Latest Trends In Short Sales

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Over the last several months, there have been a number of trends emerging in the short sale world. Most borrowers who engage in loss mitigation are doing so for one main goal: to eliminate deficiency liability and mitigate damages. The deficiency liability is the difference between the amount of the outstanding mortgage balance as of the date of the sale (including all associated court costs and attorneys fees) minus the net closing proceeds from the sale (contract price minus the commissions and closing costs).

As such, a short sale is typically the fastest and most effective approach to accomplish a mortgage workout on the deficiency and to mitigate damages. Many individuals ask why that is the case. The basic principle is that the lender is receiving cash from a buyer today rather than taking back the property themselves avoiding additional carry costs, fees and other expenses while having the ability to engage in negotiations on the deficiency balance with the borrower/seller during the short sale process. This approach is far less costly for the banks and the borrowers and allows the property to go to a buyer and not sit in the Bank's inventory as an REO for months on end.

While there are a number of current trends in short sales, some of them are particular important for borrowers. One of those trends is that lenders have become far more particular on the contract price. In previous months, the lender's range of the acceptable contract price was wider and the lender was far more likely to review a comparative market analysis from the seller's agent for a value dispute. However, the attitude of the banks now are that the prices are on the rise and that they don't have to accept this lower contract price today as they could potentially net more in a year. The fact that the lenders believe that the market prices are growing is positive and inspiring news; however, it appears that the prices they are setting for these properties are more inflated than true current values. Unfortunately, this inflation on the price is to the detriment of all parties; the seller cannot liquidate the property, the buyer is rejected, and the bank is faced with foreclosing on the property, creating yet again a negative cycle.

Another, more positive trend in short sales are that some lenders are willing to forego the traditional "arms length" requirements are previously implemented. Some lenders only require a net amount at closing and regardless of whether the borrower is affiliated with the buyer themselves (a member of an LLC, for example) and establishing that certain lender, the lender doesn't care who buys the property. This has become an approach that many borrowers are now taking advantage of in residential properties as this was an approach previously taken by many lenders only on commercial loans.

Lastly and most importantly, more borrowers are engaging in short sales as a viable loan default workout scenario, or, at the very least, should be engaging in short sales format. If the borrower is upside on their primary residence (negative equity) and has been declined for modifications time after time, the best and most effective method would be to pursue a short sale before the end of 2012 to take advantage of the Mortgage Debt Forgiveness Relief Act. This Act, in short, states that if the borrower is relieved of debt liability (deficiency liability) on their primary residence before the end of 2012, the borrower does not have to pay income tax on the forgiven debt. This forgiven debt is "phantom income" to the borrower and can be an extremely negative effect in that the borrower now owes a substantial amount of money to the IRS. The Act, which is currently under review for extension until the end of 2013, currently prevents the borrower (if the property is the primary residence for two (2) of the past five (5) years) from being penalized with income tax for "phantom income" or a waiver of deficiency.

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