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Expert Analysis

The secret of the short sale

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The practice of real estate law has undergone major changes since the housing bubble finally burst between 2007 and 2008. Once a rarity, the short sale has become an integral part of a real estate attorney's practice.

Unfortunately, belying its name, the short sale is anything but "short." The process of obtaining approval for a short sale from one or more lenders is a time-consuming and often stressful proposition. Not many attorneys are familiar with short sales, and the field can be a lucrative addition to the practice of real estate law.

A real estate short sale occurs when the outstanding liens on a property are greater than the proceeds from the sale of the property. In plain language, this means that the lender is asked to accept less than it is owed after payment of any closing costs traditionally paid by the seller, such as real estate commissions, transfer tax and attorney fees.

This commentary outlines the actual procedures involved in a typical short sale, discuss how to avoid its pitfalls and point out what sellers' attorneys need to do to keep the transaction moving. It also highlights some of the questionable practices involved in this area of law. Recognizing deception and outright fraud in these transactions will save many hours of frustration and avoid work without compensation.

PREPARING FOR THE SHORT SALE

All property listed for sale, when there will be a deficiency in proceeds, must include a statement in the listing that the sale is "contingent upon lender approval," also known as "third-party approval" or "short-sale approval." Sometimes the seller does not disclose this to the real estate agent. If there is no agent and the attorney is preparing the contract, it is imperative that before the contract is drawn up, the attorney ascertain whether the seller has enough equity in the property to close without lender approval.

More than 60 percent of failed short-sale transactions are a result of the lender's delay in approving the transaction, causing the buyer to walk away from the property. It is therefore crucial that the seller's attorney take control of this transaction from day one, so the buyer will not have an excuse to cancel after an enormous amount of



work has been invested in the file and the exhaustive process of lender approval has been completed.

The following is a step-by-step guide demonstrating how to achieve success:

1. Before submitting the short-sale package to the lender, the seller's attorney must ensure that the buyer has all inspections completed. These inspections should be completed within 10 to 14 days after the contracts are fully approved, just like in any other real estate transaction. Since the seller is not in a financial position to make repairs or issue credits to the buyer, addressing inspection issues before submitting the short-sale package to the lender allows the attorney to renegotiate the price to take repair costs into account. For example, a contract price of \$450,000, after determining \$10,000 in repairs are needed to the property, can be renegotiated to \$440,000. Once that is done, the revised contract will be submitted to the lender for \$440,000, and the repair issues will be resolved before securing lender approval. One of the worst scenarios an attorney can encounter is to obtain short-sale approval (after several months of work on the attorney's part) and allow the buyer to do inspections afterward, only to have the buyer then demand a "credit" of \$20,000 to be deducted from the price. It is extremely difficult to convince the lender to reduce the "short payoff" amount it will receive after it has already given the attorney an approval for a certain number. The time for inspections must be *before* the package is submitted.
2. The seller's attorney should request a deposit from the buyer that is substantial enough to ensure that the buyer is invested in the contract. If there is enough money at stake, the buyer will be less likely to let the property go. I have seen short-sale contracts where the initial deposit of \$1,000 is the only money held in trust. Most buyers are willing to forfeit that amount and move on to their next "bargain" while the attorney has spent months of work without a payday.
3. The contract should allow the seller to obtain lender approval in no less than 60 to 90 days from conclusion of attorney review before the buyer can terminate the transaction.
4. The seller's attorney must have a written mortgage preapproval from a lender in hand for the buyer during contract review. If it is a cash purchase, proof of funds must be provided.
5. The attorney should confirm that both real estate agents and the buyer's attorney are familiar with short-sale procedures and have an understanding of the work that goes into negotiating this type of transaction. If they have no experience with short sales, the attorney will need to point out the realistic time frame to obtain lender approval and emphasize that the buyer must be patient.
6. Once the seller is close to obtaining short-sale approval from the lender(s), all parties should be informed so that the buyer's attorney is on notice that the buyer needs to obtain a firm mortgage commitment. Short-sale approvals are good for a fixed amount of time, and if an extension is needed, the lender may assess a fee and/or a per diem after the expiration date. If the buyer delays the closing, the buyer should be responsible for any extension costs.

THE SHORT-SALE PROCEDURE

Some lenders have their own printed forms for the “short-sale package” that the seller’s attorney will be submitting. The attorney can call each lender’s loss mitigation department and ask if there are particular documents it wants him or her to use or if a generic package is acceptable. (See Document Section A, P. 25, for the short-sale seller questionnaire). My firm uses this form to get information before it starts the process with the lender.

