SIGNIFICA SHORT SALES

NATIONAL SHORT SALE MANUAL

Our Mission

We are the homeowner's guiding light in their darkest hour.

Our Vision

We are America's short sale solution.

Our Core Values

Leadership – By example, influence, inspiration, and dignity

Integrity – We set the highest possible standard in the industry

Connection – Our clients are not loan numbers; they are people we care about

Dignity – We provide hope and respect for our fellow man

Contribution – We add value to our community

Growth – A life of fulfillment through constant, never-ending improvement

Inspiration – We lift America's spirits, one household at a time

Foreword

Former U.S. President Theodore Roosevelt once said, "Do what you can, with what you have, where you are." A lot of Americans are doing what they can with less than what they had before.

We are in the midst of a national housing crisis. Analysts estimate that as many as one in three American owners of real estate owe more on their mortgage than what their property is worth. If you are reading this, chances are you may be one of millions of Americans who are wondering what to do next.

Financial woes are creating great stress in households across America. We are seeing couples filing for divorce. We are seeing families split apart. We are seeing elderly people exhausting their retirement accounts, just to pay for a mortgage they can no longer afford. We are seeing people living on the streets after losing their home. We are seeing people destroy their credit, their reputation, and their confidence as they struggle to pay their bills. There are, sadly, even people committing suicide over the stress of foreclosure.

We are here to tell you that even though you may be in the midst of a dark winter financially, know that spring is just around the corner. The night is darkest just before the dawn. Every problem we face is a gift, if only we embrace it that way. Problems test us and make us stronger and more appreciative of the good things in life. Even if you are in a tough financial position, know that it is only temporary. You are bigger than your house and your financial situation. And there are people out there who are willing to help you.

Significa created this short sale guide to give you more certainty in an inherently uncertain time of your life. Our innovative, industry-changing program provides a real estate attorney to represent the seller at no additional cost. We have a well-trained representative, known as a Short Sale Director, who can meet in person with the seller at a nearby real estate office. We have dozens of trained, full-time staff who work on nothing but short sales. We provide this comprehensive short sale guide to you at no charge. We are here to uplift America's spirits, one household at a time.

We will help you close one chapter of your life and start a new, much better chapter. Now let's get to work.

Sincerely,

Tai A. DeSa
Chief Executive Officer

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What is a Short Sale?

A short sale is a sale of mortgaged property where the proceeds from the sale are insufficient to pay in full the seller's outstanding mortgage and any other liens against the property and the seller lacks sufficient other assets to pay the remaining amounts due on the secured debts. Because the seller lacks the financial ability to remove these encumbrances in order to convey marketable and insurable title, the seller's lender and any other lienholders, must consent to the sale and voluntarily release their liens. If someone owes more on their house than what it is worth and they have a compelling reason to sell, then that person will need a short sale.

Example

Joe and Sally purchased their home for $300,000 in 2006. They borrowed $285,000 via a purchase money mortgage. In 2009, Joe was laid off from his job and Sally had to cut her work hours to care for her ailing father. Since Joe and Sally fell behind on their mortgage, they asked a real estate agent to list their house. The agent reviewed comparable sales from the area which suggested that the house was valued about $250,000. The agent listed the house at $249,900 and soon received an offer for $245,000. Since Joe and Sally owed about $280,000 and the mortgage was in default, the lender eventually agreed to permit the sale for $245,000. The lender allowed the agent to receive a sales commission. Joe and Sally received no proceeds from the sale, but they were pleased to avoid an embarrassing foreclosure sale of their house.

Elements of a Successful Short Sale

1. The property is worth less than what is owed.
2. The seller has a hardship that makes it impractical for the seller to keep the property.
3. The seller is cooperative and willing to work with a real estate salesperson.
4. The lender is contacted and expresses willingness to consider a short sale.
5. A ready, willing, and able buyer can purchase the property in a timely manner.

Benefits of a Short Sale

It is important to understand the benefits of a short sale to each of the parties involved. Why would a seller want to cooperate? Why would a lender accept less than what is owed? Why would a buyer want to wait for a short sale to be approved? Why would an agent take on the potential headache of a short sale?

How Sellers Benefit

- *Closure.* People facing foreclosure are inundated with collection calls, threatening letters, and visits from the county sheriff's deputies. They no longer want to answer the phone or doorbell, and they dread walking to the mailbox to check the mail. Selling a property before a final foreclosure action brings the unpleasant calls, letters, and visits to an end. The seller can move on with their life.

- *Dignity.* Imagine the shame of having sheriff's deputies forcibly move you out of what was once your home. Imagine the awkward looks of the neighbors as you hurriedly throw a handful of possessions into a waiting car or truck. Imagine seeing the lender's locksmith changing the locks as you leave the property for the final time. A short sale allows the seller to have a normal closing and a move on their own schedule. In most cases, the neighbors won't know that a seller sold their property via a short sale.

- *Credit.* A short sale, while damaging to a person's credit, is less damaging than allowing the property to go to foreclosure.[1] Settling the debt and ending the delinquent payments allows a person to stop the damage and start rebuilding their credit sooner. It is important to note that a short sale may affect a borrower's credit for at least seven years because lenders might report that a loan was settled for less than its balance. A seller may be able to convince the lender to include a letter of explanation in the credit file that outlines the extenuating circumstances that caused the short sale. This can soften the blow to one's credit.[2]

- *Prevent a Deficiency Judgment.* If the seller opts for a deed-in-lieu of foreclosure, they might surrender the property without an agreement on the lender's loss. If state law permits it, the

[1] *The Short Sale Workflow*, published by The National Association of REALTOR®, Spring 2009, pages 5-6.
[2] *California Real Estate Special Report: Legal Guide to Foreclosure-Related Transactions*, 2007.

lender may elect to pursue the seller for the remaining balance after the deed is transferred. If the seller allows the property to go to foreclosure, in some states the lender may have the right to pursue the seller for the remaining balance after the foreclosure sale. A short sale involves a negotiated settlement, whereby the seller and lender reach an agreement on the loss. In most short sales, the lender will forgive the remaining debt.

- *Avoid Bankruptcy.* A mortgage loan is typically the largest debt instrument a person must service. By selling the property via a short sale, a person might avoid bankruptcy altogether. A bankruptcy would affect all of the seller's creditors and be more damaging to the seller's credit rating.

How Lenders Benefit

- *Avoid Excess Inventory.* Banks are in the business of lending money, not owning houses. Many banks are already saddled with far more Real Estate Owned (REO) than they can handle. In many cases, lenders prefer to allow properties to be sold via a short sale.

- *Purge Toxic Loans.* Nonperforming assets hurt a lender's balance sheet. Bank executives face pressure from shareholders to keep the books free from toxic assets. While forgiving some of a defaulted mortgage loan is financially difficult for a bank, the lender then receives a tax write-off that can offset profits.

- *High Costs of Foreclosure.* A June 2007 report from the Joint Economic Committee of Congress stated that the average foreclosure results in $77,935 of costs to the lender, borrower, government, and neighbors. The Joint Economic Committee calculated that the lender will spend $50,000 of that amount on legal fees, court costs, appraisals, maintenance, rehabilitating, insuring, and reselling the property to a third party. Lenders know that taking back properties via foreclosure often results in more losses, so they are willing to permit short sales as a cost-cutting measure. The Joint Economic Committee calculated that the borrower has a typical loss of $7,200 in a foreclosure, to include legal costs, moving expenses, and loss of equity.

Neighbors typically suffer a loss of $1,508 due to a decline in area property values. On average, the local government loses $19,227 from a foreclosure.[3]

How Buyers Benefit

- *Bargains.* A patient, opportunistic buyer may be able to purchase a property below fair market value.

- *Equity Creation.* A buyer of a short sale may have purchased a property worth inherently more, thus creating equity that may benefit the buyer now or in the future. Many short sale properties fall into disrepair, and equity can be created by renovating those properties.

How Real Estate Agents Benefit

- *More Sales.* Agents who refuse to list distressed properties for sale may cost themselves thousands of dollars in lost commissions. Agents who become short sale experts, or who outsource the processing of a short sale to a competent third party, will generate many more listings. In today's market, any sale is a good one.

- *More Homebuyers.* It is a buyer's market, and many buyers specifically are looking for the bargains that may be created by distressed property. Those buyers may bypass certain agents and go to those real estate salespersons who have short sale listings. Also, if an agent helps a grateful borrower sell their property via a short sale, it may only be a matter of time before that person (or their family or friends) calls upon the agent to help them with a new real estate need.

- *More Investor Clients.* Real estate investors and landlords are enjoying the bonanza of distressed properties. Investors typically buy (and sell) multiple properties, so an agent with numerous short sale listings may generate many sales with just one client. Some agents prefer to deal with investors and landlords because of their repeat business and quick, unemotional decision-making. Even if an agent refuses to handle short sale listings, that agent will likely represent buyers interested in acquiring properties facing a short sale.

[3] *Sheltering Neighborhoods from the Subprime Foreclosure Storm*, Joint Economic Committee of Congress, April 2007.

The Players in a Short Sale Transaction

It is important to understand who is involved in a typical short sale. As an agent or investor, you will be dealing with each of these players.

- *Seller(s).* They are also referred to as the Borrower or Homeowner.

- *Lender(s).* These are the banks or investors with liens against the property. In many cases, the loan may have been sold from one lender to another. In other cases, a loan servicer may be handling the collection of payments for the lender.

- *Loss Mitigation Officers.* The loss mitigation specialists of a lender or servicer help determine an acceptable payoff.

- *Real Estate Agent(s).* Typically the property will be listed with a real estate licensee. Another agent may represent the prospective buyer.

- *Short Sale Consultant or Negotiator.* There are many legitimate and experienced short sale consultants who act as a third party liaison or negotiator to help sellers and agents. There are also many illegitimate or inexperienced people claiming to be short sale consultants. Having a professional consultant work the short sale is what can make or break a deal.

- *Contractor(s) and Inspector(s).* Many distressed properties face deferred maintenance or neglect. An estimate from a licensed contractor and a report from a certified inspector may be powerful negotiating tools in convincing a lender to accept less money.

- *Appraiser or BPO Agent.* In the latter stages of a short sale, the lender or servicer will likely pay for an appraisal or a Broker's Price Opinion (BPO) from an agent. The lender will determine a payoff based upon the valuation established by the appraiser or BPO agent. It is imperative that the listing agent and/or short sale consultant meet the appraiser or BPO agent when they visit the property.

- *Attorney(s).* The lender or servicer will hire a law firm to represent them in the foreclosure action. The seller is strongly encouraged to have legal representation too.

- *Accountant(s).* The seller is strongly encouraged to consult with their accountant in any short sale or potential short sale transaction.

- *Credit Restoration Specialist or Counselor.* The seller is strongly encouraged to speak with a credit counselor prior to a short sale transaction. After a short sale, it may be a good idea for the seller to hire a credit restoration service to help clean up their damaged credit record.

Alternatives to a Short Sale

A short sale may have legal, credit, and/or tax consequences. There are several alternatives to a short sale. These other options include:

1. Make payments to reinstate the loan and keep the property.
2. Sell the property and bring cash to close escrow.
3. Attempt a workout with the lender.
4. Assumption of the mortgage by a buyer.
5. Rent the property and move to a more affordable residence.
6. Offer the lender a deed in lieu of foreclosure.
7. Allow the property to go into foreclosure.
8. Declare bankruptcy.

Make Payments to Reinstate the Loan and Keep the Property

Lenders often will permit a borrower to making a payment that covers all of the late payments. A homeowner facing default should consider borrowing money from a family member or other lender.

Sell the Property and Bring Cash to Close Escrow

This is known as a make-whole pre-foreclosure sale. The lender does not sustain a loss. The shortfall is paid by the borrower at closing. For example, if a borrower owes $100,000, and the proceeds of the sale generate only $95,000 for the lender, then the borrower can contribute $5,000 at settlement.

Alternately, the private mortgage insurer (PMI) may pay the shortfall. In some cases, the hazard insurance company may pay the shortfall if there was damage to the premises covered by the policy.

Attempt a Workout with the Lender

Homeowners are encouraged to work with the lender to forbear the loan, develop a repayment plan, or modify the loan. A forbearance plan is one in which the lender permits a partial payment or a skipped payment if the borrower has an acceptable plan to catch up on the payments. A repayment plan is one in which the lender allows the borrower to pay an additional amount each month until they catch up. A loan modification is a permanent change to the terms of the note. Loan modification plans include:

- Requiring that property taxes and insurance be included with the monthly payment so the borrower can avoid big bills throughout the year.
- Adding all the missed payments to the loan amount and increasing the monthly payment to cover the bigger loan.
- Switching from an adjustable interest rate to a fixed rate to create stability for the homeowner.
- Lowering the monthly payment by adding years onto the duration of the loan, lowering the interest rate, and/or forgiving some of the loan balance.

Assumption of the Mortgage by a Buyer

The lender may allow a buyer to assume the mortgage. The lender will determine if the buyer is qualified to handle the monthly debt obligations. Lenders often charge a processing fee to evaluate whether to permit an assumption, and in many cases a new appraisal must be paid for by the buyer and/or original borrower. The lender may require that the original borrower still remain personally liable for the loan should the buyer default on the payments.

Rent the Property and Move to a More Affordable Residence.

Many Americans have become involuntary landlords, as they’ve been forced to rent their property to generate money to pay the mortgage loan. This is a good move for a borrower if a suitable tenant is found who can afford a reasonable rent. In some cases, the rent will not cover the entire monthly payment, leaving the borrower to pay some money out of pocket to keep the mortgage current. However, this is typically less painful for a borrower. Ultimately, market rents may increase to an amount whereby the borrower does not have to come out of pocket to make the monthly mortgage payments. Alternately, the real estate market may improve with time, allowing the borrower to eventually sell the property for more.

Offer the Lender a Deed in Lieu of Foreclosure

This is known as a "friendly foreclosure." The homeowner voluntarily conveys clear property title to the lender in exchange for the discharge of the debt. A lender might consider a deed-in-lieu of foreclosure if the following occurs:

- The lender determines that the borrower faces an involuntary hardship that creates a long-term inability to pay.
- The borrower is cooperative by communicating with the lender and allowing complete access to the property for the lender's inspection and appraisal.
- The borrower is delinquent or faces default.
- The lender sees that the homeowner made a good faith effort to sell the property but was unable to do so.

Allow the Property to Go Into Foreclosure

In this situation, the homeowner either gives up or fails in all other attempts to resolve the situation. The property is sold at a publicly advertised foreclosure sale or transferred to the mortgage lender if there are no sufficient bids. This situation is considered to be the most damaging to a borrower's credit.[4] Some attorneys may advise their homeowner clients to stop paying the mortgage and live for free in the house until the foreclosure sale. This course of action is often the last resort, given that the homeowner has exhausted all other measures to prevent the foreclosure action. By living in the house until the very end, the borrower does not have to pay rent elsewhere. In such cases, the borrower saves the money that they would have paid the lender so they can have enough to rent a home when the time comes. Remember: only an attorney or accountant familiar with bankruptcy and foreclosure situations should advise a client to stop paying their mortgage. There are serious consequences to this course of action for borrowers.

Declare Bankruptcy

A bankruptcy typically does not prevent a foreclosure action, but it will delay it. Only a bankruptcy attorney or accountant familiar with bankruptcy should advise a client to pursue this course of action. Some bankruptcy actions will eliminate the debt but the lien will still remain until the owner attempts to sell the property. At that time, it is possible the lender may expect some money to release the lien.

[4] *The Short Sale Workflow*, published by The National Association of REALTOR®, Spring 2009, pages 5-6.

What is Bankruptcy?

Bankruptcy is the financial inability to pay one's debts when they are due. Bankruptcy is a federal court procedure for individuals who are unable to pay their debts to settle those debts under a judge's supervision. Bankruptcy is not the same as insolvency. The filing of a bankruptcy case *temporarily* stops foreclosure proceedings.

There are essentially two types of bankruptcy filings for individuals: Chapter 7 and Chapter 13.

Chapter 13 Bankruptcy allows for debt reorganization. The debtor has enough disposable income to submit a reasonable debt payment plan to the court. The plan describes how the creditors will be repaid over a three to five year period. During Chapter 13 Bankruptcy, the creditors are not allowed to collect on the debtor's previously incurred debt except via the court. In general, the person is permitted to keep their property and the creditors end up with less money than the full balance of what is owed.

Chapter 7 Bankruptcy allows for a debtor to keep certain exempt property. Some liens, including mortgages, survive the bankruptcy. Other assets are sold to pay the creditors. If the mortgage lender's interests are not adequately protected, the court may allow the foreclosure proceedings to continue.

A bankruptcy will not stop a foreclosure action; it will only delay it. When a person declares bankruptcy, their mortgage lender (as well as other creditors) must stop collection activities for the moment. If a house is worth less than the total mortgage balance, the bankruptcy trustee assigned to oversee the distribution of assets will eventually realize that there is no equity in the property. In many cases, they will release the real estate from the bankruptcy, and at that time the mortgage lender can continue with a foreclosure action.

