

Don't foreclose! Do a short sale!

NEW YORK (CNNMoney.com) -- Short sales are the hottest thing going in the distressed-property market, and the trend is expected to get even hotter in coming weeks, when the government starts handing out cash to encourage lenders to close these deals.

"Banks have ramped up short sale approvals," said Duane Legate of House Buyer Network, which connects short sellers with buyers. "They're hiring a lot of the people who once worked in the mortgage-lending industry and moved them over to short sales."

These transactions, where lenders allow homeowners to sell their houses for less than they owe, accounted for 17% of all residential real estate sales in February, up from nearly 13% in November, according to a monthly real estate market survey by Campbell/Inside Mortgage Finance.

And Bank of America (BAC, Fortune 500), the country's largest mortgage servicer, has more than doubled the number of short sales it processed in recent months.

Elizabeth Weintraub, a Sacramento, Calif.-area real estate agent who handles many short sales, was amazed at how quickly a recent deal went through. "Bank of America approved it in 24 days," she said. "That flipped me out."

This is a huge change from even just six months ago when the short-sale market was stalled and most people would describe the process as real estate hell. Because lenders stand to lose so much on these transactions, they have been reluctant to make short sales happen, often waiting months before getting back to potential buyers.

Beware: You lost your house but still have to pay!

"In the past, many short sales would never come to fruition and the ones that did averaged over half a year to complete," said Chris Saitta, CEO of Equator, which produces short sale software. "Things would just fall into a black hole and not come out again," added Weintraub.

And even when banks did agree to the sale, the process could be further complicated if the original owner had a second mortgage.

In most cases, the first lender is repaid in full before any money flows to a second-lien holder. And because most distressed borrowers are severely underwater, there's usually nothing left to send on. As a result, second-lien holders are left holding the bag and have been killing many deals.

But that has been changing. For one thing, banks realize that they make out far better financially with a short sale than a foreclosure. "The lenders lose 50% on a foreclosure and only 30% on a short sale," said Glenn Kelman, founder of the real estate Web site Redfin. "And short sales offer a way to get distressed properties off their books quickly."

And on April 5, lenders and mortgage investors will have even more incentives to offer troubled borrowers short sales instead of foreclosing.

Under the new Home Affordable Foreclosure Alternatives program, borrowers will earn a \$3,000 "relocation incentive" and servicers will get \$1,500 for handling a short sale.

The investors who actually own the mortgage notes will get \$2,000 in exchange for sharing proceeds of the short sales with any second-lien holders. And, finally, those

second lien holders will receive up to \$6,000 for releasing their claims.

Lenders participating in the program must also determine the market values of properties early on and inform the owners of just what price they're willing to accept. Then, if owners come back to the lenders with bonafide offers, they have to be accepted within 10 days.

Equator's Saitta anticipates a short sale explosion in response to the new program. "The challenge will be handling all the volume," he said.

The company has already tweaked its software, which 58 servicers use, to handle the new HAFSA rules. And that should help reduce the time it takes to execute a sale, which currently averages 88 days.

The boom in short sales may accelerate the end to the foreclosure crisis by cleaning out the overhang of borrowers in distress and replacing them with more stable homeowners.

Plus, these sales are better for distressed borrowers because their credit scores suffer less. ***Going through a foreclosure can knock 200 points off a FICO score, twice as much as the penalty for a short sale.***

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