Short Sales - Seller Advisory

Recent economic challenges have resulted in many homeowners needing to sell their home but owing more on their home than the home is worth. The information below is intended to provide information to sellers in that situation. Information is from the Washington Department of Financial Institutions and the Washington Department of Licensing.

On this page:

What is a short sale?

A short sale is a real estate transaction in which the sales price is insufficient to pay the debt(s) and obligations encumbering the property along with the costs of sale, and the seller is unable to pay the difference.

Every short sale is dependent upon the seller's lender(s) consenting to the transaction and agreeing to release the lender's security interest in exchange for less than what is owed. In some cases however, the lender's approval of a short sale does not necessarily mean the lender relieves the seller of liability for repayment of the entire debt.

It is possible the seller can sell the home and still owe the unpaid difference, plus interest and penalties, to the lender (the "deficiency"). The lender may then seek a deficiency judgment against the seller for this difference. If the judgment is issued by a court, it could be in effect for up to 20 years if not paid sooner. This is one of the most fundamental issues that sellers must address in considering whether to sell property as a short sale.

Simply "walking away" from the property through foreclosure also does not necessarily relieve a seller of these debts as while Washington State is a "non-deficiency" state that only pertains to the foreclosing party. A homeowner could lose their property to foreclosure generally to the 1st mortgage lien holder and still owe the balance(s) from the 2nd mortgage or other lien holders.

A short sale is a very complex transaction that involves numerous issues as well as legal and financial risks. All sellers are advised to seek the advice of a lawyer and tax professional before proceeding with a short sale.

Before proceeding with a short sale

- Understand a lender's creditors options upon loan default
  There are many types of liens and other obligations that are secured by real estate. These may be purchase loans, refinance loans, home equity lines of credit, contractor liens, IRS tax liens, DSHS liens for unpaid child support, or other obligations. The type of debt and type of property will determine what remedies a lender may have if you fail to make the required payments. The lender's policies regarding forgiveness of debt, the tax consequences, your overall current or potential future financial strength, the lender's willingness and procedure for processing a short sale request, and the number and nature of other recorded encumbrances (second mortgages for example) on the property are some of the many factors a seller should consider in deciding whether to pursue a short sale.

- Be aware of predatory rescue scams and short sale fraud
  Homeowners worried about foreclosure may be susceptible to predatory "rescue" scams which may cost money with no results, result in the loss of the home entirely, or involve the seller in a fraudulent scheme. For more information, see this advisory from Fannie Mae (PDF)*.

  Red flags of fraudulent schemes include:

  - Guarantees to stop the foreclosure
  - A promise that you can buy the house back or stay in the house following transfer of title
  - Upfront fees
  - Instructions not to contact the lender
  - Transfer of title or lease of the property
  - Requests that the homeowner execute a power of attorney

  Report suspected scams to the Department of Financial Institutions at: www.dfi.wa.gov or 1-877-RINGDFI (746-4334).

- Contact a free HUD-approved housing counselor or contact your lender directly
  Contact a HUD-approved housing counseling agency online at portal.hud.gov/portal/page/portal/HUD/i_want_to/talk_to_a_housing_counselor or call (800) 569-4287 or TDD (800) 877-8339 for advice on your options.

For additional HUD resources visit
portal.hud.gov/portal/page/portal/HUD/topics/avoiding_foreclosure

You may also contact the Neighborhood Assistance Corporation of America at: www.naca.com/refinance/refinanceTenStep.jsp

Try contacting the lender directly. To find the lender's contact information, check the loan billing statement, or coupon book. Ask for the lender's home retention department, loss mitigation department, (or other department that handles negotiation of loans in default); explain the situation and find out if the lender is willing to discuss options.

