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Legal Update

A WRA Publication Exclusively for the Designated REALTOR®

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Uniform Short Sales

Throughout 2009, the National Association of REALTORS® urged the U.S. Treasury Department, the Federal Housing Finance Agency, Fannie Mae and Freddie Mac to improve the short sales process. NAR's persistence was rewarded on November 30, 2009, when the Obama Administration released guidelines and uniform forms for its Home Affordable Foreclosure Alternatives Program (HAFAs). Mortgage loan servicers that are in the Home Affordable Modification Program (HAMP) must follow the HAFAs guidelines and procedures that go into effect on April 5, 2010.

HAFAs brings what REALTORS® have been asking for when it comes to short sales: a uniform process, streamlined short sale rules, uniform forms, pre-approved short sale terms from the lender and perhaps most importantly, firm deadlines. A government protocol for pre-approved short sales has been created. HAFAs also provides financial incentives to sellers, loan servicers and investors to encourage them to work together to avoid foreclosure. HAFAs shows great promise to speed up short sales and increase the number of successful closings as long as the servicers and investors understand they are better off with a short sale instead of a foreclosure.

This *Update* reviews the HAFAs guidelines for short sales and deeds in lieu of foreclosure and reviews some of the other pitfalls and considerations for REALTORS® working with 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 pay 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.

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 options 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.

Shorts sales can be extraordinarily challenging and try the patience of the parties and the REALTORS® involved. In most cases there are several parties who must sign off on a short sale transaction;

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the holders of the first and second liens, the buyer, the seller and the mortgage insurer all have the power to kill a deal. It can be like herding cats to get everyone to fall into place and create a successful short sale.

Even if a closing is reached there may be additional traps. Some mortgage insurers and second-lien holders are asking the sellers to pay them out of pocket to cover a portion of their losses in exchange for signing off on a short sale. Some lenders have aggressively chased the seller after a short sale and obtained deficiency judgments against them. The lenders sometimes ask anxious short sellers to sign a letter acknowledging that, in order to agree to the short sale, the lender expects the owner to pay the deficiency. Desperate to sell and move on with their lives, or sometimes not sure of what they are signing, sellers may sign these letters that can easily be used in court to obtain a deficiency judgment.

REALTOR® Practice Tips:

For additional background regarding short sales, see the short sale resources on Page 13 of this *Update*.

Even though short sales typically make financial sense for lenders, analysts report that only one in four short-sale attempts were successful in 2009. It is very common for short sales to take four to six months (or even much longer than that) to close. This time-consuming process has frustrated countless parties and REALTORS® who are eager for any measure that will streamline the process.

Home Affordable Foreclosure Alternatives Program

HAFAP will help homeowners who are unable to retain their home under HAMP. HAFAP provides financial incentives to servicers and borrowers

who utilize a short sale or a deed-in-lieu of foreclosure (DIL) to avoid a foreclosure on a loan that meets the HAMP eligibility requirements. Both of these foreclosure alternatives reduce the need for potentially lengthy and expensive foreclosure proceedings. The options help preserve the condition and value of the property by minimizing the time a property is vacant and subject to vandalism and deterioration. In addition, these options generally provide a substantially better outcome than a foreclosure sale for borrowers, investors and communities. The rules – in effect from April 5, 2010, through December 31, 2012 – also are intended to speed up the short sale process. HAFAP:

- Complements HAMP by providing viable alternatives for homeowners who are HAMP-eligible.
- Utilizes homeowner financial and hardship information collected in conjunction with HAMP, eliminating the need for additional eligibility analysis.
- Allows the homeowner to receive pre-approved short sale terms prior to the property listing.
- Prohibits the servicer from requiring, as a condition of approving the short sale, a reduction in the real estate commission (up to 6 percent) agreed upon in the listing agreement.
- Requires that homeowners be fully released from future liability for the debt.
- Uses standard processes, documents and timeframes.
- Provides financial incentives to homeowners, servicers and investors.

Loan Eligibility

The HAFAP guidelines do not apply to mortgages that are owned or guaranteed by Fannie Mae or Freddie Mac, or to Federal Housing Administration or Veteran Administration loans. Fannie Mae and Freddie Mac,

however, are developing programs based on the federal HAFA standards that are expected to be released soon.

The Making Home Affordable Supplemental Directive 09-09, "Introduction of Home Affordable Foreclosure Alternatives – Short Sale and Deed-in-Lieu of Foreclosure" (November 30, 2009) (www.hmpad-min.com/portal/docs/hamp_servicer/sd0909.pdf) provides guidance to loan servicers for adoption and implementation of HAFA for first lien mortgage loans that are not owned or guaranteed by Fannie Mae or Freddie Mac (Non-GSE Mortgages). In order for a servicer to participate in HAFA for Non-GSE Mortgages, the servicer must have executed a servicer participation agreement (SPA) with Fannie Mae, which has been designated by the Treasury to act as financial agent for the United States.

The HAFA guidelines apply to lenders who voluntarily participate in the HAMP program. The Department of Housing and Urban Development says more than 100 servicers have signed up to participate in HAMP, covering more than 89 percent of outstanding mortgage debt in the country.

Servicers must evaluate a borrower for a HAMP modification before considering any HAFA options. A loan meets the basic eligibility criteria if all of the following conditions are met:

- The property is the borrower's principal residence.
- The mortgage loan is a first lien mortgage originated on or before January 1, 2009.
- The mortgage is delinquent or default is reasonably foreseeable.
- The homeowner demonstrates hardship.
- The current unpaid principal balance is equal to or less than \$729,750.
- The borrower's total monthly

mortgage payment (including principal, interest, taxes, insurance and any homeowners' association dues) exceeds 31 percent of the borrower's gross income.

