

Short Sale Guide



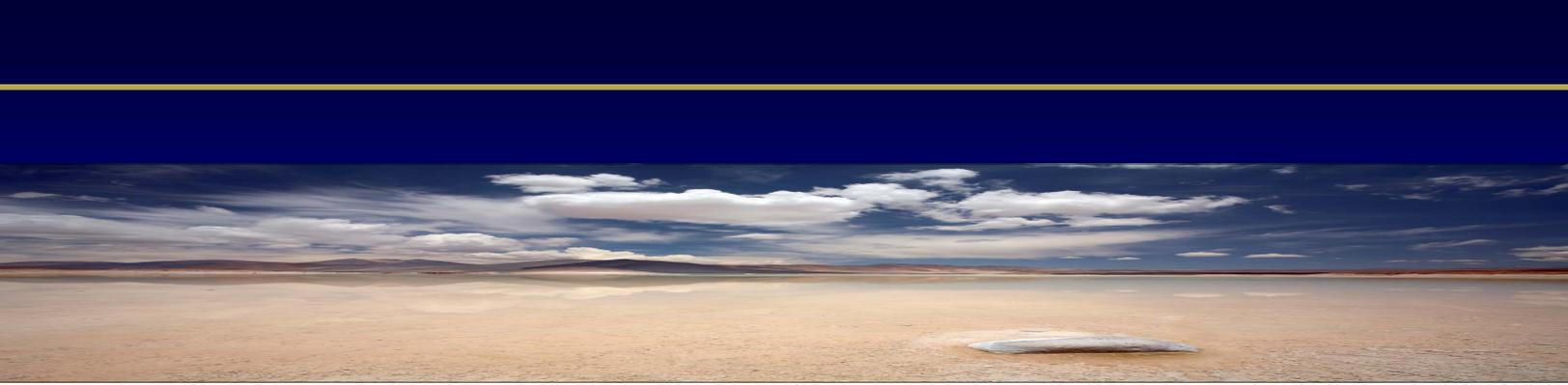
Guide To Arizona's Short Sale Process



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TITLE AGENCY, INC.

*A Member of the Orange Coast Title
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Dear Client,

Our real estate market is in precarious times. The current economic conditions have forced many people to become late or completely stop making their mortgage payments. Unfortunately, bad circumstances have fallen upon good people.

Should you find yourself in this situation, it is important that you become educated on your options. It is important to understand that there are some solutions that can help you minimize the damage to your financial status and your lifestyle. One possible solution is a Short Sale.

A Short Sale is a common occurrence in today's market and requires the written approval of your existing Lender(s). Be aware that the Lender is not required to participate in a short sale and there is no time limit for your Lender's approval or response. Each Lender is different and has different requirements.

As your Real Estate Professional, I can help you navigate through the unknowns. I can guide you through the Short Sale process and assist you in uncertain times.



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Definition of Terms

Notice of Default (NOD):

This is an official notice from the Lender that the borrower has defaulted on the mortgage. The NOD will be filed by the Trustee at the County Recorder's Office in the county in which the property is located. 'NOD' is common terminology describing the first step in the Foreclosure Process however, it is not used in Arizona. When you hear this term in Arizona, it often refers to the Notice of Trustee Sale (see definition below).

Pre-Foreclosure:

The period beginning with the initial mortgage default up to when the distressed property is sold at Trustee Sale or transferred back to the Lender. The length of what is considered a pre-foreclosure varies, depending on state laws and the Lender.

Reinstatement period:

The time stipulated by the lender in which the borrower may reinstate the loan – making required payments and bringing one's account into good standing. The loan can be reinstated at anytime prior to the Trustee Sale.

Notice of Trustee Sale:

The Lender will prepare, record and publish (in a legal newspaper once each week for at least 3 weeks) a Notice of Trustee Sale that includes a sale date, time and place for the auction of the property. This notice informs the borrower/owner that the Lender intends on selling the property.

