

What Buyers Should Know About Short Sales

A San Francisco title company familiar with short sales estimates that only 20% of all accepted offers on short sale listings close escrow. Buyers who choose to make offers on short sales need to know that the likelihood of closing the escrow is not good and that if escrow closes the property may be in substantially different condition from when it was first viewed. This is important when buyers are expending money on inspections, appraisals, etc., or when buyers need to have occupancy by a certain date. Following is a brief description of the short sale process and a list of some of the pitfalls that can occur in a short sale.

- **What is a short sale?** A short sale occurs when a seller owes more on their home than it is worth. As an example:

	<u>Existing Financing</u>	<u>Negotiated Short Sale</u>
Current market value:	\$600,000	\$600,000
First loan:	-\$ 500,000	Reduced to -\$450,000
Second Loan	-\$ 150,000	Reduced to -\$110,000
Cost of sale (Commission, etc)	-\$ 40,000	<u>Commission -\$ 40,000</u>
Amount Due from Seller at Close of Escrow	(\$ 90,000)	-- 0 --

Since most sellers in this situation are unable or unwilling to bring money to the table at close of escrow the only way they can 'sell' the property is if the lenders agree to reduce the amounts owed them. In effect, the owners 'own' title to the home but the lenders have all the equity. The owners can only sign an offer to sell the home subject to the lenders agreeing to take less on their payoffs.

- **Lenders control the deal.** Lenders will only reduce the principal amount they are owed when they believe that there is no alternative. Sellers must show hardship and lenders must be convinced that the offers received represent maximum sales price for the property. Even when the lenders have agreed to reduce the loan balances they often reserve the right to 'change their mind' and occasionally they do at the last minute. Changes of this kind can result in the failure of the transaction to close or the buyers' having to bring additional funds to close the escrow.
- **Lenders move slowly.** Lenders do not move quickly on short sales and when there is more than one lender with a lien on the property then it is necessary to negotiate with each lender and for the lenders to cooperate with each other. It can take four or five months for a lender to approve a buyer's offer on a property in which the lender is agreeing to modify the principal balance of the loan. Often, even after the lender has approved an offer it will reserve the right to accept a better offer should one come in.
- **Short sale offers do not stop the foreclosure process.** If the seller has not been making payments on the loan, the lender has likely started foreclosure proceedings. Most lenders have different departments for negotiating short sales and for processing foreclosures and these departments do not necessarily communicate with one another. It is possible that a property may be foreclosed upon while a short sale is being negotiated and that the buyer may be unaware that the ownership of the property has changed. A purchase agreement for a short sale does not translate into a purchase agreement for a bank owned property and it is unlikely that the buyers will be able to purchase the property directly from the lender.
- **Short sales are "as is".** Most short sale purchases are 'as is'. Buyers are generally allowed to have inspections but lenders rarely make concessions for repairs or pay for required retrofit work or other costs of sale. These costs frequently must be borne by the purchaser.
- **Seller's liability may be limited by seller's ability to pay.** In a normal buyer/seller transaction if the seller does not comply with the contract the buyer can pursue the seller for damages. Because the seller in a short sale is not receiving any proceeds from the sale and usually has no other assets there is little a buyer can do to ensure the seller's compliance with the contract as the seller may be "judgment-proof". There is no way to guarantee that the seller will convey the property in the condition in which the buyer viewed it. Frequently all appliances and fixtures and even sometimes the copper plumbing are removed from the property; sometimes the interior has been trashed. The seller may have rented the property to tenants while in escrow and kept the rent and security deposit, leaving the buyer with a tenant occupied property. Sometimes the seller refuses to move after close of escrow and claims occupancy rights as a tenant. Sometimes the seller decides that it is in his best interest to allow the property to go to foreclosure and refuses to sign the closing papers, essentially killing the deal. Additionally, while the seller is required to fill out the Transfer Disclosure Statement in a short sale transaction, it is important to understand that a buyer has little redress against a seller who has made inaccurate or incomplete disclosures.

Foreclosure: Terms & Processes

Type	Description
Short Sale	When there are not enough proceeds to close escrow per the contract terms.
REO – Real Estate Owned	The foreclosure process is completed and the property is Real Estate Owned (REO) generally by the lender. Sold as per normal real estate transaction with some disclosure exceptions.
Notice of Default (NOD)	Letter sent to party as reminder loan has not been paid; may include a grace period and penalties for failing to cure the default. Lien holder may file a Notice of Default (NOD) against the property. Timing is days 1-90.
Notice of Sale (NOS)	The next 30 days after the NOD. Days 91-120.
SD – Sale Day	Day 121. When the property is “SOLD” or auctioned on the “Steps of City Hall”.
Redemption Period	Right of mortgagor to property by paying debt before sale at foreclosure; right of owner to reclaim property after its foreclosure sale to settle claims for unpaid taxes. Generally up to 5 days before the sale date by bringing loan current plus all charges for owner occupied 1-4 dwellings. Up to 90th day on other property.
Civil Code Section §1695	Civil Code Section §1695 mandates various duties of the Buyer and Seller. Note: Seller gets 5 days notice and can rescind accepted offer within this period. Example – “within 5 days after acceptance”. Must be in state mandated form. Civil Code Section §1695 is used when it cannot be ascertained whether the property is to be owner occupied or not. Use the CAR contract form “Notice of Default Purchase Agreement” (NODPA). This form includes the “Declaration and Proof of Real Estate License” as well as the notice required by Civil Code Section §1695 (page 11 of NODPA – rev. 4/08). Civil Code Section §1695 is issued on any property where a Notice of Default (NOD) has been filed including short sales. An equity purchaser (person who acquires title to any residence in foreclosure) is exempted from Civil Code Section §1695 if the property is to be a personal residence. Zephyr highly recommends Civil Code Section §1695 be used in all transactions whether exceptions apply or not when a property has a filed Notice of Default (NOD).

Issues in the foreclosures process:

1. How does a commission get paid?
2. How do the Buyers get financing?
3. Do I get a full title policy?
4. How do we get fire/liability insurance?
5. How and/or can we do an inspection?
6. How do we get the owner and/or tenant(s) out?
7. How do I get the security deposits for the tenant?
8. Are leases valid?
9. Why in the heck did I every think about doing foreclosures???