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Real Estate Short Sales

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Certainly, the dire state of the home mortgage foreclosure crisis is in this country over the past several years has been well-documented, and the State of Michigan (the tri-county area in particular) has been affected more severely than most. Virtually every Michigander has suffered its effects in one way or another. The combination of sliding property values and mortgage defaults has created a situation much worse than many of us had anticipated.

One potential tool for lessening the impact of this problem is the so-called "short sale." In a short sale transaction, the Lender agrees to accept less than the full mortgage amount owed on the property so that the Owner/Borrower can sell it (which is no longer worth what he/she owes on it). As part of the short sale the Lender generally agrees to forgive, by accepting the lower price, any remaining balance on the mortgage debt.

For those who wonder why the Lender would agree to a short sale, consider first that Lenders are in the loan business, not the real estate business. Nearly every time the Lender forecloses on a property, it becomes the reluctant owner of a piece of real estate. This creates an extra set of responsibilities that the lender often is not in the best position to address. Becoming an owner of real estate creates certain responsibilities which, by their nature, require time and money. Lenders are not exempt from the day-to-day costs that affect every homeowner: security, insurance, taxes, condominium assessments, utilities and everyday maintenance. Additionally, the cost of a foreclosure action is itself very expensive, and many times the foreclosed property does not provide a positive return to the Lender. Lenders therefore have become more inclined to agree to short sales as a practical means of resolving defaulted mortgages.

Condominium Association benefit from the short sale process. By owning a condominium unit, each individual co-owner becomes an investor in the affairs of the other co-owners. By allowing short sales, the community is stabilized by the decrease in foreclosed and vacant units. Although foreclosing lenders remain responsible for assessments from the foreclosure sale date forward, they are often slow to pay, and many times a portion of assessments, incurred just prior to the foreclosure sale, goes uncollected. Where the property is sold, the Association is entitled to all of the assessments due on the account without interruption.

In keeping all assessments as current as possible, the Board of Directors is able to better plan for future big-ticket items such as capital improvements or large maintenance or repair items. The other and more subtle benefits include more stable property values, no eyesore vacant units, and avoiding the problems that can result when vacant units are not properly winterized and/or maintained (something that can be very expensive). For example, in the month preceding the writing of this article, the Associations handled by this writer had two units that incurred serious damage, with the costs of repairs running in the tens of thousands of dollars. Such damage occurred when water pipes within the unit froze and burst (the foreclosing lender had not maintained the heat inside the unit during the winter), which resulted in severe water damage to the two vacant units' interiors.

Finally, short sales benefit borrowers who can no longer afford their mortgages, realtors, and the economy in general. The Federal Government made this a more enticing option to borrowers by amending the Internal Revenue Code. Prior to the Mortgage Forgiveness Debt Relief Act of 2007, when lenders accepted a short sale and forgave the balance of the debt owed, that forgiven debt was treated as taxable income to the borrower just like all other wages and salary received. The Act amended 26 USC §108 allowed a borrower (under certain circumstances) to exclude this amount of forgiven debt from his or her taxable income, thereby enabling the co-owner to walk away from the short sale with little downside.

Realtors benefit from the new law because it creates a new potential class of buyers and sellers, which allows the economy to keep moving. Realtors are still paid their commissions on short sales, so they are generally amenable to doing most of the work involved in getting a short sale approved. Even if the real estate market continues to move at the current snail's pace, this change in the law will continue to put money into the economy from the spinoff businesses that are part of the short sales process. Over the long run, this will benefit everyone.

The short sale is just one of many tools available to minimize the impact of a mortgage foreclosure. We recommend that all borrowers/homeowners facing a possible foreclosure/short sale situation should seek the counsel of a qualified professional before deciding on which course of action to pursue, as there may be other relief available to the borrower/homeowner depending on the specific facts pertaining to that person's situation.