<u>Short Sale Basics</u>

The following steps are to be used as a basic guideline on determining what to offer the lender for a short sale acceptance.

1. Determine Fair Market Value (FMV). The FMV can be determined by evaluating sold, comparable properties in a similar or close proximity to the subject short sale property. A realtor will have access to the MLS (Multiple Listing Service) and can create a CMA (Comparative Market Analysis) for the subject property. This analysis will identify sold comparable properties with same square footage, bedrooms, baths, garage and other similar characteristics as subject property. Request the realtors use a sold time frame within 6-12 months when pulling properties in the immediate or surrounding areas. Usually the short sale lender will not consider any sold comparables that are older than 12 months and that are further away than 2 miles from the location of the subject property.

2. Evaluating sold comps systematically. Contrary to popular and often misguided belief, you can use a formulaic system to work in your favor when determining what to offer on the short sale property. This system has been around for years, but for some reason you may have not heard of it mentioned dealing with real estate. Here is the system. You will use the law of averaging. The way this works is like this.

Let's say you have eight sold comparables that are all similar in size, square feet, bedrooms etc. Here is how you apply the formula. You would take out the two highest comps and the two lowest ones and average the rest.

EXAMPLE:

You have a property you think is worth $145,000.

You have a realtor pull a CMA and you find eight sold comparable properties that match the criteria above.

The MLS shows the following:

$159,000
$154,000
$153,000
$161,000
$148,000
$143,000
$146,000
$151,500

Using our formulaic approach you would take out the two highest sold comparables ($159,000 and $161,000). Then take out the two lowest sold comparables ($143,000 and $146,000). This would leave four other sold comparables.

$154,000
$153,000
$148,000
$151,500
————

You would then take an average by simply adding up the sum of all the sold comparables and dividing them by the total number of properties left. In this case, that number would be four.

Total: $606,500 divided by 4 = $151,625

You can reasonably justify the house may sell for $151,625 instead of the $145,00 you originally estimated.

3. Revealing the ARV (After Repair Value). This terminology is slang often used with real estate investors. It is similar to the FMV with a few differences made up by the amount of repairs the investor estimates the property needs in order to sell quickly on the open market using FSBO (for sale by owner) techniques and not using the MLS. It can be argued the ARV is more of a guess or suggested value derived by using sold comparables from houses that were NOT sold by a realtor. One way to explain the difference is a realtor will typically use a FMV and a real estate investor may elect to use an ARV. An appraiser can use both value methods, but generally sticks to the ones that come from off the MLS. In my opinion… the ARV is a less accurate and dependable value than what come off the MLS.

4. Figuring out the BPO. The BPO (Broker Price Opinion) is perhaps the single greatest value factor the lender will use to determine the acceptance of your short sale offer. The BPO is KING! BPO is a generalized opinion or value of a property the lender uses to determine what the short sale property is worth on paper. They are ordered by the lender and sent to a Third Party Company, such as BPO Direct, First America, LandSafe, etc. These companies have a list of realtors for each state. The BPO's are ordered and conducted by realtors. The BPO can be an Interior or Exterior type. If an Exterior type BPO is conducted, it means the realtor (BPO agent) did not go inside the property to evaluate its condition. This could be due to the homeowner vacating the house or not being cooperative with the BPO agent when requesting a time to come appraise the house.

Dealing with "Pretty House" type short sales (categories later defined), you will find the BPO will typically come in 10-20% lower than FMV or ARV. Based on this, you might consider offering 60% of the ARV or FMV value for your initial purchase offer. Of course, this depends on the amount of repairs needed for the property. If you have what can be classified as a "Pretty House" short sale, which would show very little needed repairs, don't expect to get a huge discount from the lender for it. If you cannot JUSTIFY a reason for the lender to accept either a small or large discount … don't expect them to give one to you. This also dispels the myth that all houses heading towards foreclosure are good short sale candidates. They are not.

Here are some classifications and examples to make it easier to determine how much of a loss the lender may agree to accept.