HAMP requires borrowers to enter into a trial period plan before receiving a permanent Home Affordable modification. During this trial period, borrowers must submit regular payments and the forms and documents needed for the servicer to verify eligibility and offer a permanent HAMP modification before the trial period plan expires. Borrowers who meet the eligibility criteria for HAMP but are not offered a trial period plan, do not successfully complete a trial period plan or default on a HAMP modification should first be considered for other loan modification or retention programs offered by the servicer prior to being evaluated for HAFA. The goal is to keep the borrower in his or her home if at all reasonably possible.

Pursuant to the servicer's policy, every potentially eligible borrower must be considered for HAFA before the borrower's loan is referred to foreclosure or the servicer allows a pending foreclosure sale to be conducted. Servicers must consider possible HAMP-eligible borrowers for HAFA short sales or DIL within 30 calendar days of the date the borrower:

- does not qualify for a trial period plan;
- does not successfully complete a trial period plan;
- is delinquent on a HAMP modification by missing at least two consecutive payments; or
- requests a short sale or DIL.

A Uniform Process

If the servicer determines that a borrower is eligible for a HAFA offer, the servicer must follow the steps below to determine if a short sale or DIL offer will be extended to the borrower.

1. **Notice to Homeowner.** If the servicer has not already discussed a short sale or DIL with the borrower, the servicer must notify the borrower in writing of the availability of the HAFA options and give the homeowner 14 calendar days from the date of the notification to contact the servicer verbally or in writing to ask to be considered for HAFA. If the homeowner does not contact the servicer within the timeframe, or at any time indicates that he or she is not interested in these options, the servicer has no further obligation to offer HAFA alternatives.
2. **Expected Recovery through Foreclosure vs. Short Sale or DIL.** Though not a HAFA requirement, it is expected that servicers will, in accordance with investor guidelines, perform a financial analysis to determine if a short sale or DIL is in the best interest of the investor, guarantor and/or mortgage insurer.
3. **Verified Financial Information.** Verified borrower financial information obtained in conjunction with HAMP may be used to determine a homeowner's HAFA eligibility. If financial and hardship information is documented and verified, no additional financial or hardship assessment is required under HAFA. However, in accordance with investor guidelines, the servicer may request updated financial information. If a borrower was evaluated for HAMP based on verbal financial data, the servicer may send the borrower a Short Sale Agreement (SSA) and require the borrower to deliver documentation of the necessary financial information when the borrower returns the executed SSA. The servicer must verify a borrower's financial information through documentation and obtain a signed hardship affidavit prior to approving a short sale or accepting a DIL under HAFA.
4. **Property Valuation.** The servicer must independently assess the current value of the property in accordance

with the investor's guidelines. The servicer may not require the borrower to pay in advance for the valuation, but may add the cost to the outstanding debt in accordance with the borrower's mortgage documents and applicable law in the event the short sale or DIL is not completed.

5. **Title Review.** The servicer must review readily available information provided by the borrower, the borrower's credit report, the loan file or other sources to identify subordinate liens and other claims on title to determine if the borrower will be able to deliver clear, marketable title to a prospective purchaser or the investor. Although not required by HAFAs, the servicer may order a title search or preliminary title report. The servicer may not charge the borrower in advance for any cost incurred in the title review, but may add the cost to the outstanding debt in accordance with the borrower's mortgage documents and applicable law in the event the short sale or DIL is not completed.
6. **Borrower Notice.** If a HAFAs short sale or DIL is not available, the servicer must communicate this decision in writing to the borrower who requested it. The notice must explain why a short sale or DIL under HAFAs cannot be offered and provide a toll-free telephone number that the customer may call to discuss the decision.
7. **Minimum Acceptable Net Proceeds.** Prior to approving a borrower to participate in a HAFAs short sale, the servicer must determine the minimum acceptable net proceeds (minimum net) that the investor will accept from the transaction. Each servicer must develop a written policy, consistent with investor guidelines, that describes the basis on which the minimum net will be determined. This policy may incorporate such factors as local market conditions, customary transactional costs of such sales and the amounts that may be required to release any

subordinate liens on the property. A servicer's policy for determining the minimum net must be consistently applied for all loans serviced for that investor. The minimum net may be expressed as a fixed dollar amount, a percentage of the current market value of the property, or a percentage of the list price approved by the servicer. After signing an SSA, the servicer may not increase the minimum net requirement stated in the SSA until the initial SSA termination date is reached (not less than 120 calendar days).

8. **Allowable Transaction Costs.** In determining the minimum net, the servicer must consider reasonable and customary real estate transaction costs for the community in which the property is located and determine what costs the servicer or investor is willing to pay from sale proceeds. The servicer must describe the costs that may be deducted from the gross sale proceeds in the SSA.
9. **Request for Approval of Short Sale.** Within three business days following receipt of an accepted offer, the seller or the listing broker must deliver to the servicer a completed Request for Approval of a Short Sale (RASS) form describing the terms of the sale transaction. With the RASS, homeowners also must submit to the servicer:
 - A copy of the executed sales contract (offer to purchase) and all addenda.
 - Buyer's documentation of funds or buyer's pre-approval or commitment letter on letterhead from a lender.
 - Information regarding the status of subordinate liens and/or negotiations with subordinate lien holders to secure their release.
10. **Approval or Disapproval of Sale.** Within 10 business days of receipt of the RASS and all required attachments, the servicer must indicate its approval or disapproval of the proposed sale by signing the appropriate section of the RASS and mailing

it to the homeowner. The servicer must approve a RASS if the net sale proceeds available for payment to the servicer equal or exceed the minimum net determined by the servicer prior to the execution or extension of the SSA and all other sales terms and conditions in the SSA have been met.