Short Sale:

A Real Estate Transaction in which the seller (1) owes more money on the loan than the sale of the property will net and (2) is unable or unwilling to bring money to closing. The seller may or may not be in pre-foreclosure.

Real Estate Owned (REO):

The status of the property when the Trustee Sale is not successful and ownership of the property is transferred involuntarily to the Lender. At this time, the Lender may chose to use a Real Estate Agent to market the property for sale.

Who is Involved?

Homeowner:

The Seller. The owner, according to the Title, will accept a Buyer's Contract and be the Principal in the contract.

Lender:

The Lender is who the money is owed to. They have the right to accept or deny a Short Sale offer, but they are not the Seller or a Principal in the contract.

Real Estate Agent (for the Seller):

The Listing Agent is responsible for putting the home on the market for sale.

R4-28-1101 – Duties to Client

- (H) A salesperson or broker shall not undertake to provide professional services concerning a type of property or services that is outside the salesperson's or broker's field of competence without engaging the assistance of a person who is competent to provide those services, unless the salesperson's or broker's lack of expertise is first disclosed to the client in writing and the client subsequently employs the salesperson or broker.
- (K) A salesperson or broker shall recommend to a client that the client seek appropriate counsel from insurance, legal, tax, and accounting professionals regarding the risks of pre-possession or post-possession of a property.

Buyer:

Person making the offer on the property. All offers are subject to Lender approval.

Real Estate Agent (for the Buyer):

Typically, the buyer's agent will perform the same services as in a normal real estate transaction.

Escrow Officer:

The Escrow Officer becomes involved after the terms of the contract are agreed upon by the Buyer and Seller. The agent will bring the contract to the title company to open Escrow. The Escrow Officer will provide a HUD-1 and a Preliminary Title Report to the agents. The Listing Agent will use the HUD to submit the Short Sale Package to the Lender for approval. The Escrow / Title Company acts as an unbiased third party during the escrow process.

Lien Holder Options and Corresponding Credit Implications

Loan Modification

Late Pays on Credit, Special Forbearance, Loan Mod Permanent – FICO Score impact only
Approximately 1 year of good credit history to “Heal” FICO

Short Sale

FICO Score Impact
Unable to secure a Fannie / Freddie Mac Loan for 2 - 3 years

Foreclosure

FICO Score Impact
Red Flag to Future Creditors
Unable to secure a Fannie Mae / Freddie Mac Loan for 4 -5 years

Bankruptcy

FICO Score Impact
Red Flag to Future Creditors
3 – 5 Year Impact on Credit

(Source: Scottsdale Law Group)

A Closer Look: Short Sale vs. Foreclosure

Short Sale

- How a Short Sale is reported will affect the credit score
- After short sale, Lender can report as:
 - Paid in full – paid as agreed
 - OR
 - Paid – Settled
 - OR
 - Paid – Unrated
- If the owner is current with other payments it is possible that a short sale could lower the credit score by as little as 50 points

Foreclosure

- Can lower credit score by 200 points or more
- Foreclosure remains a public record and on credit history for 7 years

(Source: National Association of Realtors)

Needed Documentation

Most Lenders require the following documentation. All Lender required documentation must be provided in order to open a case with the Lender.

- 1. Letter of Authorization for Agent or Broker:** Names the agent as authorized representative in order to communicate and negotiate with the Lender on Borrower's behalf. Must be signed by all Borrowers.
- 2. Listing Agreement:** Lender may require a fully executed Listing Agreement
- 3. Broker Price Opinion (BPO) / Comparative Market Analysis (CMA):** Lender will require a Market Analysis or other justification of the estimated value of the property. Include recent, valid comparables within close proximity.
- 4. Purchase Contract:** A complete, readable, fully executed copy of the entire agreement. Be sure to include all counter offers and addendums.
- 5. Financial Statement/P&L:** The borrower will need to disclose enough information to demonstrate that a financial hardship exists. The Lender has the right to require extensive financial information. Generally a completed Freddie Mac Financial statement is sufficient.
- 6. Lender Statements:** Lender will want to see two to three months of Lender activity for all borrowers on the loan. Statements for all non-retirement accounts should be included.
- 7. Hardship Letter:** Borrower should explain why they need relief from the mortgage. The letter should detail any job loss, illness, relocation or other circumstances that caused the inability to continue the scheduled payments.
- 8. Proof of Income:** Two to three months of pay stubs for all borrowers.
- 9. Tax Returns:** Provide at least the last two years of Federal income tax returns (1040 only)

