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Legal Update

A WRA Publication Exclusively for the Designated REALTOR®

Please Route to:

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Inside This Issue

3
Foreclosure Alternatives

4
Short Sale Process Overview

6
Lender Approval of Short Sales

9
Listing a Property for a Short Sale

14
Buying a Short Sale Property

16
Short Sale Resources

WRA Wisconsin REALTORS® Association

Solving the Mysteries of Short Sales

Due to the recent economic crisis, including rising unemployment and falling home prices in communities across the nation, the number of short sales is increasing. Flat or falling home prices, home-equity credit lines, 100-percent financing that sucked out equity and spiking interest rates on adjustable mortgages have left many homeowners "under water" or "upside down" with mortgage balances in excess of the home's fair market value. Homeowners who bought at the top of the market or took out large amounts of equity with a refinance and now need to sell because of a divorce or job transfer may also find themselves owing more than the home is currently worth.

Many of these upside down homeowners are in default on their mortgages and their lenders have filed foreclosure actions or are on the verge of doing so. After consideration of other alternatives including refinancing and loan modifications, these upside homeowners may conclude that a short sale may be their best remaining option. A short sale may not hurt their credit standing as much as a foreclosure. As a result, homeowners may qualify for another mortgage sooner once they get back on their feet financially. Since a short sale generally costs the lender less than a foreclosure and a subsequent REO sale, it can be a viable way for a lender to minimize its losses.

Short sale transactions are not the typical sales most REALTORS® have experienced when working with non-distressed properties. Short sales require the approval of the mortgage holder or investors, the mortgage insurance company and any junior lienholders and take months to put together, if the parties are that lucky. REALTORS® find themselves working with emotional, even desperate sellers who face losing their homes, frustrated buyers who struggle to understand why lender approval takes so long and numerous mortgage servicers with different short sale application requirements and procedures and lengthy response time to short sale offers.

One of the best ways a REALTOR® can be effective in a short sale transaction is to understand the perspectives and procedures of all of the players involved. This *Legal Update* attempts to unravel some of the mysteries associated with short sales, lender approvals and the potential obstacles that may be encountered along the way. The short sale discussion refers to the Wisconsin REALTORS® Association short sale checklist and short sale addenda for listing contracts and offers to purchase, but the suggestions and pointers are generally applicable even if different short sale addenda are used.

Short Sales Background

Many homeowners in foreclosure or in default and on the verge of foreclosure are good candidates for short sales. Because foreclosure is often on the horizon, it is important to understand the foreclosure process and how it may affect short sales and their timing.

The Foreclosure Freight Train

Foreclosure is the legal process that a mortgage lender can use to take title

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to the properties of owners in serious default on their mortgages. When a homeowner does not make his or her mortgage payments, the lender may take title to the property at the sheriff's sale and, in most instances, resell the home. If the property is worth less than the total amount owed on the mortgage loan, a deficiency judgment may be pursued against the borrower/former homeowner. Both foreclosures and deficiency judgments can seriously affect an owner's ability to qualify for credit in the future. There generally is no doubt that foreclosure should be avoided at all costs.

The foreclosure process is governed by Wis. Stat. Chapter 846 and generally takes four to 18 months. The state of Wisconsin requires mortgage foreclosures to be handled through the courts. Once commenced, foreclosure is like a freight train, always moving forward in a slow and steady progression.

When a property owner has not made any mortgage payments for approximately 90 days, the mortgage servicer for the mortgage holder will have its attorneys begin a foreclosure lawsuit, assuming that the owner has not been able to secure refinancing, loan modification or some other foreclosure avoidance resolution. The attorneys will prepare a summons and complaint that is served upon the owner and all other lien holders. The owner has 20 days to answer the complaint.

In this current climate where mortgages are sold and resold on the secondary market or securitized and sold to investors, the players often may be surprisingly sloppy with the legal niceties, which means that a knowledgeable attorney may be able to find defenses to the foreclosure action. Posing legal defenses may not permanently solve the homeowner's problems, but it certainly can lengthen the process and buy the homeowner some additional time. After the homeowner answers the foreclosure complaint, or after the 20 days if no answer is filed, the attorneys will schedule a court appearance. At the hearing the attorneys will begin to address any defenses. Additional hearings and time may be needed for the court to rule on meritorious defenses. If the defenses are not sufficient to prevent continuation of the foreclosure, the lender's attorneys will ask the court for a judgment specifying the total amount due on the mortgage loan and ask for a sheriff's sale.

When the mortgage holder obtains a judgment of foreclosure, the court confirms that the homeowner/borrower is in default on the mortgage loan, that the mortgage holder has the right to have the property sold at sheriff's sale, the time and place of the sale and whether or not the lender is seeking a deficiency judgment. A deficiency judgment holds the borrower responsible for any amounts still owed to the lender after the proceeds of the sheriff's sale have been applied to the debt. The foreclosure judgment also specifies the length of the borrower's redemption period, that is, the amount of time the homeowner has to pay the entire mortgage debt and thus prevent the sheriff's sale. The length of the redemption period will depend upon the type and size of the property, whether or not the lender is seeking a deficiency judgment and whether the property is owner-occupied or abandoned. For occupied residential properties, the redemption period is 12 months if the mortgage holder seeks a deficiency judgment and six months if the mortgage holder forgoes the deficiency. At the end of the redemption period, the property is sold at a sheriff's sale to the highest bidder, typically the mortgage holder.

Anywhere from 10 days to three weeks after the sheriff's sale, the attorneys for the mortgage holder will hold a confirmation hearing. The court will normally approve the highest bid and possibly determine the order of payment to the lien holders. If the owner is able to sell the property before the sale is confirmed, the foreclosure sale will have been averted.

REALTOR® Practice Tips: The property owner may redeem his or her property by selling the property and paying off the foreclosure judgment before judicial confirmation of the sheriff's sale. If the mortgage holder is persuaded to take less than the full amount owed, the sale of the property will likely be a short sale.

For a review of the mortgage foreclosure process, read *Legal Update 99.05*, "Mortgage Foreclosures," online at www.wra.org/LU9905, and the March 2009 *Legal Update*, "Working with Distressed Sales," at www.wra.org/LU0903.

Foreclosure Alternatives

Before leaping into the short sale process, REALTORS® should always try to make sure that the homeowner has explored all other options. Ideally the distressed property owner would be able to evaluate alternatives with an attorney and a CPA who thoroughly examine the owner's legal and financial status and make a well-considered recommendation, but the nature of the beast dictates that such an evaluation is rarely possible. Distressed homeowners are in financial and emotional pain and often paralyzed by the perceived hopelessness of their predicament.

Make Sure Owner Has Considered Alternatives

The Alternatives to a Short Sale section of the WRA Short Sale Checklist lists many options a homeowner may consider. The WRA Short Sale Checklist is available in hard copy from the WRA and on ZipForm.

The Alternatives to a Short Sale section prompts the agent to discuss the various alternatives to short sales. The point is to be sure that there are not any other viable options that would allow the owner to remain in his or her home and that would be less damaging to the owner's finances and credit standing. Evaluation of these options may require that the homeowner have some of the information in the Preliminary Background section of the checklist and the REALTOR® can help the owner gather needed information.