A homeowner who is seriously delinquent on their mortgage could declare bankruptcy shortly before the foreclosure action to essentially buy more time in the home. Declaring bankruptcy may be a good course of action for someone who has multiple delinquent debts and insufficient income to cover all those obligations. A person considering this should definitely speak with a bankruptcy attorney.

What is the Foreclosure Process?

Foreclosure is a legal procedure in which property pledged as security is sold to satisfy the debt. A mortgage lender's rights can be enforced through foreclosure if the borrower defaults on mortgage payments or fails to fulfill any of the other obligations in the mortgage.

The foreclosure process varies among states. The type of procedure depends on whether the state uses deeds of trust or mortgages. Generally, states that use mortgages conduct judicial foreclosures. A judicial foreclosure is one that must proceed through the court system. States that use deeds of trust conduct non-judicial foreclosures, using an out-of-court process.

Under the judicial procedure, a mortgage lender must prove in the county court that the borrower is in default. The lender hires an attorney, who files a lawsuit against the borrower to establish the precise amount owed. Furthermore, the attorney provides evidence of the default and obtains the court's approval to continue with the foreclosure.

For states with non-judicial foreclosures, the deed of trust will contain a power-of-sale clause. The clause allows the trustee to initiate a foreclosure sale without having to file a lawsuit or go to court. The trustee must issue a notice of default. If the borrower does not respond, the trustee may sell the house.

Legal Issues With Short Sales

We've described many of the benefits of a successful short sale. Now we're going to make you aware of many of the legal problems associated with short sales.

Consequences for Agents

- *Inability to Handle the Workload.* Some real estate agents, in order to obtain a listing, promise their clients that they'll personally process the short sale. There are numerous situations where the agent becomes overwhelmed and fails to follow up on case files. In short sales, time is of the essence. Sellers face a foreclosure date that may be difficult to delay. If the agent fails to process the short sale in a timely manner, the seller could lose the property to foreclosure. In some cases, sellers have initiated lawsuits against inexperienced or overwhelmed agents for bungling the short sale negotiation.

- *Misrepresenting Tax Consequences.* Sometimes a person inexperienced with short sales may inform borrowers that they will not face any taxation on forgiven mortgage debt. Historically, the Internal Revenue Service (IRS) has treated cancelled or forgiven debt as if it were income, which means that a person has to pay income tax on the forgiven amount. Some taxpayers will not have to pay any income tax on debt forgiven via a short sale. **The Mortgage Forgiveness Debt Relief Act of 2007 applies to certain mortgage debts forgiven in years 2007 through 2012. The Act generally allows taxpayers to exclude income from the discharge of debt on their principal residence. Debt reduced to mortgage restructuring and mortgage debt forgiven in connection with a foreclosure action both qualify for relief. Up to $2 million of forgiven mortgage debt (if married, filing jointly) qualifies for the tax relief. Up to $1 million of forgiven debt is permitted for taxpayers who file individually.** Debt used to refinance a primary residence qualifies for the tax relief, but only up to the amount of the old mortgage immediately before the refinancing. **It is important for a seller to consult with their accountant, tax preparer, or tax attorney to see if they will qualify for tax relief.**

- *Leading the Seller to Believe that All Their Debt is Forgiven.* A seller may believe that they can walk away from the short sale with no further liability to pay off debt. In many cases that is true, but in other cases the lender may pursue the seller for the remaining balance. Holders of second mortgages or deeds of trust sometimes do not forgive the debt. In some short sales, the second mortgage holder accepts a partial payment to release the mortgage lien, but they later sell the balance to a collection agency. Also, it is imperative for the agent and seller to understand whether they have a recourse or non-recourse loan. With a recourse loan, unless otherwise stated in the short sale approval paperwork, the lender may later seek payment of the remaining debt. An irate seller who finds out a year later that they still owe money might sue the agent who handled the short sale. **It is best to have the seller review the short sale approval document with their attorney to determine if there would be any continued debt obligation after the short sale. The Significa short sale program provides an attorney to represent the seller if they do not have one. That attorney will review the short sale approval letter with the seller and advise them whether to accept the terms and conditions.**

- *Failing to Uphold One's Fiduciary Duty.* A real estate licensee has a fiduciary duty to do what is best for the client. If a listing agent allows a "double-close and flip" scenario, the seller client may feel that the agent failed to bring the highest and best offer. The situation will be compounded if the seller client must pay income taxes on a larger portion of forgiven debt than they would have.

Some opportunists and investors may induce the seller and agent to unknowingly commit mortgage fraud.

When a short sale is listed, some sellers and agents are besieged by unorthodox requests from seemingly helpful real estate investors or other short sale opportunists. Of course many buyers look for a good deal, and it is the bank's prerogative to allow a property to be sold for less than fair market value. However, some of these investors or opportunists may entangle the agent and seller in what amounts to mortgage fraud.

One fraudulent situation is the double-close-and-flip transaction. That occurs when an investor places the property under contract at a low price and offers to negotiate that offer with the bank. Meanwhile, the investor tells the listing agent to continue marketing the property so they can procure a much higher offer. The investor tells the bank that the low offer is the only one, while concealing the much higher offer from the bank. The investor's intention is to engineer the transaction so they can collect the difference between the low offer and the higher offer while keeping the bank unaware. The listing agent, who has a fiduciary duty to the seller, ends up procuring a higher offer for the investor's benefit and not the seller's benefit. Furthermore, the short sale fraud department within many banks may sue all the parties if they discover that a double-close-and-flip transaction occurred.

Another potentially fraudulent situation involves the investor placing an option on the property or inducing the seller to turn over the deed without paying off the mortgage. The investor creates a cloud on the title and then demands a payment from the ultimate buyer to release their option or transfer the deed.

The third type of fraudulent transaction involves a non-arm's length transaction or collusion in which the buyer allows the seller to remain in the property. Some sellers convince a family member, often with a different last name, to buy the house at a discount. Then the family member either rents or sells the house back to the former borrower. The bank is defrauded out of thousands of dollars.

Some sellers may attempt to defraud their bank.
In some situations, it is the seller who attempts to defraud their lender by encouraging their agent to allow a family member or business associate to surreptitiously purchase the house. The intent of the seller is to have their family member or associate pretend to be someone they do not know, and then the bank may allow the house to be sold for a discount along with the debt being forgiven. That way the seller receives the benefit of staying in the house while being relieved of the debt obligation. Some sellers may believe that if their family member or associate has a different last name, then the lender will believe it is an arm's length transaction. If a lender discovers that the sale was not an arm's length transaction, they have the right to file criminal charges and initiate a civil lawsuit against all the parties involved.

Significa protects sellers and agents from fraudulent transactions. Significa's trained staff can quickly identify a proposal from a potential buyer that is designed to defraud the lender. Significa can guide the agent and seller through the transaction, explaining the various benefits and consequences associated with offers. Furthermore, the real estate attorney provided to the seller at no cost under the short sale program helps keep everyone out of trouble with the law. The system is designed to protect the consumer and the agent.

Note:

We at Significa are not attorneys, accountants, or certified credit counselors. Your attorney and accountant can advise you regarding your particular situation and how it is affected by your state's laws. Our National Short Sale Guide is merely for informational purposes.

What Federal Government Programs are Available?

Home Affordable Modification Program

The Home Affordable Modification Program (HAMP) is a federal program designed to help homeowners avoid foreclosure by modifying loans to an affordable and sustainable amount. The program provides loan modification guidelines for the mortgage industry to use.

Borrower eligibility is based on meeting the following criteria:

1. The property can be owner-occupied or it can be a rental.
2. The borrower is delinquent or faces an imminent risk of default. If the property is not owner-occupied, then the borrower must be delinquent.
3. The mortgage was originated on or before January 1, 2009.
4. The unpaid principal balance must be less than $729,751 for one-unit properties.
    a. If a 2-unit property, the unpaid balance must be less than $934,201.
    b. If a 3-unit property, the unpaid balance must be less than $1,129,251.
    c. If a 4-unit property, the unpaid balance must be less than $1,403,401.
5. The property must not be condemned.
6. The borrower must show sufficient income to support a modified payment.

If the lender or servicer determines that a borrower is eligible for a HAMP modification, they can take a series of steps to adjust the monthly mortgage payment to 31% of the borrower's total pretax monthly income. The steps are:

1. First, reduce the interest rate to as low as 2%.
2. Next, if necessary, extend the loan term to 40 years.
3. Finally, if necessary, defer (forbear) a portion of the principal until the loan is paid off and waive interest on the deferred amount.

Borrowers whose debt ratio is already below 31% may still qualify. A borrower who previously defaulted on their HAMP trial period plan could still qualify again for the program.

Lenders and servicers may elect to forgive some principal at their discretion to achieve the target monthly mortgage payment. The HAMP program provides incentives to lenders, servicers, and investors who cooperate.

Home Affordable Foreclosure Alternatives

In 2009, the Treasury Department , working in conjunction with the Department of Housing and Urban Development (HUD), introduced the Home Affordable Foreclosure Alternatives (HAFA) program to provide additional options for borrowers who are unable to keep their homes through the HAMP program. HAFA took effect on April 5, 2010 and eligibility ends on December 31, 2013. For people who are accepted into the program in December 2013, they must sell their property by September 30, 2014.

The HAFA program offers incentives to borrowers, lenders, servicers, and investors who utilize a short sale or deed-in-lieu to avoid foreclosure.[5] HAFA streamlines the short sale and deed-in-lieu process across participating banks by using standardized paperwork and establishing minimum performance deadlines.

HAFA alternatives are available to all HAMP-eligible borrowers who:

1. Do not qualify for a Trial Period Plan.
2. Do not successfully complete a Trial Period Plan.
3. Miss at least two consecutive payments during a HAMP modification.
4. Request a short sale or deed-in-lieu of foreclosure.

The eligibility criteria for HAFA include:

1. The borrower has a documented financial hardship.
2. The borrower has not purchased a house in the previous 12 months.
3. The first mortgage balance is less than $729,751.
4. The mortgage was originated on or before January 1, 2009.
5. In the past 10 years, the borrower cannot have been convicted of theft, felony larceny, money laundering, fraud, or tax evasion in a real estate transaction.

[5] Press Release, published by the National Association of REALTORS®, published April 5, 2010.

6. The loan is owned or guaranteed by Fannie Mae or Freddie Mac, or is serviced by a participating servicer or lender. The list of participating servicers and lenders can be viewed at http://www.makinghomeaffordable.gov/programs/lower-payments/Pages/hamp.aspx.

In a short sale under the HAFA program, the borrower is permitted to list and sell the property. Generally, if the borrower makes a good faith effort to sell the property but fails to sell it, the lender may consider a deed-in-lieu of foreclosure if there are no other liens.

If the borrower qualifies for the HAFA program, the servicer may not demand a cash contribution or promissory note from the borrower. Furthermore, the servicer will not be allowed to pursue a deficiency judgment against the borrower. The proceeds of the sale of the property represent full and final satisfaction of the note.

Under HAFA, the servicer uses the financial and hardship information already collected when considering a loan modification under HAMP. The borrower can receive pre-approved short sale terms before listing the property for sale. The servicer can state the minimum acceptable net proceeds or the minimum acceptable sales price. That pre-approval provides the listing agent with valuable information that can make a listing more effective in generating a solid offer.

A HAFA-approved homeowner will receive $3,000 for relocation assistance. However, if a tenant is residing in the property at the time of the sale, then the tenant will receive the $3,000 instead of the homeowner. This payment is made at settlement or upon post-settlement move-out by the occupant. The servicer is given $1,500 to cover processing costs. The investor (lender) is given up to $2,000. Secondary lienholders can receive up to $8,500 in short sale proceeds, on a one-for-three matching basis.

Once a HAFA short sale pre-approval is granted, the listing agent has 120 days to procure a buyer. The listing period could be extended up to 12 months. The real estate commission will be 6 percent, as long as the listing contract states that the commission is at least 6 percent.

Effective June 1, 2012, if a HAFA-approved borrower sells their house via the HAFA program and they were current on their mortgage at the time of the sale, then the lender must report the loan as paid in full to the credit bureaus. In theory, a person who is current on their mortgage could sell their house via a HAFA short sale one day and qualify for a mortgage loan the next day.

The HAFA program guidelines vary slightly between Fannie Mae, Freddie Mac, FHA, and lenders of non-government backed loans.

The majority of short sales are traditional, non-HAFA short sales. However, the HAFA program provides great benefits for sellers. Participating lenders typically will consider a borrower for HAFA first, before considering a traditional short sale. A borrower may request a HAFA packet from their lender.

FHA Preforeclosure Sale Program

FHA provides mortgage insurance on loans made by FHA-approved lenders. FHA is the largest mortgage insurer in the world. FHA became part of the Department of Housing and Urban Development (HUD) in 1965.

Below are the criteria for participation in the HUD Preforeclosure Sale Program (PFS):

- The home must be owner-occupied, with exceptions made for death, divorce, forced job relocation, or unemployment.
- Investment properties or strategic defaults do not qualify for the PFS Program.
- The property must be listed with a licensed real estate agent who is not related to the borrower.
- The short sale must be an arms-length transaction, whereby the buyer cannot be a relative or business associate of the seller.
- The borrower must be at least 31 days behind on their mortgage payment when they sell the property.
- The property is to be listed on the market for at least four months, with the potential to keep it on the market for an additional 12 months.
- Real estate commission cannot exceed six percent of the sale price.
- The borrower must submit documentation proving the inability to continue making payments.
- The buyer will be allowed a seller closing cost assist up to one percent. If the buyer needs more, a variance has to approved by HUD.
- HUD will allocate up to $1,500 toward secondary liens.
- HUD will not pay for:

  - Title insurance
  - A home warranty
  - Repair reimbursements
  - Discount points for non-FHA financing.
- A relocation incentive up to $1,000 will be paid to the borrower if the sale occurs within three months from the date of application. Thereafter, the incentive is reduced to $750.
- The lender must order an FHA appraisal, which will contain the "As-Is" Fair Market Value (FMV). The appraisal is valid for 120 days. The appraisal must be provided to the borrower or real estate agent upon request.

If the property is approved for the PFS Program, an Approval to Participate (ATP) is issued. The date of the form becomes the starting date of the PFS participation. The ATP is a short sale pre-approval. It will state the date by which a signed sales contract must be obtained and the minimum acceptable sale price. The ATP is valid for four months and can be automatically extended for two months. The lender has to delay the foreclosure proceeding during that period.

Once the ATP is issued, one can predict the acceptable sale price if it is below the amount stated in the ATP. HUD adheres to the following Tiered Net Sales Proceeds guidelines:

- For the first 30 days of marketing, lenders may only approve offers that will result in a minimum net sales proceeds of 88 percent of the As-Is appraised value.
- For the next 30 days of marketing, lenders may only approve offers that will result in a minimum net sales proceeds of 86 percent of the As-Is appraised value.
- For the duration of the PFS marketing period, lenders may only approve offers that will result in minimum net sales proceeds of 84 percent of the As-Is value.

Sometimes the As-Is appraisal value is well above what buyers are willing to offer. FHA has the following appraisal dispute guidelines (which are not published publicly by HUD but we learned from experience):

- FHA must be provided with three to four comparable sales that sold in the six-month period prior to the date that the appraisal was completed.
- The comparables must be full, Agent Detail Multiple Listing Service (MLS) sheets showing the sold date, sold price, and property description.
- Sales used in the original appraisal cannot be submitted as dispute comparables.

- The comparables must be submitted via email, not via fax or regular mail.
- The seller needs to be advised that the dispute decision is final.
- If the approval is granted to order a second appraisal, the As-Is FMV is final, even if it is higher or unchanged.

There is a serious flaw in the FHA appraisal dispute process. They do not take into account a declining market or a deteriorating house. FHA demands the dispute comparables be ones that sold in the six-month period prior to their appraisal. However, if the property has been on the market for multiple months, those comparables are too old and no longer indicative of the market condition. Furthermore, the house could be losing value due to deferred maintenance, and FHA does not properly account for property deterioration. Therefore, it is critical for the seller or listing agent to liaison with the appraiser ahead of time so the appraiser is made aware of the market conditions.

Fannie Mae and Freddie Mac

Fannie Mae (Federal National Mortgage Association) and Freddie Mac (Federal Home Loan Mortgage Corporation) make loans and loan guarantees. Both are regulated by the Federal Housing Finance Agency (FHFA), which acts as a conservatorship.

Fannie Mae and Freddie Mac both permit short sales. They both participate in the HAFA program, and they both have traditional short sale programs for non-HAFA short sales.

As of June 2012, Fannie Mae and Freddie Mac require their loan servicers to make a decision on a short sale offer within 30 days. If they cannot make an approval decision in 30 days, then they are to provide weekly status updates and make a decision no later than 60 days after receiving an offer.