Financial Implications

TAXATION

The Mortgage Debt Relief Act of 2007 and Debt Cancellation

If you owe a debt to someone else and they cancel or forgive that debt, the canceled amount may be taxable.

Generally allows taxpayers to exclude income from the discharge of debt on their principal residence. Debt reduced through mortgage restructuring, as well as mortgage debt forgiven in connection with a foreclosure, qualifies for the relief.

This provision applies to debt forgiven in calendar years 2007 through 2012. Up to \$2 million of forgiven debt is eligible for this exclusion (\$1 million if married filing separately). The exclusion does not apply if the discharge is due to services performed for the Lender or any other reason not directly related to a decline in the home's value or the taxpayer's financial condition.

What is Cancellation of Debt?

If you borrow money from a commercial Lender and the Lender later cancels or forgives the debt, you may have to include the cancelled amount in income for tax purposes, depending on the circumstances. When you borrowed the money you were not required to include the loan proceeds in income because you had an obligation to repay the Lender. When that obligation is subsequently forgiven, the amount you received as loan proceeds is normally reportable as income because you no longer have an obligation to repay the Lender. The Lender is usually required to report the amount of the canceled debt to you and the IRS on a Form 1099-C, Cancellation of Debt.

Here's a very simplified example. You borrow \$10,000 and default on the loan after paying back \$2,000. If the Lender is unable to collect the remaining debt from you, there is a cancellation of debt of \$8,000, which generally is taxable income to you.

(Source: <http://www.irs.gov/individuals/article/0,,id=179414,00.html>)

LENDER RECOURSE

Arizona's Anti-Deficiency Statute (A.R.S. 33-814(G))

If trust property of two and one-half acres or less which is limited to and utilized for either a single one-family or a single two-family dwelling is sold pursuant to the trustee's power of sale, no action may be maintained to recover any difference between the amount obtained by sale and the amount of the indebtedness and any interest, costs and expenses.

General Requirements:

- Single family or duplex
- 2 ½ acres or less
- Utilized as a dwelling

Please note: Some Lenders may request the Seller to sign a Note as a requirement of Short Sale approval. The Seller should seek professional counsel prior to signing such a document.

Fees that are paid through escrow...

In a Short Sale situation, the Lender is the one who is essentially paying the fees. In many cases, the Lender will notify the seller of the amount they need to net in order to complete the Short Sale Real Estate Transaction. Below are items that may need to be paid in the Short Sale Transaction and may affect the successful closing of your sale:

Secured Loans and Mortgages: All Loans against the property – first and second mortgages, as well as *equity lines of credit*. In addition to the principal balance of loans, there is interest due through the time the Lender is paid, late fees, applicable pre-payment penalties and any release or close-out fees required by your Lender.

Note: the first Lender may dictate the amount paid to junior lien holders.

County Property Taxes: Taxes are normally paid in arrears. This means that you will still owe taxes at close of escrow even if you have paid your property taxes on time. In addition, if your taxes are not paid current, then all back taxes, including penalties and interest must be paid to the County Treasurer. These amounts may be allowed by the Lender.

Homeowners Association Dues, Fees and Liens: Transfer fees and back dues have to be brought current. If there is enough money in the transaction, the Lender may allow for those fees to be paid in escrow.

Mechanic's and Materialmen's Liens: If you retained a licensed contractor to work on your property, the contractor has a legal right to place a lien against the property to ensure payment. Any such lien must be paid in full and a release provided before the escrow can close.

