



# REAL PROPERTY

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## Navigating the short sale

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Your client has fallen behind in his mortgage payments and is served with a foreclosure complaint. He wants to avoid a foreclosure sale and the possibility of a deficiency judgment and would like to sell the property. He even has a potential buyer lined up. He has heard he can do a "Short Sale" and asks you to coordinate one for him. What do you do?

### Introduction

A "Short Sale" is the label we put on a transaction involving the sale of property for less than its existing mortgage(s). We are 'shorting' the lender with respect to their loan repayment. In convincing a lender to accept your short sale proposal, you will have to show 1) that your client's financial situation warrants a short sale, and 2) that the certainty of the short sale outweighs the risk faced by a lender at a foreclosure sale.

This article will help you navigate through many of the dangers lurking beneath the surface of a Short Sale transaction.

### Gather Information

It is essential from the beginning that you have a full understanding of your client's current financial situation. Some factors to inquire about during your initial client interview include: Has the client (or the client's spouse) filed for divorce? Is a divorce imminent? Does the spouse have any marital rights to the property? Has the client filed (or intending to file) bankruptcy? How has the client encumbered the property? Is the property being rented? Is the client behind in condominium association dues? Has the client been sued by the association for past dues? Do the spouses agree regarding the disposition of the property? What is the client's current and prospective employment status? Does the client have sufficient funds to pay for closing costs, transfer taxes and attorney fees?

It is true these are all questions that should be addressed in a standard closing as well. However, for a short sale, it is more a matter of timing. For example, you do not want to wait until the lender has approved your Short Sale proposal to request your paid assessment letter from a condo association. If you find out there are past due assessments, move out fees or document preparation fees, you might have a problem. Your client might not be able to afford to pay for these items. In a Short Sale, the lender will not allow the seller to take cash away from the closing, and once the lender has settled on a payoff, it may be difficult or time consuming to re-negotiate. Thus, in a Short Sale, you are essentially preparing your closing statement at the very beginning of the process rather than the end. You need to know all potential costs, fees, dues, prorations and taxes up front so you can make an offer to the lender which accurately reflects what they can expect to net from the sale.

### Purchase Contract

Next, you must review the contract entered into between the buyer and seller. Make sure that the contract includes a Short Sale addendum. The addendum should be signed by all parties and brokers involved in the transaction. Some issues that should be addressed in a Short Sale addendum include the following:

1. That the seller's acceptance of the contract is contingent upon the seller's lender approving of the transaction and issuing a payoff letter. It may take 90 days or more to secure lender approval. However, it should be agreed that the sale must then close within 30 days after lender's approval is secured. If the buyer is purchasing with a mortgage, then the mortgage contingency provision should be adjusted so that the buyer is permitted to cancel the transaction if the buyer is unable to secure a mortgage within 15 days after the seller's lender issues its payoff.
2. That the buyer accepts the condition of the property "as is" and that no credits of any kind will be given. Inspections should be conducted and final price agreed upon before the Short Sale packet is submitted to the lender.
3. That the seller will receive no cash from this transaction. Any funds usually due to the seller will be paid to the lender.
4. That the buyer shall be bound by the offer for a period certain (e.g. 45-60 days) while the Short Sale is being negotiated with the lender. After said period, the buyer may cancel the contract and receive return of the earnest money. The parties need to strike a balance between binding the buyer to the deal versus being unfairly open ended.
5. That if no sale is consummated, then no commission is earned by either broker. This is an important issue for a cash strapped seller. If the lender does not approve of the contract and the transaction does not close, the seller should not have to pay a commission. In addition, the commission might have to be negotiated down depending on what the lender is willing to accept by way of pay off. These issues should be addressed by all the parties, and appropriate notices should be placed in MLS listing.
6. That the seller should consult with a tax advisor as to the implications of undertaking a short sale. The forgiven portion of the loan may be considered taxable income by the IRS. A seller should consider signing a re-affirmation agreement with the lender for that portion of the debt not covered by the short sale. Such an offer may also encourage the lender to accept the Short Sale proposal.