If a Freddie Mac servicer makes a counteroffer, the borrower is expected to respond within five business days. The servicer must then respond within 10 business days of receiving the borrower’s response.

HARP and HARP 2.0

HARP is a federal government program for people who are current on their mortgage payments but have been unable to refinance their mortgage. To be eligible, the mortgage must be owned or guaranteed by Fannie Mae or Freddie Mac, and it the sale to Fannie or Freddie must have occurred before June 1, 2009. The mortgage cannot have been refinanced under HARP unless it was a Fannie Mae loan that was refinanced via HARP from March to May of 2009.

The loan-to-value (LTV) ratio must be greater than 80 percent. That means that there must be at least 20 percent equity in the property. The borrower must be current on the mortgage, with an on-time payment history for the previous year.

HARP 2.0, a revised version of the original HARP, ends on December 31, 2013. Not all mortgage servicers participate in the program. People looking to refinance through HARP will need to complete a loan application and go through the underwriting process. Refinance fees will be charged.

HARP 2.0 is designed to help borrowers who could not refinance to a more affordable interest rate but still paid their mortgage on time.

Frequently Asked Questions

Below are answers to many common questions. The answers below do not constitute legal, tax, or credit advice. Consult with your attorney, tax advisor, and/or certified credit counselor for guidance specific to your situation. If you participate in Significa's short sale program, a real estate attorney can be provided for you at no additional cost.

The bank won't stop calling me. Should I talk with them?
We believe you should communicate with your bank on a periodic basis. If you are behind on your mortgage payment, expect up to four phone calls a day. You will also receive a lot of mail.

It is unwise to completely ignore the bank. If you do not communicate at all with your lender, they will probably put you in the category of the people who refuse to pay. That is the worst category for you, as that means they will move the foreclosure process along as fast as possible.

You do not have to answer the phone every single time the bank calls, but it is good to communicate with your lender at least twice a month. If you are considering a short sale, tell the representative. Ask them to send you the bank's short sale paperwork package.

If you are already attempting to sell your property, then tell the person on the phone about it. Reiterate your hardship each time you talk with your lender. If you are still occupying the property, tell the lender so they do not send someone over to verify occupancy.

Can a landlord facing foreclosure still collect rent from the tenant?
Yes, a landlord who has not paid the mortgage may continue to collect rent from the tenant. Many mortgage lenders have an Assignment of Rents clause in the note, whereby the mortgage company has the right to receive the rent when the loan is in default. In actual practice, we have not seen the Assignment of Rents clause exercised on residential properties.

The lease will lay out the duties and expectations of the landlord and the tenant. If the landlord fulfills their duties, such as keeping the property maintained, the tenant has to pay rent. If the landlord breaches the lease, the tenant can take the landlord to court to resolve the problem or obtain some relief for the breach.

We've seen several cases where the tenant stopped paying the rent when they realized the landlord was not paying the mortgage. The landlord took the tenant to court for non-payment of rent. We've seen the judge rule that the tenant must be evicted since they failed to pay the rent. However, the judge also ruled that the landlord would not receive a judgment against the tenant for the unpaid rent.

Five things buyers need to know when purchasing a short sale.

1.) **Neither the seller nor the lender is likely to make repairs to the property.** Many short sale properties have deferred maintenance, as the seller may stop paying for maintenance as money becomes tight. By the time the sale occurs, many short sale sellers are either unable or unwilling to pay for repairs. They realize that every dollar they spend on the property is a dollar they will not receive back. If a buyer wants to purchase a short sale and the property requires repairs before the buyer's bank will lend any money, the buyer should find a way to make the repairs themselves or find a different property to buy. There is a risk to the buyer repairing a house before they purchase it or obtain a short sale approval to purchase it. If the buyer improves the house and the short sale fails or the buyer opts to walk away, then the buyer will have wasted their time and money on a house they will not own. Furthermore, few contractors will work on a property and wait to be paid at closing.

2.) **If the buyer waits until after the short sale approval is granted to ask for a repair concession or lower price, it is far less likely to be approved.** Some buyers wish to wait until after a written short sale approval is granted before they conduct their home inspection. In a regular transaction, the inspection period may be an opportunity for the buyer to request a credit or price reduction for repairs. Buyers should realize that if the seller's lender has already approved a short sale, then it is highly unlikely that the lender will allow a price reduction or repair credit. If a buyer believes that a repair credit or price reduction may be needed, they should conduct their home inspection right after the signing of the real estate contract. It is much easier to amend the price or terms of the transaction before the seller's lender makes a final decision. In most short sale transactions, it is better for the buyer to conduct their home inspection right away instead of waiting for a short sale approval.

3.) **It may take months to receive a response from the seller's bank.** Short sales happen gradually, then suddenly. A buyer who must move into a home within 60 days of submitting an offer should seriously consider making an offer on a property that is not a short sale. The closing date is hard to predict early in a short sale negotiation process. Furthermore, there is a risk that a short sale may not be approved, and the buyer may not learn of this until weeks have passed. Anyone who wishes to buy a short sale should be patient and not under pressure to move in soon.

4.) **If the buyer is under contract with the seller, take steps to ensure that the seller is committed to the transaction.** The policy on how to mark a short sale listing in the Multiple Listing Service (Pending, Available with Contingency, or Available, among others) is subject to the office's Broker in charge and perhaps the local Association of REALTORS®. Once a seller signs an offer from a buyer, some listing agents mark the listing as being under contract with no more showings as a sign that the seller is committed to that buyer. Other listing agents continue to market the property, soliciting offers that may be superior to the one that the seller already signed. If the listing agent continues to advertise the property, that could jeopardize the initial buyer's position, as there is a distinct possibility that the listing agent and seller may seek to terminate the contract in favor of a better offer. If the buyer has already paid for inspections, an appraisal, an interest rate lock, and other costs associated with the purchase of real estate, the buyer may forfeit those costs if their contract is terminated. In some states, the policy is to have the property remain active or available in the MLS even though the seller is under contract with a buyer. Regardless, the buyer and their agent should convey their high level of commitment to the seller and elicit a high level of commitment in return.

5.) **Be prepared to pay a little more at closing, as last-minute payoffs creep up that the seller and their bank may not pay.** As the final fees and costs are tallied on the Settlement Statement, there is a possibility that someone will have to pay more than expected. A water bill that is higher than planned, a late fee added to a delinquent lien, or a property tax credit that is smaller than anticipated could increase the seller's costs. However, the seller may not have the funds to pay the extra cost, and the bank may be unwilling to take less to cover the shortfall. That may mean the buyer has to pay a little more just to ensure that the transaction occurs. The buyer should be prepared to absorb several hundred dollars in additional costs just in case.

I'm behind on my mortgage. Should I move out or stay in the house?

In many cases, it is wise for a homeowner to stay in their house. Many people who are behind on their mortgage payments have an unfounded fear that they will come home one night to find their belongings removed and their door padlocked.

Banks prefer to have someone, particularly the homeowner, stay in the house. Mortgage lenders do not like vacant houses, as they lose value due to break-ins, ice damage in the winter, or lack of upkeep.

A homeowner behind on their payments can save money by staying in their house. Rather than paying for rent somewhere else, they can live rent-free in their house until the property is sold. The money that is saved during this period can be allocated for moving costs, a security deposit, and rent when they eventually move elsewhere.

Even if the homeowner is delinquent with their mortgage, they are still the owner of record and therefore remain responsible for the property. The owner could be cited by the local municipality for not maintaining the grounds, such as failure to cut the grass or shovel the snow off the sidewalk. The owner is still responsible for paying property taxes.

The owner is also liable for what occurs on the property. For example, if the owner abandons the property and has a pool, they could be liable if someone falls into the pool even if that person were trespassing. The owner is also expected to maintain insurance on the property. If they cannot afford insurance, they should inform their mortgage lender so the lender can pay for forced placed insurance.

Unless there is a compelling reason to move now, such as a job relocation or a contentious divorce, it is wise for a homeowner to stay in the home while the foreclosure process unfolds.

Will my bank allow me to do a short sale if I'm current on my mortgage payments?
Not all short sales involve sellers who are delinquent on their mortgage. Some banks will consider a short sale for a person who is current on their mortgage if there is a legitimate hardship and a documented decline in property values.

Some banks have a policy whereby they will only consider a short sale if the borrower is behind on their payments. This policy can be viewed as absurd, especially if property values have dropped dramatically in the area. On the other hand, why would a creditor want to consider taking less money when someone keeps paying them per their original loan agreement?

A technique used by some people who want to minimize their damage to credit while also having a short sale approved is to deliberately pay their mortgage late, but no more than 29 days late. When a bank receives their mortgage payment 30 or more days late, they inform the credit bureaus. For someone who is looking to borrow money, especially via a mortgage loan, in the next two years, a single instance of being 30 days late can prevent them from obtaining the loan they desire.

A person could choose to not pay their mortgage on time, which after a few days (typically the 6th of the month or later) causes the bank to treat the loan differently than if it were paid on time. The bank may send the file to their loss mitigation department once the loan is delinquent. The bank will call the borrower, and may send mail, offering options and assistance. One of the options may be a short sale. Of course, the technique to prevent a 30-day report to the credit bureaus involves the borrower paying their mortgage plus the late fee just before the end of the month. That way the loan never goes 30 days behind, but the bank starts offering options to the borrower. That action may trigger the bank to consider a short sale or loan modification.

Some banks unfortunately have the policy whereby the borrower must be at least three months behind before they'll consider a short sale. If that's the case, then the homeowner must make a decision whether they should stop paying the mortgage. In some cases, it may be the best option for a person to stop paying the mortgage. That is a decision that should be made after consulting various professionals and weighing the pros and cons.

The first thing one should do is call their bank to express difficulty in paying the mortgage or selling the house. Many banks will mail a short sale package to the borrower if asked. Some banks will reveal their precise policy on how to qualify for a short sale, while other banks will provide nebulous answers.

I want to do a short sale and the bank says I need to display a hardship. What counts as a hardship?

A hardship is a situation that renders a borrower unable to continue making monthly mortgage payments and/or unable to sell their property and cover the entire mortgage balance.

Legitimate hardships include:

- The death of a breadwinner.
- Serious illness of a breadwinner.
- Serious illness of a family member, whereby the income earner(s) in a family take time off work to care for the person.
- Serious damage to or a material defect with the property that will not be covered by insurance.
- Loss of a job.
- Reduced hours at work, which lowers a person's take-home pay.
- Loss of a job by one of the two people in a dual-income household.
- A forced job relocation, typically more than 100 miles away.
- A divorce, typically one that involves a sharp decline in income and/or significant reduction in liquid assets.

Situations that are not hardships include:

- Desire not to pay, even though the borrower has substantial income or assets.
- Decline in property values (in some areas of the country, like California, Arizona, Florida, and Nevada, the decline is so sharp that it may qualify as a hardship).
- A break-up between a boyfriend and girlfriend who were both on the mortgage.
- A person who has substantial liquid assets and who therefore could easily pay the difference that is owed.
- Depression experienced by the borrower.
- A person who is angry at the bank and wants to stop paying to make a point.

If there is no hardship, then it is unlikely that a short sale may be approved. Check with your lender.

I'm facing foreclosure and received a letter about a status conference. What is a status conference, and should I go?

Many counties across the country are scheduling what is known as a status conference to help some homeowners facing foreclosure. The status conference is like a timeout in sports. It involves the judge who presides over the lender's foreclosure lawsuit against the borrower.

A brief meeting is scheduled between the borrower and the mortgage lender's attorney in the judge's chambers. The judge wants to see if the homeowner is working toward a loan modification, short sale, deed-in-lieu of foreclosure, or other solution to prevent the foreclosure. The judge is also evaluating the borrower to see if they are a deadbeat who probably deserves to lose their house. The judge also wants to see if the mortgage lender's attorney understands the case and is willing to entertain the borrower's proposed solution.

If the borrower or the lawyer for the bank fails to show up to the status conference, that may annoy the judge. There are instances where the attorney does not show up, and the judge grants an extension in the foreclosure process for the homeowner. If the borrower does not show up, the judge will likely allow the foreclosure suit to continue unabated.

It is strongly suggested that the homeowner show up for the status conference if they wish to conduct a short sale, loan modification, or deed-in-lieu of foreclosure. If the borrower does not attend, it is highly likely that the judge will allow the foreclosure to move forward at full speed. The judge has the power to delay the foreclosure action, and the judge wants to help homeowners who are trying to help themselves. Also, there are many instances where the bank's attorney does not attend, so their failure to show up can shift the matter in favor of the homeowner.

If a homeowner is attempting a short sale, they should print out the listing of the house and bring a copy of the Agreement of Sale if the property is under contract. They should also bring their most recent mortgage statement or a letter from the lender about the foreclosure. The homeowner is welcome to bring their attorney if they have one, but a lawyer is not necessary. A status conference typically only lasts a few minutes. If the borrower shows up prepared, they may find that the judge encourages the bank's lawyer to work toward a solution that does not end in foreclosure.

We received multiple offers for our short sale listing. Should we send all the offers to our bank to decide which one to accept?

In a short sale, the bank is not the owner and therefore does not have the right to decide which offer to accept. The sale contract is between the seller and the buyer, not between the bank and the buyer. The seller decides which offer to accept. Once that offer is accepted, the seller and buyer are committed to each other per the terms of the agreement. The fully signed contract is then submitted to the seller's bank to see if they will be willing to accept the net proceeds of the sale. The seller is responsible for deciding which offer has the best chance of being approved for a short sale by their lender.

In some states the law requires that the lienholders be informed of all short sale offers. There have been cases where the bank's representative demands to see all the offers. In states that require that the lienholder be notified of other offers, then the lienholder does wield significant influence over which offer is acceptable for the short sale. In states that do not have such laws in place, then the lienholder only needs to see the contract that the seller signed and accepted.

If the bank has taken the property back via foreclosure, then the property is owned by the bank. The situation is no longer a short sale. The bank sells the property and therefore has the right to decide which offer to accept.

It is possible that the federal government may extend the principal residence short sale tax forgiveness beyond December 31, 2012. It is also possible that the government may not extend this provision. The government needs tax revenues and 2012 is an election year, which may affect political decisions. Given what we know now, people who are considering a short sale of their principal residence are better off if they sell their house in 2012.

Please be advised that your mortgage lender might not agree to forgive the mortgage deficiency. If they do not forgive the deficiency, they may legally pursue you personally to collect this debt.

Short sales are simple, but not easy!

Short sales are simple, but not easy. Short sales in real estate are fairly straightforward, and follow these steps:

1.) The seller owes more than the property is worth and has a compelling reason to sell.
2.) The seller submits paperwork to their mortgage lender to justify their inability to pay.
3.) The property is listed for sale by a real estate agent at a price at or slightly below fair market value.
4.) A ready, willing, and able buyer submits an offer.
5.) The seller accepts the offer.
6.) The Agreement of Sale is submitted to the seller's lender for a short sale approval or denial.
7.) The lender sends either an appraiser or an agent to the property to provide an opinion of value.
8.) If the valuation is close enough to the sale price in the Agreement of Sale, a short sale approval is issued in writing.
9.) If the seller agrees to the short sale approval conditions, then everyone prepares for the settlement.
10.) The lender reviews the final HUD-1 Settlement Statement shortly before closing, and if it meets their criteria the sale goes forward as planned.

So the steps are easy to understand. Yet the process is far from easy. Short sales involve numerous moving parts that must align or the transaction is unlikely to occur.

If the sale price in the Agreement of Sale is too low relative to the lender's valuation, the short sale will not be approved. If the bank's valuation is too high, then no buyer will pay enough to meet the lender's desired amount. If the property is listed too high by the agent, then buyers may not be interested enough to make an offer. If the seller does not submit the paperwork the lender requires, then the short sale will not be approved.

If the buyer becomes impatient and backs out of the deal, then the transaction is unlikely to happen. If the foreclosure sale date is in the near future, the bank may simply allow the property to be sold at the foreclosure auction. If the lender's staff is overwhelmed or inexperienced, they may prevent the short sale from being approved.

If the seller owes other creditors with liens on the property, those creditors might prevent the sale. If the lender has strict deadlines for submission of documents and a deadline is missed, that can prevent a short sale from being approved. If the property is damaged from vandals, frozen pipes, or other calamities, the seller might not have the funds or the ability to make repairs.

For a short sale to work, all the parties in the transaction must be patient and flexible. Remember, the process is simple, but not easy.

What causes delays in a short sale negotiation?

Short sales are often referred to as long sales. Many sellers, buyers, and real estate agents find that short sales may take much longer than initially expected.

So what causes delays (or perceived delays) in a short sale?