This 10-day deadline under HAFAs is in stark contrast to the 90-120 days many buyers have had to wait in the past to learn whether the lender would approve their offers to purchase. Many times lenders have waited for better offers to come along, betting against the risk that prices in the market might decline and that they might end up with no viable offers. This waiting game ends under HAFAs.

11. **Commission.** The servicer may not require, as a condition of approving a short sale, a reduction in the real estate commission below the real estate commission agreed upon in the listing agreement (up to 6 percent).
12. **Closing.** The servicer may require that closing take place within a reasonable period following acceptance of the RASS, but in no event may the servicer require that a transaction close in less than 45 calendar days from the date of the offer without the consent of the seller.

Firm Deadlines

1. A homeowner has 14 days to ask for a short sale (or a DIL) after the servicer gives the homeowner written notice regarding the availability of the HAFAs short sale and DIL options.
2. In order to accept an SSA proposed by the servicer, the seller and the listing broker must sign and return the SSA to the servicer within 14 days of the date of the SSA along with information about other liens and a copy of the listing contract.
3. The homeowner must be given a minimum of 120 days to sell the

home (extensions of up to a total of 12 months may be granted).

4. If the seller accepts an offer that meets the SSA requirements, the seller has three business days in which to submit a RASS to the servicer, along with a copy of the offer to purchase and all addenda, the buyer's documentation of funds or pre-approval/commitment letter on letterhead from a lender, and information regarding the status of all subordinate liens.
5. Within 10 business days of receipt of the RASS and all required attachments, the servicer must indicate its approval or disapproval of the proposed sale by signing the appropriate section of the RASS and mailing it to the seller.
6. The servicer may require the closing to take place within a reasonable period after approving the RASS, but not sooner than 45 days from the date of the contract unless the seller agrees otherwise.
7. The servicer must release its first mortgage lien within 10 business days (or earlier if required by state or local law) after receipt of sales proceeds from a short sale or delivery of the DIL.

There do not seem to be any deadlines between the time when the homeowner has requested a HAFA short sale and the time when the loan servicer offers an SSA to the homeowner. The guidelines state that servicers must "consider" HAMP-eligible owners for HAFA within 30 days of the homeowner's request, but it is not entirely clear what this means. During this time frame it is expected that the servicer will verify the borrower's financial information and hardship, look at the property's title and value, and then determine if a short sale or DIL is better than a foreclosure for the lender, investors, guarantors and mortgage insurers. As in the past, this may take some time. Another reason this interval may be long is that the

servicer also sets the minimum acceptable net proceeds that the lender/investor will accept in a short sale before the SSA is offered to the owner.

Participation Incentives

Incentive payments were written into HAFA to offset some of the financial pain experienced by lenders when they agree to settle for less than the amount owed on home loans. For a short sale or DIL, incentives will be paid as follows:

- **Seller Relocation Assistance.** Following the successful closing of a short sale or DIL, the seller shall be entitled to an incentive payment to assist with relocation expenses. The seller relocation incentive, originally announced to be \$1,500, was raised to \$3,000 in a program enhancement announced March 26, 2010. In a short sale transaction, the servicer must instruct the settlement agent to pay the seller from the sale proceeds at the same time that all other payments, including the payoff to the servicer, are disbursed by the settlement agent. The amount paid to the seller must appear on the HUD-1 Settlement Statement. This \$3,000 for moving expenses may be taxable income to the seller.
- **Servicer Incentive.** The servicer will be paid \$1,500 (increased from the originally announced \$1,000) to cover administrative and processing costs for a short sale or DIL completed in accordance with the requirements of HAFA and the applicable documents. Investors may elect to pay additional incentive compensation to servicers that will not affect the HAFA servicer incentive.
- **Investor Incentive and Subordinate Lien Payments.** Under the HAFA Program enhancements announced March 26, 2010, the Treasury Department will pay the investor a maximum of \$2,000 for allowing up to \$6,000 of the short sale proceeds to be paid to subordinate lien holders. This reimbursement will be earned on a one-for-three matching

basis. For each \$3 an investor pays from the short sale proceeds to secure the release of a subordinate lien, the investor will be entitled to \$1 of reimbursement. In other words, a first lender that provides \$6,000 in proceeds from a short sale to a second lender can receive \$2,000 from the Treasury Department. To receive an incentive, subordinate lien holders must release their liens and waive all future claims against the borrower.

No incentives will be paid to the borrower, servicer or investor if the net proceeds from a sale are more than the total amount due on the first mortgage when title is transferred. Borrowers, servicers and investors will be eligible for HAFA incentives upon successful completion of the short sale or DIL if an SSA, Alternative SSA or DIL Agreement was executed on or before December 31, 2012.

Uniform Forms

Standardized forms are one of the most welcome benefits of HAFA.

HAFA Short Sale Agreement

HAFA allows sellers to receive pre-approved short sale terms before listing the property (including the minimum acceptable net proceeds). If a homeowner expresses interest in a short sale to his or her loan servicer and is eligible (per the basic HAMP criteria at <http://making-homeaffordable.gov/>), and if the servicer determines the proposed sale is in the best interest of any investor, the seller will receive a standardized SSA (see the agreement at www.hmpadmin.com/portal/docs/hafa/hafaletters_ssagreement.doc) that will give the seller the list price or the net sales proceeds amount that will be acceptable to the servicer and set a maximum limit on closing costs.

The SSA also outlines the roles and responsibilities of the servicer and

borrower in the short sale listing process and provides key marketing terms. The SSA must give the seller an initial period of 120 days to sell the house, although extensions are permitted up to a total of 12 months. The SSA indicates that the servicer will not reduce the real estate commission agreed upon in the listing agreement (up to 6 percent).

All loan servicers participating in HAMP must implement HAFA in accordance with their own written policies, consistent with investor guidelines. These policies and guidelines may require the servicer to take into account factors such as the severity of the potential loss, local markets, the timing of pending foreclosure actions, and borrower motivation and cooperation. As a result, servicers may amend the terms of the SSA in

accordance with their policies and investor requirements, as well as applicable laws or local real estate practice.

