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Anatomy of a Successful Short Sale Program©

The Short sale is a foreclosure alternative which provides an outstanding opportunity for the lender, the borrower/seller, and a prospective purchaser to mitigate damages. Unfortunately, in today's troubled real estate marketplace, the short sale process is one fraught with a substantial amount of misunderstanding and delay, which may result in frustration that can be avoided. Utilizing basic fundamental information and a well-thought-out approach, a short sale can be achieved for the benefit of the borrower, lender, and prospective purchaser, as well as with a reduction in the amount of frustration and effort on behalf of the real estate professionals (real estate brokers, real estate attorneys and/or title agents) involved in such transaction.

1. DEFINITION OF A SHORT SALE

A short sale involving real estate is defined as a transaction in which the purchase price of the property is less than the amount necessary to pay off the mortgage and related closing expenses which results in the lender considering either;

- a) Releasing its mortgage on the property and further releasing the borrower;
- b) Releasing its mortgage on the property and demanding payment of the difference from the borrower; or
- c) Releasing its mortgage on the property and obtaining a negotiated amount from the borrower for the deficiency amount which results from the short sale. (either cash or promissory note or some combination of both)

2. PRE SHORT SALE PREPARATION, DUE DILIGENCE AND MITIGATION EFFORTS

Prior to presenting a short sale contract to the lender for determination of lender's approval of a short sale, the borrower (and, more precisely, the borrower's real estate professional representatives and, ideally, a real estate attorney) should undertake the following steps:

- 1) Obtainment of an Appraisal of the property;
- 2) Obtainment of a Comparative Market Analysis (CMA) or Broker's Price Opinion (BPO);
- 3) A review with the borrower of the borrower's option to either:
 - a) continue payments;
 - b) discontinue payments; or
 - c) attempt to minimize and mitigate damages with the lender.
- 4) Offer to provide borrower with a "Deed In Reduction©" (see www.kfjlaw.com) which is an unconditional fee simple deed to lender on the property with an agreement to negotiate with the lender for any deficiency amount which the lender may claim after the lender recaptures the property and places a value upon the property (see attached "Deed In Reduction©" program analysis)
- 5) Inquire as to a mortgage modification between the borrower and lender;
- 6) Review governmental mortgage modification program which might be available to assist the borrower. (See www.makinghomeaffordable.gov)
- 7) Identification of any other possible workout scenarios between the borrower and lender;
- 8) Preparation of a Financial Worksheet of the borrower showing current financial status, two years tax returns, current income, paystubs and list of assets consistent with a standardized form financial analysis. This package will most likely will be requested by the lender, in the event the lender is being requested to waive or reduce its deficiency claim against the borrower.

3.) PRE SHORT SALE MODIFICATION EFFORTS

It is not a necessary prerequisite to engage in a formal mortgage modification application in order to proceed with a short sale, especially in the event that the borrower decides that it is either:

- a) Unwilling to retain occupancy of the premises;
- b) Unwilling to retain ownership of the premises; or
- c) Unwilling to continue to service this debt regardless of what the payment reduction is in regard to the loan.

While a mortgage modification effort might in some cases result in the resolution of the existing loan problem, a mortgage modification should be undertaken only in the event that the borrower acknowledges its desire to retain title to the property and continue to service the debt or some portion thereof and is willing to work through the application process. If the borrower is unable or unwilling to continue with mortgage payments, processing an entire mortgage modification review is simply a waste of the borrower's and lender's time and also contributes to additional carry costs (increasing deficiency exposure) on the property while utilizing a procedure and process which has no chance of success.

4.) LISTING OF THE PROPERTY FOR SHORT SALE

In order to be successful in the short sale, a number of realities must be addressed, starting with initially evaluating and determining the current fair market value of the property for purposes of selling the property within the next 30, 60 to 90 days.

It is important to have a Broker/agent who is trained in the area of short sales, who clearly understands the real estate marketplace, and who knows the specific property attempting to be short sold. Having such a Broker/agent is crucial in setting the appropriate price of the property. The purchase price on a short sale may not accurately reflect the fair market value of the property under normal circumstances, since an effective short sale price (see definition below) might be influenced by the urgency to sell.

5.) "FAIR MARKET VALUE"

Fair Market Value in Florida is defined as "the amount that would be paid for the property to a willing seller, not compelled to sell, by a willing buyer, not compelled to buy." Savers Federal Sav. & Loan Asso. v. Sandcastle Beach Joint Venture, 498 So. 2d 519 (Fla. 1st DCA 1986).

This is the traditional current fair market value definition for deficiency judgments in Florida but may only be a general "guideline" as to what a short sale price should reflect. In today's real estate economy in which prices are either stagnant (or in many circumstances still continuing to freefall) the current listing price for a short sale should be determined and identified as that price which will enable a property to be sold in today's marketplace within the next 30, 60, to 90 days. This generally means a purchase price to move the property in relation to the many other properties on the marketplace, all of which themselves are being sold at distressed prices.

The reality is that the purchase price on a short sale is not going to be a reflection of the traditional "current fair market value price" and, in many instances, does not even reflect the actual hard costs to rebuild this property at a square footage price. Most short sale prices are coming in below what the actual cost would be to construct the residential unit, even without any consideration to the actual land and improvements upon which the residential unit is located. A successful short sale participant must be cognizant of these facts.

