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WHAT YOU NEED TO KNOW ABOUT BUYING A SHORT SALE

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The following summary is intended to address some of the practical and legal issues that can arise in a Short Sale transaction. This summary is not intended to be a complete explanation, does not constitute legal advice, and should not be relied upon in lieu of securing competent legal, tax and consumer credit advice.

Short sales can be a markedly different buying experience from previous home purchases, and many of the assumptions that apply under 2 party transactions may not apply in a short sale, which will have typically 3 but possibly 4 parties involved. It is important you understand the potential issues that can arise and have realistic expectations about what can and may occur on a short sale.

1. DEFINITION. The term "Short Sale" is used to refer to those real estate transactions in which the agreed-upon purchase price is insufficient to pay off all of the secured debt on the property (such as mortgages, trust deeds, state/federal income taxes, liens, property taxes or other local assessments) including the costs of closing, such as escrow and recording fees, title insurance premiums, real estate commissions, etc. If the seller is in bankruptcy, a trustee for the seller's creditors will take control of the sale. In most Short Sales, the seller must secure an agreement from one or more third-party creditors to accept from the closing proceeds something less than the remaining amount of the debt due them. In other words, the debt is "shorted" or reduced. ***The one thing common to all Short Sales is that the final decision on price and terms of the transaction, as well as the identity of the ultimate buyer, will be in the control of third parties, usually creditors, whose consent to the transaction is required in order for the seller to convey clear title to a buyer. This one issue alone is what can and does create all of the potential issues and pitfalls addressed in this document.***

2. TRANSACTION CONTINGENT ON THIRD-PARTY CREDITOR CONSENT. Since a Short Sale requires approval from one or more creditors who are not parties to the pending real estate sale transaction, the seller's agreement to sell must be made subject to (or "contingent upon") third-party consent. This generally means that if the seller is unable to secure the necessary consent (e.g. because the creditor refuses to give consent or it cannot be obtained by the closing date), the transaction fails and all earnest money is to be promptly refunded to the buyer.

3. TRANSACTIONAL CHANGES REQUIRED BY THIRD-PARTY CREDITORS. In Short Sales it is not unusual for a creditor whose consent is sought to insist that other creditors who would be paid from the closing also share some of the cost. They may also insist that the sale price be increased, or require removal of provisions for the seller to pay for certain repairs, etc. Some creditors may require an appraisal or independent broker's price opinion ("BPO") of the property before making any decision. Thus, in Short Sale transactions, seller and buyer must be prepared for delays resulting from changes to the price, terms and conditions agreed upon in the original transaction, responses from third-party creditors, as well as other events outside of the seller's and buyer's control. As a result it is not uncommon to wait a couple to several

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months before getting final confirmation on the price and closing date. Extreme patience is required on all short sale transactions.

4. BUYER DUE DILIGENCE CONTINGENCIES. In Short Sale transactions, the deadlines for completion of buyer contingencies may need to be suspended pending third-party creditor consent. However, if consent is slow in coming and the buyer wishes to proceed anyway, buyers must understand that there is a risk they could expend their funds only to later learn that the necessary creditor's consent to the Short Sale cannot be obtained. Normally, buyers have no recourse for recovery of these expenditures in a short sale. For example, it may be necessary to spend money on a home inspection to feel comfortable that the property meets your standards, only to find the bank rejects your offer. This is not the case in a normal 2 party purchase transaction between buyer and seller. There is also a possibility you may need to get an appraisal completed and paid for *prior* to final agreement from the third party, especially if they give their consent but a very short time frame to close the transaction. The bank may make you wait 3 months for an answer but want the transaction concluded in a week. Since a multitude of different parties must cooperate to get a transaction completed (buyer and seller, both sets of realtors, creditors, escrow company, insurance company, the lender, the broker AND the bank finally) it may be necessary to have everything completed BEFORE the bank signs off on it, allowing it to be concluded in an abnormally short time frame. Any out of pocket costs that are incurred by the buyer will not be refunded in the event the bank denies the sales price. Not being able to meet a very short bank deadline could mean the price is no longer offered after the set closing date or otherwise a substantial day by day charge is assessed by the bank. This charge will not be paid by the lender or broker but will be passed on to you, the buyer, in the event we are given a time frame insufficient for all parties to due their due diligence.