1.) The seller does not submit the paperwork their mortgage lender requires to evaluate the short sale.
2.) The mortgage lender's staff is inundated or disorganized.
3.) The mortgage lender closes the file and it must be started again from scratch.
4.) The listing agent and the seller price the property way too high, so no one makes an offer.
5.) The buyer backs out of the transaction.
6.) The property loses value from vandalism, theft, frozen pipes, or deferred maintenance, which causes the buyer to walk away or demand a lower price that the lender will not approve.
7.) The person or company negotiating the short sale for the seller is disorganized, inexperienced, inundated, or otherwise slow with the processing of the file.
8.) The mortgage lender issues a counter-offer that forces the buyer and seller to take time to negotiate.
9.) Another lienholder or creditor negotiates as well.
10.) The mortgage lender loses the file.
11.) The seller is unable or unwilling to pay certain closing costs, which forces the other parties to negotiate how to pay those costs.
12.) The appraiser or agent sent by the lender to the property is unable to access the property on the inside.

13.) The mortgage lender restructures or institutes new software that the staff takes time to learn.

14.) The mortgage lender changes the locks on the property, and the seller or buyer demands access before moving toward settlement.

15.) Emotional outbursts among some of the parties force others in the transaction to engage in time-consuming activities to defuse the rash decisions fueled by those emotions.

16.) A private mortgage insurer is involved and therefore must also approve the short sale.

17.) A government agency or other organization, like Fannie Mae, Freddie Mac, the Department of Housing and Urban Development (HUD), or the Veterans Administration (VA) is involved and therefore must also approve the short sale.

18.) A seller or tenant refuses to move out in a timely manner, so the buyer delays the purchase until the house is vacant.

19.) A title agent prepares an inaccurate HUD-1 Settlement Statement, which must be revised.

20.) The mortgage lender's system has a sole decision maker or influencer, and that person is away from the office at a critical moment.

When should home inspections be done in a short sale transaction?

A matter of debate is whether a buyer should conduct their home inspection right after going under contract with a short sale seller, or if the buyer should wait until a written short sale approval is provided. In typical non-distressed sales, the buyer opts to conduct their home inspection within 10 to 20 days after all parties have signed the real estate contract. However, when a short sale is involved, there are pros and cons of conducting a home inspection right away. What is advantageous for the buyer may not be advantageous for the seller, and vice-versa.

Why a buyer should want to conduct inspections right away

- If the buyer decides from the inspection results that they do not want the property, the buyer saves valuable time by terminating the contract. They can then focus their search for a better home.
- If the buyer decides that they need a repair credit or price reduction, they have a much greater chance of having the seller's mortgage lender approve the concession. The information from the inspection report can help with convincing the seller's bank that the property needs to sell

for less due to projected repairs. Once a short sale is approved, it is extremely difficult to negotiate a concession with the seller's mortgage lender.

- In many real estate contracts, the buyer may forfeit their deposit if they attempt to back out of the transaction only days before a closing is set to occur.

Why a buyer should wait until they have short sale approval before conducting inspections

- If the buyer's offer price is not approved by the seller's mortgage lender, then the buyer does not spend money on an inspection for a home they cannot buy.
- The condition of the property may deteriorate from deferred maintenance while waiting for the seller's mortgage lender to respond. The buyer's inspection report may more accurately represent the condition of the property as of the proposed settlement date.

Why a seller should want the buyer to conduct inspections right away

- If the seller takes the property off the market for months while waiting for short sale approval, the seller takes a huge risk. If the buyer terminates the contract due to inspection results, the seller will have wasted valuable marketing time. Once a short sale approval is granted and the lender expects a closing in 30 days, the likelihood of finding another buyer who can purchase the property in that time frame is slim.
- If the buyer walks away only a few days after signing the sale contract, the seller now has valuable information about the property thanks to that former buyer. That knowledge can help with the short sale negotiation with the bank. Furthermore, the listing agent may be better able to price the property in line with its condition.

Why the seller should not want the buyer to wait until they have short sale approval before conducting inspections

- If the buyer needs a mortgage loan, they may run out of time. If the seller's lender demands that the settlement occur within 30 days, and the buyer spends 15 days on inspections, it leaves only 15 days for them to obtain the mortgage loan. If there is a delay with the buyer's appraisal or their bank's underwriters, then the transaction is in jeopardy. The seller's lender may not extend the short sale approval, or if they do they'll demand extra money for every extra day. In such situations, an argument can ensue over who will pay the per diem to the seller's lender.
- The seller may have made preparations to move out, only to find that the buyer walks away just days before the projected settlement. The seller has to move out, and many people need about

four weeks' notice to plan a move. If the seller's lender demands a closing in 30 days after the short sale approval is granted, and the buyer decides 15 days later to walk away, then the seller is stuck in limbo. The seller may have already begun the move-out process when they find that the buyer decides to terminate the Agreement of Sale just days before the planned closing date. Then the house will sit vacant for weeks, even months, as the listing agent works to procure a new buyer.

If either buyer or seller is not fully committed to the other party, there is a high probability that the transaction will fail. When a buyer conducts their inspections right away, it demonstrates the buyer's commitment since the buyer is willing to spend money up front. The seller in turn should feel assured that they can take the property off the market to commit to that buyer.

It may be best for all parties to have the home inspections conducted right after signing of the contract. While the buyer has to spend several hundred dollars on inspections, that is the cost of doing business. Typically a buyer can purchase a short sale at a discount to fair market value, and that discount justifies the expenditure of money up front. In fact, the inspection results may benefit the buyer in that the report and any repair estimates can influence the seller's lender to allow the house to be sold at a discount.

If a tenant resides in a property that is foreclosed, does the lease survive the foreclosure action?

Each state has its own laws to govern the rights of tenants if a house is foreclosed. In many states, a lease is terminated or invalidated once a property is foreclosed.

Some lenders are offering tenants the opportunity to continue living in a foreclosed house as long as they pay rent under a new lease agreement with the lender. However, in the majority of cases, the lender seeks to evict the occupant because their goal is to sell the house.

What is cash for keys?

Cash for keys is a situation where the new owner, typically the bank that foreclosed, pays the occupant a few hundred to a few thousand dollars to move out so the bank can take possession of the property.

Cash for keys may save a bank the time, money, and hassle of going through the courts to evict the occupant. In some situations, the only reason the occupant continues to reside in the house is because they do not have enough money to move. Some lenders realize that the occupant needs enough money for a moving truck, a security deposit, and one to two months' rent at an apartment.

The lender may send their real estate agent or maintenance person to the house to negotiate with the occupant. The lender may also hire an attorney to communicate with the resident. Typically, the bank will mail a letter to the house or have someone post a notice.

Some lenders are willing to negotiate the amount of the cash for keys settlement. For instance, a lender may offer $2,000 to the person in the house, but they might be willing to go up to $4,000 if the person negotiates further. If you are in the tough position of living in a recently foreclosed home, it may be worthwhile to negotiate a little. Just be careful not to play hardball with the lender, because they could simply file for eviction and potentially even obtain a judgment of some sort. And remember that the person the lender sends to the house may be a real estate agent or maintenance person who does not work directly for the bank. Be cordial with them because they may be your biggest advocate in the cash for keys negotiation.

We are selling our property via a short sale and we just received a low offer. Should we make a counteroffer, or will the bank do that?

The seller of a short sale listing has the right to make counteroffers or even reject an offer outright. If a seller receives an offer that they believe is too low for their mortgage lender to approve, then the seller may negotiate with the buyer to increase the offer price.

Some buyers will be puzzled as to why they receive a counteroffer from the seller. These buyers prefer to have the seller sign off on their low offer, take the property off the market, and submit the low offer to the bank in the hopes of a short sale approval. By accepting a low offer, the seller might be missing out on a higher, better offer from another potential buyer. Yet it is also possible that the bank might issue a short sale approval on a low offer some of the time.

If an offer price is a little low but still close to fair market value, it is advisable for the seller to accept the offer and submit it to their bank. If the bank issues a counter-offer to the buyer, the buyer will perceive that the bank is the bad guy in the negotiation process. That way the seller preserves some goodwill in the negotiation. The seller may be more likely to receive a late-stage concession from a buyer who appreciates that the seller did not issue any counter-offers themselves.

If an offer price is ridiculously low, it may be best for the seller to issue a counter-offer to the buyer. If the buyer is truly interested in the property, they may come up in price.

Why You Should Work With Us to Avoid Foreclosure

1. **Foreclosure is a permanent stain.** On all future mortgage applications and on many job applications, people will have to disclose that they lost a property in a Sheriff's Sale. This means that you will likely pay higher interest rates, which can add up to tens of thousands of dollars. This is a credit item that is asked specifically in all credit inquiries. There is no seven-year time limit on this item.
2. **Possible deficiency judgment.** Your bank can still sue you after a Sheriff's Sale and collect any amount they did not recover.
3. **Badly damaged credit.** Credit scores will be lowered by 300+ points per loan. Along with bankruptcy, a foreclosure is one of the most devastating credit issues you can have. A short sale has a lesser impact on your credit, and you could be back to normal within two years.
4. **Tax liability.** The tax liability in a foreclosure or deed-in-lieu of foreclosure may be higher than in a properly negotiated short sale.
5. **Ineligibility for a government insured loan.** A person who was foreclosed upon will be ineligible for a government insured loan for 5-7 years, whereas in a short sale the time period is only two years. A foreclosure is the one credit report item that is almost impossible to have repaired.
6. **Potentially damaging for employment.** Many current employers run credit checks. Future employers often do. A foreclosure can put a current position in jeopardy and prevent you from being hired to a good job in the future.
7. **Negative on security clearances.** Security clearances and sensitive government positions, including but not limited to military and law enforcement, can be jeopardized by a foreclosure. Revocation of a security clearance could trigger a job reassignment or a firing.

8. **You have alternatives.** As your trusted short sale guide, I will explore every option with you to help you reach the best solution.
9. **Do everything you can.** While it may not seem like it now, there will come a time where your current financial troubles will pass. You will feel much better knowing that you did everything in your power to avoid this devastating financial consequence that millions of people face today.

My bank is sending someone over for a BPO. What should I do?

The Broker's Price Opinion (BPO) is perhaps the most critical step in the short sale approval process. A BPO is the bank's field review of the property to determine the basis for its value.

A lender will typically approve a mortgage payoff that is a predetermined percentage of the BPO value. For example, a lender might only allow a payoff of no less than 84 percent of the value established in the BPO report. In other words, if the BPO states that the property is worth $100,000, then the lender might expect to receive no less than $84,000. That does not mean the lender would approve a sale price of $84,000. Adding realty commission, closing costs, and property taxes on top of that, it is feasible the lender would accept a sale price of $92,000 or higher.

So, if the Agreement of Sale price is $105,000 and the BPO values the property at $100,000, the bank will be eager to approve a short sale at $105,000. If the BPO values the property at $100,000 but the price in the Agreement of Sale is $60,000, the bank will likely reject that sale price. Therefore, it is important that the BPO valuation be reasonably close to the sale price.

The lender often uses hires a real estate agent from the area to perform the valuation. In some cases, the agent may not be from the area. In some cases, the agent may not be aware that the property is a short sale. In some situations, the bank will pay for an appraiser to conduct an appraisal, but the lender may still refer to the report as a BPO.

A short sale seller does not need to tidy up the house for the BPO agent. The seller does not need to leave the house, as this is not a normal showing with a buyer. The BPO agent will take exterior photos and in most cases, interior photos. The seller, or the listing agent, should point out the defects and necessary repairs for inclusion in the report that goes to the bank. The BPO agent should be informed that this is a short sale situation. The cause of the hardship should be conveyed.

It is okay to give a few comparable sales to the BPO agent, and many will appreciate that gesture as it can save them time in preparing the report. Someone should tell the BPO agent the sale price.

The objective is to inform the BPO agent of the circumstances of the sale, with the hope that their valuation will be in line with the sale price. If the BPO valuation is close to the sale price, then the bank is far more likely to approve the short sale.

If you are the listing agent, you should be involved in every aspect regarding the BPO. You should be the point of contact that the BPO agent calls to gain entry to the property.

Bring the following with you to the BPO appointment:

1. The comparable sales that you believe indicate the current value of the property.
2. The listing detail report from the Multiple List Service (MLS).
3. A list of needed repairs, supported by estimate(s) from a licensed contractor.
4. Copies of code violations or other notices.
5. Copy of the seller's hardship letter.
6. The listing history, to show price reductions over time. If possible, also include a list of prior showings and negative feedback from those who viewed the property.
7. A description of the neighborhood and its demographics. Include a printout of a map showing the area.
8. Anything else that justifies the offer price that was submitted to the lender.

Explain to the BPO agent why the offer for the property is the best possible offer. The BPO agent is typically paid $30.00 to $95.00 to conduct the report.

Bring a cold bottle of water or soda for the BPO agent. Strike up a good rapport and help make their job easier. If you're convincing enough, the BPO might come in at the number that you need to make the short sale work.

Some banks are hiring appraisers but still referring to the report as a BPO. Depending on individual state law, some agents are not permitted to conduct a "BPO" but they are allowed to generate a

Comparable Market Analysis (CMA). Nevertheless, the bank will probably refer to the valuation report as a "BPO," regardless of whether it is a CMA, BPO, or appraisal.

Most of the time, the mortgage lender will not reveal the exact valuation from the BPO or appraisal. They do not have to tell you the amount. If the loan negotiator refuses to tell you what the valuation was, you may be able to figure it out. Ask a question like, "How close is the BPO amount to the offer price?" or "How reasonable is the offer price compared to the BPO amount?" or "What price range did the BPO amount come in at?"

If I'm facing foreclosure, can the bank change the locks before they foreclose?

When a borrower becomes seriously delinquent on their mortgage, the bank will eventually send someone to the house to verify occupancy and perhaps assess the current market value. If the bank's representative, who may be a real estate agent, contractor, or other third party, deems that the property is abandoned, then the bank may change the locks and secure the premises even if the bank does not yet own it. The bank might even winterize the property to defend against the possibility of water damage from frozen pipes in the winter.

The fine print in most mortgage loan documents allows banks to secure a mortgaged property if their field representative sees that the property is vacant. Even if the doors are locked, the bank may change the locks on an abandoned property. Typically the bank will not tell the owner or listing agent that they've changed the locks. However, the owner and listing agent have the right to request the new keys from the bank. We have seen banks mail the keys or provide a lockbox combination upon request, although sometimes it will take several phone calls to obtain the keys.

If a mortgage lender changes the locks on a vacant house prior to foreclosing on the property, they will not remove any personal items. In other words, the bank will not clean out the house before they foreclose.

If the bank's representative sees that the house is occupied, then they will not change the locks until after a foreclosure sale. A lot of homeowners facing foreclosure have an unfounded fear that the bank will lock them out of their home prior to a foreclosure auction. If the home is occupied, then the mortgage lender will not change the locks, nor will they seize any personal property.

If a person who is behind on their mortgage payments still lives in the property, it is wise for them to inform their bank that the house is occupied. If the bank is notified that someone is living in the premises, then they may not send a field representative to the house.

If I'm facing foreclosure, should I still pay for homeowner's insurance?

If a person owns a house, they are responsible for maintenance and they are liable for what happens on the premises. The cost of paying for insurance coverage is much smaller than the cost of catastrophic loss. It is important to avoid owning a house that is uninsured.

If a house is not insured and it burns to the ground, the owner is still responsible for removal of the debris and payment of the mortgage loan. If someone is injured on the premises and the owner is at fault but does not have insurance coverage, the owner faces a costly challenge.

In wintertime, the owner is responsible for preventing damage from frozen pipes. If the owner is unable or unwilling to pay for heat, then the house should be winterized. If the owner is unable to pay for the cost of winterization, they should notify their mortgage lender immediately. In many cases the mortgage lender will pay to winterize a house and add the cost to the principal balance.

If the pipes burst from frozen water, then the insurance company might not pay to repair the property if the adjustor deems that the owner was negligent. We knew of a case where owners facing foreclosure moved out of their house and stopped paying for electricity. The house had electric heat. When the pipes burst from freezing water, the house became flooded in multiple places inside. The owners, believing that their insurance would pay to repair the house, hired contractors to make almost $10,000 in repairs. When the insurance adjustor called the electric provider and found that the owners had shut off the electricity, the insurance company decided not to pay for any repairs due to owner negligence. The contractors then sued the owner for payment.

If a homeowner cannot pay for insurance to cover their house, then they should notify their bank immediately. Many banks will pay for what is known as forced placed insurance. That insurance is generally more expensive than insurance that the owner could obtain through a normal provider. The bank will add the cost of the insurance to the principal balance.

If a seller is under contract with a buyer, the seller is responsible for maintaining the property in its present condition until the closing. If the pipes freeze before the sale, the owner will be responsible for repairing the property to the condition it was in before the damage. Without insurance, the seller will be in an expensive situation. If they fail to repair the property for the buyer, the buyer could sue the seller. Therefore, it is imperative that a seller maintain homeowner's insurance on their property.

I'm selling my house via a short sale and we are under contract with a buyer. If we receive a higher, better offer, can we send that to the bank?

The terms of the real estate contract must be followed. Most standard contracts commit the buyer and seller to each other, so the seller cannot arbitrarily terminate an agreement with one buyer to go with another buyer.