REALTORS® can provide an invaluable service by trying to make sure that any potential short sale client has first done the following:

- **Learn about foreclosure avoidance.** Urge the homeowner to visit the Wisconsin Foreclosure Assistance Resource Center, online at www.wisconsinforeclosurekit.org, a comprehensive resource for homeowners currently facing foreclosure or worried about the possibility. The site (launching the week of July 6, 2009) explains the Wisconsin foreclosure process, lists action steps for the homeowner to follow and provides contact information for various assistance providers.
- **Call the lender.** The single most important thing licensees should always do when talking with an owner struggling with mortgage payments is to urge the owner to call his or her mortgage servicer. The mortgage servicer frequently will not be the same company that originated the loan. The options for retaining the home are most effective when owners talk to the loan servicer before they are deep in default. The longer they wait, the greater the chance of them losing their property. Contact information for various mortgage loan servicers is available on the Making Home Affordable Web site at http://makinghomeaffordable.gov/contact_servicer.html and on the HOPE NOW Web site at www.hopenow.com/.
- **Speak with a counselor.** If the homeowner does not feel comfortable calling the loan servicer, the homeowner should seek foreclosure prevention or mortgage counseling. A homeowner can call 1-888-995-HOPE to speak to a compassionate counselor in English and Spanish 24 hours a day, seven days a week. Visit www.wisconsinforeclosureresource.com for more information and additional resources.
- **Determine eligibility.** Ask if the homeowner has visited www.makinghomeaffordable.gov to determine if he or she is eligible for refinancing or loan modification under the Making Home Affordable Program. Any forbearance, repayment plan, loan modification or refinancing must be handled by the homeowner and the loan servicer. The owner needs to call the mortgage servicer and ask about these potential solutions.
- **Avoid scam artists.** Homeowners in financial distress must be urged to protect themselves from foreclosure scam artists promising easy fixes. Visit the June 2009 *Legal Update*, "Mortgage Foreclosure Scams," at www.wra.org/LU0906, and "Don't Fall for a Foreclosure Rescue Scam" in the March 2008 edition of the *Wisconsin Real Estate Magazine*, online at http://news.wra.org/story.asp?a=893 for information.

Deed in Lieu of Foreclosure

A deed in lieu of foreclosure (DIL) and bankruptcy may be other viable options depending upon the homeowner's circumstances. A DIL is generally considered to be less desirable than a short sale in terms of the homeowner's future financial recovery and is something the property owner should discuss with an attorney and the loan servicer. With a DIL, the owner voluntarily deeds the property to the loan servicer, provided the title is free and clear. A DIL may be better for the homeowner than allowing a foreclosure to proceed, but this depends upon individual circumstances best discussed with legal counsel.

Bankruptcy

Bankruptcy may also offer relief to the distressed homeowner. Basic bankruptcy information is available online at www.uscourts.gov/bankruptcycourts/bankruptcybasics.html and at www.wiwb.uscourts.gov/Bankruptcy_Info.htm. A bankruptcy may stall or delay a foreclosure. Whether a bankruptcy is a viable alternative to foreclosure is a question for the homeowner's attorney. A homeowner who has filed bankruptcy may still be eligible for a short sale provided the bankruptcy trustee consents to the sale of the property.

More information about foreclosure avoidance is available in the January 2007 *Legal Update*, "Avoiding Foreclosure," at www.wra.org/LU0701, and in the "Best of the Legal Hotline: Finding Help for Homeowners," in the May 2009 edition of the *Wisconsin Real Estate Magazine*, online at http://news.wra.org/story.asp?a=1114.

Despite everyone's best efforts, some homeowners may still wind up looking for a short sale transaction in order to prevent a sheriff's sale. When homeowner efforts to refinance, work out a loan modification or otherwise avert a foreclosure fail, many homeowners will sell their home before the foreclosure runs its full course in a "short sale." In a short sale, a reasonable sales price in the current market is not sufficient to pay the mortgage(s), other liens and expenses at closing so the seller either will have to pay additional money at closing to cover the shortage or reach an agreement with the lender(s)/mortgage investors whereby they accept less than the full amount owed. Most short sales involve properties in foreclosure, but not all properties in foreclosure are sold in short sales.

Short Sale Process Overview

A short sale is a transaction in which the lender or lenders agree to accept less than the total mortgage balance owed (principal, interest, fees, costs and advances) by the current homeowner. In some cases, the difference is forgiven by the lender, and in others the homeowner must make arrangements with the lender to settle the remainder of the debt. A short sale occurs when the net proceeds from the sale of a home are not enough to cover the sellers' mortgage obligations and closing costs, such as property taxes, transfer taxes and commission, and the homeowner is unable to cover the difference due to the homeowner's personal financial hardship.

Why Short Sales?

Short sales are generally preferable to foreclosures because foreclosures are costly and time-consuming – mortgage holders and homeowners both lose big. A short sale is often the last resort prior to foreclosure when all other ways for the homeowner to stay in the home have been exhausted.

Short sales are desirable from a policy and community standpoint. For every short sale there generally is one less Real Estate Owned (REO) property on the market. REOs often are vacant and deteriorating while short sales bring new owners. Occupied properties help stabilize neighborhoods and property values.

Lender/Mortgage Servicer

A lender or mortgage servicer may be inclined to accept a short sale if the loss incurred is less than the loss that would be incurred in a foreclosure. A good deal of the data goes into the calculations that project the likely sales price of an eventual REO and the estimates of the costs of foreclosure, holding costs and the costs of the REO sale. If a local real estate market changes or costs change, the loss projections need to be updated. The lender/servicer will accept a lower price for the property today than it could (potentially) get for the REO, because the short sale saves on the foreclosure, holding and resale expenses and avoids any possible depreciation resulting from foreclosure and REO marketing. Short sales are beneficial because they minimize the financial loss to the investors/lenders.

Homeowner

A short sale is beneficial to a homeowner because it avoids the stress of foreclosure and provides an honorable exit to a difficult situation. The homeowners may live in the home until closing, giving them time to make other living arrangements. A short sale will halt the foreclosure freight train and the collection calls once a short sale offer has been approved by the lender/mortgage servicer. The short sale is a cooperative solution.

If the short sale closes, the homeowner's credit report will state "paid off in full for less than full balance" rather than indicating a foreclosure or repossession. This is less damaging to the individual's credit status although the individual will likely need to re-establish credit to qualify for a new mortgage down the line.

Short Sale Challenges for REALTORS®

The rapid increase in the number of short sales and the short sales process itself present a number of challenges for REALTORS®. REALTORS® report difficulties with unresponsive lenders, lost documents that require multiple submissions, inaccurate or unrealistic home value assessments and long processing delays that cause buyers to walk away. The mortgage servicers claim the short sale approval process takes 30 to 90 days, but every agent working with short sales has experienced or heard of situations when it took much longer to secure lender approval. Other challenges that have been cited by agents include:

- Low closing percentages.
- Servicers do not work well with agents.
- More work is involved than with non-distressed properties.
- Limited experience. Many REALTORS® are new to the short sale process, a difficulty that is compounded by the fact that many overwhelmed mortgage servicers have not had sufficiently trained or experienced staff on board to process short sales.
- Absence of a uniform process and application. Currently, both short sale documents and processes are lender-specific, making it difficult and time-consuming for REALTORS® to become knowledgeable and efficient in facilitating these transactions.
- Multiple lenders. When more than one lender is involved, arranging a short sale is much more difficult. Second lien holders may hold up the transaction to extract the largest possible payment in exchange for releasing their lien, even though in foreclosure they may get nothing.

