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Success of Short Sales May Fall Short

A short sale is the sale of real estate in which the proceeds of the sale fall short of what the owner/debtor still owes on the mortgage. In a short sale, the owner/debtor sells the mortgaged property for less than the outstanding balance of the loan and then turns over all the proceeds of the sale to the lender, sometimes in full satisfaction of the debt.

More often than not, a short sale is executed to prevent the foreclosure of property. Because foreclosures can be lengthy and costly, a lender may choose a short sale in lieu of a foreclosure if it believes doing so would result in a smaller financial loss to the lender. For the owner/debtor, a short sale helps the owner/debtor avoid the stigma of being foreclosed upon. While beyond the scope of this article, be aware that there may be tax issues caused by the forgiveness of debt.

The owner/debtor must seek the lender's approval of a short sale. Lenders have varying requirements, but they usually want as much information from the owner/debtor as possible, including financial information and an appraisal of the property with comparisons to recently sold properties in the area The owner/debtor should not sign an agreement to sell the property to a prospective buyer until the owner/debtor receives the lender's approval for the short sale because the lender may require specific contract terms, including a minimum purchase price, reduced commissions, and a requirement that the debtor/owner not agree to pay for certain items, such as home protection plans or termite inspections. (Short sale properties are often sold "as-is") The owner/debtor should get the lender's approval in writing, setting forth the lender's requirements for the short sale and stating that the proceeds from the sale will be in full satisfaction of the debt. Obtaining such information in writing in advance helps prevent misunderstandings as to what is required of the parties.

The lender is the most important player in a short sale because it has complete control over whether the sale actually goes through. Factors a lender might consider in deciding whether to approve a short sale include: (i) the value of the property; (ii) the amount owed on the debt; and (iii) the cost of foreclosing and the possibility of the lender needing to resell the property. Short sales are less likely to be approved in Texas because of the lender's ability to quickly conduct a non-judicial foreclosure.

Potential buyers of short-sale property need to be aware that just because a property is listed with short sale terms, and the seller accepts the potential buyer's offer, does not mean the lender will accept it. Potential buyers also need to be aware that such transactions often take significant time to close. In many cases the transactions never close because the lender changes its mind about the advantageousness of the short sale, or the seller/debtor/owner cannot meet the lender's requirements. Potential buyers, often drawn in by good deals, may become frustrated as the process drags, with sellers and lenders arguing over the loan issues while potential buyers are unsure of whether the transaction will ever close.

In conclusion, early in the process the owner/debtor needs to obtain the lender's approval for the short sale in writing, including any loan forgiveness terms. The lender controls the entire process, and potential buyers should anticipate a long process that may never close.

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