- Utilize free services available to Washington residents
  Non profit foreclosure counseling is available by calling: 1-877-894-HOME (4663). If legal advice is needed, callers will be referred to a pro bono attorney through the Washington State Bar Association. More help and resources are available at www.WAHomeowners.com.
- Obtain legal advice
  An attorney can advise you about your options and legal liability. You may be able to receive free or reduced fee legal assistance from one of these sources:

  Northwest Justice Project, www.nwjustice.org, (206) 464-1519 or 1-888-201-1012

  Your county's local Bar Association
- Obtain tax advice
  For Mortgage Forgiveness Debt Relief Act and Debt Cancellation tax information, go to www.irs.gov/individuals/article/0,,id=179414,00.html
- Be aware of the consequences of committing waste
  Damaging the property or removing fixtures such as sinks, toilets, cabinets, air conditioners, and water heaters may result in liability to the lender for "waste." In other words, the lender may be able to sue you for damages if you have physically abused, damaged or destroyed any part of the property.

Short sale considerations

- First, understand that a short sale may not discharge the debt. You should know whether you will still owe your lender money (a deficiency) after the short sale. You should know this before you close the sale of your home.
  Even if a lender agrees to a short sale, the lender and any junior lien holders may not agree to forgive the debt entirely and may require you to pay the difference as a personal obligation. This outstanding personal obligation could result in a subsequent collection action against you. For example, a lender may accept the short sale purchase price to "release the lien" on the property but still require you to pay the full amount of the original debt. You

must be certain of the terms of any short sale before making a decision. All agreements between you and the lender must be in writing. Consult an attorney regarding whether the lender is entitled to pursue collection of any deficiency. Obtain any debt forgiveness agreements with the lender in writing but be aware that the language used in these agreements can be extremely confusing and even misleading. Seek the advice of legal counsel before accepting the lender's terms.

- Second, under that a short sale may result in a higher tax debt
  A short sale in which the debt is forgiven is considered a relief of debt and may be treated as income for tax purposes. The Mortgage Forgiveness Debt Relief Act of 2007 created a limited exemption to allow homeowners to pay no taxes on debt forgiveness; however, only cancelled debt used to buy, build or improve a principal residence or refinance debt incurred for those purposes qualifies for this tax exemption. For more information on the tax consequences of debt relief, seek professional tax advice and go to www.irs.gov and conduct a search regarding the Tax Relief Act.

  If you decide to pursue a short sale, understand that the process will likely take several months or more to complete. Consider taking the following actions.

- Contact a qualified real estate professional
  Interview several real estate professionals and ask about their experience in short sales, the number of short sale transactions they have handled, their education and training in short sales and inquire about any past or pending lawsuits or disciplinary actions.

- Investigate documentation and eligibility
  Documentation and eligibility criteria for short sales vary depending on specific lender and investor guidelines. Generally, you must prove that you are financially incapable of paying the loan. The lender will consider this when determining the costs of accepting the short sale versus foreclosing. You will have to document your financial situation. If you have funds to pay the deficiency, a lender will not necessarily allow a short sale. However, some lenders will not require you to dip into retirement accounts to fund the deficiency. These issues will have to be negotiated with your lender.

- Determine the amount owed on the property
  All debt and costs must be factored in before a lender can determine whether a short sale is more economical for them. The analysis will include the delinquent loan, all other recorded debt (past due homeowner's association fees, unpaid property taxes), and the costs of a sale (closing costs, brokerage commissions, and necessary repairs). If you have more than one loan on the property, a short sale will require the approval of all lenders.

- Determine the estimated Fair Market Value of the property
  You must prove to the lender that the home is worth less than the unpaid loan balance plus closing costs. Consult a real estate professional or an appraiser for assistance in estimating the value of the property.