Some of these frustrations may be alleviated when REALTORS® understand the perspective and procedures of some of the other players and when they can explain the extra steps and delays to the parties.

Short Sale Players

An excellent starting point for some background and perspective on the short sale process is to watch the short video, "The Crisis of Credit Visualized," online at www.crisisofcredit.com. In addition to offering an explanation of how we came to the present economic downturn, it also illustrates an important point with regard to who owns or holds mortgage loans and mortgages. This generally is not the traditional scenario where the lender who made the loan and issued the mortgage and mortgage note to the borrower still holds the note or mortgage.

Often the lender sells mortgages and mortgage notes on the secondary market to investors. In a typical example, the homeowner obtains a loan from a lender, often with the assistance of a mortgage broker. The lender usually will sell the loan on the secondary market. In other cases mortgages are pooled and put in a trust managed by a trustee. Interests in the trust (securities) are sold to investors. The homeowner makes payment to the mortgage servicer. The mortgage servicer and the trustee manage the loans and payment delinquencies according to the terms and conditions of a pooling and servicing agreement. Clearly the mortgage on 123 Elm Street is not often still held by the local community bank.

It may appear to the homeowner that the loan is held by the mortgage servicer, but that is not really the case. However, the mortgage servicer generally is responsible to deal with homeowner delinquencies, try to resolve default situations and hire legal counsel to initiate foreclosure. Short sale applications and approvals will typically occur with the loss mitigation department of the mortgage servicer, which may or may not have the delegated authority to make decisions on behalf of the investors or actual mortgage holders.

It is important to be able to understand the point of view of all the parties involved. The players in a short sale transaction are more numerous than in a typical non-distressed transaction and will typically include the following:

Homeowner

In financial stress for whatever reason, the homeowner is the decision maker as far as whether to list the property for a short sale and ask the mortgage servicer(s) to accept less than the full amount owed. The homeowner/seller decides when and if to accept any offers to purchase, amendments, etc., in a short sale just as with any other transaction. Accepted offers, however, will be contingent upon lender/mortgage servicer approval. That approval may be conditioned upon the parties modifying their original offer and upon the homeowner signing a promissory note for any shortage.

The homeowner's role in a short sale is to gather and prepare the financial information needed, provide the listing agent with authorization to communicate with the mortgage servicer(s) and confer with legal counsel and financial advisors, as needed.

Lender/Mortgage Holder/Investors

There are three different types of "lenders" in short sale scenarios: (1) lenders such as community banks that do not sell their mortgages, (2) secondary market mortgage holders such as Fannie Mae and Freddie Mac and (3) investors who purchased pooled securitized mortgages, often held in a trust. While some mortgage servicers own the loans they service, often they service the loans for secondary market mortgage holders or investors. Some investors delegate short sale decision-making authority to the mortgage servicer, but often the investor is the decision maker. When this is the case, the short sale approval process will be longer because it takes time to present information to investors and allow them to evaluate the information to reach a decision.

Mortgage Servicer

Generally in charge of collecting monthly principal and interest payments, penalties, keeping records, handling tax and insurance payments and escrows, dealing with borrower defaults and foreclosing when the owner becomes seriously delinquent, all for a fee, the mortgage servicer handles short sales but is not the real mortgage holder in many cases. The mortgage servicer may or may not have the delegated authority from the mortgage holder or investors to make decisions regarding short sales. When they do not, it generally adds up to 30 days to the short sale approval process.

Contact information for various mortgage servicers is available on the Making Home Affordable Web site at http://makinghomeaffordable.gov/contact_servicer.html and on the HOPE NOW Web site at www.hopenow.com.

Short Sale Listing Agent

Short sale listing agents work with the emotionally and financially drained homeowner, the overwhelmed mortgage servicer and the cooperating agent to try to get a short sale approved and closed. This job requires extra work, the willingness to repeatedly explain the short sale timelines and procedures and an endless supply of patience. The listing agent gathers title information, renders a Comparable Market Assessment (CMA), and forwards information back and forth with the mortgage servicer, seller and cooperating agent. The agent should never play attorney.

Buyer

The buyer cannot be related to the seller because short sales must be arm's length transactions: no friends, family or business associates. Short sale buyers have to be willing to quickly submit an offer at fair market value and a loan approval letter, then wait for weeks only to have to hurry once more if the buyer is so lucky as to have approval from the seller's lender. Offer implementation and closing often must happen quickly before lender approval expires or the mortgage holder changes its mind. Short sale buyers need to be able to wait 30 to 90 days for approval from the seller's lender and tolerate fast-paced changes.

Short Sale Cooperating Agent

Like the listing agent, the cooperating agent working with the buyer needs endless patience and good communication skills. The cooperating agent must reassure the buyer that long waits are part of the process and be willing to explain what is happening.

Junior Lien Holders

If there are second or equity mortgages on the homeowner's property in addition to the first mortgage, these junior lienholders need to be convinced to release their liens for less than the full balance due. If foreclosure is looming, they may receive little or nothing, so they will hopefully listen to reason. Some junior lienholders resort to collection agencies to seek recovery of the debt.

Private Mortgage Insurance Company

A private mortgage insurance (PMI) company is used when a borrower has less than 20 percent for a down payment. Private mortgage insurance protects mortgage lenders against potential losses in the event of borrower default. The insurance company collects a monthly premium from the borrower and agrees to pay the lender a certain amount of money if the loan defaults (usually 20 percent of the loan amount). A lender might also purchase PMI behind the scenes when the mortgage is pooled and sold to investors. If a borrower defaults on the mortgage (goes 90 days late on a payment), the lender files for foreclosure and sends in a claim to the insurance company to recover as much as 20 percent of the mortgage balance. The borrower's shortage may be assigned by the lender to the PMI company after the claim is paid, which may result in the PMI company demanding that the homeowner give a promissory note for the shortage. The PMI company does not want to pay out on a loss and, if they must, they want to recoup their outlay.

Lender Approval of Short Sales

Short sales allow the sale of a home for less than the amount owed on the homeowner's mortgage. Short sales occur because the homeowner has experienced an involuntary hardship and can no longer afford the monthly mortgage payments and because the home is worth less than what is owed on the mortgage. Short sales are at fair market value and the proceeds are applied to the outstanding mortgage balance. A homeowner must qualify with the lender to be considered for a short sale but borrower qualification does not ensure a short sale approval. A short sale cannot go through unless all parties accept some level of loss. All actors should try to be flexible and realistic.

Basic Short Sale Approval Process

The quest for short sale approval pits the needs of a homeowner (possibly facing imminent foreclosure) against the interests of the lender/investors, the junior lienholders and the PMI companies who all want to be sure that the short sale brings a better result than allowing a foreclosure to proceed. The lender/investors typically compare the outcome of the proposed short sale with the alternative of allowing the foreclosure to proceed, buying the property in the sheriff's sale and selling the property as an REO. This is evaluated primarily from a monetary basis although other factors such as the time and manpower requirements also play a role.

