Real Estate Advisor

Short sale, foreclosure, bank owned? What does it all mean?

With all the media coverage on bank owned, foreclosed and short sale homes, real estate can seem like a scary business. But what exactly do all those varying degrees of scary mean? Each type of property sale and transfer of ownership is based on different circumstances and means different things for the lender, the seller and the buyer.

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The short sale of a property is intended to prevent foreclosure and bank ownership in the first place. A short sale occurs because the amount the owner owes on the house outweighs the house's value. This can happen for several reasons. If the owner has defaulted on the loan and can no longer make payments, he may wish to make a short sale to avoid foreclosure. Sometimes short sales occur even though the owner is current on his payments; if the home has decreased in value, he may still owe more for the home than it's currently worth. The owner has to work with the lender, and the lender must approve the short sale, because it's the lender who will be losing money. Sometimes, lenders will negotiate to reduce the amount owed or make concessions. Other times, they will hold the owner responsible regardless.

Short sales are often priced lower than comparable sales, and buyers look to short sales for good deals. However, short sales can take months to close, because offers are all contingent on lender approval, not just seller approval. For this same reason, many short sales never close at all, because lenders want to lose the least money possible. Sometimes short sales allow lenders to lose less money than a foreclosure, however, because of the fees associated with foreclosure. Short sales are favorable to borrowers because they don't impact credit scores in the same way foreclosures do, and although they take months to close, they are usually faster and cheaper than foreclosures.

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Foreclosures, on the other hand, occur when owners have defaulted on the loan by missing multiple payments. This can happen for many reasons, such as loss of employment, large debts or simply having too many expenses. To compound the problem, the owners typically also fail to reinstate the loan by bringing payments current. Finally, owners neglect to work with the lender to negotiate options, such as a short sale. The bank usually sets the date of foreclosure about three months after it records the default of the loan, or the amount of time specified in the mortgage documents. This is also the date that the bank can legally evict the owner. The bank publishes the notice of the foreclosure auction. Five days before the auction, the owner can no longer reinstate the loan. If the house is sold to a bidder at the foreclosure auction, the bidder can have the owner evicted within 24 hours.

If the house does not sell at the auction, the property becomes bank owned. At this point, the bank will list and show the house just like the owner would have had he been the one to sell it. The bank can choose either to evict the owner or to allow him to continue living there until the house does sell. Because banks only need to collect the remaining debt, the prices of such property can be very low; however, this is not always the case, since some owners actually owe more than the property value itself.

Short sales, foreclosures, and bank-owned homes all cause homeowners to lose ownership of their homes and take a hit on their credit scores. Do the smart thing and avoid the mess by staying current on mortgage payments. While some of the above are better than others, none of them are positive for homeowners.

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