Generally speaking in a real estate contract, the seller has to sell and the buyer does not necessarily have to buy. If a buyer defaults, the remedy for the seller is that they keep the buyer's deposit. If the seller defaults, the buyer could sue for performance. In other words, the buyer could sue to compel the seller to sell the property per the terms and conditions outlined in the contract.

Typically, a seller of a short sale commits to the buyer via the signed contract. In many cases, the listing agent should mark the listing as Pending or Under Contract. The property is not actively marketed to other buyers while the buyer and seller await a short sale approval, or denial, from the seller's mortgage lender.

Think about it this way: The buyer stops searching for another property to purchase. The buyer pays for inspections and perhaps for a loan rate lock. The buyer may sell their property or terminate their lease based upon the representations of the seller. Therefore, the buyer is committed to the deal. The seller should recognize the buyer's commitment and allow the short sale approval process to play out, without planning to remove the buyer from the deal if a more enticing offer comes along.

Some people erroneously believe that all buyer offers, whenever they come in, should be presented to the seller's bank. The seller, as the owner of the property, chooses the one offer that they will accept.

Once signed, that contract is the only one submitted to the seller's bank for a short sale approval. The bank is not the owner and does not have the authority to pick and choose among offers.

In a short sale, the buyer and seller should commit to each other. Once the seller's mortgage lender makes a decision about the short sale, then the buyer and seller can either proceed to closing or go their separate ways.

Will I receive any money for selling my house?

In the vast majority of short sales, the seller does not receive any money. The bank and perhaps some other creditors lose thousands of dollars, and so they will not permit the seller to receive any proceeds from the sale.

In some cases, the seller may be expected to pay some money at closing. In most cases where the seller has to contribute something, the amount the seller pays is just to make up the difference on pro-rated taxes, a higher-than-expected water/sewer bill, or some other shortfall that appears at the last minute. For example, if the mortgage lender agrees to take a minimum of $132,655.17 and the closing costs are a little higher than expected, the lender will likely be unwilling to take less than the precise amount they stated. Therefore, the buyer, seller, real estate agents, or other parties must contribute in some way to make up the shortfall. In some cases, the buyer will refuse to pay more, stating that they will not pay for the seller's costs. In such situations, the seller may have to bring some money to closing to cover extra closing costs. Typically that amount would be fairly low, ranging from a few dollars to a couple thousand dollars.

In some short sales, the mortgage lender may stipulate that the seller must contribute some amount of money or the lender may ask the seller to sign a promissory note to pay back some of the remaining debt. The mortgage company must declare any such stipulations in their short sale approval letter, so the seller would know well in advance. In most short sales these days, the mortgage company does not expect the seller to contribute any money as it may be apparent that the seller does not have any funds to give.

In some short sales, the seller may be given some money at closing or upon post-settlement move-out. The federal government's Home Affordable Foreclosure Alternatives (HAFA) program provides

$3,000.00 for eligible sellers. Loans insured by the Federal Housing Administration (FHA) may grant $750.00 to $1,000.00 to the seller as a moving incentive. Some mortgage lenders, like Bank of America and Chase Home Finance, offer to pay $3,000.00 up to $25,000.00 to sellers at closing if they cooperate with the short sale of their property.

Sellers in a short sale should expect to receive no money at closing. If they do qualify for a special short sale program, then they should be grateful to receive what little money they do. The greater financial benefit to the seller is that they will no longer have to maintain a property they cannot afford.

Can I sell my short sale property without a real estate agent?

It is possible in some cases for someone to conduct a short sale without the involvement of real estate agents. However, it is much better for someone considering a short sale to list their property with a licensed agent.

Below are the reasons why sellers of a short sale property should work with an agent:

1.) Many banks will only consider a short sale if the property is listed by a licensed agent. The banks know that an agent will be able to market the property on a wide scale. The banks also realize that agents will disclose known defects about the property. Agents will disclose to buyers that the transaction is a potential short sale. Furthermore, many agents will provide guidance to the seller on which offer to accept.

2.) Banks like to work with licensed agents because of the reduced potential for mortgage fraud. Licensed agents know about the basic concepts of real estate. Licensees are less likely to commit fraud, as doing so could cause them to lose their license and their livelihood. Many agents are REALTORS®, who are bound by a common Code of Ethics. All agents operate under the guidance of a broker, whose role is to ensure that transactions are conducted effectively, ethically, and legally.

3.) Banks prefer to review and approve standardized real estate contracts, which agents typically use. A standardized contract is often worded with protections for buyer and seller. A standardized contract is less likely to contain hidden clauses that may create unfair advantages for the buyer or another party. Non-standard contracts created by auctioneers, attorneys, private buyers, or the sellers themselves may contain provisions (or a lack of provisions) that swing the contract totally in favor of one party.

4.) Mortgage lenders may wish to talk with a listing agent about the short sale, with the expectation that the agent would be more credible than the seller. A seller might be too emotional or inexperienced to deal with the bank's negotiator.

5.) Agents will qualify a buyer's ability to purchase the property. If an owner trying to sell their house themselves enters into a contract with a buyer who is not qualified, then the entire transaction is a waste of time and money.

Many owners of a short sale who have tried to sell their property themselves have found that the bank demands extensive proof that the property has been marketed effectively. Providing such proof may be difficult. Since most mortgage lenders now mandate that the property must be listed with an agent as a condition of considering a short sale, it is not worth the time and money for a seller to attempt to sell the property themselves.

People who try to sell their short sale property on their own may also embroil themselves in legal liability if they fail to properly disclose the short sale nature of the transaction. A seller who unwittingly signs a contract without a short sale disclosure and/or short sale clause may be compelled to sell the house even though a short sale approval is not obtained.

There are some fraudulent buyers and flippers who seek to take advantage of a naïve or unwitting short sale seller. A person trying to commit fraud may be attempting to engineer a transaction whereby the bank is deceived. Some people may attempt to lure the seller into signing over the deed or signing an option to purchase, which clouds the title and forces any end-buyer to pay the deed or option-holder money. Some people may tell the bank that their low offer is the very best price that the market will bear, only to deliberately conceal the existence of a substantially higher offer in the hopes of collecting the difference. If there were a real estate agent involved in the transaction, he or she may spot the fraudulent activity and alert the seller and perhaps others.

A short sale seller who wants to use an auctioneer may find that the highest bid price is below what a bank would accept. Furthermore, many auction companies may not want to spend advertising dollars on an auction sale that is contingent upon a short sale.

In short, it is best for a seller of a short sale to list their property with a licensed agent.

What asking price should we choose when listing our short sale property for sale?

A short sale listing should be listed for sale at fair market value or slightly below. The price can be lowered every three to four weeks if there is not enough interest from buyers.

It is futile to list a property too high. Some agents and sellers list the property at a ridiculously high price that would theoretically pay off the entire mortgage balance and all other closing costs. Buyers will not accidentally pay too much for a property. They typically will not even look at a property that is listed well above market value. Listing at too high a price is a waste of time.

Some agents and sellers think that the mortgage lender dictates the list price. In certain short sale programs, like the HAFA program or the FHA Preforeclosure Sale program, the mortgage lender does determine the list price. Some cooperative short sale programs also entail the lender choosing the list price. In traditional short sales, which comprise the majority of all short sales, the seller determines the asking price after consulting with their agent.

Some agents list short sales well below fair market value, hoping to attract a multitude of buyers. Some agents may simply use the short sale listing to attract buyers who they will divert to other listings. The challenge with listing a property too low is that the seller's lender may be unlikely to approve a sale price substantially below fair market value. The lender will send an agent to the property to conduct a Broker's Price Opinion (BPO), or the lender might even hire an appraiser. If the lender's valuation is much higher than the sale price in the Agreement of Sale, then the sale will probably not be approved at the low price.

On a national scale, according to Zillow.com, the average short sale sells for 20 percent below fair market value. The average foreclosed home sells for 40 percent below fair market value. Nevertheless, the ultimate market value of a short sale is dependent upon local market conditions and the condition of the property. If the house is in a desirable neighborhood and it is in good condition, then the property will likely sell close to fair market value.

I need a short sale on one property of mine. Can the bank go after my other house?
The mortgage given by the owner to the bank gives the bank the right to take ownership of the house via the foreclosure process if the owner does not pay. The mortgage lender's remedy is to take ownership of the house so it can be sold to recoup some or all of the defaulted loan.

The bank cannot seize other real estate owned by the borrower unless the borrower has some type of blanket mortgage loan that applies to more than one property. Most mortgage loans are not blanket loans but simply a loan secured by one property.

In some cases and in some states, the mortgage lender can foreclose on the borrower and may sue the borrower after the sale if the lender did not recoup the balance of the loan. In other words, if the bank foreclosed and found that the value of the property is far below what they are owed, they can pursue the former owner for some or all of the remaining balance. If the bank sues and is granted a deficiency judgment, then the former owner has to pay off that judgment somehow. The payment of that judgment may come when the person sells another one of their properties.

Although some states restrict the collection of deficiency balances, most states have laws that permit deficiencies to be treated like other unsecured debts. In states that allow deficiency judgments, the lender may be able to garnish the borrower's wages, levy their bank accounts, and/or place a lien on other real estate they own.

In some short sales, the bank desires to retain the right to pursue a deficiency judgment after the sale of the property. The mortgage lender should declare that intention on their short sale approval letter. The borrower has the right to reject that condition of the short sale, and the parties may re-negotiate. The borrower may propose that the bank forgive the remaining debt instead of pursuing the deficiency judgment.

States with anti-deficiency laws are Alaska, Arizona, California, Iowa, Minnesota, Montana, North Carolina, North Dakota, Oregon, and Washington. It should be noted that some of these states allow deficiency lawsuits in certain situations. These anti-deficiency laws are rarely straightforward.

In rare cases, the bank may be willing to release its lien on one property to allow a short sale to occur, but the bank will add a lien to another property as long as the owner consents. This tactic is more prevalent with local banks instead of national banks. The parties negotiate a deal whereby the seller allows the bank to place a mortgage against another property for the amount of the loan that remains unpaid by the short sale. This may be a wise tactic for the seller if they have equity in one property but no equity in another.

How long does it take for a bank to foreclose once I stop making payments?

The average time to foreclose on a property has increased across the country. Banks, courts, foreclosure attorneys, and Sheriff's Departments have become inundated. Borrowers are attempting loan modifications, short sales, and other programs which typically delay the foreclosure process. Banks have sometimes delayed sales to maintain good public relations. For example, many banks choose to suspend foreclosure sales around Christmas. Other banks have placed a temporary moratorium on foreclosures due to complaints by borrowers, state governments, or others. In addition, an increasing number of borrowers choose to contest the foreclosure action against them, which delays the foreclosure sale.

Should I pay my property taxes while I am facing foreclosure?

It is the owner's responsibility to pay real estate taxes. However, if someone is in financial distress, it is likely they will not have the means to pay the taxes. Many borrowers who are behind on their mortgage payments are also behind on their property tax payments.

Some mortgage companies pay property taxes on behalf of the owner via an escrow account that the owner is supposed to pay into on a monthly basis. If a person is delinquent for only a few months and they have an escrow arrangement with their mortgage lender, there may be enough funds in the escrow account to pay off the current year's taxes. The lender might even temporarily fund the escrow account if there is a slight shortfall. If the borrower believes they can sell the property in the near future or they reach an alternative arrangement with the lender, no other property taxes may be due at that time.

If the borrower is more than a year behind on payments, then any escrow account will probably have no money left. If nothing is done, the property taxes will go unpaid. Eventually a tax sale will be scheduled, with the borrower and the lender being notified of the sale. In many cases, the mortgage lender will pay the delinquent property taxes shortly before the tax sale just to protect their interest in the property.

If a borrower is facing foreclosure, it is a judgment call whether they should pay the property taxes. Assuming they have the funds to pay the property taxes, it is often wise to pay the delinquent taxes if they have equity in the property. That will eliminate the tax sale and buy the owner time to sell the property or find another solution to the foreclosure action. It protects the owner's equity.

If a borrower is attempting to sell their property via a short sale, the property taxes are often paid out of the lender's proceeds at the sale provided that the back taxes were included on the preliminary HUD-1 Settlement Statement submitted to the lender. It may not be as prudent for the owner to pay the property taxes in a short sale, as every dollar they spend on the property is a dollar that they will not recover.

If a mortgaged property is sold at tax sale, the mortgage obligation may still exist. Depending on the type of tax sale, the original borrower will still be on the hook to pay the mortgage loan while the new owner will have the mortgage clouding the property's title. Until that mortgage is paid, the lender can pursue the seller for the balance while continuing with the foreclosure action.

If I'm current on my mortgage loan, can I still do a short sale?

In some situations, certain banks may consider a short sale on a property where the borrower is current with their payments. In a state where foreclosures are rampant, such as Nevada, California, Florida, and Arizona, banks are far more likely to consider a short sale for someone who has not missed a payment. A person who is current on their mortgage needs to display a legitimate hardship. They typically have to be in danger of imminent default. In other words, they must demonstrate that they're financially struggling to pay all of their bills, which indicates that mortgage default is likely.

In some cases, however, banks will only consider a short sale if the borrower is behind on their payments. Some lenders will consider a short sale if a person is more than five days late. Many banks state that the borrower must be at least 30 days behind. Other banks will only consider a short sale if the borrower is delinquent by more than 90 days. The national trend is that more and more banks are permitting short sales for people who are current on their mortgage but likely to default in the near future.

If there is a compelling reason to sell, a verifiable hardship, and it is clear that the market value is less than the amount owed, a seller's first step should be to talk to their bank. They should ask their lender about the criteria needed to qualify for a short sale. If the lender states that the borrower must be delinquent by a certain period of time, then the borrower needs to make a business decision on whether to stop paying.

Some people find that they must be delinquent for a short sale to be permitted, but they still want to preserve their good credit rating as much as possible. If a person is 30 days behind on their mortgage, that delinquency is reported to the credit bureaus. For the next two years, lenders will likely shun that person because of the delinquency. Even if the person qualifies for a new loan, the interest rate will typically be higher and more costly over time.

A technique some people use is to deliberately fall behind on their mortgage payment. Those who want to avoid going 30 days late if they can help it have the option to pay their mortgage about 25 days late. They will have to pay a late fee along with the monthly payment. This technique flags the loan as delinquent in the lender's system, but the borrower avoids a negative hit to their credit. This could spur the lender to offer a short sale to the borrower.

Other people strategically default on their mortgage, whereby they stop paying altogether. After doing the math, they realize that it is pointless to continue paying. They might as well save up the money they would have paid to the bank, and they recognize that they have no equity in the property whatsoever.

Lawyers and accountants can recommend to their clients that they stop paying the mortgage to put into motion the events that will lead to a short sale. A real estate agent should never tell their client to stop paying. A decision to stop paying one's mortgage is a tough one, and a person should evaluate all their options carefully.

Can the bank lock me out of the house?

If the mortgage lender has not foreclosed on a house and it is still occupied, then the lender is not allowed to change the locks. Many homeowners have an unfounded fear that they will come home one night to find they are locked out and their possessions are seized. Many people move out of their house prematurely due to this fear.

When a person falls behind on their mortgage payments, the bank will eventually send someone to the property to determine if it is still occupied. In some cases it will be a bank employee, but in many cases it is a real estate agent or third party representative sent out to the property. If the property is deemed to be occupied, the bank will continue with the foreclosure proceeding but will not secure the house.

If the property is deemed to be vacant or abandoned, then the bank may change the locks and secure the property even though the bank does not yet own it. That may entail boarding up broken windows or winterizing the house. The mortgage lender does this to prevent further loss of value that may result from vandalism, burglary, or frozen pipes in the winter. Vacant or abandoned houses face a much higher risk of damage from theft or deferred maintenance. Mortgage lenders prefer to know that the property is occupied.

If the bank secures the property before they take it via the foreclosure process, they must release the keys to the homeowner or the real estate agent for the owner. Sometimes the keys are mailed to the owner or agent. In other cases, the keys are placed in a lockbox on the premises, and the bank simply provides the code to open the lockbox. In rare circumstances, the bank may mail the wrong keys.

It is relatively common for a listing agent of a vacant house facing foreclosure to receive a call from another agent who says that the lockbox combination they were given is not working. That is a telltale sign that the lender changed the locks. The third party companies that secure properties often do not contact the owner or the listing agent.

If a homeowner facing foreclosure is going to be away from home for a time, they should inform their bank that the property is still occupied. Perhaps the owner could even post a note in the front window that would be noticeable to the bank's representative who is sent to verify occupancy.

In many cases, it is advisable for a homeowner in default to continue residing in their house for as long as possible. The homeowner will save money because they do not have to pay rent elsewhere. Also, the house maintains its value longer due to it being occupied. If the house is worth more due to it being in good condition, that means the bank will lose less money when it does sell. If the bank minimizes its losses, that makes a short sale more likely to be approved for the borrower.

Are short sales allowed on commercial and investment properties?