The process of obtaining approval from the lender/investors is orchestrated by the mortgage servicer. The servicer endeavors to assemble information about the homeowner's financial status, loan status, current market value of the property and projected proceeds expected if the submitted offer were approved. An appraisal is ordered by the mortgage servicer; some will do this before an accepted offer is received while others will wait for the homeowner to first submit an offer and the completed HUD-1 or net sheet. Once all this information has been assembled, it is then forwarded to the decision maker. Sometimes the servicer is the mortgage holder or the investors who own the loan have delegated authority to the servicer to make that decision, which means the decision may be made more quickly than those for mortgages held by investors. Additional time is needed in those cases to transmit the information to the investors and PMI companies who then review the file and make their decision.

This all occurs against a backdrop of fluid market values and changing variables which may cause the trigger point where the lender will benefit from a short sale to shift. What may have been an acceptable offer one week may no longer be acceptable the next week because the property values or the costs of allowing the foreclosure to proceed have changed.

Timeline

The timelines for the different mortgage servicers will vary because they have different policies, procedures and staff. The approval process generally may take anywhere from 30 to 90 days as the mortgage servicer reviews all of the documentation submitted by the homeowner to determine homeowner eligibility, orders an appraisal and submits the complete short sale package (including an accepted offer to purchase and projected HUD-1) to the investors/mortgage holder and mortgage insurer for a decision.

Every major servicer has its own specific short sale timelines and procedures and the listing agent should always ask the mortgage servicer for the specific parameters for the transaction. The following is intended to provide a general indication and understanding of the steps most often followed as a short sale offer winds its way through the servicer's short sale approval channels.

1. The process begins when the documents needed for a complete short sale application have been received. The components of a particular servicer's application will vary, but often may include the listing contract, the seller's signed and dated financial worksheet showing monthly expenses, the seller's hardship letter and a letter authorizing the listing agent to access account information. Other mortgage servicers will not begin the process until an accepted offer and projected HUD-1 have been submitted. It may take one to two business days to set up the application file, review the application for completeness and assign the file to a negotiator.
2. It may take approximately five to 15 business days to review the application, assess the seller's situation and investigate for non-arm's-length transactions and misrepresentations. Once this is completed, the negotiator may then have an introduction call with the listing agent and/or seller. The listing agent should use this opportunity to ask questions and gather information to the greatest extent possible.

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3. The appraisal or property evaluation will take eight to 17 business days on average.

4. Once an offer, pre-approval letter and completed HUD or net sheet are submitted, the servicer will work on obtaining approval from the mortgage insurer (PMI company) and the investors. This will take in the neighborhood of 10 to 40 business days. The approvals will take less time if the investors/mortgage holder has delegated decision-making authority to the servicer.

5. When all items are complete, a final decision on the application is made and decision letters are issued over the course of two business days.

6. The short sale approval will indicate the conditions of the approval, for instance, a requirement that the seller sign a promissory note for the shortage. The approval may be good for a limited period of time.

Short Sale Pointers

- **Arm's length transaction.** A short sale must be an arm's length transaction. This means that short sale buyers cannot be related to the seller: no family, close friends or business associates.

- **Multiple offers.** Some mortgage servicers want the homeowner to submit only one accepted offer while others will entertain multiple accepted offers.

- **Mortgage payments.** Short sale sellers are expected to make their mortgage payments while their home is on the market.

- **Concessions.** Commissions and any buyer concessions must be approved by the investors. Any concessions made to a buyer in the offer are really costs passed through to the mortgage holder.

- **Shortage.** When a lender/investor approves a short sale, one of the conditions of that approval may be that the seller makes arrangements to pay the remaining balance due on the mortgage loan not paid by the short sale proceeds (the shortage or deficiency) outside of the real estate transaction. The seller may have to sign a promissory note, make a cash contribution or give other security for the shortage. The promissory note for the remaining loan balance may be required by some investors, PMI companies or junior lienholders as a condition of their agreement to the short sale.

- **Forgiveness of debt.** If the lender does forgive the shortage and lets the seller off the hook, the seller must determine whether the forgiveness of part of the seller's debt will result in taxable income to the seller. The Mortgage Forgiveness Act of 2007 alleviates that tax liability for many sellers in short sales closing before January 1, 2013. See Page 14 of the *Update* for further information and resources.

- **Servicer's objectives.** The mortgage servicer wants to be sure that a property is appropriately priced.

- **Association dues.** Mortgage holders may object to homeowner or condominium association dues that are delinquent. If the homeowner is current, it may be wise to put in the listing contract that the seller will stay current. If the owner is delinquent, he or she should try to reach a settlement to remove the delinquency.

- **Junior lienholders.** The homeowner and the listing agent will need to work separately with junior lienholders to find a way for the release of those liens. This may delay the process. Junior lienholders at times will not approve a short sale even when the lender/investors have approved. Holders of home equity lines and second mortgages may have strict standards for the minimum payment they will accept before releasing their liens for a short sale. The Bank of America, for example, requires 5 percent (had been 10 percent) of the net sale proceeds to release its second liens.

- **Closing time limits.** Short sale approvals may only be good for a limited period of time, for example, 30 days currently is used by Wells Fargo. If there is no closing within the 30 days, the entire short sale package may need to be resubmitted with updated information. This is because market prices and other factors are constantly changing and the servicers must re-evaluate periodically the price levels that make sense for the investors.

Problems that May Delay or Prevent Lender/Investor Approval

- The seller refuses to sign a promissory note for the shortage or contribute cash to the loss, as required by the investors or the PMI company.

- The seller does not provide access to the property for appraisals, inspections, etc.

- Processing delays in getting the appraisal.

- Documents not all submitted or missing signatures or proper dates.

- The accepted offer is not at or near fair market value so that it does not present a mitigation of loss for the lender/investors when compared to an REO sale.

- Submitted offer does not represent an arm's length transaction.

- Some players choose to take a no-loss hard line; other times someone's ego gets in the way of closing a deal.

Short Sale Obstacles

- The parties do not understand the lengthy timelines that may be involved.

- Buyers are unable to secure financing.

- Defects on title.

- The list price is too high or too low and is not generating enough offers or is generating offers that are too low; the list price needs to be carefully set, and perhaps periodically adjusted, to target fair market value.

- Low ball offers.
- Excessive seller concessions and costs.

For insight into the short sale process, see the *Wells Fargo REALTOR® Short Sale Guide* at www.realtor.org/wps/wcm/myconnect/e5dd7d804e01f067be0abf4eb13ae60f/fpr-wellsshortsales.pdf?mod=ajperes.

Listing a Property for a Short Sale

Losing your home can be very emotional. Many people behave like ostriches and put their heads in the sand. They don't want to face reality. Many homeowners feel ashamed about their financial situation and the choices that led them to their current predicament. Licensees who work with these sellers may be well-served by a compassionate, non-judgmental soft-sell approach. Patience and the ability to explain short sales and possible obstacles are essential.

Licensees working with short sale sellers must also firmly keep sellers focused on completing the necessary forms and paperwork. Homeowners are often unable or unwilling to do the paperwork required by the lending institution. It is hard for many to compile financial paperwork under normal circumstances and the task may be a constant reminder of their unhappy situation. It is also difficult to write a hardship letter admitting what they may see as their financial failures. Many people are also reluctant to disclose information about their income and assets.