At a minimum, however, every SSA must include the following elements and provisions:

- **Termination Date.** A fixed termination date not less than 120 calendar days from the effective date of the SSA (Effective Date). The Effective Date is the date the SSA is mailed to the homeowner and will be indicated in the SSA. The term of the SSA may be extended at the discretion of the servicer up to a total term of 12 months, in accordance with the requirements of the investor.
- **Listing with Practicing Broker.** A requirement that the property be listed with a licensed real estate professional who is regularly doing business in the community where the

property is located.

- **Approved List Price or Net Proceeds.** Either a list price approved by the servicer or the acceptable sale proceeds, expressed as a net amount after subtracting allowable closing costs. In other words, an acceptable sales amount is established before the home is put on the market.
- **Maximum Closing Costs.** The amount of closing costs or other expenses the servicer will allow to be deducted from the gross sale proceeds expressed as a dollar amount, a percentage of the list price or a list by category of reasonable closing costs and other expenses that the servicer will permit to be deducted from the gross sale proceeds.
- **Real Estate Commission.** The amount of the real estate commission that may be paid, not to exceed



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6 percent of the purchase price.

- **Payment of Third-Party Vendors.** A statement if a third-party vendor has been retained by the servicer to work with the listing broker to facilitate the sale and how that vendor will be paid. If the third-party vendor is paid from sale proceeds at closing for a fixed amount or in an amount equal to a percentage of the sales price, such payment must be reflected on the HUD-1 Settlement Statement. The vendor might also be paid outside of the transaction.
- **Financial Information Authorization.** A statement by the homeowner authorizing the servicer to communicate the homeowner's personal financial information to other parties (including the Treasury Department and its agents) as necessary to complete the transaction.
- **Mandatory Listing Contract Language.** A requirement that the listing contract contain the following language: "Seller may cancel this Agreement prior to the ending date of the listing period without advance notice to the broker, and without payment of a commission or any other consideration, if the property is conveyed to the mortgage insurer or the mortgage holder," and "Sale of the property is contingent on written agreement to all sale terms by the mortgage holder and the mortgage insurer (if applicable)." Listing agents should be prepared to write this into their listing contracts.
- **Arm's Length Transaction: No Commission to Seller.** Notice that the seller can't list the property with or sell it to anyone to which he or she is related or with which he or she has a close personal or business relationship (must be an arm's length transaction), and, if the seller has a real estate license, the seller cannot earn a commission by listing the seller's own property. The seller may not have any agreements to receive a portion of the commission or the sales price after closing.
- **Mandatory Offer Language.** A requirement that the offer contain the following language: "Seller and Buyer each represent that the sale is an 'arm's length' transaction and the Seller and Buyer are

unrelated to each other by family, marriage or commercial enterprise." "The Buyer agrees not to sell the property within 90 days of closing of this sale." Cooperating agents should be prepared to write this into any HAFA short sale offers.

- **First Lien Liability Release.** An agreement that upon successful closing of a short sale acceptable to the servicer, the homeowner will be released from all liability for repayment of the first mortgage debt.
- **Moving Expense Incentive.** An agreement that upon successful closing of a short sale acceptable to the servicer, the homeowner will be entitled to a relocation incentive of \$3,000, which will be deducted from the gross sale proceeds at closing.
- **Subordinate Lien Releases.** Notice that the servicer will allow a portion of gross sale proceeds to be paid to subordinate lien holders in exchange for release and full satisfaction of their liens. All subordinate liens must be released to qualify for short sale approval.
- **Tax and Credit Score Consequences.** Notice that a short sale may have income tax consequences and may have a negative impact on the borrower's credit score, and a recommendation that the borrower seek professional advice regarding these matters.
- **Monthly Payments until Closing.** The amount of the monthly mortgage payment, if any, that the borrower will be required to pay during the term of the SSA (cannot exceed 31 percent of the borrower's gross monthly income).
- **Foreclosure on Hold.** An agreement that so long as the homeowner performs in accordance with the terms of the SSA, the servicer will not complete a foreclosure sale.
- **Cause for Termination.** During the term of the SSA, the servicer may terminate the SSA before its expiration if any of the following occur:
 - The homeowner's financial situation improves significantly, the homeowner

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qualifies for a loan modification or the homeowner brings his account current or pays the mortgage in full.

- The homeowner or the listing broker fails to act in good faith in listing, marketing or closing the sale, or fails to abide by the terms of the SSA.
- A significant change occurs to the property condition or value.
- There is evidence of fraud or misrepresentation.
- The homeowner files for bankruptcy and the Bankruptcy Court does not approve the SSA.
- Litigation is initiated or threatened that could affect title to the property or interfere with a valid conveyance.
- The homeowner fails to make the monthly payment, if any, stated in the SSA.

 **REALTOR® Practice Tips:**

The following language must be written into any listing contract used for a HAFA short sale: “Seller may cancel this Agreement prior to the ending date of the listing period without advance notice to the broker, and without payment of a commission or any other consideration, if the property is conveyed to the mortgage insurer or the mortgage holder,” and “Sale of the property is contingent on written agreement to all sale terms by the mortgage holder and the mortgage insurer (if applicable).” Listing agents must write this into their listing contracts for HAFA short sales.

 **REALTOR® Practice Tips:**

The following language must be written into any offer used for a HAFA short sale: “Seller and Buyer each represent that the sale is an ‘arm’s length’ transaction and the Seller and Buyer are unrelated to each other by family, marriage or commercial enterprise,”

and “The Buyer agrees not to sell the property within 90 days of closing of this sale.” Cooperating agents must write this into any HAFA short sale offers.