IRS or Arizona Tax Liens: A lien placed against a taxpayer must be released against the property before escrow will be permitted to close. The taxpayer must work directly with the IRS to obtain a release, *otherwise the full amount must be paid.*

Judgments and Unsecured Creditor Liens: Judgments placed against individuals will also attach to real property. In many cases these judgments will fall under the Arizona Homestead Exemption, except in the case of child and/or spousal support.

Impact Fees, CFD's and Bonds: Some communities are subject to fees that were levied by the city or county when the subdivision was developed. They constitute a lien against the property and must be paid from seller's proceeds unless otherwise accounted for in the Contract.

Commissions: Real Estate Agent commissions (as agreed between you and your agent in the Listing Agreement) need to be paid.

Home Warranty: In the contract, the Home Warranty can be paid for by the Buyer or the Seller. The Lender may or may not allow this to be a charge to the seller.

Credit to the Buyer: Often the contract will be written to include credits to the buyer. The Lender may or may not allow such a credit.

Escrow & Title: Lenders are normally willing to pay any normal seller Title and Escrow fees.

Attorney Fees: You may choose to obtain an attorney to assist in your Short Sale. Sometimes a Lender will allow those fees to be paid for in escrow.

All fees paid through escrow must be approved by the Short Sale Lender. The list contains commonly seen fees, but is not a complete list of fees that may be charged in a Real Estate Transaction.

SHORT SALES FREQUENTLY ASKED QUESTIONS

Can the Seller receive any proceeds from the sale?

No. Generally the Lender will not allow the Seller to walk away with any money.

The Seller is current on all home loan payments. Is the Seller eligible for a short sale?

Lenders usually will not entertain a Short Sale request if the payments are current, though some exceptions may exist.

Will the Seller be required to pay any money into the closing?

It is possible that the Lender will require the Seller or another party to the transaction to pay fees or costs above what the Lender is willing to absorb.

What fees will the Seller's Lender pay to close the short sale?

The Lender will generally pay normal Seller closing costs only. Customary title and escrow fees, pre-approved Real Estate commissions, normal HOA transfer and disclosure fees, documentary costs, taxes and recording fees are usually approved. Additional repair and maintenance costs, delinquent HOA fees, judgments or liens will require specific approval. Real Estate commissions may be reduced by the Lender regardless of the amount stated in the Listing Agreement.

When will a Short Sale close?

Only when all of the following conditions have been met may the sale close:

1. Seller's Lender has approved the contract in writing and stipulated an amount for their reduced payoff.
2. Buyer's Lender has fully approved the new loan and has funded the loan amount to the escrow in "Good Funds".
3. All requirements listed in the Commitment for Title Insurance have been satisfied or removed.
4. Any additional funds necessary to pay all costs, fees and obligations have been paid into the escrow in "Good Funds" by the Buyer, Seller or other applicable party.

How long does the Lender have to approve the Short Sale Contract?

There is no limit to how long the Lender may take and there is no way to know in advance how long the approval process may take. Each Lender has its' own process. Approval can occur in as little as two weeks, but can take 6 to 12 weeks or more.

Is the Lender required to participate in the Short Sale?

No. The Lender has absolute discretion as to its' approval of the Short sale.

Why is the Short Sale contract subject to the Lender's approval when the Buyer and Seller have agreed to the sale.

The Seller's Lender is being asked to take less than they are owed in return for releasing their loan. The sales price and costs in the transaction will affect the amount that remains for the loan payoff, so the Lender actually becomes another principal in the transaction.

What happens if the Lender does not approve the Short Sale?

Often the Lender will stipulate an amount for the loan payoff that they will accept. In that event, the Buyer, Seller and other interested parties may choose to contribute more money in order to make the sale work. If the Lender rejects the Contract outright then the parties can always agree to increase the purchase price and re-submit the offer to the Lender.

When the Lender is reviewing a Short Sale contract for approval, is the Trustee Sale automatically postponed?

No. The Trustee Sale can be held on schedule even if there is a contract under consideration.