Agents embarking on short sale listings should realize that the transaction will undoubtedly take more time and work than a traditional transaction involving a non-distressed property. The most effective agents realize that these are unusual times and choose to devote themselves to helping the homeowner. The short sale agent should try to reduce anxiety and frustration on his or her own part and on the part of the homeowner and be the calm voice of reason.

Agents working with short sales also must never let their efforts to help the homeowner overcome the limits of the agent's credentials. It is imperative that REALTORS® resist the urge to overstep the bounds of their authority and expertise. DO NOT GIVE LEGAL, TAX OR ACCOUNTING ADVICE. Always refer the homeowner to the appropriate experts and resources.

Assess the Property Owner's Financial Situation

When meeting with the prospective seller-client, the best thing that REALTORS® can do for the sake of the sellers and themselves when facing a listing where the numbers may be tight – a possible short sale – is to take the time to do their homework regarding the homeowner, the mortgage and title to the property before the listing contract is signed. This will help the REALTOR® and the homeowner choose the best course of action and save them from unpleasant surprises and from wasting their time and energy on fruitless strategies. Honest communication with the homeowner is key.

REALTORS® can use WRA-SSC Short Sale Checklist to help the property owner gather the information needed to assess the owner's situation and help the owner decide if a short sale is a good solution. The Preliminary Background section of the Short Sale Checklist provides a roadmap for this process. Brokers should prepare a CMA and a HUD-1 or a net sheet showing the seller's estimated proceeds, both routine steps in a traditional listing presentation. The CMA gives homeowners a reading on how much they might expect to receive if the property is sold. This can be compared to the liens and costs of sale to see what the net proceeds or shortage may be. The listing agent should emphasize to the homeowner that the CMA is preliminary and is only as good as the information provided.

A CMA may also be used when communicating with a mortgage servicer as an indicator of the property's fair market value. The mortgage servicer evaluating a short sale will want an offer for fair market value. The mortgage servicer will have their own appraisal done but also will consider the listing agent's CMA or other appraisals.

In order to complete these tasks, the broker must gather information about the liens and encumbrances that will be involved at closing.

1. Perform a CMA to estimate the current fair market value of the property. This is valuable because it gives the homeowner a realistic gauge of what the home is presently worth and will be submitted to the mortgage servicer when the short sale approval process begins. It is critical to be as accurate as possible.
2. Obtain a search and hold/title report from the title company. It is critical to know what liens are outstanding and how much money will be needed to clear those liens from title. While this certainly is not within a real estate broker's job description, it is better to try to get a full picture of what the broker is dealing with up front and try to head off disaster down the line.
3. Have the owner complete a Listing Questionnaire Regarding Title Issues (available online at www.wra.org/LU0309quest and on ZipForm). This form will help trigger the homeowner to identify potential title issues that would not be evident from simply examining recorded documents, including whether he or she is behind on mortgage payments. While the Listing Questionnaire and the title search may come up with the same list of liens, sometimes they may be critically different. Sellers in financial straits may not reveal or remember all that is going on and thus may overlook disclosing one or

more liens.

The owner should also review correspondence from the mortgage servicer and any legal paperwork that might have been received. If a foreclosure action has been filed in court, it will be beneficial to determine how far down the tracks the foreclosure freight train has traveled and how much time remains until the end of the homeowner's redemption period and the sheriff's sale. If the homeowner has filed bankruptcy, the homeowner should also try to see if there are any applicable obstacles or deadlines if the owner pursues a short sale.

It is critical to explain different aspects of the short sales to the seller and make sure they understand the short sale process and the additional paperwork and time involved before the seller executes the listing contract and associated forms.

Once the information has been assembled and options have been considered, it is up to the property owner whether or not they wish to go forward with a short sale. Short sales are consumer-driven procedures. The other side of the coin here is whether the agent wants to take the listing. It helps no one if the agent does not believe he or she can offer a constructive opportunity for the homeowner to achieve a successful short sale.

Short Sale Listing Process

At this point the agent and the owner will have worked through the steps in the first two sections of the Short Sales Checklist and it is time to proceed to the third section of the Short Sale Checklist that assists the agent to Prepare for Short Sale. The agent is reminded to first contact the mortgage servicer's loss mitigation department.

Once the homeowner decides to go forward the broker should identify the mortgage servicer and contact the loss mitigation department or appropriate party from the mortgage servicer to learn the servicer's documentation requirements, procedure and timeline. It is useful to know what the homeowner will be required to submit so that he or she can begin to work on assembling the financial components immediately.

Commission maximums and whether the servicer accepts multiple offers are other important factors that should be learned as soon as possible.

When contacting the mortgage servicer, the listing agent will want to determine:

1. Are their specific forms the homeowner must complete and how can they be obtained?
2. Is there a short sale guide available on the mortgage servicer's Web site?
3. What is the current estimate for an approval timeframe?
4. What time zone is the mortgage servicer located in and what are the best times to reach them?
5. Who is the mortgage holder? Is it part of a bank portfolio, owned or guaranteed by Fannie Mae or Freddie Mac, or securitized? Is there a PMI company on the loan?
6. Is there is a second mortgage? If there is, who holds that mortgage?
7. Can the servicer pre-approve a short sale, in other words, indicate what price and other conditions are needed for approval? What are the investor guidelines for short sale offers?
8. Are there commission guidelines or limits? Discuss them upfront. Ask for a firm commission (some loan servicers such as Wells Fargo will provide the actual commission).

The other steps on the Short Sales Checklist remind the listing agent to:

1. Present the listing contract and "Addendum SSL to the Listing Contract – Short Sales" to the seller

and have the seller review them with the seller's attorney and tax advisor.

2. Execute the listing contract and Addendum SSL.
3. Obtain the seller's authorization to talk to the seller's lender(s).
4. Prepare a CMA or obtain an appraisal for the lender if not done before.

An important part of this process is the use of the WRA Addendum SSL, available in hard copy from the WRA and on ZipForm.

While face-to-face discussions help the broker gauge if the homeowner is tracking the explanation of the process, the broker should have at least the key points regarding short sales summarized in a document requiring the seller's signature. Having a short sale addendum to the listing contract, which provides a resource that the homeowner can refer to and which protects the broker from future backlash if things do not turn out as the homeowner had envisioned, is one effective way to achieve this measure. An addendum gives the broker an opportunity to drive home to homeowners the main points that should have already been covered in their discussion of short sales and to obtain the homeowners' signatures on a document that acknowledges that they have been cautioned about the potential outcome and consequences of a short sale.

Key points that should be covered in a short sale listing addendum include all of the personal financial information and additional paperwork involved, the maddening delays, the seemingly discretionary and arbitrary control that the lenders have and the last-minute obligations that lenders seem to create for seller payment of any deficiency. Specifically, the short sale listing addendum should emphasize to the homeowner:

1. **Explanation of a short sale.** The homeowner must obtain an agreement with the mortgage servicer whereby the mortgage holder will accept less than what is actually owed to release the mortgage on the property.
2. **Potential tax consequences.** If the lender does not make the homeowner pay any remaining balance due on the loan after the short sale closes, then the homeowner may owe income taxes on the debt forgiven, unless the Mortgage Forgiveness Debt Relief Act of 2007 negates that tax liability. Capital gains might also be due; the homeowner should consult with a tax advisor regarding the seller's specific circumstances.
3. **Credit rating consequences.** The seller's credit rating may be adversely affected if the lender forgives part of debt, depending upon what the lender reports to the credit bureau. Credit impacts may depend on how many mortgage payments the homeowner has missed. A homeowner's credit recovery should take less time with a short sale compared to a foreclosure.
4. **Documentation needed to apply for lender approval.** The listing agent should try to find out exactly what the particular mortgage servicer requires as early as possible (if it is not already known). Servicers may provide financial forms or worksheets for the owner to complete detailing monthly income and expenses and/or a list of additional documents. The seller, with the listing agent's encouragement and support, must gather the information needed to meet the mortgage servicer's requirements.