Seller Acceptance of SSA

In order to accept the SSA proposed by the servicer, the seller and the listing broker must sign and return the SSA to the servicer within 14 days of the Effective Date along with information about other liens and a copy of the listing contract. By returning and signing the SSA, the seller agrees to:

- Provide all information and sign documents required to verify program eligibility.
- Cooperate with the listing broker to actively market the property and respond to servicer inquiries.
- Maintain the interior and exterior of the property in a manner that facilitates marketability.
- Work to clear any liens or other impediments to title that would prevent conveyance.
- Make any monthly payment stipulated in the SSA.

Request for Approval of Short Sale Form

The HAFA servicer will send a RASS form (see the form at www.hmpadmin.com/portal/docs/hafa/hafaletters_ssapprovalreq.doc) to the seller along with the SSA so that the seller will be ready to submit the RASS to the servicer when an offer is accepted. The RASS will be partially filled in to give the contact information for the servicer, the property address and the loan number.

The servicer must approve a RASS if the net sale proceeds available for payment to the servicer equal or exceed the minimum net determined by the servicer prior to the execution of the SSA and all other sales terms and conditions in the SSA have been met.

Alternative Request for Approval of Short Sale Form

In the event that a borrower has an accepted offer and requests that the servicer approves a short sale under HAFA before an SSA has been executed, the servicer must evaluate the seller for HAFA and use the Alternative Request for Approval of a Short Sale (Alternative RASS) (see the agreement at www.hmpadmin.com/portal/docs/hafa/hafaletters_ssapproval.doc).

Upon receipt of the Alternative RASS, the servicer must determine the basic HAMP eligibility of the seller. If the seller appears to be eligible and was not previously considered for a trial period plan, the servicer must notify the seller verbally or in writing of the availability of a HAMP modification and give the seller 14 calendar days from the date of the notification to contact the servicer and request consideration for a HAMP modification. In addition, the servicer must verify the seller’s financial information through documentation and obtain a signed Hardship Affidavit from the seller prior to approving the short sale.

If the seller does not wish to be considered for a modification, the servicer may consider the Alternative RASS without first entering into an SSA with the seller. If the servicer approves the short sale, then the loan will qualify for the HAFA program.

Deed in Lieu of Foreclosure

In a DIL, the borrower voluntarily transfers ownership of the mortgaged home to the servicer in full satisfaction of the total amount due on the first mortgage. The servicer’s willingness to approve and accept a DIL is contingent upon the homeowner’s ability to provide marketable title, free and clear of mortgages, liens and encumbrances.

In accordance with investor requirements, servicers have the discretion to

accept a HAFA DIL, which requires a full release of the debt and waiver of all claims against the owner. The owner must agree to vacate the property by a certain date, leave the property in broom clean condition and deliver clear, marketable title.

Typically, servicers require that the owner make a good faith effort to list and market the property before the servicer will agree to accept a DIL. Under circumstances acceptable to the investor, servicers may agree to accept a DIL without requiring a marketing period. In either circumstance, the transaction will be eligible for incentives that are offered for short sales.

The SSA contains optional DIL language that may be included or deleted by the servicer prior to execution of the SSA. If the DIL language is included, the investor is obligated to accept a DIL in accordance with the terms of the SSA if the term of the SSA expires without resulting in a sale of the property. If the servicer offers the DIL option separately from the SSA or without a marketing period, the servicer must provide the Deed-in-Lieu Agreement form (DIL Agreement) (see the agreement at www.hmpadmin.com/portal/docs/hafa/hafaletters_dilagreement.doc).

The following terms apply to a HAFA DIL:

- **Marketable Title.** The owner must be able to convey clear, marketable title to the servicer or investor. The requirements for the release of subordinate liens apply to both HAFA short sales and DILs.
- **Written Agreement.** The conditions for acceptance of a DIL must be in writing and signed by both the servicer and owner. They may be set forth in the SSA or in the DIL Agreement.
- **Vacancy Date.** The SSA or DIL Agreement must specify the date by which the owner must vacate the property, which shall not be less than

30 calendar days from the date of the termination date of the SSA or the date of the separate DIL Agreement, unless the owner voluntarily agrees to an earlier date.

- **Relocation Assistance.** Owners who participate in a HAFA DIL transaction are eligible for \$3,000 in relocation assistance.

General HAFA Terms and Conditions

Vacant Properties

The mortgaged property can be vacant up to 90 days prior to the date of the Short Sale Agreement (SSA), Alternative Request of Approval of Short Sale (RASS) or DIL only if the owner provides documentation that the owner was required to relocate at least 100 miles from the property to accept new employment or was transferred by the current employer and there is no evidence – such as credit report information – indicating that the owner has purchased another home 90 days prior to the date of the SSA, Alternative RASS or DIL.

Foreclosure Action

At the servicer's discretion, the servicer may initiate foreclosure or continue with an existing foreclosure proceeding during the HAFA process, but may not complete a foreclosure sale:

- While determining the owner's eligibility and qualification for HAMP or HAFA.
- While awaiting the timely return of a fully executed SSA.
- During the term of a fully executed SSA.
- Pending transfer of property ownership based on an approved offer per an RASS or Alternative RASS.
- Pending transfer of property ownership via a DIL by the date specified in the SSA or DIL Agreement.

Monthly Mortgage Payment

The servicer will identify in the SSA,

Alternative RASS or DIL Agreement the amount of the monthly mortgage payment, if any, that the owner is required to make during the term of the applicable agreement and pending transfer of property ownership, as applicable. The amount of the owner's monthly payment may not exceed 31 percent of the borrower's gross monthly income.

