# SHORT SALE-FREQUENTLY ASKED QUESTIONS

**Q: What is a Short Sale?**

**ANSWER:** In a short sale, the lender agrees to settle the debt owed on the property for less than the full amount. "Settled" means that the lender is writing off the debt (which is why you get a 1099 after a short sale for the amount of debt forgiven) and that they are not going to go after you for the money they lost by filing a deficiency judgment in the future.

**Q: How will a short sale affect my credit?**

**ANSWER:** A short sale is recorded on your credit report as "debt settled for less than the amount owed". This typically will result in a relatively minor hit on your credit compared to a foreclosure or late payments on your mortgage. I say '"typically" because it affects everyone's credit differently. The more established your credit, the less of an impact it will have on your score. The reason you often hear and read that a short sale will drop your credit 100 points or more, is that, many people, when they do a short sale, stop making their mortgage payments. If you stop making your mortgage payments for 4 months, regardless of whether you do a short sale or not, 4 months of missed mortgage payments will have a significant negative impact on your credit. In other words, it is the missed mortgage payments that have the big impact on your credit, not the short sale itself. With this said, if you are already behind on your payments, you have already incurred the majority of the hit that a short sale will have on your credit. A successful short sale at this point will insure that your debt is settled with your lender. If you are current on your payments and can stay current throughout the short sale process, you will save your credit to a large extent. Finally, if you do stop making your mortgage payments, there are various credit repair agencies that can repair your credit by removing late payments from your credit report after a short sale.

**Q: Will I have to pay federal taxes on the money my lender loses in the short sale?**

**ANSWER:** There are several different scenarios with regard to whether or not you will owe federal income taxes on the loss the lender takes in a short sale. When you do a short sale, your lender is agreeing to settle the debt on the property for less than the amount they are owed. The IRS therefore allows them to write off this loss, which is why your lender will send you a 1099-C after the short sale. The IRS considers "debt relief" to be income for tax purposes. In other words, if your lender writes off $50,000 on your short sale, they will send you a 1099-C for that amount, and you would include that when you file your income taxes. The "C" stands for "Cancellation of Debt" and the law says cancelled debt is taxable as income. There are however a few exceptions that most people who do a short sale qualify for that exclude them from having to pay taxes on their short sale. Thanks to the Mortgage Tax Debt Relief Act that George W. Bush signed into law in January of 2008, homeowners who do a short sale on their primary residence, and have a purchase money loan (in other words, they have not pulled cash out of their home with a cash-out refinance) pay no taxes on the loss that their lender incurs in a short sale. Homeowners who have pulled out cash from their home but have put that money back into their home to "substantially improve" their home, also are excluded from taxes on the short sale. All other short sale scenarios – if you pulled cash out on your primary residence but spent it something other than upgrading your home or if you are doing a short sale on a second home or investment property – result in a taxable event unless you qualify for the "Insolvency" exclusion. The IRS does not require you to pay taxes on the loss the lender takes in a short sale if, at the time of the short sale, you are insolvent. Insolvency means your debts (including your mortgage) exceed the value of all your assets. In other words, if, at the time of the short sale, you have more debt than you do money or assets, you are considered insolvent.

Many people who find themselves facing a short sale are in exactly this situation and are thus excluded from paying taxes on a short sale. We recommend you check with your CPA or accountant or go to the IRS website and look up IRS Form 982, which is the IRS form for debt relief and short sales. The IRS gives an explanation of "Insolvency". Finally, the time period for The Mortgage Tax Debt Relief Act was originally only slated to go until the end of 2008, however it has now been extended to the end of 2012.

**Q: Can my lender go after me for the money it loses in the short sale?**

**ANSWER:** The point of a short sale is to get out from under the debt of the mortgage. This is why your lender will send you a 1099-C after the short sale. The "C" in "1099-C" stands for "Cancellation of Debt." Your lender cannot write off their loss on their corporate taxes, send you a 1099-C so you have to pay taxes on the loss, report the short sale as a "settled debt" on your credit and then turn around and go after you for the money.

**Q: What if I have a first and a second loan on my property with 2 different lenders (or the same lender)?**

**ANSWER:** Most people that we do short sales for have a first and a second loan, often with 2 different lenders. For the short sale to reach a successful close of escrow, both lenders have to approve the short sale and agree to settle the debt. It is important to note that both lenders have a vested interest in doing this. The lender with the first loan does not want to foreclose, and therefore is willing to give a little money to the second in order to get them to agree to the short sale. The second lender will get nothing if the first forecloses, so with the attitude that something is better than nothing, they will agree to take a fraction of what they are owed in order to avoid getting absolutely nothing.

**Q: What is the difference between a recourse and a non recourse loan?**

**ANSWER:** In general, a purchase money loan is considered to be a "non recourse" loan, while a "cash out" loan is considered to be a "recourse" loan. The difference between these two loans is that in a "recourse loan" the lender technically has recourse to go after the borrower for the money they lose in a foreclosure.