A short sale can be conducted on any type of property. If the seller owes more than the property is worth, and the mortgage lender is willing to take less than what is owed, then a short sale can occur. Short sales can occur with one's primary residence, a vacation home, a commercial property, a multi-unit property, or vacant land.

In any short sale, if the mortgage lender forgives the remaining debt, the former borrower can expect to receive a 1099C form the following January. The forgiven debt will be reported to the Internal Revenue Service. If the property was an investment property, second home, vacant land, or a commercial property, then the former borrower will likely have to pay some tax on the forgiven debt. The IRS has historically treated forgiven debt as ordinary income.

If a person sells their primary residence via a short sale, they may not have to pay any income tax. The Mortgage Forgiveness Debt Relief Act of 2007 applies to debt forgiven in calendar years 2007 through 2012. Up to $2 million of forgiven debt is eligible for this exclusion ($1 million if married filing separately). Debt reduced through mortgage restructuring, as well as mortgage debt forgiven in connection with a foreclosure, may qualify for this relief. In most cases, eligible homeowners only need to fill out a few lines on IRS Form 982.

The debt must have been used to buy, build, or substantially improve the taxpayer's principal residence and must have been secured by that residence. Debt used to refinance qualifying debt is also eligible for the exclusion, but only up to the amount of the old mortgage principal, just before the refinancing.

REALTOR® Short Sale Horror Stories

The buyer had to pay for a hotel room for a couple of weeks and will never use their agent again.

The closing date in the Agreement of Sale may mean little if the short sale is not yet approved. An agent's buyer insisted upon seeing a home listed as a short sale. Their offer was accepted by the seller and then submitted to the seller's mortgage lender for short sale approval. The representative at the seller's bank told the listing agent over the phone that the short sale would be approved, with the written approval to be faxed within a few days. As soon as he got off the phone with the bank, the listing agent told the buyer's agent right away about the good news. The buyer's agent immediately told the buyer and their title agent that the short sale had been approved. The buyer terminated their lease and scheduled a date for the closing.

Unfortunately, the seller's bank reassigned the loan negotiator before he could issue the written approval, so it was never faxed. Unbeknownst to everyone else in the transaction, the seller's bank neglected the file. On the day before the scheduled closing, the title agent asked the listing agent for the written short sale approval. The listing agent had never received it from the seller's lender. When the listing agent tried to call the representative he had been dealing with, he was sent to other people at the bank who did not know what file he was talking about.

The buyer, believing that the closing was going to happen the next day, decided to stay at a hotel for the night and parked their fully-loaded moving truck in the parking lot. However, without the written short sale approval, the title company would not hold settlement. The buyer decided to stay another night at the hotel, thinking that settlement would occur the next day.

Two weeks later, the seller's bank still had not responded to the repeated requests for a written short sale approval. The buyer had to place all their items in a storage facility and had exhausted their short-term savings on hotel costs. The buyer voiced their dissatisfaction with their agent, who passed blame on to the listing agent and the seller's bank.

After another two weeks, the buyer had moved into a relative's house temporarily while they waited for settlement. Finally, a supervisor at the seller's bank authorized the short sale in writing, and the settlement occurred. The buyer angrily told their agent they wanted some compensation for all the time and money they had spent waiting for the closing. The seller did not have any money to give, and the seller's bank refused to offer any concessions. The buyers decided to go ahead with the settlement, but they were so upset they refused to speak with their agent again.

The REALTOR® was sued for successfully processing the short sale.

The listing agent did exactly what he promised his sellers he would do. He listed their short sale property. He procured a buyer. The agent negotiated with the sellers' bank and convinced them to approve the short sale. At the settlement, the sellers cried tears of joy and gratitude, thanking the agent profusely for selling their house.

Thirty days after the sale of the house, the former owners received notice of a lawsuit from their mortgage lender. The bank filed a lawsuit for the entire remaining balance of the mortgage. The former owners thought there must have been some mistake. But there was no mistake, as the bank's attorney pointed out that the mortgage lender stated in the short sale approval letter that they reserved the right to sue for the deficiency. The former owners had never seen the approval letter before, as their real estate agent had handled all the paperwork.

The bank was awarded a judgment against the former owners for the entire remaining balance, plus collection costs and legal fees. The former owners then sued the agent, his broker, and the brokerage firm for failing to inform them about the bank's decision not to waive the deficiency. They stated that had they known about the bank's intention to pursue a deficiency judgment, they might have renegotiated with the bank or tried an alternative to the short sale. The amount the former owners decided to seek was the entire judgment levied against them, plus their legal fees.

The agent's Errors and Omissions insurance company stated that they would not cover the claim, as short sale negotiation falls outside the normal activities of a real estate agent. The agent and his broker were left to defend themselves without insurance coverage. They eventually had to settle out of court, paying a large sum to dismiss the lawsuit against them.

Address: P.O. Box 3444 Bethlehem, PA 18017 **Phone:** 610-681-8247 **Fax:** 484-214-0030
Website: www.SignificaShortSales.com **Blog:** www.StopMyForeclosureInstantly.com

I'm on the deed but not on the mortgage. Will the mortgage company come after me?
There are situations where not all of the people on the deed are on the mortgage too. The lender can pursue the people who signed the mortgage and note. All of the owners of record will be notified about the foreclosure sale.

Below are examples of actual situations we have seen. The names have been changed to protect the parties.

Wife later added to deed but not the mortgage.

John Doe borrowed money from a mortgage lender to purchase his home. A couple of years later, John married Jane. John decided to add Jane's name to the deed, so they could both be official owners of the property. John and Jane then fell upon hard times, and they defaulted on John's mortgage loan. John received numerous collection calls at the phone numbers he had registered with his lender. John's credit score was severely damaged by the mortgage default, but Jane's credit score was unaffected.

The lender entered a Default Judgment against John in the county court. John and Jane both received notices of the foreclosure sale. When the house was foreclosed, John and Jane had to move out. John permanently has a foreclosure against his record, and on future loan applications John has to disclose the foreclosure. Jane has no foreclosure against her record, and on future loan applications Jane can report that she was never foreclosed upon.

Divorce.

Joe and Sue Smith borrowed money from a mortgage lender to purchase their home, and both of their names went on the deed. A few years later, Joe and Sue decided to divorce each other. As part of the divorce agreement, Sue was allowed to continue residing in the house and Joe removed his name from the deed. The divorce agreement also called for Sue to remove Joe's name from the mortgage and note. However, the mortgage lender would not simply remove Joe's name. The lender told Sue that she had to pay off the loan in full or refinance to a new loan in her own name that would pay off the old loan. Unfortunately, property values dropped and Sue's income was not sufficient to qualify for a loan.

For the time being, Sue decided to continue paying on the existing loan. Unfortunately, Sue could not maintain the payments, and the loan went into default. Both Joe and Sue received collection calls from the lender. Both Joe and Sue had default judgments entered against them.

Joe tried to explain to the lender that he had no more ownership or interest in the house, but the lender replied that he was still a guarantor. The credit scores for Joe and Sue went down. Eventually, the lender foreclosed, and both Joe and Sue had a foreclosure against their record.

Straw party.

Francis had a low credit score, so he convinced his friend James to sign for a mortgage loan. James purchased the house in his name, and Francis moved in. Francis made a payment every month to James, who then paid the mortgage company. Since they were friends, they had no written agreement between them.

One day, Francis was stunned to be served with a foreclosure notice. Francis learned that for the past year, James had not paid the mortgage even though Francis had been making payments to him. James had been ignoring the collection calls from the lender all that time.

Francis tried to call the lender to ask them to transfer the loan into his name, but the lender would not even talk to Francis. Francis asked James to try for a loan modification, but the lender stated that they were too far along in the foreclosure process. The lender foreclosed on the house, and Francis was evicted. Francis and James did not talk to each other after that.

Improvements to house.

Sally obtained a mortgage loan and purchased a fixer-upper. She did some of the work herself over time as she lived at the house. Unfortunately, the work she did was not up to code, and she had a lot of unfinished projects. Sally ran out of money and could no longer pay for repairs. She fell behind on her mortgage payments.

Sally approached her friend Fred, who was a handyman. Sally told Fred that if he paid for materials and finished the renovation, then Sally would sell her house and give him half the profit. Fred began work, repairing the shoddy improvements that Sally had already made in addition to handling some of the other projects.

One day while working at the house, a Sheriff's deputy handed Fred a notice of a foreclosure sale. The notice stated that the sale date was the following month. Fred was stunned and approached Sally. Sally said she would call a real estate agent to quickly sell the house.

The agent told Sally that property values had dropped in the area, and that the fair market value was below the amount that Sally owed to her mortgage lender. The agent added that it was unrealistic to sell the house in a month. Sally listed the house with the agent as a short sale, but no offers came in that month.

Fred realized that all the materials he had installed at the house, and all his labor, were essentially lost. The buyer of the house at the foreclosure auction received the benefit of all the improvements. Fred and Sally never talked again.

Will I go to jail over not paying my mortgage?

A borrower will not go to jail if they default on their mortgage loan, but they could face criminal charges in a couple of extreme situations described below.

In some states, foreclosure involves judicial proceedings. In other words, the lender must hire an attorney who initiates a foreclosure lawsuit against the borrower. The lawsuit does not involve any criminal charges against the borrower. It is merely a civil proceeding that involves the lender's attempt to collect a debt or be given ownership of the property in exchange for the unpaid debt obligation.

If a borrower fails to maintain their property prior to being foreclosed, the local municipality could issue a citation and/or a fine. Common citations include failure to keep grass cut, leaving pets behind, having an unfenced or tepid swimming pool, or leaving a house unsecured. Some municipalities will even condemn a property. If the borrower fails to address the issues and pay the fines, some municipalities have the ability to take the borrower to court. In rare cases, failure to show up for court could result in an arrest warrant being issued.

If a borrower deliberately trashes a house, it is possible for the lender to sue them after the sale for destruction of property and perhaps even press criminal charges. While rare, it is done in cases where the borrower creates major damage to the house. We have seen cases of angry borrowers clogging toilets and sinks with concrete mix or stopping the drains with other things like tennis balls. They then turn the water on and leave it on. In other cases, borrowers have ripped out all the fixtures and appliances.

In some blighted cities, lenders have taken the unusual step of not foreclosing since they determine that the property's value is so low that it is better to not take it back. This is known as a bank walkaway, where the bank charges off the loan and stops the foreclosure action. Therefore, the borrower remains as the owner. The city can then issue citations against the owner for failure to maintain their property. In some cases we have seen, the owner walked away from the property only to find out years later that they still owned the property. The city may even have the right to demolish the property and bill the owner for the cost. In rare cases, failure to respond to the city's citations or court hearings could result in an arrest warrant being issued.

What is a bank walkaway?

A bank walkaway is a situation where the mortgage lender decides to charge off a defaulted loan and cancel a foreclosure action. The lender might do this if they deem that it would cost more money to foreclose and take back the property.

This bank walkaway phenomenon began in earnest in 2009. Detroit and Chicago are the cities with the most bank walkaways.

Below are several bank walkaway scenarios.

1. The lender begins the foreclosure process, the occupants move out, and the lender later decides to cancel the foreclosure action. The owner assumes that the foreclosure sale occurred. Many months or years later, after the house has been vandalized and loses tremendous value, the municipality informs the owner that they are responsible for the property.

2. The lender decides not to begin foreclosure proceedings. The lender may sell the defaulted note to a collection agency or another bank for pennies on the dollar. Eventually, the collection agency or bank may charge off the loan but not release the lien.
3. The borrower declares bankruptcy, but the lender never files a Proof of Claim or moves to lift the automatic stay. The lien typically remains, but the lender stops trying to collect payments on the loan.
4. In what is known as principal extinguishment, the lender agrees to charge off the debt and satisfy the mortgage lien. This is the best scenario for the borrower if their desire is to keep the property.

What is principal extinguishment?

Principal extinguishment is a growing trend among mortgage lenders, particularly secondary lienholders. Principal extinguishment is a negotiated agreement between the lender and the borrower whereby the lender agrees to release all of the remaining debt and satisfy the mortgage lien. In other words, the lender tells the borrower that they no longer owe any money and the lien will be removed.

The borrower will likely receive a 1099C from the lender for the amount of the forgiven debt. The borrower may have to pay tax to the Internal Revenue Service (IRS) on the forgiven debt.

Principal extinguishment is slightly different than principal reduction. Principal reduction involves the removal of some of the underlying debt, but the borrower will still be responsible for the remaining debt. The mortgage lien will not be satisfied until the balance of the loan is paid in full.

The federal government's Making Home Affordable Program has provisions known as the Principal Reduction Alternative and the Second Lien Modification Program. On June 3, 2012, the Department of the Treasury issued Supplemental Directive 10-05 announcing a Principal Reduction Alternative (PRA) regarding first lien mortgage loans. On October 15, 2011, Supplemental Directive 10-14 provided further guidance. Under PRA, lenders are eligible for financial compensation whenever they reduce mortgage principal under the Home Affordable Modification Program (HAMP).

The Second Lien Modification Program, announced on March 26, 2010 in Supplemental Directive 09-05, provides financial incentives for secondary mortgage lenders for a full extinguishment or a principal reduction if the borrower's first lien was modified under HAMP guidelines.

The guidance in the Supplemental Directives does not apply to loans owned or guaranteed by Fannie Mae, Freddie Mac, insured or guaranteed by the Veterans Administration (VA) or the Department of Agriculture's Rural Housing Service or insured by the Federal Housing Administration (FHA).

Can a Sheriff's Sale be delayed?

Yes, a Sheriff's Sale can be delayed, also known as stayed, either at the request of the lender or upon a stay granted by a judge. In some states, the Sheriff's Sale can be delayed up to one hour before the bidding at a foreclosure sale. Note that some states do not have Sheriff's Sales but some form of a foreclosure sale.

The common technique to delay a Sheriff's Sale is to convince the foreclosing mortgage lender to request it. In many cases, though not all, a lender will delay a Sheriff's Sale to allow a short sale to reach settlement.

Sometimes a lender will only initiate their request to stay the Sheriff's Sale a mere two to three days before the sale date. The bank does this just in case the short sale transaction is not working out to their satisfaction, so they can quickly go ahead with the foreclosure sale if necessary. The risk to sellers and agents is that if the left hand does not know what the right hand is doing, the Sheriff's auctioneer might not receive the message to delay the sale. Unfortunately, we have seen this happen on several occasions.

In some states, once the Sheriff's Sale occurs, it is final. Some states permit a right of redemption, whereby the former owner could unwind the sale a few days after it occurs if they provide enough money to pay off the loan.

Another method of delaying a Sheriff's Sale is for the borrower to declare bankruptcy. A bankruptcy will postpone the foreclosure sale until the trustee or presiding judge releases the real estate from the bankruptcy proceeding. We have seen borrowers declare bankruptcy a mere hour before a Sheriff's

Sale. In those cases, they have been able to delay the foreclosure action for months while the bankruptcy runs its course.

One other technique to delay a Sheriff's Sale is for the borrower or their representative to convince a judge to grant a stay. Sometimes a judge will delay a Sheriff's Sale to allow for a possible conciliation. We have seen various judges grant stays from 30 days to six months. The borrower may file a petition seeking relief from the judgment or a delay of the Sheriff's Sale.

In rare cases, the Sheriff's department will postpone a foreclosure sale due to a high volume of cases.

Since we're negotiating a loan modification or short sale, does that mean the bank will stop their foreclosure action against us?

In most cases, a mortgage lender will continue the foreclosure action even though they are negotiating a loan modification or short sale with the borrower. Just because someone is working on a loan modification or short sale does not mean that the bank halts the foreclosure proceeding.

The perspective of the lender is that if the loan modification or short sale fails, then they can quickly finalize the foreclosure. We have also seen situations where the bank negotiator states that they will temporarily stop the foreclosure action, but the borrower receives notice of an impending foreclosure sale. Those are frequently cases of the left hand not knowing what the right hand is doing at the bank.

In some loan modification and short sale programs, the lender agrees to stop the foreclosure action for the duration of the program. For example, the foreclosure action is halted on FHA (Federal Housing Administration) loans that are granted a short sale pre-approval, known as an Approval to Participate (ATP). If the house does not sell during the listing period, then the borrower may transfer ownership via a deed-in-lieu of foreclosure and they will not be liable for any deficiency amount.

Do Fannie Mae, Freddie Mac, FHA, VA, and USDA waive deficiency judgments for short sales?

Fannie Mae

Fannie Mae used to ensure that the deficiency would be waived with all loans that they own or guarantee. However, in 2011 Fannie Mae made an amendment to that policy. Fannie Mae now reserves the right to pursue a deficiency judgment on people who they believe strategically defaulted on their mortgage. In other words, if Fannie Mae learns that the borrower had no hardship and the financial means to continue making payments for the foreseeable future, then they may sue the borrower after the short sale for the remaining amount plus collection costs.

