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The **10** Biggest Myths About Short Sales

(and How They Affect Both Buyers and Sellers)

A Special Report Prepared By Derf Fredericks



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A Growing Trend

With the aftermath of the sub-prime mortgage meltdown and the subsequent fallout from so many questionable loans, more and more listings on today’s market are categorized as “short sales.” This is one of the most misunderstood terms in the real estate industry. As a real estate professional working with both sellers and buyers, I come across short sale situations every day. I’ve found that people who know what they are doing are able to avoid the common pitfalls and make good financial decisions for their future, whether you are a buyer looking to find a good deal on a home or a seller looking to get out from under your upside-down loan.

The Definition of a Short Sale

Let’s start with a basic definition of a short sale. A short sale (also known as a “short payoff”) occurs when a lender or lenders accept a discounted payoff on an existing mortgage. Generally, they agree to minimize—and sometimes completely eliminate—closing costs for the homeowner in order for the bank to avoid the costs and hassles of foreclosure. In other words, when a homeowner owes more than can be collected through the traditional sale of their property, a short sale allows them to sell the property before it gets foreclosed upon, thus lessening—and in some cases, eliminating—the negative impact on the individual’s credit rating.

The Definition of a Compromise Sale

If the seller has other assets or is gainfully employed, the lender might choose to do a compromise sale. In a compromise sale, the lender will place a short demand into escrow that allows the sale to close, but will require a payoff from the seller for the balance still owed. This note may be secured by other real property or it may be a personal note.

Know How to Make the Right Decisions

Though it's important to know about the compromise sale option, my focus in this special report is on short sales. My goal is to provide you with the education and insights you need before going down the complex path of the short sale. Whether you are a buyer looking to purchase a short sale property or a seller looking for short sale approval on your property that may be worth less than you still owe, this report will outline the pros and cons of short sales. Here, you will find 10 of today's most common myths about short sales along with the accurate information you need to know to make educated real estate decisions.

You will find that the first five myths are geared toward sellers and the last five are geared toward buyers, but I highly recommend studying all of them in order to have a full understanding of how short sales will affect every facet of your real estate experience.

Seller Myths

Seller Myth #1:

It's Easy to Get Approval from Your Bank to Conduct a Short Sale

Perhaps the biggest misconception about short sales is that it is easy to get the bank to agree to a reduced payoff on the loan. Many homeowners figure that as long as they are in a situation where their property is worth less than they owe, they are a candidate for a short sale—with the hopes of “breaking even” at the very least.

The truth is, it's not that easy to get approved for a short sale. The thing to remember is that banks are always looking out for their own best interests. Nobody is more tuned into current property values than banks and they will generally do what's best for their bottom line. Whether they foreclose or go to a short sale, they are taking a hit financially. So, if it makes more sense for them to foreclose on your property for any number of

reasons, there is a good chance they will pursue that option. Rarely can the bank be swayed emotionally by your financial situation. Most times it comes down to this: if they feel they can save additional time and costs by approving a short sale, then they will be more willing to work it out with you.

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The first thing you should do is consult with a real estate agent who understands short sales and has a strong grasp of the subtle intricacies of banks' approval

processes. A knowledgeable agent can offer you guidance throughout the short sale approval process. Then, once you and your agent have a good understanding of what you are asking for, contact your lender as soon as possible to discuss your situation, research your options and ultimately ask for a short sale approval on your property.

Seller Myth #2: The Agreed-Upon Short Sale Price is the FINAL Price

This is where many sellers—and the buyers making offers—get caught off-guard by short sales. Though the initial short sale approval process is quite detailed and in-depth by the bank, they are primarily looking at the bottom line (that a short sale will cost them the least amount of extra time and money). Basically, with the initial price approval, they are willing to put the property out there as a short sale to see what they can get in return. They will determine a price range at that point, usually with a “bottom-end” price they are willing to accept.