Will the Trustee Sale be postponed once the Short Sale Contract is approved?

Not automatically. You should inquire about this and specifically request the Sale be postponed if needed.

Is the Buyer still entitled to buy the property under the Short Sale Contract once the Trustee Sale is Held?

No. The Lender is not bound to the Short Sale Contract if the property is conveyed at Trustee Sale.

Continued.....

How can I get the Lender to approve the Short Sale Contract?

There is no way to pressure the Lender into approval, however, by knowing exactly what the Lender requires and making complete and timely submission of all the Lender's requirements, you greatly improve your chances.

When should I contact the Lender about a potential Short Sale?

When, or even before, the property is listed for sale the Seller or Seller's Agent should contact the Lender's Loss Mitigation Dept and request a "Short Sale Package", or a list of all the Lender's Short Sale requirements. Some Lender's require that a contract be in place before they will send a package, but the earlier the contact, the better.

What happens when the Seller's Lender has approved the contract?

Once written approval has been obtained from Seller's Lender, they will usually stipulate a time by which the escrow must close. The Buyer should be ready to close as soon as possible. This means that Buyer's Lender will need to expedite the new loan processing, appraisal and approval. Buyer should expedite all necessary inspections and arrange to have good funds needed to close.

What happens if the Buyer can't close within the time frame stipulated by the Seller's Lender.

If the escrow has not closed in time to satisfy Seller's Lender then a new written authorization to close will be required. Since the Lender's time requirement is often based upon the net loan proceeds they will receive, it is often necessary for the Lender to obtain new approval for any additional costs incurred by the delay. This approval can take time and is not automatic.

The property has a 1st loan and a 2nd loan. What does that mean in a short sale?

Both loans will need to be released, therefore both Lenders need to approve the Short Sale.

The Seller's Lender is requiring the Seller to sign an agreement or authorization before closing the Short Sale. What should the Seller do?

Some agreements may bind the Seller to repay any forgiven debt. Any party in a short sale should obtain professional legal counsel if they have any questions regarding the transaction or required documents. The Real Estate Agents and the Escrow Officer can't give any legal advice.

I have heard that the IRS will forgive any tax obligation resulting from any forgiven debt from the Short Sale.

This may or may not be the case and depends on a number of factors. NEVER make any assumption regarding taxes. All parties should obtain professional financial advice regarding the transaction. The Real Estate Agents and the Escrow Officer can't give any legal or tax advice.

Is it true that after that sale closes, the Seller will not owe anything to the Lender(s)?

This will be determined by the Lenders, and Sellers should satisfy themselves that they are comfortable with the Lender's Short Sale Terms.

Can the Escrow Officer negotiate with the Lender to get the Contract approved?

No. The Escrow Officer is the neutral third party and can not act as the Seller's agent in dealing with the Lender. The Escrow Officer can act as an intermediary for the parties, and facilitate the transaction by passing on communications and documents. The Escrow Officer has no ability to require any action or enforce any compliance by any party in the transaction.

How much time should be allowed for closing a Short Sale?

A general rule of thumb is to allow at least 90 days from Buyer and Seller's Contract acceptance. You may consider adding a provision that the sale can close earlier if the Lenders approval is obtained.

Obtain Legal Advice

An attorney can advise you about your options and legal liability.

- To find out if you are eligible for free or low cost legal assistance, contact a legal aid organization in your county of one of the organizations listed at www.azbar.org/LawyersHelpingYou/freelegal.cfm or www.azlawhelp.org/housing.cfm
- Contact the Lawyer Referral Service in your county where you can consult with an attorney for a small fee for a half-hour consultation.
Maricopa County: www.maricopabar.org/displaycommon.cfm?an=16 or (602)-506-3296

Pima County: www.pimacountybar.org/web/lawyer-referral-service-1rs or (520)-623-4625
- Attorneys who are State Bar Real Estate Law Certified Specialists can be located at: www.azbar.org/LegalResources/findspecialist.cfm.

Notes

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