

What is a Short Sale?

A short sale is the process by which a homeowner can sell a house for less money than actually owed on the mortgage(s).

There are alternatives to bankruptcy or foreclosure proceedings for homeowners/borrowers who can no longer afford to keep mortgage payments current. One of those options is called a "short sale." Sometimes, to avoid going through the costs of foreclosure, a lender will sanction a short sale by allowing a homeowner to sell (allowing a buyer to purchase) the home for less than the mortgage balance while the home is in pre-foreclosure stage.

Sample steps of a short sale:

- Seller signs a listing agreement with a real estate agent subject to selling as a short sale with third-party approval.
- The owner, or if the owner has an agent, finds a buyer who makes an offer for less than the amount of the mortgage.
- Seller accepts the buyer's purchase offer subject to the lender's approval.
- Seller's lender accepts the buyer's purchase offer.
- Transaction closes when the buyer delivers the funds, the lender releases the lien and the seller delivers the deed.

The decline in market value of a property below the total debt owed on that property does not automatically qualify a homeowner for a short sale. Banks take several factors into consideration when determining if it will allow for a short sale to occur.

Qualifications for a Short Sale

- The Home's Market Value Has Dropped. Comparable sales must substantiate that the home is worth less than the unpaid balance due the lender. This unpaid balance may include a prepayment penalty.
- The Mortgage is in or Near Default Status. It used to be that lenders would not consider a short sale if the payments were current, but in many cases, lenders realize that other factors contribute to a potential default making them eager to head off future problems.
- The Homeowner Has Fallen on Hard Times. The homeowner must submit a letter of hardship that explains why they can not pay the difference due upon sale, including why the homeowner has or will stop making the monthly payments.

Examples of hardship are:

- Unemployment
 - Divorce
 - Medical emergency/sudden illness
 - Bankruptcy
 - Death
 - Other unforeseen circumstances that caused financial hardship
- The Homeowner Has No Assets. The lender will probably want to see a copy of the owner's tax returns and/or a financial statement. If the lender discovers assets, the lender may not grant the short sale because the lender will feel that the homeowner has the ability to pay the shorted difference. Homeowners with assets may still be granted a short sale but could be required to pay back the shortfall.

Short Sale Consequences

A short sale is dependent on a buyer making an offer to purchase. If you do not receive an offer, you will not qualify for a short sale. So even if you meet all the other criteria, it is possible that no one will buy the short sale. It is also dependent on the lender accepting the buyer's offer. If the lender rejects the offer, a short sale will not take place.

- Tax Consequences. If the lender agrees to the short sale, the lender may possess the right to issue you a 1099 for the shorted difference, due to a provision in the IRS code about debt forgiveness. Many situations are exempt from debt forgiveness, according to the Mortgage Forgiveness Debt Relief Act of 2007.

You should speak to a real estate lawyer and a tax accountant to determine the amount of short sale tax consequences, and whether you can afford to pay those taxes, if any.

- Blemished Credit Report. A short sale will show up on your credit report. It's a pre-foreclosure that has been redeemed. Short sales affect credit ratings. While the damage to your credit report may not seem as bad as a foreclosure to you, creditors may not make the distinction.

Always seek legal counsel before attempting to pursue a short sale. A real estate agent cannot give you legal advice.

This handout provided by the city of Phoenix Neighborhood Services Department is intended to foster communication between the owner and real estate professionals. This handout should not be regarded as legal advice or considered a replacement for the responsibilities to be familiar with the law.