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this point, the bank will re-review the *current* market value of the property, including a full appraisal. They will also fully review the financial situations of both the seller and the buyer to ensure that their investment is safe. Through this detailed—and often quite lengthy—process, the bank will determine if they are still willing to accept the price. And so begins the

frustrating part of the short sale roller coaster. They may choose to come back with a counter-offer or pull the plug on the listing altogether. Ideally, they will accept the offer and it will most likely go smoothly after that. But you always have to remember the bank will hold the cards as long as they want through what can be a lengthy process.

Seller Myth #3: **Defaulted Payments and Home Equity Loans Will Not Impact Short Sale Approval**

Unfortunately, many sellers seeking short sale approval from their bank are under the impression that this is an opportunity to “cut the cord” and get out of their property clean and scot-free. As you can tell from reading this report, it’s not as simple as that.

In many cases, homeowners have defaulted on loan payments and/or Homeowner Association dues. If this is your situation, don’t go into the short sale process assuming that you will be absolved of these back payments. In fact, any money you owe will certainly factor into the short sale approval by your bank. You may come out of the short sale process still owing them money, it may become a compromise sale or you may not be approved for a short sale at all. Rather, the bank may opt for foreclosure if the payment situation is severe enough.

If you are considering seeking a short sale at all, it’s important that you keep your mortgage payments and HOA dues current. This will greatly improve your chances of getting your short sale approved. It will also help your credit rating. If all your payments are up to date, then a short sale will not have as much of a negative impact—and in some rare cases, not at all—on your credit score. If you have defaulted on payments, then it could have more of a negative impact on your rating.

If your payments are all up to date, then another option you can ask your real estate agent and lender about is offering your deed in lieu of foreclosure. In a nutshell, this is when you simply hand over your title deed to the bank before the foreclosure process begins. This can be a viable option to consider depending on your situation, but make sure you have the information and guidance you need from industry experts. Nothing is ever as simple as it seems.

Another factor that can come into play is if you have an outstanding home equity loan or second/third mortgage. If there are multiple lenders involved, it *greatly* complicates the approval process and lessens your likelihood of attaining short sale approval. The bank that holds your first loan will have the biggest say, but the more lenders and loans that are involved, the harder it will be to get a short sale agreement that is to everyone's liking. In many cases, the bank holding the second loan will not recover much—if any—money in a short sale. If your second loan is held by the same bank that holds the first, then it slightly increases your chances for approval.

Seller Myth #4: **Once Approved for a Short Sale, Your Worries of Slipping into Foreclosure Are Over**

As we've discussed in previous myths, you must keep in mind the bank is always in control and always doing what's in *its* best interest. Even though the bank has indicated it is willing to approve your short sale and allow your agent to put the listing on the market, they will always reserve the right to retract the offer and begin the foreclosure process. This can be a very frustrating experience for sellers looking to avoid the unpleasant foreclosure process.

Rarely will this happen once your short sale is approved, but it's important to know that it can. Banks don't like going through the foreclosure process any more than homeowners do, but they will do what they have to in order to do what they think will be best for their bottom line. So, if your listing stays on the market for a really long time or if they begin to feel that the short sale listing price is too high to sell in the current market, then they may choose to pursue foreclosure of the property.

Again, it's vital to know what you are getting into when selling your property via short sale. Make sure you read the paperwork thoroughly and look out for any deadlines or loopholes that might be included in the contracts. Don't be afraid to speak with a real estate agent and lender in order to better understand the playing field when it comes to short sales and foreclosures.

Seller Myth #5: Real Estate Agents Are “Cleaning Up” in the Short Sale Market

While it's been a tough time for the majority of real estate agents out there in today's market, some agents have been able to find business in the short sale and foreclosure markets of recent years. But it's not a bed of roses. Listing agents are generally getting less commission in a short sale because of the bank's heavy involvement and in order to keep the seller's closing costs to a minimum. With that said, it is often a lot more work for an agent to represent the listing because they are dealing with both the bank and the seller. There is a lot of going back and forth. They have to manage both sides to keep everyone as happy and informed as possible throughout the process, oftentimes acting as more than a regular agent. They are more like an interpreter, intermediary and peacekeeper.