   The loss mitigation departments of most mortgage servicers will require a hardship letter and a copy of the listing contract (including short sale addendum) as well as other financial data that may include employment verification along with paycheck stubs or verification of a lost job, personal financial statements, a current credit report, copies of bank statements, copies of income tax returns (may require a signed Internal Revenue Service Form 4506-T instead) and a cash flow analysis. IRS Form 4506-T (www.irs.gov/pub/irs-pdf/f4506t.pdf) is used to request that the IRS send the mortgage servicer a tax return transcript that shows most of the line items from the tax return.

   The hardship letter should be a brief written explanation of the homeowner's financial hardship. A good formula for the homeowner's hardship letter is a short, one-page letter with separate paragraphs that make three key points: (a) say "I'm sorry," (b) give an honest but brief description of the homeowner's circumstances, including job loss, medical emergencies, family crisis, depletion of savings and retirement funds, etc., and (c) indicate that all other options have been exhausted and the property will go to foreclosure if a short sale is not completed.
5. **Authorization for broker to converse with lender.** The seller must authorizes the broker to discuss the seller's loan and financial situation with the mortgage servicer, determine their short sale requirements, submit the seller's financial documents and market data and provide other non-legal assistance to expedite the short sale process. Any negotiations involving legal, tax or personal financial advice must be handled by the seller's attorney or other credentialed advisors.

   The letter authorizing the listing agent to access information should be dated and signed by the borrower and include the last four digits of the borrower's Social Security number, the account number and the property address.
6. **Authorization to advertise as a potential short sale.** The listing agent should market the transaction as a potential short sale, subject to lender approval.
7. **Lender approval is discretionary.** Approval of a short sale is purely at the discretion of the investors or mortgage holder. The decision to condition a short sale upon additional

requirements or a restructuring of the transaction, or to decline the short sale, is made solely by the investors or mortgage holder as well as any PMI companies or junior lienholders. They may require the homeowner to sign a promissory note for the remaining balance due on the mortgage as a condition of the short sale approval.

8. **Broker not liable.** The homeowner agrees to not hold the broker responsible if a short sale is rejected, if the mortgage holder imposes unacceptable terms and conditions or if the process takes so long that buyers give up.

These issues are all addressed on the WRA Addendum SSL. Sellers should be encouraged at every juncture to consult with their attorneys and tax advisors if they have any legal or financial questions or concerns.

List Price

As is directed on the Short Sale Checklist, the broker and seller should review and execute the listing contract and the Addendum SSL. The listing agent should use the CMA to thoughtfully and carefully set the list price to attract offers at fair market value. If the list price is too high or too low, it will not generate enough offers or it will generate offers that are too low. Periodic adjustments may be needed to keep it at fair market value.

Speeding up Short Sales

The listing agent should:

- Become familiarized as soon as possible with the lender's short sale approval requirements and the financial documents that the seller must submit.
- Understand the servicer's processes and explain them to the seller; set realistic expectations for approval time.
- Prepare the financial disclosure materials and the hardship letter before listing the property. Some mortgage servicers may accept the seller's financial document package before any accepted offers are submitted for lender approval while others may want the financial information together with the offers.
- Notify the mortgage servicer as soon as the listing contract is signed and forward a copy (unless otherwise directed). Some mortgage servicers open a file and start the property valuation and the borrower financial evaluation upon receipt of the listing instead of waiting until an offer is received.
- Stay in the approval queue and look for another buyer offering the same terms if a buyer walks because of the delays.
- Be sure that the seller gives the mortgage servicer's appraiser ready access.

Disclosure of Short Sale

Wis. Admin. Code § RL 24.07(2) requires licensees to promptly disclose material adverse facts in writing to all parties to the transaction. Failure to disclose may lead to licensee liability. A transaction that might be a short sale may fall more squarely under § RL 24.07(3), which provides that a licensee is practicing competently when the licensee discloses to the parties in writing the information suggesting the possibility of material adverse facts to the transaction, recommends that the parties obtain expert assistance and, if directed by the parties, drafts appropriate contingencies to address this matter.

The fact that the transaction may be subject to lender(s) approval and apparently will not be able to close without such approval falls within the category of information that may be stated factually to buyers. If it is disclosed that lender approval will be needed, then the appropriate contingencies can be included in the offer to purchase for the protection of both the seller and buyer. MLSs must give the listing broker the ability to disclose to potential cooperating brokers the possibility of a short sale. The broker may disclose the potential short sale in MLS remarks (unless the MLS has created some other system for short sale disclosures) and in the Real Estate Condition Report as well. Any offer must be made subject to lender approval of a short sale (see the WRA offer addendum for short sales: Addendum SSO).

Commission Concerns

The listing agent should also prepare for the possibility that commission may need to be reduced as a condition of the short sale approval. Recent surveys show that the most common commissions paid to short sale listing brokers are 5 or 6 percent, with 6 percent being the apparent maximum. Lender rules for broker commissions vary a bit depending upon the particular mortgage holder or investor. In multiple representation situations some investors may limit commission to 5 percent and some cap it at 3 percent; some use a reduced commission structure while others do not. Listing brokers should always ask the mortgage servicer what the commission will be during their first call.

The key for short sale listing brokers is to disclose a possible commission reduction in advance of the cooperating broker producing an offer in a manner that allows the cooperating broker to determine the compensation being offered by the listing broker and the potential commission reduction for the co-broke.

Standard of Practice 3-2 of the REALTOR® Code of Ethics requires REALTORS® to timely communicate any change of compensation for cooperative services to other REALTORS® prior to the time such REALTOR® produces an offer to purchase the property. Therefore an offer of compensation cannot be unilaterally changed by the listing broker after the offer to purchase has been submitted.

MLSs must give the listing broker the ability to disclose potential short sales to cooperating brokers and may, as a matter of local discretion, require listing brokers to disclose potential short sales. In an instance where a listing broker discloses a potential short sale, they may also be permitted to communicate to other participants how any reduction in the gross commission established in the listing contract that is required by the lender as a condition of approving the sale will be apportioned between listing and cooperating brokers. All confidential disclosures and confidential information related to short sales allowed by the MLS must be communicated through dedicated fields or confidential "remarks" available only to participants and subscribers.

The listing agent may disclose in the MLS how any reduction in commission required as a condition of the lender's approval will be apportioned between the listing broker and the cooperating broker if permitted under local rules. The listing broker might want to inform MLS participants that the cooperating broker's commission shall be reduced by an amount equal to ____% of the reduction required by the lender. The percentage of the reduction can be in any amount – it is not required to be in the same percentage as the division of the commission initially offered to cooperating brokers.