Short Sale Classifications:

PRETTY HOUSE
UGLY HOUSE
SCARY HOUSE

EXAMPLES:
* Pretty House: (Generally in safe, desirable areas and houses selling fairly quickly)
ARV/FMV: $100,000
REPAIRS: $5-10,000 (5-10%)
BPO: $80-90,000 +/- 5%
* Ugly House: (Generally a light rehab or fixer-upper, handyman special house in fair neighborhoods)
ARV/FMV: $100,000 (With Ugly Houses this number tends to be the "as is" value instead of ARV.)
REPAIRS: $11-20,000 (11-20%)
BPO: $80,000 +/- 5%
* Scary House: (Generally in areas that are not desirable, massive repairs needed, lots of crime isn't uncommon)
ARV/FMV: $100,000 (With Scary Houses this value tends to be the "as is" value instead of ARV.)
REPAIRS: $35,000 (21 – 35% +)
BPO: $65,000 +/- 5-10%

You can have a Scary House located in a great, fast selling neighborhood and combination of the others, but generally speaking Scary and Ugly Houses will not be located in excellent neighborhoods. Remember this is a guideline, not an exact science. The BPO agent will generally consider the "as is" value for both Ugly and Scary Houses.

Now let's discuss the different loan types the lenders will consider a factor per short sale submission.

5. Learning the loan types. When you learn these, you can increase your closing rate for lender accepting your short sale by as much as 50%! Here's why: if you know more about any property, it provides you better leveraging and ultimately negotiation strategies to target. Not all short sales are created equal.
* Conventional loans. These loans are found all over the place. They provide the most flexibility especially dealing with short sales. Using the $100,000 example, you might start out your offer submitting 60% x 100,000 (FMV) = $60,000… The $60,000 is actually 70% of the BPO Price. However it is very common to see the lender accepting around 80-85% of the BPO price, which would be around $68,000 – $72,250.

This model can fluctuate a little bit, but this is a common average. The BPO (value opinion also considered the PERCEIVED value of the property) to the lender is the MAIN FACTOR. Therefore in this example if you thought the BPO was going to come in around $65,000 … You would take 82% of THAT number, which would be $53,300. The lender may very well accept $53,300 based on their perception of the value of the property (their asset).
* FHA loan. I repeat: this is not a scientific grading scale. It is the model used by many short sale investors as a guideline. You can and will have other factors that make you stray from this. If you are dealing with an FHA type loan or any government backed loan, they are going to recoup a set amount if the foreclosure is completed. For example with FHA loans, the insurer will basically guarantee the lender 82% of an FHA Certified Appraisal amount. Notice I did not say BPO. For these loans, you will need an FHA Certified Appraisal for the lender to consider in their evaluation process on the property. The BPO will not suffice on these types of loans. You can massage the numbers 1-2%, but 82% is listed in their guidelines.

Here is a compiled list lst that I provide in my home study course. You can go online to find a similar list for free too.
o All FHA loans are insured by the federal government.
o As long as the lender follows FHA guidelines, they are guaranteed at least 82% of the "as is" appraised value.
o FHA-type loans will not use a BPO. Instead they will require an FHA Certified Appraisal. Use the same techniques on the FHA Appraisal that you would for a typical short sale deal.
o If the debtor is in bankruptcy, no short sale will be approved.
o If the property was used as a rental for more than 12 months, no short sale will be approved.
o If the homeowner does not occupy the property, no short sale will be approved. (There can be exceptions to this.)
o The cooperating lender is eligible to receive $1,000 from FHA for performing a short sale.
o Seller MUST fill out FHA specific forms for approval. This will include an Application to Participate and a Homeowners Counseling Certificate, all of which the lender will supply in their FHA Short Sale Packet.
o FHA loans must be at least 30 days past due for short sale consideration.
o The lender is required to give a copy of the appraisal to the homeowner.
o The homeowner can receive up to $1,000 directly from the HUD 1.
o FHA will not go after the homeowner for a deficiency once the short sale is accepted and closed.
* VA (Veterans Affairs) loans. These type of loans have a guarantee of 88% of the appraised value of the property.
o Designed for veterans.
o These loans are federally insured.
o VA guarantees the lender at least 88% of the "as is" appraised value.
o A VA appraisal is usually automatically ordered once the debtor becomes 60 days past due.
o The appraisal value can be appealed by the homeowner.
o The VA will work the homeowner and do everything possible for the homeowner to retain VA benefits.