The following items and documents need to be sent to the lender to begin the short-sale negotiation process:

- Fully executed contract of sale.
- Copy of client’s most recent mortgage statement(s). This must have name, phone number and loan number.
- Real estate agent’s listing agreement.
- Authorization form to be signed by the homeowner (see Document Section A, P. 27).
- Most recent collection letters the client has received from the lender(s), including a copy of the foreclosure complaint, if applicable. The attorney’s fee for the short sale fee does *not* include representing the seller in the foreclosure action.
- Financial statement to be completed and signed (see Document Section A, P. 28).
- Hardship letter signed by the home-owner (see Document Section A, P. 29).
- Last two years’ tax returns for all parties on the mortgage. If the tax return has not been filed for the current year, a copy of the Internal Revenue Service extension form should be included.
- Two months of the most current bank statements. All pages must be included.
- Pay stubs from the previous month. If the seller is self-employed, provide a year-to-date profit-and-loss statement.
- Copy of the buyer’s mortgage preapproval letter from the buyer’s mortgage broker or lending institution. If this is a cash transaction, proof of funds must be submitted.
- List of repairs required (see sample list in Document Section A, P. 30). This emphasizes that the value of the home has been further reduced by repairs or replacements needed.
- Proposed HUD-1 settlement statement with all closing costs shown, including a proposed payoff amount to the lender(s) (see sample in Document Section A, P. 31). The bottom line on page 1 of the HUD-1 should have a “zero” balance.
- Real estate agent’s comparable sales information. This is not required, but helpful if it is available.

If the package sent to the lender is incomplete, it will cause a delay in the processing of the short sale. If the seller has more than one mortgage, as is often the case,

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the package must also be forwarded to the second lien holder (this is usually a home equity line of credit). It takes about 10 days for the lender to get the package "into the system."

The first contact the seller's attorney has is usually with the "loss mitigation department." This department will process the package and contact the attorney if it needs other items. More often than not, the department will need additional information, and there will be occasions that require the attorney to re-send a short-sale package.

Contact with the lender is almost always through e-mail and faxes, as it is extremely time-consuming and aggravating trying to reach the proper person by telephone. The short-sale package will be passed along to several people at the lender's offices until it finally reaches the seller's attorney's "negotiator."

It is at this point in time that the attorney will be contacted to schedule a "broker price opinion" on the property. The BPO is typically a cursory inspection of the property by a real estate agent hired by the lender to give an opinion as to the market value of the property. The agent is paid a minimal amount of money (usually about \$75 to \$100), and therefore the BPO is rarely comprehensive.

More often than not, the BPO will come in close to the contract price unless there is an unrealistic offer on the property. The seller's attorney will not receive a copy of the BPO from the lender. The attorney has the option to challenge a BPO by having a licensed appraiser do a full appraisal. The seller should be advised that this option is available and that the seller should pay the cost of this appraisal up front.

Usually, before a written approval is received from the lender, a call will be made or an e-mail will be sent to the seller's attorney indicating that the short sale will be approved or that the file is with the investor for final approval. It is at this point that all parties to this transaction must be made aware of the short-sale status. It is now vital to begin regular and frequent contact with the buyer's attorney and real estate agent to get updates on the buyer's mortgage application and approval status. The seller's attorney must be assured that the buyer has moved forward and should make a request for disclosure of the name of the buyer's mortgage lender.

After receiving written short-sale approval from the seller's lender, the seller's attorney must provide a copy to the buyer's attorney. The approval letter will state the sale price, minimum payoff amount the lender will accept and closing costs it will allow (see Document Section A, P. 33 and 36 for sample approval letters from a first and second lender). The seller's HUD-1 must match the figures on the approval letter. For example, if the initial proposed HUD-1 includes a cancellation fee for the mortgage and the lender will not allow this fee, it must be removed.

Virtually all lenders will pay an attorney fee on behalf of the seller, and it will be included in the calculation of their minimum payoff amount. Since the seller's attorney has done additional work on this transaction for the seller by negotiating the short sale, the average fee for a sale is woefully inadequate. When submitting the original proposed HUD-1 with the short-sale package at the start of this transaction, it is imperative that the seller's attorney incorporate his or her fees. The way the fees are broken down on the HUD-1 is extremely important, and the attorney will be able to secure a higher fee from the lender by separating them as follows:

- Attorney fee on the appropriate line as shown on the sample HUD-1. (The fee shown on the sample is the actual fee my firm requested and received).
- Fee for preparation of documents.
- "Settlement fee."

The point here is that a lender will not pay an attorney fee of \$5,000 if shown as a lump sum. However, many lenders will accept separate fees that will total the amount, or come close to the amount, the attorney wishes to be paid for his or her services. Be aware that many lenders will attempt to reduce the "attorney fee" but not the "settlement" or "document preparation" fees. My firm routinely charges \$5,000 to \$6,500 in total fees for a short sale, and the average payment is between \$3,500 and \$5,500 per transaction.

Finally, avoid a situation where the seller's attorney obtains an approval of the short sale, the buyer has obtained a written mortgage commitment and then the seller's attorney finds that the seller does not have enough money to close because of tax adjustments, water/sewer adjustments, condominium maintenance fees and more that were not anticipated when the HUD-1 was submitted.

Therefore, the seller's attorney will need to incorporate estimated "unpaid" taxes, "unpaid" water/sewer charges, etc., into the initial proposed HUD-1. After each of these items, my firm writes "to be adjusted at closing." We routinely put a number that is higher than we anticipate needing, and any overage can be added to the minimum payoff amount to the lender at closing. Lenders are happy to accept higher proceeds, but will not accept less than they demanded in their approval letter. This also eliminates the need to request contribution from the real estate agents (not a good public relations move), the seller or the buyer.