Freddie Mac

Freddie Mac waives the deficiency on all loans they own or guarantee. Per Freddie Mac Bulletin Number 2012-5, issued on February 15, 2012, it states, “We have updated the Guide to reinforce the requirement that the Servicer, for itself and on behalf of Freddie Mac, must waive all rights to pursue payment of the remaining balance owed by the Borrower under a Freddie Mac-owned Mortgage for all approved short payoffs and deed-in-lieu of foreclosure transactions that have closed in accordance with the Guide and applicable law.”

FHA

The Federal Housing Administration (FHA) insures more mortgage loans than any other entity. As part of the Department of Housing and Urban Development (HUD), FHA issues an Approval to Participate (ATP) for their short sales under what is known as the Preforeclosure Sale Program (PFS). FHA waives the lender’s right to pursue a deficiency on short sales and on foreclosures where an ATP was issued but the property did not sell. In Mortgagee Letter 2008-43, dated December 24, 2008, it states, “A PFS sale must be an outright sale of the property. If a foreclosure occurs after the mortgagor unsuccessfully participated in the PFS process in good faith, neither the mortgagee nor HUD will pursue the mortgagor for a deficiency judgment.”

VA

The Veterans Administration (VA) may reserve the right to pursue a deficiency judgment on some loans, and its right to do so may supercede the laws of some states. In the 1961 case, *United States v. Shimer 376 U.S. 374*, the U.S. Supreme Court ruled that the VA had the right to pursue a Pennsylvania veteran who had defaulted on his loan even after the VA seized the house via a Sheriff’s Sale.

USDA

The U.S. Department of Agriculture may reserve the right to pursue a deficiency judgment. In Chapter 6: Liquidation And Acquisition of HB-2-3550, USDA states, “When sales proceeds will not fully satisfy the debt, CSC (Centralized Servicing Center) will make the determination of whether the borrower will be released from personal liability. This determination is based upon a Debt Settlement Package completed by the borrower and forwarded to CSC for review and approval."

Will I get any money if I sell my house as a short sale?

In the majority of short sales, the seller receives no money. In some cases, the seller is expected to contribute some money at settlement. The lender's attitude is that if they're losing tens of thousands of dollars, then they certainly do not want the seller to receive any money.

There are situations where the seller can receive some money even though it is a short sale. FHA/HUD short sales pay $750 to $1,000 as a seller incentive. The federal government's Home Affordable Foreclosure Alternatives (HAFA) program pays $3,000 to the occupant of a property at the time of sale or upon post-settlement move-out. Under the HAFA program, the $3,000 could actually go to a tenant.

In 2011, J.P. Morgan Chase and Bank of America rolled out pilot programs known as cooperative short sales. Under the Chase Foreclosure Outreach, Chase offers selected borrowers who are in default up to $25,000 as an incentive to sell. The loan must be owned by Chase and not merely serviced by them. We have seen actual letters sent from Chase offering $3,000, $10,000, $15,000, and $25,000. Chase tells the borrower they will receive the money if they list with a licensed agent and the contract generated by the agent is acceptable to Chase. The borrower is not expected to submit any financial paperwork. In the traditional short sales, the seller constantly submits paperwork displaying their finances.

Bank of America's cooperative short sale program offers up to $30,000 to selected borrowers who are in default. We saw one letter where the borrower was told they would receive $23,765.49 upon the sale of their property. The borrower is likewise not expected to submit financial paperwork. In the Bank of America program, the seller and listing agent are told what the list price must be.

It should be noted that the majority of people who sell their property via a short sale will not receive any money. We recommend that sellers save up at least several hundred dollars in preparation for the settlement. Sometimes the seller will be asked to contribute some money to cover unanticipated closing costs that the bank will not pay.

Know how much negative equity you really have.
Many homeowners are overly optimistic, even delusional, about how much their property is worth. They do not want to sell unless they can at least break even. This mentality is similar to those who own stocks. People are far more likely to sell a stock at a profit than sell a stock at a loss, instead hoping that it goes up before they sell it. In many cases, they hold the underperforming stock for a very long time, all the while watching it decline in value. Instead, if they sold the underperforming stock and invested the proceeds into a high performance stock, they would likely make more money, faster.

Harvard's Joint Center for Housing Studies calculated in July 2012 that about 11 million American homeowners owe more than what their house is worth. Zillow.com estimates that the number is closer to 16 million, stating that about 33 percent of the people with mortgages are upside down.

Most upside down homeowners believe that they cannot sell until housing prices return to the level they were at when they bought the house. That belief is misguided, as mortgage lenders are approving short sales at a higher rate than ever before. Some lenders are even approving short sales when the loan is current. Since lenders usually absorb the loss in a short sale when they forgive the remaining debt, a short sale may be a worthy business decision for homeowners who are upside down.

Those who want to get back to a break-even level before considering a sale should find out what their property is really worth, with no fluff or fancy optimism. If the property is worth 25 percent less than what it was when they bought it, they may need about a 25-30 percent increase in housing prices to reach that break-even level. With at least 2 million foreclosures in the national pipeline, that 25-30 percent increase in values may be many years away.

With interest rates at historical lows and housing prices so inexpensive too, it may make sense to sell the current house at a loss or via a short sale. Then one could purchase a home with a low interest mortgage and some built-in equity. When housing prices rebound years from now, one would have positive equity instead of negative equity.

Homeowners who want to hold out until they reach a break-even level should examine how much money and time they are costing themselves while they wait just to hopefully break even. For some, it may be well over a decade before they do.

Some of the nutty reasons why mortgage lenders make short sales take so long.
In many situations, the mortgage lender or servicer cannot get out of their own way. They create inane reasons why they cannot make a decision on whether to approve a short sale. Below are just some of the reasons we have seen.

1. The sale contract had the buyer's name misspelled in one section, and the servicer refused to make a decision until a fully corrected contract was issued. The contract had the correct spelling of the buyer's name elsewhere, and the buyer's signature was authentic, but the servicer insisted upon having no misspellings anywhere.

2. The IRS tax return was not signed by the seller, and the lender refused to consider a short sale until the seller signed the tax return. Note that the seller's tax preparer had submitted the tax return to the IRS on the seller's behalf. The IRS considered the tax return to be valid with the tax preparer's signature. However, the lender insisted upon having the seller sign the tax return even though it was good enough for the IRS.

3. The bank negotiator went on a three week vacation, and no one else in the company would cover for him in his absence.

4. The sale contract did not have the seller's middle initial, and the servicer refused to render a decision until the middle initial was added. Even though the contract was legally sufficient in that state, it was not good enough for the servicer.

5. The bank negotiator was fired and no one else at the bank took over the file. It simply sat in limbo for months. One would think that a manager who fired a staff member would reassign the file to someone else, but apparently that did not happen.

6. The bank stated that they would not speak with the seller because the seller was represented by an attorney. The bank stated that even though the seller is the borrower and was being called several times a day as part of the bank's collection efforts, their policy is that when the seller hires an attorney they only speak with the attorney. Here's the kicker: the bank would not speak with the attorney because they could not find the Authorization to Release Information Form in which the seller granted permission for the attorney to speak to the lender. So the bank

would not talk to the borrower, who was trying to grant permission for his lawyer to communicate with the lender.

7. When dealing with one bank negotiator at Wells Fargo, her voicemail stated that she would not return any calls. Interestingly enough, her voicemail was full and thus no one could leave any messages either.

8. A Bank of America negotiator stated for weeks that the investor was close to making a final decision. Eventually, the buyer threatened to terminate the contract. When pressed for an answer, the Bank of America negotiator admitted that he had never submitted the file to the investor for a decision. When told to submit the file immediately or the buyer would walk away, the negotiator replied that the appraisal had expired and therefore he would have to wait for a new appraisal. The buyer walked away, and shortly thereafter thieves stole all the copper and wiring from the house. Bank of America lost tens of thousands of dollars because a file sat on the negotiator's desk.

What is an arm's length transaction?

Most banks these days insist upon an arm's length transaction. That is a transaction in which the buyer and seller act independently and have no relationship to each other. They are not related, nor are they business associates. The concept of an arm's length transaction is to ensure that the parties are acting in their own self-interest and are not subject to any pressure from the other party.

If a woman sells a house to her brother, she may sell the house at a discount. If the owner of a business sells his commercial property to an employee, he may sell at a discount or perhaps provide favorable financing.

If two strangers are involved in the sale of a house, it is more likely that the sale price and terms will be close to fair market value. The assumption is that both parties are well informed, well represented, and not under any major duress. The notion is that the seller seeks the highest possible price and the buyer seeks the lowest possible price, and they meet near fair market value.

In a short sale, the mortgage lender insists upon an arm's length transaction to prevent collusion or fraud. There are instances where someone facing foreclosure will ask a family member with a different last name to purchase the house. The lender would forgive the remaining debt, which could be tens of thousands of dollars. The family member who buys the house might then rent or sell it back to the previous owner. That person would have the benefit of continuing to live in the house, but for less money. Furthermore, the lender would bear the brunt of the loss. In addition, the lender assumes that the offer price from the family member might be far below fair market value, further deepening the lender's loss and unjustly enriching the owner.

Most lenders today require that the buyer, seller, and real estate agents sign an affidavit in which they swear that it is an arm's length transaction. Some banks have short sale fraud departments, and they investigate suspicious transactions a few months after they are consummated. If a bank discovers evidence of a non-arm's length transaction when the parties all signed an affidavit to the contrary, the lender can press criminal charges and sue for civil damages. The buyer, seller, real estate agents, and even the title agent or attorney can be sued for committing a fraud. Lenders are losing tens of millions of dollars in fraudulent short sales, and they are serious about finding evidence of illicit activity.

Will the bank forgive my debt on a commercial property or vacation home?

Everything in real estate is negotiable. Many lenders are willing to forgive the remaining debt on short sales involving commercial properties, vacation homes, and multi-unit buildings. The decision whether to forgive the debt or pursue the seller for a deficiency judgment is up to the lender. If the bank believes that the seller is destitute, then it does not make good business sense for them to spend thousands of dollars trying to collect money from someone who does not have it.

The bigger issue for a short sale seller of a commercial property, second home, or investment building may be the tax consequence of the forgiven debt. If a lender does forgive thousands of dollars of mortgage debt, they will issue a 1099C to the borrower. That is also reported to the Internal Revenue Service. The IRS treats forgiven debt in these circumstances as if it is ordinary income.

If a business owner has $200,000 of debt forgiven on a commercial building, then that owner will probably be liable for paying income tax on that $200,000. If the phantom income, as it is called, is not offset by losses or expenses, then there will be a hefty tax due. $200,000 of added income in a 25 percent tax bracket means that the person could owe $50,000 to the IRS. Anyone considering a short sale should consult with their advisors about the potential tax consequences.

Should I shut off my utilities if I vacate the house?

As the owner, you are still responsible for what happens on and to the premises.

In wintertime, the owner is responsible for preventing damage from frozen pipes. If the owner is unable or unwilling to pay for heat, then the house should be winterized. If the owner is unable to pay for the cost of winterization, they should notify their mortgage lender immediately. In many cases the mortgage lender will pay to winterize a house and add the cost to the principal balance.

If the owner shuts off the utilities, it can cause problems when the buyer conducts their home inspection. Many real estate contracts state that the seller will have the utilities on for inspections. If the buyer has to activate the utilities, they may be reluctant to make an offer in the first place, or they may simply make a lower offer than what they originally intended.

Also, if the electricity is shut off, that can wreak havoc with showings, particularly showings in the evening. If the house is dark, buyers are likely to be less interested in the home. Keeping the electricity on makes showings run much more smoothly.

When the buyer conducts their pre-settlement walk-through inspection of the house, they will feel more comfortable if the utilities are on. If the electricity and water are on, that could prevent any last-minute doubts or late-stage negotiation. If financially feasible, it is wise to keep the utilities on. At the very least, keeping the electricity and the water on can aid in the smooth sale of the property.

How will a short sale affect my credit?

A short sale will lower your credit score, but it depends on how many mortgage loans you have and the length of time the loans are delinquent. Generally speaking, if you have one mortgage loan and you are more than 30 days behind, you can expect your credit score to fall at least 100 to 150 points. However, a major factor is how much debt you're carrying on other items, such as credit cards, auto loans, and installment agreements. If you are behind on those payments too, then your credit score will fall even more.

The major advantage of a short sale versus a foreclosure is that a short sale is a temporary setback to your credit, whereas a foreclosure is a long-term stain on your record. If you are foreclosed, the foreclosure is permanent in the county records for all to see. On many loan applications, there is a question asking if you were ever foreclosed. If you were foreclosed upon, then you jeopardize your ability to obtain a loan in the future. Even if you are granted a loan, you will pay more in interest which could cost you tens of thousands of dollars over time. Some employment applications ask if you have been foreclosed in the past, so a foreclosure could affect your ability to land a job, particularly if it is a sensitive position.

A short sale is usually marked on your credit report as “Loan paid in full but not as agreed” or “Paid as negotiated.” That is equivalent to making a settlement with a credit card company. Effective in June 2012, short sale sellers approved for the HAFA program who were current on their mortgage at the time of the sale will have their loan marked as “Paid in full” on their credit report. A short sale will not show up in the judgments section of your credit report. On future loan applications, when asked if you were ever foreclosed upon, you can truthfully answer “no.” In many cases, if you are paying all your other bills on time and you have a relatively small amount of debt, then you could obtain a new mortgage loan about two years after the short sale of your house. If you value your credit and hope to obtain a mortgage loan, car loan, or college loan in the future, then a short sale is typically a better alternative than a foreclosure.

What is a strategic short sale?

A strategic short sale, sometimes known as a strategic default, occurs when a borrower chooses to stop paying their mortgage even though they still have the ability to make payments. An increasing number of borrowers are walking away from their mortgages. They do so because from a financial perspective, it does not make sense to keep the property. Perhaps they do not see the need to pay for a loan that is far greater than the house’s value. Perhaps they realize that they can live in the house for free for well over a year before the bank forecloses. Maybe they choose to default because certain tax breaks for short sale sellers are about to expire, and they want to take advantage of those tax breaks.

I want to just give my property to the bank. Can I do that?

Yes, but only if your lender is willing to permit a deed-in-lieu of foreclosure. Also known as a friendly foreclosure, a deed-in-lieu of foreclosure occurs when the lender agrees to take ownership of the house from the borrower without going through with the full foreclosure process. In some cases, the lender may still reserve the right to pursue the borrower for money after the property is conveyed. Keep in mind that banks are in the business of lending money, not owning houses. Most banks would prefer a short sale because they would not have to take back the house.

Will I have to pay income tax on my forgiven debt?

Under the Mortgage Forgiveness Debt Relief Act of 2007, enacted December 20, 2007, **taxpayers may exclude debt forgiven on their principal residence**. This provision applies to debt forgiven in calendar years 2007 through 2012. Up to $2 million of forgiven debt is eligible for this exclusion ($1 million if married filing separately). Details are on Internal Revenue Service (IRS) Form 982 and its instructions, available on www.irs.gov. Debt reduced through mortgage restructuring, as well as mortgage debt forgiven in connection with a foreclosure, may qualify for this relief. In most cases, eligible homeowners only need to fill out a few lines on IRS Form 982 (specifically, lines 1e, 2 and 10b).

The debt must have been used to buy, build, or substantially improve the taxpayer's principal residence and must have been secured by that residence. Debt used to refinance qualifying debt is also eligible for the exclusion, but only up to the amount of the old mortgage principal, just before the refinancing. **Debt forgiven on second homes, rental property, business property, credit cards or car loans does not qualify for this tax-relief provision.** In some cases, however, other kinds of tax relief, based on insolvency, for example, may be available.

Note:

We at Significa are not attorneys, accountants, or certified credit counselors. Your attorney and accountant can advise you regarding your particular situation and how it is affected by your state's laws. Our National Short Sale Guide is merely for informational purposes.

Thank you for taking the time to read this guide. We wish you and your family the very best.

Form **982**
(Rev. February 2011)
Department of the Treasury
Internal Revenue Service

Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)

▶ **Attach this form to your income tax return.**

OMB No. 1545-0046

Attachment Sequence No. **94**

Name shown on return | **Identifying number**

Part I General Information (see instructions)

1 Amount excluded is due to (check applicable box(es)):
a Discharge of indebtedness in a title 11 case . . . ☐
b Discharge of indebtedness to the extent insolvent (not in a title 11 case) . . . ☐
c Discharge of qualified farm indebtedness . . . ☐
d Discharge of qualified real property business indebtedness . . . ☐
e Discharge of qualified principal residence indebtedness . . . ☐
2 Total amount of discharged indebtedness excluded from gross income . . . **2**
3 Do you elect to treat all real property described in section 1221(a)(1), relating to property held for sale to customers in the ordinary course of a trade or business, as if it were depreciable property? . . . ☐ Yes ☐ No

Part II Reduction of Tax Attributes.
You must attach a description of any transactions resulting in the reduction in basis under section 1017. See Regulations section 1.1017-1 for basis reduction ordering rules, and, if applicable, required partnership consent statements. (For additional information, see the instructions for Part II.)

