

Dual Upside To Foreclosure Alternative

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(CBS) The Early Show's financial guru, Ray Martin, wraps up his three-part series on home buying and selling in a buyers' market with a look at the foreclosure process, and a way homeowners who are behind on their payments can escape some of the worst consequences of foreclosure. Buyers of their homes can gain advantages over foreclosure, too.

As Foreclosures Rise, More Sellers and Lenders Consider Short-Selling

The headline news recently was that the number of mortgages entering the foreclosure process rose to a record level. Of the nearly 44 million mortgages, about 0.58 percent — that's 254,590 — or one out of every 172 loans, are now officially in foreclosure.

Foreclosure occurs when borrowers have not made two or more payments and lenders respond by filing a legal notice and commencing a legal proceeding to take possession of the home.

The record number of foreclosures does not appear to be evenly spread around the country. According to the Mortgage Bankers Association, the rate of mortgages in foreclosure would have fallen if not for big jumps in foreclosures in local markets of California, Florida, Nevada and Arizona, where investors who bought on speculation that values would rise are walking away from property that is now worth less than they owe. Also, in regions of Ohio, Michigan and Indiana, areas marked by large job losses in manufacturing are seeing big increases in foreclosures.

A Foreclosure Alternative

The prospect of foreclosure is difficult for a homeowner, but there is another option.

A little-known alternative, once more commonly used in the real estate downturn of the early '90s, is the "short sale," which works like this: A homeowner falls behind on his or her mortgage payments, usually due to a job loss, rising debt payments, or both. Facing a situation in which the home value has fallen and cannot be sold for the amount of the mortgage owed, the homeowner works out a deal with the lender to sell the home for whatever the market will bear. If the amount of the sale is for less than the amount owed on the mortgage, the lender gets the proceeds and discharges the remaining debt. The homeowner will have to leave the house as soon as it is sold.

Alternatively, with a foreclosure, homeowners who can no longer make payments are served with a notice of foreclosure, which essentially informs them to either bring the loan current or face the home being taken over and sold at a public auction, after which the homeowner will face eviction proceedings. While this process is going on, the homeowner can live in the house rent-free for up to a year, depending on that state's foreclosure and eviction laws. But this fact alone does not mean the foreclosure is better; in fact, it may be worse.

Lose the House, but Not Your Credit

According to sources in the mortgage industry, people who agree to a short sale with the lender do far less damage to their credit rating than those who go through foreclosure.

While in both cases, short sale and foreclosure, the delinquent mortgage will negatively affect their credit rating, at least short sellers avoid having a "debt discharged due to foreclosure" on their credit reports. Mortgage and credit experts say that, after bankruptcy, having a foreclosure on your credit report is the worst result and will reduce your credit score by over 250 points. You could also have to wait up to three years to qualify for a mortgage at a reasonable rate.

Short sales show up on a credit report as a "pre-foreclosure in redemption" status and can result in a credit score reduction of 100 points or less. After the sale, the mortgage may show up as "discharged." People who successfully complete a short sale may also qualify for a mortgage at a reasonable interest rate in as little as 18 months. So, if buying a home is a future goal, then a short sale is the better option for many.

Homeowners cannot simply decide that they want to unload a home with a short sale; the lender must agree to it. The key to getting a lender to go along is to demonstrate two things: that you have no other financial resources to pay the mortgage, and that the sale price the buyer is willing to pay is the fair price the market will bear. If a lender believes it can get more for the house by taking possession of it and selling it themselves, then they will not go along with a short sale.

To begin the process of a short sale, you first need to call the lender and speak directly with the person in the loan workout or short sale department. At GMAC ResCap, a large residential mortgage lender, there is a "foreclosure prevention department" with people trained to work with homeowners in exactly this situation. Their motivation is summed up by Steve Nelson at that company: "We pretty much know what our loss is going to be if we foreclose. If a short-seller results in a payoff that's better than that number, we're talking all day long with people who want to put a short sale together." Some lenders report a three- to four-times rise in the number of short

sales over the past year.

People who want to go this route should contact a local real estate firm and ask to work with a real estate agent who has actual experience with short sales. These specially trained agents will know the process and deliver the documentation that the lender requires to authorize the short sale. The agent can also find a buyer that is qualified to complete the transaction.

If all goes as planned, the lender will receive all of the proceeds, typically not enough to pay off the loan. The remaining balance of the loan is discharged. But a homeowner agreeing to a short sale should also get legal advice to protect his or herself from future claims of the lender. In some states, only purchase mortgages are fully discharged. For all other types of debt (equity loans, refinancing, etc), the homeowner can be held personally liable for repayment in the future. For this reason, a lawyer's advice will include getting the lender to agree to fully discharge all mortgage debt involved in the short sale.

Buying a Short Sale Home

Buyers who can find a short-sale can get a good deal. The advantages of buying a property through a short sale include buying at a discounted price and buying a house where the sellers are still motivated to sell the home and may take care of it until it is sold.

Some buyers think they can get a better deal by waiting to buy a house when it goes into foreclosure, but buying a house through foreclosure is risky business and not for first-time buyers or inexperienced real estate investors. You should get advice from an experienced professional. Hire a lawyer to help you with the eviction process if the home is occupied. Sometimes, tenants who are sued for eviction can retaliate. When sellers realize they will lose their home to foreclosure, they often stop caring for it. Many states require buyers to make certain disclosures to the owners, and failure to do so on the proper forms and in the required timeframes can result in fines, lawsuits, and even cancellation of the sale and loss of your money.

It's typically advised to work with a realtor with experience in short sales, because they can help you research the market to find the properties where foreclosure notices have been filed as well as how much is owed by the lender. Typically, this can be done at the county registrar of deeds. They can also approach these homeowners for you to let them know that they are aware that the foreclosure notice has been filed and that, if the owner is interested, there is a buyer who could work with them to complete a short sale.

Even if you find a home where the owner is willing to work out a short sale, don't assume the lender will go along with it. Once the seller agrees to your offer, your agent will need to send it to the lender for approval, and you will not have a deal until the lender OKs it.

Expect a lender to negotiate a higher price; they will want to know they are getting paid the most they can get for the house. Since the lender is paying the realtor's commission, it will likely ask your agent to lower his commission, or you to pay some of it. Typically, the lender will not bear the cost of items that are typically paid for by sellers, such as inspections, and the lender will agree only to sell the property if the buyer agrees to buy it in "as is" condition. This makes it all the more important for a buyer of a property through a short sale to make an offer contingent upon approving a through home inspection.

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