nerej
CELEBRATING 55 YEARS

Short sales - A market exploding - Part 1

July 15, 2010 - Connecticut

Buyers, sellers, real estate agents, appraisers - really anyone involved in the current real estate market can easily see that listings identified as 'Short Sales' have become a common occurrence. Freddie Mac just announced that the number of short sale transactions have increased 600% over 2008 volume. The CT MLS, the largest MLS in CT covering all but Fairfield County, didn't even offer agents a way to identify listings as 'potential short sales' in 2008. But in June 2010, CT MLS listings identified as potential short sales represent 8.2% of the 1-4 family market. Nationally, RealtyTrac estimates that short sales were 12% of all sales in the first quarter of 2010. No matter how you look at it, short sales are a factor to be reckoned with.

A short sale occurs when the property owner sells at a price that is less than the mortgage balance outstanding. First American CoreLogic estimates that 11.3 million homes have 'negative equity' - a higher balance owed on the mortgage(s) than the property is worth in today's market. That translates to 24% of all mortgages being 'underwater'. So, there are lots of owners who might face the need to sell short.

The economy has left millions of people unemployed or under employed. Nationally, the Bureau of Labor Statistics says that the unemployment rate for June 2010 is 9.5%. That leaves many with no way to make the monthly payments on their mortgage. Facing a likely foreclosure and looking for a way to lessen the damage to their credit report and long term financial prospects, many will consider trying to sell the property before the bank takes it. If they can sell the home in a short sale, they can walk away without having a foreclosure on their credit report. And some lenders are even offering a cash incentive for delinquent borrowers to bring a valid short sale offer. Not only will the borrower avoid the foreclosure, the lender will even give them a few thousand dollars to help them move on.

Lenders have recognized the benefits of short sales and in many cases are ramping up programs to promote the use of this previously little used option. If a property is foreclosed, and the lender has to list and sell it as a 'bank owned' property, also known as REO (Real Estate Owned by the lender), experience indicates that the property will sell at a big discount. Often in today's market, that discount can be 30% to 60% off the normal market value. Typically REO properties will sit vacant and with utilities turned off for many months. Properties sold in short sales are most likely still occupied, and maintained, by the borrowers. Short sale properties may sell at or close to full market value, with many that are sold at discounts of 10% to 20%. So, the losses to lenders on these 'underwater' properties can be far lower than what they would be if the mortgage goes into foreclosure.

Potential buyers of short sale properties are attracted by the potential discounts. They might consider the larger discounts available from foreclosed properties, but when foreclosed properties are marketed, there are no disclosures and no warranties for buyers. So, for the typical buyer, the potential short sale property offers a much more attractive opportunity. There is a good chance they can negotiate a price that represents a discount from full market value that they couldn't get on a normal listing. The seller still needs to make the normal disclosures, and the property is demonstrated to be in livable condition prior to the sale because the owner is still there. The risks faced when making an offer on a short sale include the fact that it usually will take a long time to get the approvals from the lender (4 to 6 months is not uncommon), and that there is no guarantee that the offer will be approved, at any amount, due to factors beyond the buyer's control.

There are many obstacles to getting a short sale approved. First is the sheer volume of distressed properties and the fact that even with the lender staffing levels on the increase, they are often buried in the paperwork involved. It takes a long time to get through the process. Add to that the fact that many homes have not only a first mortgage but also a second mortgage or home equity line of credit loan. Liens on the property like IRS liens, property tax liens, mechanics liens, etc., can complicate or even disqualify a property for a short sale. And there are state and federal government programs (including HAMP) that offer homeowners the possibility of qualifying for a loan modification that will allow them to stay in the home. If that happens, that seller won't want to continue with a short sale if they can help it.

A lender, when approached by a borrower about a potential short sale, needs to decide if the offer is worth considering. To make decisions regarding the value, lenders will consult different sources. The computer generated AVM or Automated Valuation Model is the quickest and cheapest option. This option, though, can have a wide accuracy range and typically does not include any interior or exterior inspection to report on the condition of the property.

BPOs (Broker Price Opinions) are being ordered by the tens of thousands. These might be done as a 'desktop' product without any inspection, or with either an exterior (from the street) or interior inspection by a real estate agent who looks at recent listings and sales and provides an estimate of the value. These are usually performed at a relatively inexpensive price and in a short time frame. But they are not the same as obtaining an appraisal performed by a certified appraiser. And, in many states it is actually illegal for the agents to be selling the BPOs as a valuation service separate from their listing and selling role.

In Connecticut, for example, state licensing laws specifically prohibit real estate sales persons and brokers from performing BPOs for a fee for any purpose other than to support a potential listing, sale or lease of property.

Some lenders will order an appraisal done by a certified appraiser to evaluate a short sale offer. As an alternative, sometimes the lender will ask for a copy of the appraisal that is performed for the new mortgage being applied for by the purchaser in a short sale transaction. And, in other cases, the existing lender may already have started the long foreclosure process and may have, or may order, an appraisal as a part of that process so that they can evaluate the short sale, and if the offer is not acceptable they have already taken another step forward toward completion of the foreclosure process.

The short sale will not work in all situations. Still, for those situations where a short sale WILL work, going that route can be a Win/ Win/ Win for all involved.

Frank O'Neill, Jr., SRA is senior vice president and chief appraiser at Sepso Appraisal Associates in Stratford, Conn.