Release of Subordinate Liens

It is the responsibility of the seller to deliver clear marketable title to the purchaser or investor and to work with the listing broker, closing agent and lien holders to clear title impediments. The servicer may, but is not required to, negotiate with subordinate lien holders on behalf of the seller. The servicer, on behalf of the investor, will authorize the closing agent to allow up to a total of \$6,000 of the gross sale proceeds as payment(s) to subordinate mortgage/lien holder(s) in exchange for a lien release and full release of seller liability. Lien holders, in order of priority, may be paid 6 percent (each) of the unpaid principal balance of their loan, until the \$6,000 maximum is reached. Payments will be made at closing from the gross sale proceeds and must be reflected on the HUD-1 Settlement Statement. Junior lien holders may not require contributions from either the real estate agent or owner as a condition for releasing their lien and releasing the owner from personal liability.

Servicers may instruct the closing agent that the transaction may not close without a written commitment from all junior lien holders that they will release their liens and the seller from personal liability in exchange for payment equivalent to 6 percent of the unpaid principal balance of their liens, that the total payment to all lien holders will not exceed a total of \$6,000 and that payment for release of any junior lien is contingent upon the agreement of all junior lien

holders to release their liens and the owner from personal liability. HAFAs servicers may require the closing attorney to either confirm that they are in receipt of this commitment from junior lien holders on the HUD-1 Settlement Statement or request that a copy of the written commitment provided by the junior lien holder be sent to the servicer with the HUD-1 provided in advance of closing.

REALTOR® Practice Tips: Brokers working with HAFAs short sales should try to determine whether the loan servicer will communicate with any second lien holders or whether that must be undertaken by the seller and his or her attorney, broker, etc. Ensuring the release of the subordinate liens is critical and can be the biggest obstacle in the process.

Deficiency Forgiveness

The servicer must release its first mortgage lien within 10 business days (or earlier if required by state or local law) after receipt of the sales proceeds from a short sale or delivery of the deed and property in a DIL transaction. Investors must waive their rights to seek deficiency judgments and may not require a promissory note for any deficiency. In other words, the seller must be fully released from future liability for the first mortgage debt and, if the subordinate lien holder receives a payment under HAFAs, that debt as well (no cash contribution, promissory note or deficiency judgment is allowed).

No Fees

Servicers may not charge the owner any administrative processing fees in connection with HAFAs. The servicer must pay all out-of-pocket expenses, including but not limited to notary fees, recordation fees, release fees, title costs, property valuation fees, credit report fees, or other allowable and documented expenses, but the servicer may add these costs to the outstanding debt

in accordance with owner's mortgage documents and applicable laws if a short sale or DIL is not completed.

Mortgage Insurer Approval

For loans that have mortgage insurance coverage, the servicer/investor must obtain mortgage insurer approval for HAFAs foreclosure alternatives. A mortgage loan does not qualify for HAFAs unless the mortgage insurer waives any right to collect additional sums (cash contribution or a promissory note) from the borrower.

Electronic Documents and Signatures

Any party to a document utilized in HAFAs may, subject to applicable law and any investor requirements or restrictions, prepare, sign and send the document through electronic means provided:

- (a) appropriate technology is used to store an authentic record of the

executed document and the technology otherwise ensures the security, confidentiality and privacy of the transaction;

- (b) the document is enforceable under applicable law;
- (c) the servicer obtains the borrower's consent to use electronic means to enter into the document;
- (d) the servicer ensures that the borrower is able to retain a copy of the document and provides a copy to the borrower that the borrower may download, store and print; and
- (e) The borrower, at any time, may elect to enter into the document through paper means or to receive a paper copy of the document.

The HAMP Track Record

More than five million households are behind on their mortgages and risk foreclosure. The govern-

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**As of 3/10. List Subject to change.*

ment's \$75 billion HAMP mortgage modification plan has helped only a small number of them. The program is designed to lower borrowers' monthly payments by reducing mortgage rates to as low as 2 percent for five years and extending loan terms to as long as 40 years.

HAMP has more than one million active borrowers, though fewer than 10 percent have obtained permanent loan modifications, according to a Treasury Department report released on March 12, 2010. The report said there were 1,003,902 active loan modifications through February and 168,708 of those have been made permanent. That was up from 946,735 active loan modifications and 116,297 permanent loan modifications through January. The Treasury Department said it still hopes to help three to four million homeowners by 2012 under HAMP. Of the six million borrowers currently 60 days delinquent on their loans, 1.8 million are eligible for HAMP, and the government expects that number to increase through 2012.

To receive a permanent HAMP loan modification, homeowners need to make three payments and provide proof of their income, plus a letter documenting their financial hardship. To date, about 90,000 borrowers have dropped out. Many more are at risk of losing the help, according to Treasury Department data.

Many of those borrowers did not turn in required documents to prove they qualified for the program, which typically lowers mortgage payments by more than \$500 a month. The most common documentation problems preventing trial modifications from converting to permanent include:

- Improperly or incompletely filling out forms, especially omitting required signatures;
- Including income from someone

who is not a borrower on the mortgage, whose contribution to the household income cannot be verified by the lender;

- Inadequately documenting hardships like death and divorce, or income like overtime or bonus pay;
- Discrepancies between income shown on tax returns and income claimed on financial forms; and
- A change in income between the time the trial modification was approved and the time it ended.

Some applicants earned too much under the government's formula, while others made too little and were unlikely to be able to keep up even with the lower payments.

While homeowners struggle to provide the proper paperwork, loan servicers have had their own difficulties. The Obama Administration was forced to loosen those guidelines as lenders struggled to collect all the required documents, including pay stubs and tax returns. The modification process is complex and, at times, can result in poor two-way communication and delays. About 500,000 have passed the required a three-month threshold without receiving a permanent loan modification.

Housing counselors complain that many homeowners are forced to wait many months for a decision. Those borrowers are in limbo while mortgage lenders review their applications to see whether they qualify for the government program or should be considered for other types of mortgage relief.

