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Understanding short sales - Including their pitfalls and strategies

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In addition to a predictable rise in foreclosures, the lending crisis and consequent economic malaise has engendered a rise in short sale transactions. Ultimately, these short sales are simply another strategy which lenders can employ to manage losses in non-performing assets, and in concept at least, they are straight forward. On its most basic level, a short sale is simply a transaction wherein a lender accepts less than it is owed in full payment of its note, following which it discharges the mortgage securing the seller's real estate.

The Pitfalls:

Generally, the bulk of the problems presented in managing short sale transactions are derived from two sources; (1) a failure to define and document the respective parties' rights; and, (2) a failure to recognize and/or prevent fraud and misrepresentation or fact patterns which could reasonably lead to viable claims of fraud and misrepresentation. Some of the most common problems are presented below;

*The Short Sale Flip:

The short sale flip is by far the most problematic version of short sale. The transaction is made possible by the largesse of the short sale lender who has effectively consented to the sale by foregoing foreclosure and taking a loss on its security. It is for this reason that the conveyancer must ensure that the short sale lender is fully informed of all facts germane to the transaction, including the terms of the end sale in a flip. It's that disclosure, or lack of it that ultimately drives the viability of a short sale flip.

As long as the short sale lender is cognizant of, and has authorized in writing the terms of the end deal, (i.e., the deal between the short-sale intermediary and the end-buyer), the short sale flip is insurable.

* The Short Sale Demand/Estoppel (if only they'd call it a "Payoff") Letter: The next set of concerns presented by the short sale are those created by the short sale payoff letter. As might be expected, they tend to be heavily weighted in favor of the short sale lender. The conveyancer's goal should be to bring the letter into line with a conventional payoff letter, or at least limit or delete the more noxious provisions therein.

* Reservations of Rights Clauses: Short sale lenders have recently begun to include clauses in their letters which reserve to the lender the right to reinstitute its note and mortgage after the transaction is consummated, if it becomes cognizant of facts which suggest fraud. These provisions should not be allowed to stand.

* Whose letter is this? When possible, the conveyancer should be recognized on the letter as the settlement agent, as opposed to being addressed to the short-sale seller only.

* Make sure that a discharge is forthcoming: The conveyancer should confirm that the letter is

revised to include the short sale lender's unequivocal obligation to issue a discharge on receipt of funds.

* Short Sale lender's conditional compliance - Short fall Note: To the extent that the lender expects a note from the seller, the onus for providing same should be on the seller or the seller's representative and not on the settlement agent.

Negotiating Short Sales

with Servicers:

Whenever dealing with a servicer in a short sale, the settlement agent should be sure to procure a recordable power of attorney to the servicer wherein the short sale lender has included the power to negotiate a short payoff.

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