While it has been suggested in other situations that a broker might have the seller sign a separate promissory note or find some other way to collect a commission shortage, this may not be a good idea with a lender-mandated commission reduction in a short sale. Wis. Admin. Code § RL 24.07(4) provides, "DISCLOSURE OF SIDE AGREEMENTS. A licensee, when engaging in real estate practice, who becomes aware of the fact that a party to the transaction has not disclosed that party's entire agreement regarding the transaction to that party's secured lender, shall disclose this fact, in writing and in a timely manner, to the party's secured lender." Any side agreement for payment of the commission reduction must be disclosed to the lender under this rule. If it is not, the broker arguably has put the seller in the position of defrauding the lender who approved the short sale.

Fannie Instructs Its Servicers Not to Cut Commissions on Short Sales

In response to concerns raised by the National Association of REALTORS®, Fannie Mae instructed its servicers on February 24, 2009, not to negotiate commissions on short sales below the amount negotiated by the listing agent (unless the commission exceeds 6 percent). The requirement took effect with respect to closings on or after March 1, 2009. Fannie Mae recognizes that (a) negotiating commissions for short sales is unfair because short sales require intensive work over many months, and (b) compensating real estate agents fairly benefits Fannie Mae because agents play a crucial role in short sales. Freddie has agreed to issue similar servicer guidance. To view the Fannie announcement, visit www.efanniemae.com and search for "Announcement 09-03."

In response to concerns raised by the NAR that some servicers of Fannie Mae loans are unaware of this policy or believe it is not binding, Fannie Mae has established a process for NAR members having problems collecting the agreed upon commission in short sale transactions.

Step 1: Determine whether the loan is owned or guaranteed by Fannie Mae. Only the holder of the loan is allowed to do this, so do so in the presence of your client or after obtaining their written permission.

Use www.fanniemae.com/loanlookup or call 1-800-7FANNIE (8 a.m. to 9 p.m. Eastern Time) if you do not have convenient Internet access.

Step 2: If the servicer is unaware of or disagrees with the policy, provide a copy of Announcement 09-03 to the servicer and negotiate an appropriate commission based on the listing agreement (up to 6 percent).

Step 3: Contact Fannie Mae if the dispute is not resolved directly with the servicer. Be prepared to provide the property address, name of owner and Fannie Mae loan number (if available). Call 1-800-7FANNIE (8 a.m. to 9 p.m. Eastern Time) or e-mail Resource_center@FannieMae.com.

Accepted Offers

Once an offer has been accepted by the seller, the seller should determine whether the offer is to be submitted to the mortgage servicer for short sale approval. This may depend upon whether it is the only offer or a secondary offer, and whether the mortgage servicer wants the homeowner to submit only one offer or as many offers as the homeowner chooses. The listing agent should have determined whether the mortgage servicer wants only one or multiple offers submitted.

The other factor impacting this decision is whether the offer itself or a short sale addendum has indicated a promise by the seller to submit all offers to the mortgage servicer/lender. The WRA Addendum SSO does indicate that the seller will submit all offers to the mortgager servicer/lender, so if the particular mortgage servicer only wants the homeowner to submit one offer, then this statement in the addendum should be lined out of the addendum when the offer is written or countered out by the seller. See lines 11-12 of the WRA Addendum SSO (2009).

Short Sale Secondary Offers

It is very risky and ill-advised for a seller to accept more than one offer to purchase as a primary offer. Standard of Practice 1-7 provides in relevant part, "REALTORS® shall recommend that sellers… obtain the advice of legal counsel prior to acceptance of a subsequent offer except where the acceptance is contingent on the termination of the pre-existing purchase contract..." Clearly the safest practice from the seller's standpoint is to make subsequent offers secondary offers – with each one also subject to the approval of the seller's lender for a short sale. The seller can submit the offers to the lender at the same time for the lender's consideration.

Although accepting all of the offers in primary position is possible because they are all contingent upon lender approval from the same lender and the lender is only going to approve one offer, it may cause the buyers and their agents to be misled and it could lead to multiple approved primary offers if communication errors are made by the lenders or agents and more than one buyer comes to believe the lender approved their offer. If a group of offers are all accepted as primary subject to lender approval, each individual buyer and agent may also believe that their offer is primary; at a minimum all buyers must clearly understand that there is a "pool" of primary offers and the fact that any particular offer is accepted as primary means nothing – there is no advantage because they are all similarly positioned. It would be prudent to alert all parties, in writing, that there are multiple accepted offers with the same bank approval contingency.

However improbable, a bank could approve more than one offer. In that instance the seller would be obligated to sell the property to more than one buyer.

Accepting all of the offers as primary may also place the seller at risk of a breach of contract claim. Each of the offers is accepted with the parties agreeing to act in good faith and with due diligence to complete the terms of the contract. Any one of the primary buyers could allege that the seller cannot in good faith attempt to negotiate a short sale to meet the terms of their contract given there are multiple primary offers.

Submission of Offer to Mortgage Servicer

An offer is typically submitted to the mortgage servicer along with a completed HUD or net sheet and a buyer pre-approval for financing. It is critical that the listing agent be as accurate as possible in indicating the amounts owed on the property, including taxes and association dues. Prorated interest charges and any prepayment penalties and closing costs should be shown.

If the mortgage servicer should respond verbally and indicate that they would approve an offer at a specified price, the listing agent should try to have the mortgage servicer clarify whether they intend to communicate an approval of the submitted offer at the specified price or whether they are providing an approval criterion applicable to all offers the seller may receive. If there is only one offer the seller would generally want to propose an amendment changing the price to the specified amount and submit the amendment to the servicer along with an updated HUD-1 if the buyer agrees. If the specified price is an approval criterion, then it should be communicated to any other buyers. If multiple offers are welcomed by the mortgage servicer, this could create a situation where a secondary buyer offers more than the price specified by the servicer and the servicer approves the secondary rather than the amended primary offer. The listing agent would have to follow the lender approval provision in the primary offer to terminate the primary offer and then elevate the secondary offer to primary status, which would be good for the seller, the second buyer and the market, but not so good for the first buyer.

Buying a Short Sale Property

Short sales are not traditional transactions. There are more participants involved, which is one of the reasons that it may take many weeks to put a deal together. It is imperative that the buyer understands the timeframe and extra hurdles involved before writing an offer to purchase. The cooperating agent must work with the buyer to set realistic time expectations and reasonable price expectations. Buyers do not do well waiting weeks or months for an answer; they have a hard time waiting three days in a non-distresses situation.

Cooperating agents in short sales should recognize that it is a workout to just to keep the buyer interested and willing to stay the course. It is essential to communicate and keep the buyer informed at frequent, regular intervals. The cooperating agent should reach out cooperatively and stay in contact with the listing agent to find out the status of the short sale file, what other liens are on the property, and what the strategy is to remove the other liens. The cooperating agent must stay in the loop so that the buyer can be updated on the short sale approval status.

It is important to encourage the buyer to get pre-approved. A pre-approval is based upon a complete application with a fee, credit check and employment verification. A pre-approval letter says that a mortgage loan is approved for a certain amount of money (or for a certain property) for a certain amount of time, subject to appraisal of the property.