Some agents do have relationships directly with specific banks and are representing any number of short sale or bank-owned (REO) properties at one time. Keep in mind that when working with an agent like this, their primary customer is generally the bank, so they may not be as attentive to the needs of the seller as they would like. It's not always the case, but it can be. In fact, one of the most frustrating parts of short sales for agents and clients is the waiting game because it takes longer to get the information reviewed by all the parties involved.

That's why it's important to develop a relationship with an agent before you pursue a short sale approval—an agent who not only knows how the short sale market works, but is definitely on your side throughout the listing process (including escrow and closing). An experienced real estate professional—with the help of your lender—can help you explore all your options before you make decisions that will greatly impact your immediate financial situation, as well as your credit rating for future purchases.

Useful Tips for Short Sale Sellers:

- 1. CURRENT PAYMENTS.** Keep your loan and HOA payments current to avoid credit problems and increase chances of short sale approval.
- 2. LENDER CONSULTATION.** Talk to your lender as soon as possible to see what your short sale options are.
- 3. REALTOR® CONSULTATION.** Talk to a real estate professional who understands short sales and can guide you through the approval and listing processes.
- 4. DO YOUR HOMEWORK.** Be flexible in your expectations. Don't automatically say "yes" or "no" to the first offer from the bank. Do your homework and make sure to consider all aspects of the offer against your financial situation to make the right decision.
- 5. EMOTIONAL VALUE.** Don't get over-attached to what you think your home is worth. In today's changing market, values are always shifting. You have to set realistic expectations and be willing to accept what you can get.
- 6. PROPERTY DAMAGE.** No matter what, do not damage the property on the way out. In some cases, it can result in civil and sometimes even criminal litigation.

Buyer Myths

Buyer Myth #1:

Buyers Will Find the Short Sale Market Teeming with Incredible Values and Even Some Downright “Steals”

It *is* true that you can find some good deals with short sale properties.

Unfortunately, most buyers go into their home search thinking they will save 10 percent, 20 percent or more when they purchase a short sale property. On average, most short sales will close at about 3-7 percent off the full market value.

The important thing to remember is just how savvy banks are. They are not going to approve a short sale if it's not going to net a decent return for them. They are losing money no matter what, so they are going to try to lose as little money as possible. They know market values better than anyone and will set the price based on what they feel will be just low enough to sell, but will be closest to full market value.

So what does this mean to buyers? It means you can save a little money by buying a short sale property, but don't always expect to find a “steal.” You must also be sure to factor in any renovation costs that may be associated with the property. With most short sale properties, it is truly “as-is” and there is rarely any “wiggle-room” in the negotiations for concessions or repairs. Because the seller is largely removed from the process, you will not easily be able to negotiate with the bank to make necessary fix-ups, replace carpet, paint, etc. If you know the property needs a lot of work, make sure to do a thorough evaluation of all the costs associated with renovating the property before you make your offer. Determine whether the reduction in selling price is worth what it will take to make the property livable for you.

A short sale transaction can be a long, laborious and time-consuming process and can sometimes fall through completely at different points in the process. As a buyer, it's important not to get completely "wrapped up" in one short sale transaction while watching other buying opportunities pass you by. Work with your agent to leave yourself some "outs" in the offer process in case you decide to pursue something else.

Buyer Myth #2: Banks Are Desperate to "Unload" Their Short Sale Properties

On the heels of Buyer Myth #1, it's always crucial to keep in mind that the banks are motivated by the bottom line. Many buyers go into a short sale offer thinking that the process will go quicker because they think the banks are desperate to unload the property. This is the perception for buyers when it comes to foreclosure properties, as well.

The fact of the matter is that banks are extremely careful with every aspect of the short sale, from initial approval of the price all the way through to the close of escrow. When you submit an offer, they will scrutinize every detail.

The fact of the matter is that banks are extremely careful with every aspect of the short sale, from initial approval of the price all the way through to the close of escrow. When you submit an offer, they will scrutinize every detail. They will fully review the seller's situation and your financial stability to make sure there will be no problems with the transfer of the property or payoff

of the loan. Again, these are the types of things that can often draw out the buying process.