5. ADDITIONAL OFFERS. Since most third-party creditors will want to secure the highest and best offer for the property, they may insist that it remain on the market, notwithstanding a pending transaction. As a result, a creditor may withhold final consent until they have had an opportunity to compare one offer with other potential offers that may come in the future. In some Short Sales, a creditor may refuse to give consent to a pending transaction because they want the seller to accept another offer, or potential offer, with a better price or terms. As a result, the entire Short Sale process may involve a significant risk of delay or failure.

6. USE OF EXPERTS. Short Sale transactions are often complicated and time consuming. They raise important issues, especially for sellers, including income tax implications, liability issues for unpaid mortgage indebtedness, credit rating issues, bankruptcy and other legal issues, all of which can affect the ultimate success of the transaction. Your real estate broker and mortgage lender are not expert in these areas. ***Buyers are strongly encouraged to secure additional competent professional advice before entering into a Short Sale transaction and are represented by their own real estate professional.***

7. LENDING GUIDELINES AND INTEREST RATE ISSUES. This past year has seen lending become more restrictive at all levels and guidelines are changing very rapidly. It is possible that a buyer could qualify for the loan at the time the offer is presented, only to find that several months later the loan program no longer exists or has become more restrictive. There is also the issue of what happens if a new credit report is required (these are good for only 120 days) and the credit profile has changed for the worse since the offer was made or accepted. With a change in credit for the worse, possible outcomes could be an increase in

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interest rate for the higher risk or at worse, no longer qualifying for this particular loan program. Also, when qualifying, the lender/broker needs to insure the interest rate used to calculate the housing payment is high enough to account for potential fluctuations in the market, especially if the buyer is just barely able to qualify for the loan amount. Note that **INTEREST RATES WILL NOT BE LOCKED UNTIL THE SELLER FIRMLY AGREES ON A CLOSING DATE AND PRICE** regardless of what date and price were on the original presented offer. The consequence is this delay by the 3rd or 4th party is that interest rates could have climbed substantially. In the worst case the buyer may no longer qualify for this loan due to the higher rate and higher monthly payment. It could also negate much of the benefit of buying this property at below market value if the monthly payment ends up being much higher than was originally expected. Of course, it is also possible that rates could have improved by the time the offer is accepted. The point is that there is no guaranty and neither your lender nor realtor have a crystal ball to accurately predict the future direction of the market. Another thing a buyer needs to consider is what implications, if any, will occur if a substantial amount of cash is held up in earnest money waiting for an answer from the bank. If you have say $5000 down as earnest money and you have no access to this and are not earning interest on it, will this have a negative impact on your ability to conduct your everyday transactions?

8. SHORT SALES ARE NOT NECESSARILY A BARGAIN. There is a common perception that a short sale is a bargain, however this is not necessarily the case. Just because the bank is willing to accept less than is owed does not automatically mean the price is a “steal”. It is possible the home is being sold at fair market value, and similar such homes in the neighborhood could be purchased much more quickly and easily at a similar price. Check with your realtor to confirm that similar properties are not readily available at the same price point, especially given the large amount of inventory currently on the market. You have many more properties to choose from than a year ago and you and your realtor should explore all possibilities. If it is indeed a real bargain, then proceed with caution now you have an awareness of the potential pitfalls ahead. If it is not much lower than other properties in the area, discuss the possible ramifications with your realtor and your lender.

9. SELLER CONCESSIONS. In a normal 2 party transaction, if the seller agrees to pay all or some of the buyer’s allowable closing costs, the seller calculates this as a reduction in the proceeds, or profit they will walk away with when the transaction is concluded. In a short sale on the other hand, there is no profit, only losses. It is highly unlikely the seller has the cash in order to be able to pay the buyers costs at closing as they probably wouldn’t be in a short sale if they could. This means that an offer to buy requesting a certain sales price and say 3% toward closing costs is seen by the bank as just a lower price offer and thus a bigger loss for them. For example, if the offer is $200,000 with 3% toward closing costs, the bank or banks see this as basically an offer of $194,000 net as they and not the seller have to agree to accept this even bigger loss.