Lender Approval Language

The key to drafting an offer to purchase on a short sale property is to make the offer contingent upon lender(s) approval of the sale. The WRA-SSO Addendum SSO to the Offer to Purchase – Short Sales defines a short sale for the benefit of the parties and contains a Lender Approval Contingency – that is the critical provision. The offer is made contingent upon each mortgage holder and lienholder who is in the short sale approving the terms and conditions of the offer. The seller agrees to submit the financial information needed by each lender to evaluate the offer (if not already submitted). If a lenders' approval requires a change to the terms and conditions of the offer, the contingency indicates that the changes are not binding upon the parties unless the buyer and seller amend the offer to include those lender-requested terms. The offer is considered to be approved by a lender when such an amendment has been done or, if no changes were required by the lender, upon the seller's written notice to the buyer. If the short sale is not approved by the lenders, or if the approval requires changes to the offer that are unacceptable to the seller, then the seller can give the buyer written notice terminating the offer. If the seller is going to terminate, this must be done within five days of the seller's receipt of the lender(s)' decision regarding the short sale.

Addendum SSO also includes optional provisions that may be used if the offer is "as is," if various contingency deadlines will run from the receipt of lender approval rather than acceptance of the offer, and to include a deadline by which the seller must obtain lender(s) approval that if not met allows the buyer to terminate the offer. This latter provision allows the buyer to set a deadline for the seller's receipt of the lender(s)' approval and if the deadline is not met, the buyer can end the offer.

If the short sale is "as is," the buyer must be sure to include all necessary inspection and testing contingencies in the offer. The buyer may also decide whether they will implement the inspection and testing contingencies right away or wait until lender approval before investing their time and money. This is a Catch 22 decision for the buyer because the lender will invariably want a speedy closing once lender approval has been given.

There are many different short sale, lender approval addenda in use so cooperating and listing agents should be sure to carefully read any addendum used in a short sale transaction. They may appear to be similar but a different word or phrase can change the direction of a transaction. Local association, attorney-drafted, lender-provided or company addenda may contain unique provisions relating to the parties' termination rights, the lender approval timeline, etc. Some may contain provisions emphasizing points for the buyer's benefit. For example, some short sale addenda include a provision explaining that the seller will continue to market the property, accept secondary offers and submit them to the mortgage servicer until lender approval of an offer is secured. Some addenda emphasize that when the seller accepts multiple offers, the mortgage servicer/holder chooses which offer to approve for a short sale, regardless of the order in which the offers were presented to the seller, accepted or submitted to the servicer.

(The WRA Addendum SSO is available in hard copy from the WRA and on ZipForm.)

Mortgage Forgiveness Debt Relief Act and Debt Cancellation

To the extent that a loan from a lender is not fully satisfied and a lender cancels the unsatisfied debt, the homeowner has cancellation of indebtedness income. If the amount forgiven or canceled is $600 or more, the lender must generally issue Form 1099-C, Cancellation of Debt, showing the amount of debt canceled. However, the homeowner may be able to exclude part or all of this income if the debt was qualified principal residence indebtedness, the homeowner was insolvent immediately before the discharge, or if the debt was canceled in a title 11 bankruptcy case. See IRS Form 982 for details, online at www.irs.gov/pub/irs-pdf/f982.pdf.

The Mortgage Forgiveness Debt Relief Act generally allows taxpayers to exclude income from discharge of debt (purchase, building and improvement costs) on their principal residence, but not on second homes or investment properties. This provision applies to debt forgiven in calendar years 2007 through 2012. The Act helps homeowners facing foreclosures or who sell their homes in a short sale by excluding up to $2 million of forgiven debt ($1 million if married, filing separately), provided the discharge is due to the decline in the home's value or the taxpayer's financial condition. See www.irs.gov/individuals/article/0,,id=179414,00.html for more information. There is also a helpful two-page brochure that can be printed and given to consumers at www.irs.gov/pub/irs-pdf/p4705.pdf.

Lenders must send Form 1099-A, Acquisition or Abandonment of Secured Property, to borrowers if there is a foreclosure or DIL, or a Form 1099-C, Cancellation of Debt, which reports the amount of debt forgiven. The form received must accurately states the fair market value of the property. For a foreclosure, the winning gross foreclosure bid is considered to be the FMV; for a short sale, it is the sales price; and for a DIL, the appraised value of the property should be used.

See IRS Publication 4681, *Canceled Debts, Foreclosures*, Repossessions, and Abandonments, online at www.irs.gov/pub/irs-pdf/p4681.pdf, for additional information and resources. Anyone facing any of these situations should always consult with a tax professional for an evaluation of his or her personal circumstances.

Foreclosures Alternatives Program

The future for short sales holds promise for improvement. The Obama Administration is endeavoring to set uniform standards and timelines for the short sale process in its new Foreclosures Alternatives Program (FAP) announced on May 14, 2009. FAP is expected to launch in late July. This new program will:

- Establish financial incentives to encourage the completion of short sale transactions. Incentives include: (1) $1,000 for mortgage servicers for the successful completion of a short sale or deed-in-lieu of foreclosure, (2) $1,500 for homeowners to motivate them and help with relocation expenses ("cash for keys") and (3) up to $1,000 for junior lien holders to release their liens (one dollar for every two dollars paid by the mortgage holder/investors to the junior lien holders).
- Create streamlined and standardized documents, including a Short Sale Agreement and an Offer Acceptance Letter.

In the FAP Short Sale Agreement, mortgage servicers will give homeowners at least 90 days – up to one year, depending on market conditions – to market and sell the property. The FAP Short Sale Agreement will specify the reasonable and customary real estate commissions and costs that may be deducted from the sales price and the servicer must agree not to reduce commissions after an offer has been received.

For information about FAP, visit www.realtor.org/wps/wcm/connect/15c5e0004e1a95378582f7ec21680fb0/Short+Sales+Uniform+Process+Brief.pdf?MOD=AJPERES&CACHEID=15c5e0004e1a95378582f7ec21680fb0 and www.treas.gov/press/releases/docs/05142009FactSheet-MakingHomesAffordable.pdf.

Short Sale Resources

- WRA-SSC Short Sale Checklist
- WRA-SSL Addendum SSL to the Listing Contract – Short Sales
- WRA-SSO Addendum SSO to the Offer to Purchase – Short Sales
- *Wells Fargo Short Sale Guide*, online at www.realtor.org/wps/wcm/myconnect/e5dd7d804e01f067be-0abf4eb13ae60f/fpr-wellsshortsales.pdf?mod=ajperes
- "Steps to Sell Short Sales" in the March 2009 edition of the *Wisconsin Real Estate Magazine*, online at http://news.wra.org/story.asp?a=1072
- "Short Sale FAQ" in the March 2009 edition of the *Wisconsin Real Estate Magazine*, online at http://news.wra.org/story.asp?a=1075
- "Working with Clients Facing Foreclosure" in the March 2008 edition of the *Wisconsin Real Estate Magazine*, online at http://news.wra.org/story.asp?a=889
- "Working with Distressed Sales" in the March 2009 issue of *Legal Update*, online at www.wra.org/LU0903
- "Short Sales – A Risky Business" in the January 2008 issue of *Legal Update*, online at www.wra.org/LU0801
- Seller and buyer handouts included in the NAR's "The Basics: Short Sales," online at www.realtor.org/realtors/basics_short_sales?wt.mc_id=rd0041 includes
- REALTORS® "Short Sales Resource Guide," online at www.realtor.org/archives/shortsales200805
- NAR *Field Guide to Short Sales*, online at www.realtor.org/libweb.nsf/pages/fg335

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