#### The Short Sale "Packet"

At the core of a Short Sale is a "Short Sale Packet." This packet constitutes a variety of documents that will be submitted to the lender for approval of the Short Sale proposal. Items that should be included in a Short Sale Packet are as follows:

1. Authorization to release information
2. Contract for purchase
3. Estimated closing statement
4. Hardship letter
5. 2 months of bank statements
6. Broker's comparative market analysis
7. Last two years of tax returns



8. A current income to debt spreadsheet

9. 2 months of pay stubs

10. Title commitment

The letter of authorization should include each mortgagor's name, address and social security number along, the lender's name and loan number. It should also contain a broad and unambiguous authorization allowing you to obtain a payoff letter and to communicate with the lender regarding the client's loan. This letter should be signed and notarized by each client whose name is on the loan.

The hardship letter should be drafted by the client. It should detail the client's current financial situation along with an explanation of why the client is experiencing an inability to make timely and/or sufficient payments on the mortgage. The client should also provide details regarding all current debts and bills as well as an accounting of their total assets and other sources of income. The client should understand that the sincerity, accuracy and completeness of this letter are an important part of the lender's decision to accept a Short Sale proposal.

The broker's comparative analysis will show the lender that the buyer's offer is fair given current market conditions and home values. The lender will eventually conduct their own appraisal, but providing this information up front will show the sincerity of the transaction and the due diligence of the seller. If this information is accurate, then the lender will see no point in taking the property through foreclosure.

### Pending Foreclosure

You must monitor the progress of any foreclosure suit pending while you are trying to coordinate the Short Sale. Although your client may have no defense to foreclosure, you must monitor the progress of the case. Once a foreclosure suit has been filed, the clock is ticking on ownership. In general, for a residential foreclosure, the right of redemption expires after the later of seven months after service of all mortgagors or three months from the date of entry of judgment of foreclosure. After that time has passed, the lender's attorney will likely file a motion for summary judgment, and a sale will be scheduled approximately 90 days after summary judgment is entered.

While waiting for an answer from the lender on your Short Sale proposal, you might need time on the pending foreclosure suit. One way to extend your time is by conducting discovery if appropriate or by challenging defective filings. However, don't forget that the mortgage your client signed will allow the lender to collect attorney fees. Additional fees incurred by the lender in prosecuting the foreclosure case will likely be passed along to your client. Nevertheless, you should keep in touch with the foreclosure attorney and keep them informed of your Short Sale status. Perhaps the foreclosing attorney will grant you additional time before filing a motion for summary judgment if they see you are making progress with the lender. In addition, you may be able to negotiate a foreclosure sale date later than 90 days after judgment. Remember, it is essential that you close prior to any foreclosure sale. Illinois does not recognize an equitable right of redemption, and the mere existence of another buyer who was ready, willing and able to close will not justify the reversal of a foreclosure sale.

### Final Directions

A few days before the closing you should again call all the creditors to confirm that their payoff letters are still up to date and accurate. If additional charges have been assessed, you should update your closing statement and make an 11th hour request that the lender reduce their payoff. Also, be creative. For example, if your client doesn't have enough money to pay transfer tax stamps; consider reaching an agreement with the buyer to use the earnest money for this purpose. If the deal does not close, then a refund can be obtained. There is no real danger to the buyer, and the seller will benefit from the assistance while in a cash-strapped condition. In addition, after the closing, make sure that the foreclosure case gets dismissed, and request that the foreclosure attorney send you a copy of the dismissal order.

In navigating the turbulent waters of a Short Sale, your overall attitude should be one of a captain guiding the ship. Be

calm, accurate and in control. Remember, your client has no 'right' to obtain a Short Sale. So, be respectful and patient when dealing those from whom you are requesting cooperation. Convey to them that you are trying to help all parties involved out of a difficult situation. In the end, you will find a great sense of satisfaction in assisting a client to resolve a potentially devastating financial crisis.

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[« Back to the October 2008 Newsletter](#)

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