With that in mind, you need to make sure you are covered on your end before submitting an offer on a short sale property. Be sure to talk to a real estate

professional and a knowledgeable lender. It is best to get pre-qualified for your loan and submit a pre-qualification letter with your offer. This will show the bank that you are not only serious about buying, but willing and able to pay for your loan. If you want to take it one step further, you can consider getting pre-qualified by the bank that holds the title. Quite simply, the more information they have about you, the more faith they'll have in you as a buyer and thus, the more likely you will be to have your offer accepted.

Buyer Myth #3: **“Short” Sale Implies a “Shorter” Closing Period**

This is where many people have misguided perceptions about short sales. People hear the term and they think it means that the process will be “shorter” because both the bank and seller want to sell the property as quickly as possible. That is true in one sense, because they do want to get it off their books sooner rather than later. However, they will still take whatever time they need to get the best return on their investment. In addition to the extra diligence they will take to make the decision, keep in mind a lot of banks are now too understaffed to handle the growing number of short sales and foreclosures in a timely manner.

Because most banks are so stringent in the short sale approval process after you've submitted an offer, it can often drag on for several extra weeks—if not months. You just need to go in knowing that it could be a quick close or it could take *much* longer. The frustrating part is that it can be hard to tell until you make the offer. This is where an agent can help “scout” the listing for you by speaking with the listing agent (and sometimes the bank itself) to feel out the situation and see what the desired terms may be.

When I am working with buyers making a short sale offer, I always recommend that they put a relatively short close period (30 days or less) in the contract. Why? Because it shows the bank you are ready and willing to close quickly. They will be drawn to your offer because they know you are more serious. It also gives you an “out” later if they choose to drag on the escrow process.

But even though the bank may be more apt to accept your offer because of a short close period, it does not necessarily mean that the escrow will close within that timeframe. Most times it does not. They can extend the process as long as they need in order to make their financial decision. This is very important to know and understand before you make your offer, especially if you are in the process of selling your current property and trying to “time it” accurately. Make sure your agent stays on top of the listing agent—and even the bank, if needed—to keep the process moving forward and to avoid having your contract get lost in the shuffle.

Buyer Myth #4: **The Listing Price is What the Bank Will Most Likely Accept When You Make Your Offer**

Before a short sale is ever put on the market, the listing agent and bank will determine an undisclosed price range for the property. The high-end will be what the bank would ideally like to get back. The low-end is the minimum they would be willing to accept at the time of approval. The listing will generally go on the market at a price that is closer to the high-end of the range.

A lot of buyers will make the mistake of making a real “low-ball” offer. If it’s below the low-end of the accepted price range, they will likely dismiss such an offer immediately. Remember, banks are not as desperate to sell as most people think, and they will do whatever they can to have the property sell at the highest possible price. So, if you are serious about the property, make a reasonable offer. An experienced and market-savvy real estate agent will be able to help you determine what a “winning” offer is on any specific property, short sale or otherwise.

Even if the seller accepts your offer and the bank accepts the offer initially, they will still go through the full short sale approval process before anything is

finalized. They will appraise the property once more and review all aspects of the contract to make sure it is to their liking. If they determine that the property is worth more than you are offering, they can—and usually will—make a counter-offer asking for something more. This can include a higher selling price, a larger down payment from you, reduced agent commissions or, in some rare cases, a stipulation that you must secure your home loan through them.

Remember, banks are not as desperate to sell as most people think, and they will do whatever they can to have the property sell at the highest possible price. So, if you are serious about the property, make a reasonable offer.

When you submit your offer and pre-qualification letter, make sure the amount in the letter is the same as the offer price. Even though you may be qualified for more, have your lender put in the exact price you are submitting. If they see you are qualified for more, there is an increased chance that they will ask for more. Even though they will eventually review your full financial situation, you don't want to advertise upfront that you can afford more than you are offering. This is a good strategy when making any real estate offer, but especially important to remember when purchasing a short sale property.