Subordinate Lien Traps

Many would-be short sellers have second and even third mortgages on their houses. In order for a short sale with two loans to happen, the second lien holder has to drop the lien. If they don't, and there is no short sale, the home goes into foreclosure and the first lien holder gets the house

because second liens are subordinated debt to the primary loan. In short, the second lien holder gets nothing. In order to get the second lien holder to drop the lien, the first lien holder may negotiate a partial payment to the second lien holder. The second lien holder does not have to agree, but some are doing so.

Banks that own these loans are in a position to block any sale unless they get a piece of the deal. These second lien mortgages theoretically are worth nothing in cases when a house's value is less than the amount owed on the first loan. But banks that hold the second liens want to be able to collect at least something from the homeowner.

Experts have observed in many short sale transactions that second-lien holders have stopped many deals from closing when they try to reserve the right to chase after the seller for the amount of debt not covered by the home sale proceeds. Subordinate lien holders can be the biggest obstacle to successful short sales.

Since many second lien holders are getting very little, some reportedly have been requesting money on the side from either real estate agents or the buyers in the short sale. Some second mortgage holders have been asking defaulted homeowners to come up with additional funds to increase the payoff on home equity loans to 6 percent of the unpaid principal. These payments are often paid in cash outside of the transaction and not shown on the HUD-1 settlement statements, so the first lien holder does not see it. If the first lender knows a second lien holder is being paid, the first lender will kill the short sale. So these second lenders are asking for the payments "under the table," usually in a cashiers check prior to closing. Once they receive that payment, they will allow the short sale to go through. This practice appears to be fraudulent and illegal in violation of the Real Estate Settlement Procedures Act (RESPA).

Private mortgage insurance (PMI) insurers may sometimes play a role in this dilemma. If second mortgage lenders have required PMI on their loans, then they have the opportunity to recover their total loss if they refuse to allow a short sale and the owner loses the home. Many lenders obtained PMI on their entire portfolios of loans, including their second mortgages, home equity lines of credit (HELOC) and downpayment substitute loans. They may not have charged the borrowers for the PMI as a separate fee and instead included it with other loan fees and costs. If the second lender has PMI they are not very motivated to take a small recovery to agree to a short sale if they might be able to recover 100 percent of the loan amount if the home goes into foreclosure and it files a claim with its PMI company.

Under HAFA, the government will offer up to 6 percent of what they are owed, subject to a cap of \$6,000 per home. Hopefully the lien holders will see this as an incentive for them to release their liens and waive any future claims against homeowners.

Some experts, however, worry that this will not be enough. Under the HAFA incentive system, a second lender owed \$50,000 could receive no more than \$3,000, which may not be enough to convince a second lender to agree to give up its right to obtain a deficiency judgment against the homeowner or to collect under a PMI policy.

When working in short sales where there are subordinate mortgages, REALTORS® should proceed with caution – some second mortgage holders may be willing to accept the HAFA payments but others may not.

Tax Treatment

The amount of debt forgiven in a short sale is treated as income for tax purposes. The federal tax code

generally treats any forgiveness of debt by a creditor in excess of \$600 as ordinary taxable income to the recipient. Lenders forgiving deficiency amounts must report that debt forgiveness to the Internal Revenue Service and to the homeowner on IRS Form 1099-C.

However, under the Mortgage Forgiveness Debt Relief Act of 2007, taxpayers may exclude from income certain debt forgiven or canceled on their principal residence – including debt forgiven on short sales, – through the end of 2012. The federal tax exclusion only applies to mortgage balances on a principal residence and not on second homes, rental real estate or business property. The maximum amount of forgiven debt eligible under the law is \$2 million for married taxpayers filing jointly and \$1 million for single filers.

This exclusion applies to the discharge of “qualified principal residence indebtedness,” or any debt (including refinanced debt) incurred in acquiring, constructing or substantially improving a principal residence and that is secured by the principal residence. If the proceeds were used for other personal purposes, such as to pay off credit card bills, buy cars or invest in stocks, the mortgage debt attributable to those expenditures is not eligible for this IRS exclusion. Homeowners who have had debt forgiven should consult a competent tax preparer to determine whether the forgiven debt will be tax-free and assist them with claiming the debt forgiveness exemption on IRS Form 982.

Visit www.irs.gov/individuals/article/0,,id=179414,00.html for more information from the IRS about the Mortgage Forgiveness Debt Relief Act of 2007. Also see IRS news release IR-2008-17, online at www.irs.gov/irs/article/0,,id=179073,00.html. The Act is also summarized on Page 15 of the July 2009 *Legal Update*, “Solving the Mysteries of Short Sales,” at www.wra.org/LU0907.

Credit Scores

Homeowners in distress are likely going to experience negative effects on their credit scores no matter what avenue of relief they take. The adverse effects can be generated by loan modifications, short sales, DILs and foreclosure.

Some homeowners who sign up for HAMP may be surprised to see they have lower credit scores. In HAMP, borrowers enter a trial period in which they make at least three payments and many find out that their credit scores drop during this trial phase. For homeowners who are having financial troubles but managing to pay their bills, the request for a loan modification is the first sign of difficulty and will result in a sharp drop in their credit scores. For borrowers who are making their payments on time but are on the verge of default, the loan modification program can reduce their credit scores as much as 100 points. If homeowners are accepted into HAMP and have their loans permanently modified, the lenders will update the credit bureaus. This new status neither hurts nor helps the owners' credit score and over time they can see their score increase.

Still, the impact is far less severe than with foreclosure, where borrowers typically find their credit is in tatters for years. For delinquent borrowers, the damage was done when they fell behind on their loans. Months of missed payments and the foreclosure itself drag the homeowner's credit score down anywhere from 175 – 300 points, and the foreclosure will remain on the person's credit report for 10 years.

