



**\*\* CONSUMER ALERT \*\***

**WARNING REGARDING RESIDENTIAL "SHORT" SALES**

If you find yourself in a situation where your financial circumstances either challenge your ability to make your home mortgage payments or you are no longer able to make the mortgage payments at all, you will be presented with a series of difficult options that will have an impact on your personal and financial life for years to come.

One of the more familiar options is foreclosure. In a foreclosure, the bank/lender (owner of your loan) decides to sell your house as a means to get back the money they loaned you. However, in this current real estate market, some banks/lenders are not exercising their foreclosure rights and instead have opted for either "loan modifications" or "short-sale" deals. Since it appears that successful loan modifications have not been very prevalent, this alert is written to discuss another option that is currently available to the banks/lenders: short sale transactions.

**Short Sale Transactions:**

What is a short sale? To put it simply, a short sale transaction is a sale of a property in which the outstanding debt (in the form of mortgages – such as purchase loans, refinance loans, home-equity loans, or one of the various other types of loans secured by your property) was more than the price for which the property was sold. Example: 1<sup>st</sup> and 2<sup>nd</sup> mortgages totaled \$470,000.00 and the property was sold for \$325,000.00. The sale price was \$145,000.00 "short" of the amount that the seller had originally borrowed – thus the term "short sale." Since the banks/lenders were essentially paid back less than what you borrowed, you could be deemed to have received a debt "forgiveness" of \$145,000.00. A sale of this type requires bank/lender approval.

While there are many reasons why a bank/lender would choose this manner of sale, the important question is: What should you (as the seller of the property) know about this type of sale? If you participate in this type of sale, please be aware that:

1. In some instances, you may be sued by the lender/bank for the money that was "forgiven".
2. The amount you did not pay back, which is a form of "debt forgiveness", may be taxed by tax agencies for the "forgiven" amount. In the example above, you may be taxed on \$145,000.00. For Mortgage Forgiveness Debt Relief Act and Debt Cancellation tax information visit:

<http://www.irs.gov/individuals/article/0,,id=179414,00.html>

3. If there are other lenders or lien holders (such as a 2<sup>nd</sup> or 3<sup>rd</sup> loan), the holders of the second or subordinate liens, may file a deficiency judgment in civil court against you to get their money back, even though the first lien holder allowed debt forgiveness.

These are just three major consequences of choosing to sell through a short sale. Therefore, it is very important that you seek:

1. A licensed and qualified real estate agent to represent you in these types of transactions. To determine if the person is licensed by the California State Department of Real Estate and/or to check on a license status, please visit our website at [www.dre.ca.gov](http://www.dre.ca.gov).
2. The advice of an accountant. To obtain the status of a Certified Public Accountant or a Public Accountant, please visit the California Department of Consumer Affairs - California Board of Accountancy at [www.dca.ca.gov](http://www.dca.ca.gov).
3. The advice of a lawyer. To obtain the status of an attorney, please visit the State Bar of California at [www.calbar.gov](http://www.calbar.gov).

In addition, contact a free United States Department of Housing and Urban Development (HUD)-approved housing counselor at [www.hud.gov](http://www.hud.gov) or contact your lender directly.

In April of 2010, the federal government will offer financial incentives to push short sales through a program called Home Affordable Foreclosure Alternatives. The program is designed to spur home sales and one of its components will be providing government payments to homeowners (for moving and/or relocation expenses). For more information, please visit [www.makinghomeaffordable.gov](http://www.makinghomeaffordable.gov).

Be aware that in response to this new program there may be an increase in the number of companies soliciting homeowners in distressed situations and offering to conduct the short sale negotiations with your bank/lender in exchange for charges and fees. Their interest may not so much be to help you as it may be to try to be the vehicle through which they could “flip” the short sale for a profit.

Flipping of Short Sale Properties: Either an unscrupulous agent or a short sale negotiator will misrepresent the true market value of the property to the bank/lender and/or fail to forward all offers to the bank reflecting the true market value. They try to buy it themselves through the use of “straw buyers”, many of whom are limited liability companies, which are their alter egos. They will use false broker price opinions or appraisals to support a depressed valuation. Once the unscrupulous agent or a short sale negotiator has convinced the bank of the false value, they have their straw buyer purchase the property and immediately attempt to sell it at the true market value, re-visiting buyers who had made legitimate offers. Had the property been sold for the most amount of money that the market will bear, the potential tax consequence to the seller is diminished. Conversely, by accepting an artificially deflated offer, the seller’s potential tax liability is increased.

The key elements for you as a homeowner to look out for are:

1. Short sale negotiators must be licensed real estate brokers (or a licensed real estate salesperson where that person is working under the supervision of his or her broker).
2. Real estate licensees wishing to collect an advance fee in connection with performing short sales must first submit an advance fee contract to the DRE for review and then receive from the DRE the issuance of a no-objection letter relative to that contract. All advance fees collected thereafter under the terms of that contract must be placed in a trust account and handled as client trust funds.
3. Any and all payments must be fully disclosed and made part of the escrow documents. If there are any fees to be paid “outside” of escrow, this may be the red flag that the payment is illegal.
4. If your agent explains that the buyer is a fictitious person or entity or your buyer is purchasing the property under a power-of-attorney or is a limited liability company (LLC), this may be a red flag that fraud is involved in your transaction.
5. If you are told that an unlicensed processor, negotiator or facilitator is handling your short sale, this is a red flag that unlicensed activity is taking place. Only real estate licensees, California lawyers acting as lawyers and investors acting on their own behalf can engage in short sale negotiations.

If your house is already listed with a real estate broker and the broker recommends the services of a “short sale negotiator” or its variations, “debt negotiator”, “debt resolution experts”, “loss mitigation practitioners”, “foreclosure rescue negotiators”, “short sale processors”, “short sale coordinators”, “short sale expeditors” or some other type of unlicensed short sale or debt specialist, ask him or her to provide you with a printout of that person/company’s real estate licenses.

If you are considering engaging in a short sale transaction, you should fully educate yourself about the mechanics of the process and the related legal and ethical issues and work only with legitimate professionals. In addition, become aware of other options that made be available to you by visiting the Homeownership Prevention Foundation at [www.995hope.org](http://www.995hope.org).

Finally, if you become aware of information about fraudulent short sale activity, please contact the DRE’s Enforcement section in Sacramento or at the office closest to you, or via the Internet at [http://www.dre.ca.gov/cons\\_complaint.html](http://www.dre.ca.gov/cons_complaint.html). In addition, report suspected scams to the California Attorney General’s Office at [www.ag.ca.gov](http://www.ag.ca.gov), the U.S. Department of Housing and Urban Development at [www.hud.gov](http://www.hud.gov), and the Federal Bureau of Investigation at [www.fbi.gov](http://www.fbi.gov).

For additional information on Short Sales, please review the Department of Real Estate’s web page on Consumer Alerts: Short Sales – An Overview and Warning to Real Estate Licensees Re: Fraud, and Legal and Ethical Minefields, which may be accessed by visiting [www.dre.ca.gov/pdf\\_docs/article\\_shortsales03\\_2010.pdf](http://www.dre.ca.gov/pdf_docs/article_shortsales03_2010.pdf).