- **Consult legal counsel**
  Legal counsel can help you determine whether a short sale is the best option and can advise you during the short sale process. A short sale is a complex transaction.
- **Be aware of the impact on your credit score**
  The impact of a short sale on your credit score depends upon a variety of factors, including late or missed payments. A short sale may appear on your credit report as “pre-foreclosure redemption,” “paid in full for less than full balance” or other similar term. It is possible that a short sale will have a different impact on your credit than a foreclosure or deed in lieu of foreclosure (or any other outcome). But, beware that once you miss mortgage payments, your credit rating will be severely impacted. Some lenders will tell you that they will not consider you as a short sale candidate unless you are behind on payments. Do not intentionally withhold mortgage payments, solely for short sale consideration, without first consulting legal counsel.
- **Understand there may be a waiting period before you can buy another home**
  Your ability to qualify for a loan to purchase another home after a short sale will likely be impacted because of the impact on your credit score. It may be some time before a lender will loan you the money to purchase another home.
- **Home Affordable Foreclosure Alternative (HAFA) program**
  The HAFA program was designed to give homeowners alternatives to a foreclosure, which include incentives for completing a short sale. If your home sale can close as a HAFA transaction, you will emerge owing no deficiency. However, it can be very difficult to qualify as a HAFA transaction. For more information on the options available, visit the HAFA program website www.makinghomeaffordable.gov/hafa.html.

  To find the option for which you may be eligible. See www.makinghomeaffordable.gov/eligibility.html.

  To find out if your mortgage servicer participates in the HAFA program go to www.makinghomeaffordable.gov/get-assistance/contact-mortgage/Pages/default.aspx.

  For more information, visit: the Washington Department of Financial Institutions website: www.dfi.wa.gov.

Options other than short sale

A short sale may not be your best course of action. Consider all your options before making a decision.

- **Loan workout**
  Reinstatement: Paying the total amount owed by a specific date in exchange for the lender agreeing not to foreclose.

  Forbearance: An agreement to reduce or suspend payments for a short period of time.

Repayment Plan: An agreement to resume making monthly payments with a portion of the past due payments each month until they are caught up.

Claim Advance/Partial Claim: If the loan is insured, a homeowner may qualify for an interest-free loan from the mortgage guarantor to bring the account current.

- Loan modification
  The lender may agree to change the terms of the original loan to make the payments more affordable. For example, missed payments can be added to the existing loan balance, the interest rate may be modified or the loan term extended. Lenders may use government program modifications or may use their own criteria. Loan modifications may be temporary or permanent. Loan modification resources include:

  Making Home Affordable: www.makinghomeaffordable.gov

  National Foreclosure Mitigation Counseling Program: www.findaforeclosurecounselor.org/network/home.asp

  Homeownership Preservation Foundation: www.995hope.org or 1-888-995-HOPE
- Refinance
  If the lender will not agree to a loan workout or modification, the homeowner may be able to refinance the loan with another lender. The HOPE for Homeowners program will refinance mortgages for homeowners that can afford a new loan insured by HUD's Federal Housing Administration. More information about HUD's refinance program.
- Deed-in-lieu of foreclosure
  The lender may allow a homeowner to “give back” the property. This option may not be available if there are other liens recorded against the property. If a lender accepts title to property in Washington State through a deed in lieu of foreclosure, the owner’s debt owing to that lender is likely forgiven but sellers should have their paperwork reviewed by legal counsel to insure that outcome.
- Work out sale
  The lender may allow a specific amount of time for the home to be sold and the loan to be paid off. The lender may also allow a buyer to assume the loan as a method to purchase the property even if the original loan was non-assumable.
- Bankruptcy
  If you are considering bankruptcy as an option, consult with an attorney that specializes in bankruptcy law.
- Foreclosure
  Allowing the lender to foreclose is another option. With a foreclosure, the foreclosing lender may be prohibited from seeking any additional payment from you. However, other creditors with debt secured by the real property may still be able to claim the amounts owing to them. There are other pros and cons to allowing

foreclosure.

Ultimately, only you and an attorney can decide if foreclosure is the best option for you. Ask an attorney about the possibility of owing money to any of your creditors after foreclosure, the impact on your credit rating, and tax consequences. Also, seek professional tax advice about the tax consequences of a foreclosure and review the IRS information at www.irs.gov.

* This document is a PDF file, and you will need Adobe Acrobat Reader to view it. If you don't already have Acrobat Reader installed on your computer, you may download it for free from Adobe.

[Top]

Page updated 03/29/2011