In a short sale, the servicer generally will report to the credit reporting agencies that the mortgage was settled for less than full payment, which will hurt credit scores. Many experts report that when it comes to a person's credit score, there is no advantage to a short sale over

foreclosure. An owner's credit score will dip downward 200-300 points regardless of whether the owner sells in a short sale or has his or her home taken in a foreclosure sale. As far as the lenders and credit bureaus are concerned, the owner was unable to repay the debt and is being released from the mortgage obligation for less than what was owed. A consumer's FICO score will take a huge hit either way until responsible credit behavior overtakes the short sale or foreclosure over a period of time.

Others say that it is the late payments that affect the credit report, not necessarily the short sale itself. Situations where short sales have resulted in lesser impacts on credit scores than foreclosures (drop of only 100 points, for instance) have been reported by some observers, so the actual impact of a short sale on a homeowner's credit status is a bit unclear. It is safe to say that the impact of a short sale on an individual's credit score will depend upon the situation and the person's financial circumstances.

As for a DIL, the impact on credit scores is the same as for a foreclosure. Owners will take a hit of 200 to 300 points, depending on the overall condition of their credit.

In terms of how soon after a short sale an individual can buy a home again, the current rule is that you cannot obtain a federally insured loan (like FHA or VA, or a conventional loan backed by Fannie Mae or Freddie Mac) for two years following a short sale. Fannie Mae and Freddie Mac – with certain exceptions – will not lend again to someone who went through foreclosure for five years. It may be a bit challenging for a person to restore his or her financial status to qualify for a new mortgage within two years following a short sale, but at least the possibility of being able to buy another home will be there.

Appraisals or BPOs

HAEA permits the use of either appraisals or broker price opinions (BPOs) when valuing properties eligible for the HAEA short-sale incentive program. Lenders may use an appraisal performed in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP) to determine a property's list price and any permissible reductions, or one or more BPOs. Either way, the valuations must be dated within 120 days of the short sale agreement.

Several appraiser groups have objected to the use of BPOs, claiming that real estate agents and brokers are not independent or properly trained valuation specialists and that they have a "bias toward quick results and action, which produces a fee for themselves irrespective of whether the lender ... gets a fair return on the short sale." Appraisers want the Treasury Department to prohibit the use of BPOs for property-valuation requirements involving short sales, in order to "reestablish independence in the valuation process and guard against conflicts of interest in short sales."

A response from NAR recognizes the need for flexibility in any mortgage modification program and notes the importance of the appraisal for purchase money mortgage transactions. However, an appraisal may not be the best tool for other real estate transactions. BPOs are widely accepted in the real estate industry and there is no evidence that their use results in mortgage fraud. NAR also argues that there is no evidence to support the idea that appraisers are more or less likely to engage in mortgage fraud than real estate agents. In fact, all members of NAR must adhere to a strict code of ethics.

HAEA includes measures intended to thwart fraud. Properties must be publicized in a multiple listing service and marketed by the listing broker. The

HAEA short sale must be an arm's length transaction and the buyer cannot resell within 90 days of closing.

HAMP and HAEA Resources and Sample Forms

- Home Affordable Modification Program (HAMP) http://makinghomeaffordable.gov/modification_eligibility.html
- Home Affordable Foreclosure Alternatives (HAEA) Program: Overview www.hmpadmin.com/portal/programs/foreclosure_alternatives.html
- HAEA Short Sale Agreement: www.hmpadmin.com/portal/docs/hafa/hafaleters_ssagreement.doc
- HAEA Request for Approval of Short Sale: www.hmpadmin.com/portal/docs/hafa/hafaleters_ssaprovalreq.doc
- HAEA Alternate Request for Approval of Short Sale: www.hmpadmin.com/portal/docs/hafa/hafaleters_ssaltapproval.doc
- HAEA Deed in Lieu of Foreclosure Agreement: www.hmpadmin.com/portal/docs/hafa/hafaleters_dilageement.doc
- March 26, 2010 HAEA News Announcement: http://makinghomeaffordable.gov/pr_03262010.html
- HAMP and HAEA Program Enhancements (March 26, 2010): http://makinghomeaffordable.gov/docs/HAMP%20Improvements_Fact_%20Sheet_032510%20FINAL2.pdf

For additional HAEA information and resources, visit www.realtor.org/government_affairs/short_sales_hafa.

General Short Sale Resources

- March 2010 *Wisconsin Real Estate Magazine*, “Many Hats of Selling Short Sales”: <http://news.wra.org/story.asp?a=1275>
- March 2010 *Wisconsin Real Estate Magazine*, “Best of the Legal Hotline: Buyers, Sellers and Distressed Sales”: <http://news.wra.org/story.asp?a=1277>
- July 2009 *Legal Update*, “Solving the Mysteries of Short Sales”: www.wra.org/LU0907
- June 2009 *Wisconsin Real Estate Magazine*, “Short Sales and Title Insurance”: <http://news.wra.org/story.asp?a=1133>
- March 2009 *Legal Update*, “Working with Distressed Sales”: www.wra.org/LU0903
- March 2009 *Wisconsin Real Estate Magazine*, “Steps to Sell Short Sales”: <http://news.wra.org/story.asp?a=1072>
- March 2009 *Wisconsin Real Estate Magazine*, “Short Sale FAQ”: <http://news.wra.org/story.asp?a=1075>
- March 2009 *Wisconsin Real Estate Magazine*, “REALTOR Sales Tip: Short Sale Success”: <http://news.wra.org/story.asp?a=1073>
- January 2008 *Legal Update*, “Short Sales – A Risky Business”: www.wra.org/LU0801
- NAR The Basics: Short Sales: www.realtor.org/realtors/basics_short_sales

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