Enter amount excluded from gross income:

4	For a discharge of qualified real property business indebtedness applied to reduce the basis of depreciable real property	**4**	
5	That you elect under section 108(b)(5) to apply first to reduce the basis (under section 1017) of depreciable property	**5**	
6	Applied to reduce any net operating loss that occurred in the tax year of the discharge or carried over to the tax year of the discharge	**6**	
7	Applied to reduce any general business credit carryover to or from the tax year of the discharge	**7**	
8	Applied to reduce any minimum tax credit as of the beginning of the tax year immediately after the tax year of the discharge	**8**	
9	Applied to reduce any net capital loss for the tax year of the discharge, including any capital loss carryovers to the tax year of the discharge	**9**	
10a	Applied to reduce the basis of nondepreciable and depreciable property if not reduced on line 5. *DO NOT use in the case of discharge of qualified farm indebtedness*	**10a**	
b	Applied to reduce the basis of your principal residence. *Enter amount here ONLY if line 1e is checked*	**10b**	
11	For a discharge of qualified farm indebtedness applied to reduce the basis of:		
a	Depreciable property used or held for use in a trade or business or for the production of income if not reduced on line 5	**11a**	
b	Land used or held for use in a trade or business of farming	**11b**	
c	Other property used or held for use in a trade or business or for the production of income	**11c**	
12	Applied to reduce any passive activity loss and credit carryovers from the tax year of the discharge	**12**	
13	Applied to reduce any foreign tax credit carryover to or from the tax year of the discharge	**13**	

Part III Consent of Corporation to Adjustment of Basis of Its Property Under Section 1082(a)(2)

Under section 1081(b), the corporation named above has excluded $ ____________ from its gross income for the tax year beginning ____________ and ending ____________. Under that section, the corporation consents to have the basis of its property adjusted in accordance with the regulations prescribed under section 1082(a)(2) in effect at the time of filing its income tax return for that year. The corporation is organized under the laws of ____________.
(State of incorporation)

Note. *You must attach a description of the transactions resulting in the nonrecognition of gain under section 1081.*

General Instructions

Section references are to the Internal Revenue Code unless otherwise noted.

What's New

The exclusion for discharge of indebtedness of a qualified individual because of Midwestern disasters does not apply to discharges after 2009.

Purpose of Form

Generally, the amount by which you benefit from the discharge of indebtedness is included in your gross income. However, under certain circumstances described in section 108, you can exclude the amount of discharged indebtedness from your gross income.

You must file Form 982 to report the exclusion and the reduction of certain tax attributes either dollar for dollar or $33\frac{1}{3}$ cents per dollar (as explained below).

How To Complete the Form

IF the discharged debt you are excluding is . . .	THEN follow these steps . . .
Qualified principal residence indebtedness	**1.** Be sure to read the definition of qualified principal residence indebtedness in the instructions for line 1e on page 4. Part or all of your debt may not qualify for the exclusion on line 1e but may qualify for one of the other exclusions. **2.** Check the box on line 1e. **3.** Include on line 2 the amount of discharged qualified principal residence indebtedness that is excluded from gross income. Any amount in excess of the excluded amount may result in taxable income. See Pub. 4681 for more information. If you disposed of your residence, you may also be required to recognize a gain on its disposition. For details, see Pub. 523, Selling Your Home. **4.** If you continue to own your residence after the discharge, enter on line 10b the smaller of (a) the amount of qualified principal residence indebtedness included on line 2 or (b) the basis (generally, your cost plus improvements) of your principal residence. **CAUTION** *If the discharge occurs in a title 11 case, you cannot check box 1e. You must check box 1a and complete the form as discussed below under* A nonbusiness debt. *If you are insolvent (and not in a title 11 case), you can elect to follow the insolvency rules by checking box 1b instead of box 1e and completing the form as discussed below under* A nonbusiness debt.
A nonbusiness debt (other than qualified principal residence indebtedness, such as a car loan or credit card debt)	Follow these instructions if you do not have any of the tax attributes listed in Part II (other than a basis in nondepreciable property). Otherwise, follow the instructions for *Any other debt* below. **1.** Check the box on line 1a if the discharge was made in a *title 11 case* (see *Definitions* on page 3) or the box on line 1b if the discharge occurred when you were *insolvent* (see *Line 1b* on page 3). **2.** Include on line 2 the amount of discharged nonbusiness debt that is excluded from gross income. If you were insolvent, do not include more than the excess of your liabilities over the fair market value of your assets. **3.** Include on line 10a the smallest of (a) the basis of your nondepreciable property, (b) the amount of the nonbusiness debt included on line 2, or (c) the excess of the aggregate bases of the property and the amount of money you held immediately after the discharge over your aggregate liabilities immediately after the discharge.
Any other debt	Use *Part I* of Form 982 to indicate why any amount received from the discharge of indebtedness should be excluded from gross income and the amount excluded. Use *Part II* to report your reduction of tax attributes. The reduction must be made in the following order unless you check the box on line 1d for qualified real property business indebtedness or make the election on line 5 to reduce basis of depreciable property first. **1.** Any net operating loss (NOL) for the tax year of the discharge (and any NOL carryover to that year) (dollar for dollar); **2.** Any general business credit carryover to or from the tax year of the discharge ($33\frac{1}{3}$ cents per dollar); **3.** Any minimum tax credit as of the beginning of the tax year immediately after the tax year of the discharge ($33\frac{1}{3}$ cents per dollar); **4.** Any net capital loss for the tax year of the discharge (and any capital loss carryover to that tax year) (dollar for dollar); **5.** The basis of property (dollar for dollar); **6.** Any passive activity loss (dollar for dollar) and credit ($33\frac{1}{3}$ cents per dollar) carryovers from the tax year of the discharge; and **7.** Any foreign tax credit carryover to or from the tax year of the discharge ($33\frac{1}{3}$ cents per dollar). Use *Part III* to exclude from gross income under section 1081(b) any amounts of income attributable to the transfer of property described in that section.

TIP *Certain individuals may need to complete only a few lines on Form 982. For example, if you are completing this form because of a discharge of indebtedness on a personal loan (such as a car loan or credit card debt) or a loan for the purchase of your principal residence, follow the chart on page 2 to see which lines you need to complete. Also, see Pub. 4681, Canceled Debts, Foreclosures, Repossessions, and Abandonments, for additional information including many examples and sample forms.*

Definitions

Title 11 Case

A *title 11 case* is a case under title 11 of the United States Code (relating to bankruptcy), but only if you are under the jurisdiction of the court in the case and the discharge of indebtedness is granted by the court or is under a plan approved by the court.

Discharge of Indebtedness

The term *discharge of indebtedness* conveys forgiveness of, or release from, an obligation to repay.

When To File

File Form 982 with your federal income tax return for a year a discharge of indebtedness is excluded from your income under section 108(a).

The election to reduce the basis of depreciable property under section 108(b)(5) and the election made on line 1d of Part I regarding the discharge of qualified real property business indebtedness must be made on a timely filed return (including extensions) and can be revoked only with the consent of the IRS.

If you timely filed your tax return without making either of these elections, you can still make either election by filing an amended return within 6 months of the due date of the return (excluding extensions). Write “Filed pursuant to section 301.9100-2” on the amended return and file it at the same place you filed the original return.

Specific Instructions

Part I

The American Recovery and Reinvestment Act of 2009 allows certain businesses to elect under section 108(i) to defer and include ratably over a 5-taxable-year period, beginning with the taxpayer's fourth or fifth taxable year following the taxable year of the reacquisition, any income from the discharge of business debt arising from the reacquisition of certain types of business debt repurchased in 2009 and 2010. For more details, including how to make this election, see section 108(i) and Rev. Proc. 2009-37, 2009-36 I.R.B. 309, available at *www.irs.gov/irb/2009-36_IRB/ar07.html*.

CAUTION *If you made an election under section 108(i) to defer income from the discharge of business debt arising from the reacquisition of a debt instrument, you cannot exclude on lines 1a through 1d the income from the discharge of such indebtedness for the taxable year of the election or any subsequent taxable year.*

Line 1b

The insolvency exclusion does not apply to any discharge that occurs in a title 11 case. It also does not apply to a discharge of qualified principal residence indebtedness (see the instructions for line 1e on page 4) unless you elect to have the insolvency exclusion apply instead of the exclusion for qualified principal residence indebtedness.

Check the box on line 1b if the discharge of indebtedness occurred while you were insolvent. You were insolvent to the extent that your liabilities exceeded the fair market value (FMV) of your assets immediately before the discharge. For details and a worksheet to help calculate insolvency, see Pub. 4681.

Example. You were released from your obligation to pay your credit card debt in the amount of $5,000. The FMV of your total assets immediately before the discharge was $7,000 and your liabilities were $10,000. You were insolvent to the extent of $3,000 ($10,000 of total liabilities minus $7,000 of total assets). Check the box on line 1b and include $3,000 on line 2.

Line 1c

Check this box if the income you exclude is from the discharge of qualified farm indebtedness. The exclusion relating to qualified farm indebtedness does not apply to a discharge that occurs in a title 11 case or to the extent you were insolvent.

Qualified farm indebtedness is the amount of indebtedness incurred directly in connection with the trade or business of farming. In addition, 50% or more of your aggregate gross receipts for the 3 tax years preceding the tax year in which the discharge of such indebtedness occurs must be from the trade or business of farming. For more information, see sections 108(g) and 1017(b)(4).

The discharge must have been made by a qualified person. Generally, a *qualified person* is an individual, organization, etc., who is actively and regularly engaged in the business of lending money. This person cannot be related to you, be the person from whom you acquired the property, or be a person who receives a fee with respect to your investment in the property. A qualified person also includes any federal, state, or local government or agency or instrumentality thereof.

If you checked line 1c and did not make the election on line 5, the debt discharge amount will be applied to reduce the tax attributes in the order listed on lines 6 through 9. Any remaining amount will be applied to reduce the tax attributes in the order listed on lines 11a through 13.

You cannot exclude more than the total of your (a) tax attributes (determined under section 108(g)(3)(B)) and (b) basis of property used or held for use in a trade or business or for the production of income. Any excess is included in income.

Line 1d

If you check this box, the discharge of qualified real property business indebtedness is applied to reduce the basis of depreciable real property on line 4. The exclusion relating to qualified real property business indebtedness does not apply to a discharge that occurs in a title 11 case or to the extent you were insolvent.

Qualified real property business indebtedness is indebtedness (other than qualified farm indebtedness) that (a) is incurred or assumed in connection with real property used in a trade or business, (b) is secured by that real property, and (c) with respect to which you have made an election under this provision. This provision does not apply to a corporation (other than an S corporation).

Indebtedness incurred or assumed after 1992 is not qualified real property business indebtedness unless it is either (a) debt incurred to refinance qualified real property business indebtedness incurred or assumed before 1993 (but only to the extent the amount of such debt does not exceed the amount of debt being refinanced) or (b) qualified acquisition indebtedness.

Qualified acquisition indebtedness is (a) debt incurred or assumed to acquire, construct, reconstruct, or substantially improve real property that is secured by such debt and (b) debt resulting from the refinancing of qualified acquisition indebtedness to the extent the amount of such debt does not exceed the amount of debt being refinanced.

You cannot exclude more than the excess of the outstanding principal amount of the debt (immediately before the discharge) over the net FMV (as of that time) of the property securing the debt reduced by the outstanding principal amount of other qualified real property business indebtedness secured by that property (as of that time). The amount excluded is further limited to the aggregate adjusted basis (as of the first day of the next tax year or, if earlier, the date of disposition) of depreciable real property (determined after any reductions under sections 108(b) and (g)) you held immediately before the discharge (other than property acquired in contemplation of the discharge). Any excess is included in income.

Line 1e

Check this box if the income you exclude is from discharge of qualified principal residence indebtedness. Also, be sure you complete line 2 (and line 10b if you continue to own the residence after discharge). However, if the discharge occurs in a title 11 case, you must check the box on line 1a and not this box. If you are insolvent (and not in a title 11 case), you can elect to follow the insolvency rules by checking box 1b instead of checking this box. For more information, see Pub. 4681.

Principal residence. Your principal residence is your *main home*, which is the home where you ordinarily live most of the time. You can have only one main home at any one time.

Qualified principal residence indebtedness. This indebtedness is a mortgage you took out to buy, build, or substantially improve your main home. It also must be secured by your main home. If the amount of your original mortgage is more than the cost of your main home plus the cost of any substantial improvements, only the debt that is **not** more than the cost of your main home plus improvements is qualified principal residence indebtedness. Any debt secured by your main home that you use to refinance qualified principal residence indebtedness is treated as qualified principal residence indebtedness, but only up to the amount of the old mortgage principal just before the refinancing. Any additional debt you incurred to substantially improve your main home is also treated as qualified principal residence indebtedness.

Amount eligible for the exclusion. The exclusion applies only to debt discharged after 2006 and before 2013. The maximum amount you can treat as qualified principal residence indebtedness is $2 million ($1 million if married filing separately). You cannot exclude from gross income discharge of qualified principal residence indebtedness if the discharge was for services performed for the lender or on account of any other factor not directly related to a decline in the value of your residence or to your financial condition.

Ordering rule. If only a part of a loan is qualified principal residence indebtedness, the exclusion applies only to the extent the amount discharged exceeds the amount of the loan (immediately before the discharge) that is **not** qualified principal residence indebtedness. For example, assume your main home is secured by a debt of $1 million, of which $800,000 is qualified principal residence indebtedness. If your main home is sold for $700,000 and $300,000 of debt is discharged, only $100,000 of the debt discharged can be excluded (the $300,000 that was discharged minus the $200,000 of nonqualified debt). The remaining $200,000 of nonqualified debt may qualify in whole or in part for one of the other exclusions, such as the insolvency exclusion.

Line 2

Enter the total amount excluded from your gross income due to discharge of indebtedness under section 108. If you checked any box on lines 1b through 1e, do not enter more than the limit explained in the instructions for those lines. If you checked line 1a, 1b, or 1c, this amount will not necessarily equal the total reductions on lines 5 through 13 (excluding line 10b) because the debt discharge amount may exceed the total tax attributes. If you checked line 1e, this amount will not necessarily equal the total basis reduction on line 10b (which is required only if you continue to own the residence after the discharge).

See section 382(l)(5) for a special rule regarding a reduction of a corporation’s tax attributes after certain ownership changes.

Line 3

You can elect under section 1017(b)(3)(E) to treat all real property held primarily for sale to customers in the ordinary course of a trade or business as if it were depreciable property. This election does not apply to the discharge of qualified real property business indebtedness. To make the election, check the “Yes” box.

Part II

Basis Reduction

If you check any of the boxes on lines 1a through 1c, you can elect, by completing line 5, to apply all or a part of the debt discharge amount to first reduce the basis of depreciable property (including property you elected on line 3 to treat as depreciable property). Any balance of the debt discharge amount will then be applied to reduce the tax attributes in the order listed on lines 6 through 13 (excluding line 10b). You must attach a statement describing the transactions that resulted in the reduction in basis under section 1017 and identifying the property for which you reduced the basis. If you do not make the election on line 5, complete lines 6 through 13 (excluding line 10b) to reduce your attributes. See section 1017(b)(2) and (c) for limitations of reductions in basis on line 10a.

Line 7

If you have a general business credit carryover to or from the tax year of the discharge, you must reduce that carryover by $33^1/_3$ cents for each dollar excluded from gross income. See Form 3800, General Business Credit, for more details on the general business credit, including rules for figuring any carryforward or carryback.

Line 10a

In the case of a title 11 case or insolvency, the reduction in basis is limited to the aggregate of the basis of your property immediately after the discharge over the aggregate of your liabilities immediately after the discharge. However, this limit does not apply to a reduction in basis reported on line 5 pursuant to section 108(b)(5).

Line 10b

If box 1e is checked and you continue to own the residence after discharge, enter the smaller of:

- The part of line 2 that is attributable to the exclusion of qualified principal residence indebtedness, or
- The basis of your main home.

Part III

Adjustment to Basis

Unless it specifically states otherwise, the corporation, by filing this form, agrees to apply the general rule for adjusting the basis of property (as described in Regulations section 1.1082-3(b)).

If the corporation desires to have the basis of its property adjusted in a manner different from the general rule, it must attach a request for variation from the general rule. The request must show the precise method used and the allocation of amounts.

Consent to the request for variation from the general rule will be effective only if it is incorporated in a closing agreement entered into by the corporation and the Commissioner of Internal Revenue under the rules of section 7121. If no agreement is entered into, then the general rule will apply in determining the basis of the corporation's property.

Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated burden for individual taxpayers filing this form is approved under OMB control number 1545-0074 and is included in the estimates shown in the instructions for their individual income tax return. The estimated burden for all other taxpayers who file this form is shown as follows: **Recordkeeping,** 6 hr., 27 min.; **Learning about the law or the form,** 2 hr., 17 min.; **Preparing and sending the form to the IRS,** 2 hr., 29 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. See the instructions for the tax return with which this form is filed.