Summary of the Real Estate Short Sale

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A "short sale" is a sale of real estate for less than the amount of money that is due on the mortgage(s) at the time of the sale. For example, if there is a mortgage on a property in the amount of $250,000.00, but the current value of the home is only $150,000.00, the lender may agree to accept less than the total amount of the mortgage in lieu of a foreclosure and the possibility of having the property become "REO" (bank owned).

You might wonder why a lender would agree to this. The primary reason is that banks are not in business to own and sell real estate. When a homeowner ceases paying a mortgage or abandons a property, or when a bank forecloses on house, the bank becomes responsible for paying the property taxes and liability insurance on the property and must upkeep the house and its property (including such things as cutting the lawn and making sure the roof is not leaking). These are non-traditional lender responsibilities and tasks most banks do not wish to undertake. In many instances, it makes more financial sense for a lender to cut its losses and allow a sale to occur, even if the bank must discount its debt.

While short sale approvals have risen sharply since the downturn of the economy, not all offers will be approved. In most instances, it is one of the realtors involved in the matter who will negotiate with the bank for short sale approval. Banks are not always amenable to a short sale, however, there are several common hardships that most of the major lending institutions will approve as a valid reason to allow a short sale. These hardships include job loss, decrease in hours or wages, illness, divorce, death, military deployment, and incarceration. Ultimately, the lender must believe it is a good deal for the bank to enter into the short sale.

Short sale negotiation and approval used to be an arduous process that could take well over a year to complete. Over the course of the last few years, approval time frames have been shortened and new federal guidelines order that loan servicers respond to all short-sale offers, and approve or reject them within a mandated amount of time.

A seller in a short sale must also be aware that not all banks automatically waive the "deficiency balance," that is, the amount between what is owed on the loan and the amount of the sale. While some banks have such deficiency forgiveness, for others it must be negotiated as part of the deal. In addition, some banks were charging the forgiven portion of the debt as income. Though they are no longer allowed to treat it as such in certain situations (e.g. if the home is the primary residence of a borrower in default), we urge you to consult with your tax professional to confirm what, if any, tax consequences will apply to your personal situation.

NOTE: This is a generalized real estate discussion regarding the purchase of a home and this information should be used in concert with your attorney's advice regarding your particular transaction.

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