Short Sales: a Passing Trend or Superior Solution?

By Mark Powell

Over the past six months, some REO brokerages are noticing a decline in REO listings while seeing the number of short sale listings grow. Some areas of the country have exhibited this trend more than others. Fitch Ratings, a global economic rating agency headquartered in New York and London, determined that 50.0 percent of all short sales are in California, and about 8.0 percent in Florida and 7.0 percent in Arizona. Fitch expects the number of short sales to grow as the Obama administration adopts rules to cater to short sales. In fact, government encouragement is one of the most important factors driving the shift from REO sales to short sales. Government-backed programs that are encouraging borrowers to pursue alternatives to foreclosure include the Home Affordable Modification Program (HAMP) and the more recent Home Affordable Foreclosure Alternatives Program (HAFA)[1]. HAFA particularly is expected to boost short sale volumes by making the process more appealing: it standardizes processes and documents, provides financial incentives for both the borrower (monetary relocation assistance), as well as first and subordinate lien holders. Other important benefits of HAMP are the requirement that the borrower is released from further liability from the primary lender, and that the program provides standardized guidelines designed to result in short sale transactions taking a much shorter time. Another reason for the growing popularity of short sales is the spreading of the understanding of what a short sales is, as both homeowners, seeking an alternative to foreclosure, and agents, seeking to help distressed property owners while growing their businesses, spread the word; several years ago the term 'short sale' was a relatively unknown term. Although short sales have undoubtedly increased, and appear to be gaining steam and support in more and more parts of the country, it is unforeseeable whether they will be sustained in the long term as a preferred method of liquidating distressed properties. A June 22, 2010 article written by Jim Puzzanghera in the *Los Angeles Times* indicated that "more borrowers dropped out of the Obama administration's foreclosure prevention program last month than were added." Nevertheless short sales are an increasingly prevalent alternative to foreclosures and appear to be replacing REOs for the moment.

Undoubtedly if you are reading this magazine you are familiar with short sales, so I won't go into many details here, but I will discuss some of the advantages and challenges associated with these transactions. All of the parties involved in a short sale may be seen to be benefited by the sale, at least from certain perspectives. The biggest advantages to the buyer, compared with the results of foreclosure, are the potential for less negative credit impact as well as some control over timing of the sale. Advantages to the lender may be the avoidance of costs associated with foreclosure proceedings, evictions, property maintenance, and marketing. Short sales also have challenges. Gaining approval for a sale from a lender makes for a heap of paperwork. The more lenders with a security interest in the property, the greater the challenge. The borrower (seller) also needs to qualify for a short sale; the requirements vary among lenders, but insolvency and hardship are universal criteria. The transaction length of short sales, which can take 10 months or more from contract to close, can discourage potential buyers and make it difficult for them to lock a rate on a loan. The advantages and challenges of short sales to the buyers, borrowers, and lenders are unique; next let us examine what this means for real estate agents.

continued on page 34

Agents who, during the last several years, have developed a significant portion of their business driven by bank-owned listings may notice a decline in property assignments, partially due to reasons discussed earlier. The more short sales that close successfully, the fewer distressed properties make it to the bank's asset managers for eviction and REO sales. The good news is nearly all short sellers use an agent to market and sell their home. Those agents who choose to shift their work models to capture business from short sales are becoming aware of differences in short sales versus REO transactions. The listing relationship is no longer just between agent and lender, but is now a model in which the agent's clients are individuals – although there is still institutional involvement because lender approval is a requirement for a successful short sale. One implication of the client shift from bank to borrower is that distressed listings are now captured in the same way as traditional listings – marketing. Short sales, unlike REOs, are not directly appointed by bank to the agent, but are instead initiated by the borrower. Marketing to borrowers in various stages of default has been growing in popularity as agents scour public records and title searches for potential clients that may not be aware of foreclosure alternatives or need assistance doing one.

Several businesses are evolving along with the growth of short sales. There has been a development of 'short sale negotiators' who, for a fee, handle the coordination of the short sale, including the paperwork, and lender communication and approval which can take a large burden off of an agent who is balancing multiple short sales. Typically these negotiators are licensed real estate professionals, although sometimes they are not. While extremely helpful in most cases, agents ought to examine the implications and potential liabilities when considering the third party appointment of a short sale negotiator, and make sure to choose a licensed and experienced one. Because it is the agent, not the client (borrower) who appoints these negotiators, there may be liability issues that the agent may be responsible for, should the negotiator make an error. These liability issues need be examined before appointing a short sale negotiator, and there are some disclosures/hold harmless agreements which can help shield the seller's agent from liability. It is also advisable to have your client fully aware of the short sale negotiator's role in the transaction. Similar to short sale negotiators are teams of lawyers who specialize in loss mitigation transactions and will coordinate the transaction, also for a fee. The same diligence should be given to choosing a loss mitigation team as when choosing short sale negotiator. Another business increasing with short sale growth is the various short sale certification programs, training and online platforms that are popping up everywhere. Like the REO market, the short sale market can seem like a pay-to-play arena, where myriad of businesses are soliciting payments for membership, certifications or other benefits which supposedly lead to business capturing, either directly through a platform, or indirectly through certification and training. Short sale knowledge is very important with short sales due to their complexity and the infinite variations that can occur with each particular situation surrounding a short sale. It is up to an agent to decide whether to pay for a short sale training program, or to search the internet for free information. Online platforms, which require a payment in return for membership in a database available to members of the public seeking qualified short sale agents, are another popular peripheral short-sale business. Agents would be wise, before paying, to get the big picture of these platforms and attempt to find out how and if the public will utilize them. Ask questions! Is the platform being directly marketed to financially distressed borrowers? Is anyone actually using these platforms to find an agent? Can you confirm agents are receiving leads? Does this platform have any partnerships or associations with lead-generating entities such as loan servicers or lenders themselves? When paying for certification, training or platforms, an agent would be wise to do some research by asking other agents, reading online real estate forums, and asking for referrals to gain the best representation of that entity. Is it worth it to join? While some of these business that require payments are still setting up their businesses while collecting member dues, others are a legitimate source of lead generation – it is up to the agent to sort the good from the bad.

Although short sales have undoubtedly grown in volume recently, it is uncertain whether, even with government encouragement, they will continue to crowd-out REO sales. One hurdle is the short sale qualification – those that do not meet lenders' short sale criteria may face foreclosure. Lenders may even tighten qualification standards if they find that short sales are an inferior method of liquidating properties with defaulting loans. Alternatively, borrowers may lack the desire to initiate the short sale or just not care to explore alternatives to foreclosure. My personal outlook is that REOs will steadily start to increase as the number of non-performing home loans grow and banks seek to remove bad debt from their financial statements. The real estate market remains fraught with uncertainty – it is important to stay abreast of the current market trends and remember that your outlook is as good as mine!

(Endnotes)

1 To learn more about the HAMP and HAFA programs, go to *www.MakingHomeAffordable.gov*

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