**Q: How will I know that I am being released from the debt?**

**ANSWER:** It will be stated clearly on the bank's short sale approval. Your lender will state in plain English (though in different verbiage depending on the lender) that they are "releasing the lien", "accepting a short payoff to satisfy the lien", "reporting the sale as a settled debt to the reporting agencies", "issuing a full satisfaction of the mortgage", "not pursuing a deficiency judgment", or some other variation that states they are settling the debt for less than what they were owed. Further, your bank will issue a 1099-C to you, the borrower, after the short sale, confirming that the debt has been written off and is settled. Your lender cannot write off the debt, issue you a 1099-C & then go after you for the deficiency.

**Q: What are the advantages of a short sale vs. letting my home go to foreclosure?**

**ANSWER:** The primary advantage to doing a short sale vs. walking away and letting your home go to foreclosure is that in a short sale the debt is settled and you no longer owe the bank any money. If your home goes to foreclosure, you may still be liable for the deficiency in the event that the bank files a judicial foreclosure. A secondary (but still very important) advantage is that in a short sale, your credit takes much less of a hit compared to a foreclosure. The impact on your credit will vary depending on how established your credit is at the time of the short sale or foreclosure. Finally, Fannie Mae & Freddie Mac revised their guidelines in August of 2008 with regard to how they view borrowers who have filed bankruptcy, gone through foreclosure or done a short sale. Through these new guidelines, they are in effect severely penalizing those who go the route of foreclosure or bankruptcy, and rewarding or encouraging those who do short sales, which they view as the borrower doing the responsible thing in light of the circumstances. Per recent Fannie Mae / Freddie Mac guidelines, borrowers who file bankruptcy or go through foreclosure have to wait up to 7 years to buy another home. By contrast, the new guidelines stipulate only a 24 month waiting period after a short sale, so borrowers who do a short sale can buy again in just 2 years.

**Q: Are there any advantages to letting my home go to foreclosure vs. doing a short sale?**

**ANSWER:** I have yet to hear a coherent argument for letting your home go to foreclosure vs. doing a successful short sale. Depending on whether you have a recourse or non-recourse loan, when you let your home go to foreclosure you either run the risk of being liable for the deficiency amount or liable for the income taxes on that loss. Secondly, your credit will drop up to 400 points and you will not be able to buy a home or get any decent credit for up to 7 years. Compare this with a short sale, in which the lender agrees to SETTLE the debt for less than the amount owed. If you have recourse loan, you may be liable for income taxes on the lender's loss (just as in a foreclosure) but you will not be liable for the deficiency (and if you qualify for the "Insolvency" exclusion, you will avoid the income taxes as well). Further, the loss that the lender takes in a short sale will be MUCH LESS than the loss the lender takes at the end of the foreclosure process. The foreclosure process takes months & months, at the end of which the lender has to process the property through its overwhelmed system (another 3 -5 months) and then put the property back on the market, all while the market continues to drop. Finally, the impact on your credit from a short sale will be significantly less than with a foreclosure and you will be able to buy again within 2 years, compared to up to a 7 year waiting period to buy a home after a foreclosure.

**Q: How much will a short sale cost me?**

**ANSWER:** A short sale costs the seller nothing – the lender pays all closing costs, escrow fees, commissions, and short sale negotiation fees, etc. The lender may also pay any outstanding property taxes.

**Q: How long will a short sale take?**

**ANSWER:** The short sale process typically takes about 4-8 months, start to finish. It can take longer depending on Lender backlog or the Seller's ability to supply the requested paperwork. You can live in the property for the entire duration of the short sale or you can move.

**Q: Do I need to be behind on my payments to do a short sale?**

**ANSWER:** No. This is a common misconception. You do not need to be behind on your payments or have been late on a payment to do a short sale although the lenders are more motivated to do the short sale if you are not making payments.

**Q: Should I file bankruptcy?** Will it allow me to keep my home? I've heard the lender cannot foreclose if I file bankruptcy.

**ANSWER:** There are 2 types of bankruptcy commonly used by individuals – Chapter 7 ("Fresh Start") and Chapter 13 ("Wage Earner"). Chapter 7 can enable individual filers to wipe away debts such as credit card and medical bills so they can continue to make their mortgage payments. Chapter 13 involves setting up a 3-5 year repayment plan to repay your debts. Chapter 13 requires that you are earning a steady income, as you will be repaying all of your debt. Both have a very negative impact on your credit and remain on your credit report for 10 years. Because of the new 2005 bankruptcy law, which raised the bar for people to qualify for Chapter 7 "fresh start" bankruptcy proceedings, fewer and fewer people pass the "means" test to qualify for Chapter 7 and for this reason can only qualify for Chapter 13 bankruptcy (a 3-5 year repayment plan). While both Chapter 7 and Chapter 13 can temporarily delay foreclosure proceedings, neither will allow you to keep your home unless you can bring your mortgage current. If you would like more information on whether a bankruptcy is right for you, we recommend you consult a competent bankruptcy attorney, as we are not attorneys and do not dispense legal advice.

*Providing Quality Customer Service and Delivering Results!*

**Todd Rettkowski, P.A. e-PRO®**
***REALTOR®, CNHS, RCC, CDPE***
**Execuhome Realty**
**Direct: (410) 256-4605**
**Mobile: (410) 370-8926**
**ToddRettkowski@bellsouth.net**
**www.MdShortSaleHelp.net**

e-PRO REALTOR®

CDPE
CERTIFIED DISTRESSED PROPERTY EXPERT®

Certified NEW HOME SPECIALIST™

Residential Construction CERTIFIED™