Before closing, the final HUD-1 must be sent to the lender for approval. This can be e-mailed or faxed to the lender by the seller's or buyer's attorney. The seller's attorney should not close the transaction before receiving, in writing, an approval of the HUD-1 from the short-sale lender.

TIPS ON AVOIDING PITFALLS AND DECEPTION IN SHORT SALES

As one can imagine, the distressed real estate market is full of scams, deception and outright fraud. The market is heavily slanted in favor of buyers, and there are some very savvy investors and purchasers out there. The seller's attorney should be diligent in recognizing the obvious signs that a transaction is not being bargained for in "good faith." She will have put a great deal of time and effort into a short-sale transaction with the end result being no closing and no income.

The most flagrant deception is when a short sale is referred to the seller's attorney at a price that is ridiculously low and nowhere near market value. The attorney should routinely request a payoff statement from the short-sale lender(s) for accuracy in determining the amount owed. If the attorney finds that the payoff is hundreds of thousands more than the sales price and the comparables do not support that price, be assured that the parties are using the attorney as their workhorse to determine if they can get "a steal."

Often, in these situations, the seller and buyer know each other. The seller's attorney will have done all the work negotiating with the lender only to get a rejection. These buyers will come back with "counter offers" to see just how cheaply they can buy the

The HUD-1 settlement statement must match the figures on the approval letter.

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property. If they do not like the price, they will walk away. Now the agent who listed the property has a good idea of what the short-sale lender is looking for and will use the seller's attorney's work to market the property at a price consistent with the lender's numbers.

Investors are notorious for signing several contracts at one time for different short-sale properties, putting down minimum or no deposit money and allowing the various sellers' attorneys to work on the short sale to see which contract gets approved first. This is the reason why the buyer must be required to put down a sufficient deposit and why the seller's attorney should be given a substantial amount of time to secure short-sale approval.

The investors/buyers will make an offer on property, knowing full well from the day they sign the contract that they intend to request a substantial price reduction or credit for "repairs," if the seller's attorney allows them to do inspections *after* the short sale is approved. This is why all inspections must be done before the short-sale package is submitted.

Sometimes sellers who do not have any economic hardship nonetheless want their attorneys to negotiate a short sale so they can get rid of their "upside-down mortgage." It is important that the attorney review the seller's pay stubs, tax returns and monthly financial statement. The attorney will frequently find a high-income seller who can afford the mortgage payments but no longer wants the property because there is no equity left in the house. This is due to the downturn in the market value or because the seller has taken out an equity line to "cash out" on the property.

In cases such as these, the seller's attorney should request a retainer from the seller up front. When the seller has substantial assets and/or high income, it is not uncommon for the first lender or equity line lender to request a "contribution" from the seller at closing. Clients who fall into this category can afford to pay their attorneys a retainer from the onset of representation. If the seller is unwilling to come up with funds or will not sign a note with the lender when requested, the attorney will have spent valuable time without getting a fee.

An attorney may represent an uncooperative seller who is impossible to deal with and will be a drain on the lawyer's time and income. If there is a high volume of short sales in the attorney's practice, she will eventually come across the client who refuses to submit documents on a timely basis or give all the documents requested. This seller is his own worst enemy, but unfortunately, he is the attorney's as well. The seller's lender will not issue an approval because the seller refuses to cooperate. This client should be advised to seek representation elsewhere. Usually the client is angry about his financial situation, and the attorney is the outlet for this frustration. A client like this is a "no win" situation.

This commentary has attempted to generally outline the short-sale process, but the list of variables is seemingly endless. Here is a small sample:

- A few lenders, such as Bank of America, negotiate most of their short sales via the website Equator.com. The seller's attorney will need to become familiar with that site.
- Occasionally, there will be a seller who has private mortgage insurance. This must be taken into account when negotiating with the lender. The PMI underwriter has an interest in the amount offered to the lender and is entitled to payment if it requests it.

- If there is more than one lender, the first lender will determine what the second lien holder will receive. Often the second lien holder wants more than the primary lender will offer, so creative negotiation is necessary.
- A title search should be done to confirm that there are no IRS liens, tax sale certificates, judgments, etc., that the seller neglected to disclose. The seller should be required to pay for this search up front. It can be included with the attorney's initial retainer.
- Sometimes it is necessary to obtain extra funds from the seller to cover attorney fees that a lender may have drastically cut. The attorney should negotiate this with the seller.
- It is important to remember that the final negotiator the seller's attorney will deal with, who is going to approve or deny the short-sale request, is extremely overburdened with an enormous amount of files. A little courtesy to the negotiator goes a long way.

As the seller's attorney transacts more short sales, she will become aware of potential problems on these files and be able to address them before the contract falls apart. In this specific area of real estate law, common sense is invaluable to the success of a short-sale practice.