6.) OBTAINMENT OF SHORT SALE CONTRACT

Once a short sale contract is obtained, the real estate professional must make sure that the prospective purchaser is qualified to purchase the property for cash or has a prequalification letter indicating their ability to obtain financing to acquire the property at the purchase price as set for in the contract. A frustrating delay in getting short sale approval is to have a short sale contract subject to a 45 or 60-day financing contingency from the borrower, whom may not have a prequalification letter and may not be able to close the transaction. Worse yet the lender may simply reject a contract from an unqualified purchaser which ends up wasting valuable time with no tangible result.

In a successful short sale program, it is not mandatory that the borrower have cash or a prequalification letter. However, under the circumstances of the current marketplace, the failure to locate a cash buyer or buyer with prequalification is tantamount to a recipe for failure or, alternatively, a long delay that could create additional problems. The real estate professional should pre-qualify the buyer.

7.) QUALIFIED BUYER FOR CASH OR PREQUALIFICATION LETTER

If a qualified buyer submits an offer which is within a price close in proximity to what the seller and his real estate professionals believe would be an appropriate price, the seller should accept the contract offer provided the contract for sale and purchase contains appropriate contractual language with minimal contingencies (minimal inspection periods, no financing contingencies, etc.). As importantly, a specific short sale addendum (see attached format) should be made part of the contract, which relieves the seller of performance obligations if the lender does not approve and release the seller at closing.

Again, a real estate professional (preferably a qualified real estate attorney) should assist the buyer in this process as not to make matters worse by having an inappropriately drafted contract for sale and purchase which hasn't been thought out and properly drafted.

8.) PRESENTMENT PROCESS FOR SHORT SALE CONTRACT TO LENDER

Once the contract for sale and purchase is obtained, the loss mitigation specialist of the lender (this person should have been identified prior to this process beginning) should be contacted and requested to process the contract application.

To assist the lender in the contract release process, the seller/borrower should provide the lender with the following:

- 1) A clear copy of the executed contract and all addendum;
- 2) An identification that the offer is for cash or the buyer is prequalified to close the deal promptly.
- 3) An acknowledgement that this contract is an arms-length contract between an unrelated parties;
- 4) An acknowledgment that this contract will not yield any net closing proceeds to the seller;
- 5) Identification that the contract will provide the lender with a sum certain amount (identified on line 506 of the HUD1, see discussion below);
- 6) A copy of the most recent property appraisal;
- 7) A copy of the County Property Appraiser's valuation;
- 8) A copy of a Comparative Market Analysis (CMA) or Broker's Price Opinion (BPO) on the property.

The most effective way to present a short sale package to the lender is to provide the lender with a proposed HUD1 closing statement identifying a closing within 45-60 days showing the closing proceeds that the lender would net from the closing of the short sale. This would be the lender's net closing proceeds as set forth on line 506 of the HUD1 closing statement and shows the net cash due to the seller on line 603 of the HUD1 closing statement as "zero."

9.) **REASONABLE CLOSING EXPENSES**

It should also be identified that the closing expenses, including real estate commissions, should be reasonable. Many lenders will allow no more than four (4) percent to be paid to the real estate professionals, but up to six (6) percent may still be acceptable, subject to an appropriate purchase price and the realization that all closing expenses are going to be amounts reduced from the seller's net closing proceeds, which leads to the next phase: the negotiation of the borrower's potential deficiency.

10.) **THE STEPS IN LENDER EVALUATION PROCESS**

The lender has a three step process which consists of:

- a.) Agreeing to accept the net closing proceeds identified on line 506 and satisfying its mortgage and mortgage note and all obligations of the seller/borrower.
- b.) Agreeing to release its mortgage as a lien against the property but retaining all rights it has as against the seller/borrower to seek a deficiency arising after the sale;
- c.) Agreeing to accept either cash, cash and a promissory note, or a promissory note for an agreed upon settlement amount for the seller/borrower to pay for the deficiency that the lender will incur as a result of the approval for the short sale.

In order to make its determination, the lenders will require an analysis of the borrowers' ability to pay which will be based on the aforementioned financial statement, worksheet and affidavit before the lender will approve such short sale arrangement and release of the borrower. Having all of the information with the lender's representative will assist in speeding up the decision making process.

11.) **NEGOTIATION PHASE**

This is the frustrating phase, especially when participants have unreasonable expectations of approval, which are inherently delayed based upon the backlog in cases, or, alternatively, the lenders are indecisive or assign a representative who does not have final authority to approve the sale.

The real estate attorney handling this transaction should monitor the file and follow up in regard to the transaction. The attorney should also notify all parties of what the reasonable expectations are based upon the anticipated lender response. All parties should cooperate in timely providing information.

12.) **SUMMARY**

These procedures are suggested to conduct an appropriate short sale process. All participants in a short sale process should be aware of the inherent delays and work to cooperate in closing the transaction by implementing the positive and proactive procedures outlined above.

Lastly: the keys to a successful short sale are perseverance and patience based upon the confidence that all the appropriate steps have been taken to successfully conclude a short sale. An experienced real estate attorney should be conducting the negotiations for the release of the seller/borrower or, alternatively, an agreed upon procedure between seller/borrower and lender to address the deficiency post closing, with further consideration as to a release price either in the form of cash consideration, promissory note, or combination thereof.

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