What Buyers & Sellers Need to Know About Short Sales & Distressed Property

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This brochure was prepared courtesy of the Georgia Association of REALTORS® to help buyers and sellers in Georgia learn more about Short Sale and Distressed Properties. The information herein is general in nature and is not intended to be exhaustive. Some of the information may not apply to specific properties. Buyers and Sellers are encouraged to consult with experts and professionals of their own choosing to ensure that they are protected.

Property owners who run into financial difficulties often try to sell their properties quickly in an effort to avoid foreclosure. In many cases, getting rid of a property under these circumstances will result in the owner losing money. This is because the need to sell a property quickly usually means that the owner does not have the luxury of waiting for the very best offer. Still, the finality of a sale can be a relief to the owner because of the certainty of knowing that a financial burden has been lifted. This is one reason why buyers looking for bargains in the real estate market will often seek out distressed sales. The buyers who find success in this area are usually the ones with an ability to close quickly. This brochure will answer some of the most commonly asked questions of buyers and sellers regarding distressed sales.

What is a short sale and why will some lenders take less than the full amount they are owed? The most common type of distressed sale of real estate is known as a short sale. This is where the amount owed on a mortgage is more than the property is worth and the lender allows the property to be sold (or sold short) for less than the outstanding mortgage balance. While this normally results in the lender losing money, lenders also typically lose money when they foreclose on a property. Therefore, in deciding whether or not to approve a short sale, or pursue the foreclosure of the property, instead, most lenders will evaluate which option, foreclosure or short sale, will likely result in their losing the least amount of money. As the value of properties has rebounded in many housing markets, more lenders are deciding that foreclosing on a property is the best way to minimize their financial losses.

Who typically is approved for a short sale? A property owner usually has to have a serious financial hardship for the lender to approve the short sale of the owner's property. The fact that the property has gone down in value is not in and of itself a hardship. Instead, the owner normally has to prove, to the lender's satisfaction, that he or she can no longer afford to pay the existing mortgage due to such things as job loss, divorce, serious illness or business failure. Even if the owner is experiencing a significant hardship, most lenders will only approve a short sale as part of a transaction where the seller has contracted to sell the property to a specific buyer on agreed upon terms and conditions. In this way, the lender can quantify its losses and compare them to what it would lose in the event the lender pursued the foreclosure of the property as an alternative.

What documents will the lender ask for in deciding whether to approve a short sale? While every lender has its own requirements, all lenders need a thorough understanding of the owner's financial position in deciding whether or not to approve a short sale. Therefore, lenders will typically request that the owner provide detailed evidence of the seller's financial inability to pay the mortgage, including copies of checking and savings account statements, two (2) years' tax returns, a financial worksheet, most recent mortgage statement, most recent paystubs, a hardship letter and other similar documents. Giving the lender most of what it needs will not work. Lenders will normally not process a request for a short sale until all of the required documents are provided to the lender. Most lenders now have a short sale department that is available to assist sellers with financial difficulties.

Are there other options besides a short sale that are available to a property owner? Property owners who are experiencing financial difficulties are encouraged to seek professional guidance from an attorney, accountant, financial advisor or other expert and this brochure should not be a substitute for seeking such advice. Speaking with the lender directly is another good way to determine what options the owner might have. For example, some lenders are willing to delay taking action to foreclose on the property as part of what is known as a forbearance agreement. Others may allow the owner to refinance the mortgage if the owner can demonstrate that he or she can afford the reduced monthly mortgage payment. Other lenders may suggest that the owner deed the property back to the lender in lieu of foreclosure. In other instances, bankruptcy may be an option for the owner. Keeping the lines of communication open with the lender and obtaining expert advice are the best ways for an owner to understand his or her rights and decide what course of action best suits his or her needs.

Will a distressed sale affect an owner's credit score? Any time the lender takes less than the full amount that is owed on a mortgage, either because of a foreclosure, short sale or otherwise, the owner should expect that his or her credit will be adversely affected for some number of years. The impact is usually less with a short sale than with a foreclosure but there are still negative consequences.

Are there tax ramifications to a short sale or other loan forgiveness? With few exceptions, if any portion of a mortgage loan is forgiven by the lender, the amount written off is treated as income to the borrower. So, for example, if a lender approves a short sale and writes off $50,000 on a mortgage loan, this amount is treated as income to the owner on which taxes will be owed. There was a federal law which gave tax relief to property owners who sold property in a short sale. This program, however, expired at the end of 2013. Other federal programs designed to help owners with mortgages they could no longer afford have similarly expired.

Can the lender approve a short sale but still pursue the owner for a deficiency? The answer to this question is yes. Some lenders will only approve a short sale if the owner signs a note promising to repay the amount of money that the lender is writing off. The approval of a short sale is no guarantee that the unpaid portion of the loan will be forgiven. Therefore, owners should try to enter into a written agreement with the lender confirming how any deficiency will be treated. An attorney can advise the owner on the legality of such an agreement.

Can the seller's agent negotiate the short sale on behalf of the owner? The answer to this question is no. Real estate licensees are not permitted to negotiate a short sale for a property owner under Georgia law. However, real estate licensees can help the owner in filling out the paperwork or in providing needed information to the lender so long as they charge no fee for doing this other than their normal real estate commission.

How long does it take to get a short sale approved? Even when the owner meets the lender's criteria for being approved for a short sale, it can still take months for the short sale to be approved. Therefore, when selling a property, the property owner and the buyer must both be patient while the approval of the short sale by the lender is being considered. Buying a short sale is usually not a good option for buyers who need to close by a particular date.

Can a relative buy the owner's house in a short sale? A distressed sale transaction must be an arms-length transaction. The seller and buyer must acknowledge that they are not related to one another and the property is being sold to a buyer who freely and fairly negotiated its purchase. At or before closing, the lender will typically require the seller and the seller's broker to sign an acknowledgment or affidavit that the transaction is arms-length.

Can the owner rent back the property that is being sold as a short sale from the new owner? The answer to this question will vary from lender to lender. Therefore, sellers should check with their lender to determine its policy on this issue. In the early days of the last severe economic downturn, most lenders would not permit the seller in a short sale to continue to reside in the property as a tenant after the property had been sold. However, some lenders have now changed their position on this issue in an effort to promote greater community stability.

Are special provisions usually included in a purchase and sale agreement to reflect that the property is being sold as a short sale? The answer to this question is yes. Most purchase and sale agreements on properties being sold as short sales will state that the agreement is subject to the agreement of the lender to take less than what is owed on the mortgage so that the amount paid by the buyer will be sufficient to clear title and pay the amounts needed to close the transaction, including the fees of the closing attorney and the commission of the real estate broker. This gives the lender almost complete discretion to either approve or disapprove the ultimate sale of the property. Buyers will often try to protect themselves against overly long delays by including a provision in the purchase and sale agreement that if the property is not approved for a short sale by a particular date, the buyer can terminate the contract. They will also sometimes set the closing date to be a certain number of days from the date that the short sale is approved by the lender. Some buyers of distressed properties try to delay paying for property inspections until after the short sale is approved. However, there is a greater likelihood that the short sale will be approved when there are no unfulfilled contingencies in the purchase and sale agreement and the buyer is ready to close.