

Short and Sweet

Short sales save time and present a profitable arena for mortgage brokers

By **Jim Richman**, president, Richman and Associates Inc.

FIVE OR SIX TIMES A MONTH, WE handle short-sale negotiations with lenders. There don't seem to be many companies that know what a short sale is, much less how to work with mortgage brokers, investors and lenders on negotiating short sales.

Here is what we do know: Some bright investors made millions when they created a formula for buying problem residential and commercial properties — often in foreclosure — from owners at 20 percent to 30 percent less than the market price when the loan is 10 percent or even 30 percent more than the home's market value.

Most short sales are on residential properties in troubled areas. Real estate investors have learned to make money even when market values are depreciating, and so should you.

Why lenders choose short sales

Why would a lender allow a property to be sold and accept a loan payoff that is far less than the amount of the home loan? The answer is simple: to save time and money.

Typically, when a loan goes into foreclosure, the lender faces a long list of steps and possible scenarios in order to resell the house. Short-selling can eliminate all of this for the lender and leave the investor with a great opportunity to make money.

When a loan goes into foreclosure,

a Realtor will give an estimate of the property's value at the lender's request. That Realtor doesn't normally inspect the inside of the home. If the lender forecloses on the property, it will be sold "as is." Further, the lender won't know the property's true condition.

But if the lender knows that repairs are needed on the property, it should disclose that information to all potential buyers, even though it cuts the market value of the building. The lender might face repair estimates from the investor's contractor. The investor's appraisal of the home, based on the estimated repair costs to make the home perfect, will be conservative compared to the Realtor's estimate.

So here's what the lender faces: The Realtor gives a property value of \$195,000, but that is based on some photos and some comps, not an interior inspection. The lender has an investor-paid-for appraisal that gives a value far less than the Realtor's because the investor's contractor estimates repairs to cost \$35,000.

At this point, the lender knows that if it orders a full appraisal, its appraiser will also be handed a list of costly repairs. The lender therefore

believes the property will sell at a discount because of the property's condition.

Further, the lender must pay the Realtor a 6-percent commission and pay the closing costs. Plus, it will lose the time it

takes to close escrow as well as lose interest each day on the money in the loan. Add the management time and expense of this scenario, and the lender faces a big loss.

To avoid the hassle, the lender may accept an offer from the investor of \$150,000 or less. After all, there is an old saying in banking: "Your first loss is your best loss."

What the investor can expect

The lender will, of course, require a detailed account of the transaction. There can be no cash given to the seller and the real estate sale commission can't be more than 5 percent. (Each lender has its own commission rules.) The lender will require a net cash-out estimate from the escrow company handling the sale in order to accept the deal.

If there is a second loan, the investor must offer some money to buy that loan, but normally no more than 10 percent of the lender's balance is required. Keep in mind, the second loan will get wiped out if the first lender forecloses, but the lender needs some incentive just to do the paperwork.

Continued ...



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Some lenders will allow \$500 to be paid out of escrow funds to the junior lender, but in every case an investor must make a deal outside the escrow to buy the junior loan.

If investors buy the second loan, there will be no 1099 form sent to the property-owner. Now that's a deal.

Borrowers are off the hook for any loss the bank takes because the bank accepted the short sale. Note, in some states the only collateral for real estate is the property, and lenders cannot sue borrowers for any loss.

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So how do you make money in short sales? Spread the word. Tell your current and prospective investor clients about short-sale profits, and they could give you loan after loan. And you can charge an extra fee for the extra work. (Keep in mind, you can buy properties, too.)

One thing is for sure: As lenders tighten their underwriting guidelines and as rates and foreclosures increase, property values are decreasing in many parts of the country. With these factors in mind, every mortgage broker will need to explore new ways to stay profitable. **!!**

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