Buyer Myth #5: **Short Sales Are a “Goldmine” Opportunity and a Can't-Miss Investment**

As you can tell from reading this report, there are many upsides and downsides to short sale real estate. If you know what you are doing and are prepared for the process that often comes along with purchasing a short sale property, opportunities can certainly be found. You will be able to save a little money on the purchase

price, but you have to make sure that you are covered elsewhere. Be sure to factor in the fix-up costs, property taxes, HOA dues, any land lease fees and other things that will impact the overall price of the property.

Here's a good rule of thumb to consider when looking at a short sale or foreclosure purchase: Add up the selling price and the "fix-up" price. If together, they are equal-to or ideally less than what you perceive to be regular market value for that property, then it is probably a viable investment. To determine the regular market value for the property, consult with a real estate agent who can provide you with a Comparative Market Analysis (CMA) using similar properties and recent sales in the neighborhood as "measuring sticks" to estimate the home's worth.

Useful Tips for Short Sale Buyers:

- 1. LOAN PRE-APPROVAL.** Before you make an offer, get pre-approved for your loan and submit a pre-qualification letter with your offer.
- 2. PRE-QUAL LETTER AMOUNT.** Have the exact offer amount put in the pre-qualification letter by your lender. Don't advertise upfront that you can afford to pay more.
- 3. PERSONAL STATEMENT.** Submit a brief (2-3 paragraphs) personal bio with your offer to gain more trust with the listing agent and bank. Tell them about yourselves, your work and financial situations and your intent to be a good homeowner.
- 4. LENDER CHOICE.** Though you don't have to use them, consider getting pre-qualified by the lender that is holding the title on the property. The more they know about your financial situation, the better.
- 5. QUICK CLOSE.** On your offer, put the closing date at 30 days or less to show you are serious. Just go in knowing that the escrow process will probably be extended by the bank, but the shorter terms will make you a more attractive buyer.
- 6. PROPERTY COST.** Make sure to have a full assessment of property damage and understand costs associated with the property before you make your offer.
- 7. CONTINGENCY OFFERS.** If you make an offer that is contingent on the sale of your current property, you will be a less attractive buyer to the bank approving the short sale. If possible, it is best to sell your property—or at least have it in escrow—before submitting an offer on a short sale property.
- 8. FIND THE RIGHT AGENT.** Talk to a real estate professional who understands short sales and can guide you through the purchasing process.

Closing Thoughts:

I hope you found this special report helpful in understanding the myths and common pitfalls of short sales. In my experience, I've found that the more you know about every aspect of the situation, the better decisions you will be able to make.

If you have further questions about short sales after reading this report or want to pursue a short sale purchase or sale, feel free to give me a call at any time. I'd be happy to help you explore your options.

Broker Profile

Derf Fredericks



"Experience A World Of Difference!"

Background: Born and raised in the South Bay. Entered the real estate business at 21 with Fred Fredericks Realty, a family owned business started in 1957. Received broker's license in 1978, company ownership in 1982 and merged with **The Real Estate Group** in 1999. Married to Monica with 3 sons; Daniel (1983), William (1984), and Charles (1990).

Education: University of Southern California
El Camino College
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"Outstanding Young Men of America"
"Realtor of the Year – 1984"

Real Estate Affiliations: Torrance, Lomita, Carson Board of Realtors Past Service
❖ *Director & Finance Chairman*
❖ *B.O.R.P.A.C. Trustee*
❖ *Professional Standards & Practice Committee*
❖ *Arbitrator and Hearing Officer for ethics violations*
❖ *President 1987*
California Association of Realtors
❖ *Past Director*
L.A. County Board of Supervisors
❖ *Assessment Appeals Hearing Officer*
National Association of Realtors
❖ *Certified Residential Specialist*

Community Service: Torrance Rotary – Past President
Gardena Valley Kiwanis – Past Officer
Olde Torrance Neighbors – Past President
Torrance Jaycees – Past Officer
Big Brothers of Greater Los Angeles – Big Brother
City of Torrance – Retired Airport Commissioner
Torrance Chamber of Commerce – Past Director
Boy Scout Troop 948 – Charter Representative
El Camino College – Real Estate Instructor & Foundation Board Member

Greatest Achievement: Charles, William & Daniel