Note: Absolutely NO BPO's allowed. All VA loans require certified appraisers to determine value.
* Freddie Mac loans (FDMC).
o FDMC will not allow the buyer of a short sale property to be anyone but an individual. This means the buyer on the Purchase and Sale Agreement and HUD 1 cannot be a company, LLC, trustee, or anything of the sort. The purchaser must be an individual name.
o Freddie Mac will almost always require that the property be listed with a realtor, which means they are going to ask for a Listing Agreement. If the offer nets the lender less than 92%, Freddie Mac will require that the property is listed for at least 90 days before approval will be issued.
o The lender has the authority to approve short sales at a threshold of 92% or higher. Anything lower than 92% must be approved by Freddie Mac.
o Freddie Mac has a high customer service standard, which means that if the lender is not responsive to your offers, they are going to want to know about it. This creates another point of leverage to get your offer accepted.
* Fannie Mae (FNMA).
o Fannie Mae has a high customer service standard. If the lender is not responsive to your offers, they may actually step in and take over the short sale negotiation process.
o The lender has the authority to approve short sales at a threshold of 90-92% or higher. Anything lower than 90% must be approved by Fannie Mae.
o Fannie Mae rarely requires that the property be listed with a real estate agent.
o Fannie Mae will allow the lender the authority to approve short sales at a threshold of 90% or higher, but will also allow a heavier discount if needed.

For Fannie Mae, Conventional, VA and FHA short sales: The buyer can be any entity, company, person or trust (the bank may require written proof of the company or of the trust). Most of the loans that you come across regarding short sales are going to be conventional loans.

6. Memorizing the minimum accepted NET offers (of the BPO or FHA appraisal).
* VA 88%
* FHA 82%
* Freddie Mac (FDMC) 92%
* Fannie Mae (FNMA) 90-92%
* Conventional Loans 80% (no set limit)

IMPORTANT: Understand that these are NET percentages to the bank. If you have your offers padded with things like realtor commissions, closing costs and additional fees, these are NOT to be included in this percentage.

EXAMPLE: The BPO on one of your deals comes in $100,000. Offers that may be accepted based on the above criteria would be:
* VA 88% = $88,000
* FHA 82% = $82,000
* Freddie Mac (FDMC) 92% = $92,000
* Fannie Mae (MNMA) 90-92% = $90-92,000

Something else to consider is this: all LOCAL banks, usually the smaller ones, will almost always NOT ALLOW more than a 10%-15% discount off the property depending on the amount of repairs needed to fix. Local banks tend to be more conservative in their approach to discount the property. This is partly due to the network of local affiliates the bank can call to get more than one opinion of repairs needed or value of the subject property.

7. Dealing with second mortgages and junior lien holders. If you are dealing with a second mortgage holder, you are basically going to negotiate with them the same way. You will find that many 2ND Mortgage Holders will not require as much information to make a decision quickly on discounting their loan amount. They will generally order a BPO or have an appraisal on file. It could be older or current. Make sure and ask about it depending on the numbers you find out dealing with them. Sometimes a lender will actually tell you a BPO price. Now before you get all excited and think that is GREAT…think again! Typically, they will LIE to you about the price and actually inflate it. Yeah…I know… you never thought lenders lied, did you? Well…they do…and they do it a lot.

When you are dealing with the 1st mortgage holder, it is not uncommon to find out they will only allow $500 – $1000 towards paying off any 2nd Mortgages, Liens, Judgments etc. All lenders are a little different, but the norm is $1,000. This is another reason why you will deal with more 2ND position lenders that are willing to take pennies on the dollar to satisfy their loans with the homeowner. In fact, you will often negotiate for 80-90% discounts or get approval for 10-20 cents on the dollar! It is can be beneficial if you get the 1st to accept a short sale and then present that information to the 2nd IN WRITING! If the 1st is willing to take a hit, where does that leave the 2nd? This can be a powerful negotiation technique.

Remember any junior lien-holder who is holding an over-leveraged or nearly over-leverage asset (the house) is in a HORRIBLE position. They realize this and if you can build a strong case why it would be in their better interest to discount their holding position rather than risk losing EVERYTHING at the foreclosure auction sale. It will not only generally help them, but it can make you, the investor, a HUGE PILE OF MONEY. Why? You just created equity out of thin air. That is the power of short sale negotiations.

In closing, this is probably the most concise definition of putting together an adequate short sale offer ever printed. The power of this document once put into action can literally make the user of it extremely wealthy. Other real estate home study courses, books, audios etc for the most part leave out what this document disclosed. It is the “meat” of preparing a satisfactory short sale offer. There are no more secrets you need to know about doing short sales. I just revealed them all to you. If you take the steps for preparing a short sale offer exactly as shown above and apply them to your real estate short sale business; the sky is the limit for your continued success getting them approved.