



What is the difference between short sale and foreclosure?

Aiming to put a brake on short sales and foreclosures, the Obama Administration's Mortgage Relief Plan offers homeowners more options. The Home Affordable Refinance helps qualified homeowners who are current on their mortgages to refinance into a lower rate. The Home Affordable Modification enables homeowners who are experiencing financial difficulties a chance to modify their loans. There are restrictions on both programs. If you have already missed one or more mortgage payments, contact your mortgage lender immediately or call 1-888-995-HOPE (4673) to reach a HUD-approved housing counselor. Meanwhile, we would probably still see short sales and foreclosures remain a strong presence in the real estate market, so let's take a closer look at the difference between the two.

What is a short sale?

A short sale happens when a lender allows a property to be sold for less than the amount owed on a mortgage and takes a loss. Lenders are willing to do so usually because it will be a more cost-effective way for them to recover the loan amount as compared to going through the process of foreclosure.

Here's a typical scenario: The lender (or lenders if the property has more than one mortgage) involved needs to approve a short sale. The process starts with the distressed homeowner, usually with the help of a real estate agent who has short sales experiences, obtaining a short sale request from the lender. The lender will then send out a short sale package for the homeowner to fill out. The package typically includes a hardship letter and requires the homeowner to document hardship by providing recent pay stubs, bank statements, last 2 years' tax returns and other financial documents as proof. In addition, a ratified contract, copy of proposed settlement statement outlining the net proceeds to the lender will also be submitted.

If the homeowner is already late on his/her mortgage payments, his/her credit score will take a hit. Depending on how the lender recorded the debt on the conclusion of the short sale, the credit score can drop further. There's even report saying short sale is just as damaging as foreclosure to the homeowner's credit score. In any case, the homeowner usually has to wait 24 months before he/she would qualify for a mortgage again.



Buyers can usually purchase short sale properties below market value; however, they have to be prepared. Unlike a typical transaction in which only buyers and sellers have to agree to the terms of sale, a short sale needs to be approved by the lender. You must have heard horror stories that it takes months before some buyers heard back from the lender. That's because the lender not only needs to process the request based on the homeowner's personal situation, the appraised value of the property, the lender's own financial situation, but also needs to obtain approval from outside investors who have purchased the loan (sometimes banks sell their loans to outside investors.) Understandably the sheer volume of short sale requests is not helping in speeding up the turn time of those requests.

It can be a long and frustrating process waiting for the approval from all parties involved (depending on the severity of the sellers' financial hardship, some properties might end up going to foreclosure). However, once the short sale is approved by the lender, buyers can relax a bit and expect the rest of the transaction to be more like a regular sale.

What is foreclosure then?

Foreclosure is the legal proceeding in which a lender obtains a court ordered termination of a homeowner's equitable right of redemption.¹ When the property fails to sell at auction, it becomes a Real Estate Owned (REO) or bank-owned property. The lender will try to sell it to recover some if not all of the money that is owed on the property.

One good thing (if there's such a thing!) for a homeowner whose home had been foreclosed upon is there's no deficiency judgment if his/her loan was a purchase money loan. The "no deficiency judgment" rule means that the lender cannot go after the homeowner to recover the shortage, but it does not apply to loans that were refinanced. In addition, the homeowner will suffer a drop in his/her credit score and might have a longer seasoning period before he/she would be able to qualify for a mortgage again.

The current real estate market offers ample opportunities for buyers interested in purchasing bank owned properties. Many are listed by agents, thus providing reliable information on the properties and cut down the research time and risks involved as compared to buying properties at auction or pre-foreclosure. A typical REO transaction mirrors a regular purchase transaction to a certain degree. Since the bank owns the property already, you won't be dealing with as much negotiation and renegotiation on the



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final price as a short sale. This translates into a timelier close of escrow. With that said, buyers still need to be prepared for multiple counter offers situations.

Lately we have been seeing multiple offers on REOs as investors and first-time home buyers alike are looking to take advantage of the affordable prices. The first step is to get PRE-APPROVED! Not only does the pre-approval process lays out all the important elements (qualified purchase price and loan amount, monthly payment, closing costs, etc.) to get you prepared, it is also a bank requirement for potential buyers to present a pre-approval with their offers.

A real estate agent with buying and listing experiences of bank owned properties would be critical in getting your offer accepted, especially if you are a new investor or first-time home buyer. Your agent will provide you with information regarding the property, an analysis on current market value based on comparable sales information on REOs sold as well as pending sales and active listings, and factor in how repairs, inspection, and appraisal costs can affect the offer price since most properties are sold in "as is" condition.

Short sales and foreclosures alike present challenges for both buyers and sellers. Staying informed and soliciting help from experienced professionals in the field will make it easier to charge through the rough water.

Sincerely,

Catherine Sun

¹ Based on description from Wikipedia: <http://en.wikipedia.org/wiki/Foreclosure>