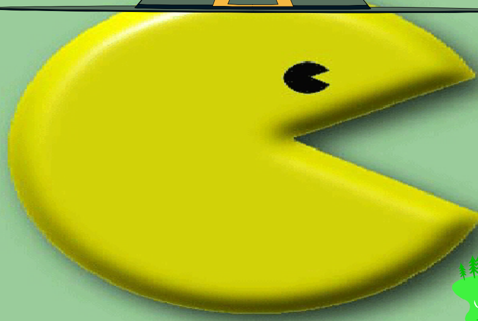

Newsletter - Vol. 8 Issue 11

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THE MONTH IN REVIEW

10/2-10/7 **With worries about Greece's solvency still in the spotlight, stocks kicked off the fourth quarter with a 258-point sell-off**. "Heightened volatility" was once again the hallmark of Tuesday's stock market as the Dow experienced a 420-point swing in the final hour to avoid falling into bear market territory as investors continued to fret about Europe's worsening debt situation and a possible slide into a global recession. **The market closed up 153 points on the day. There were 401,000 initial unemployment claims filed in the week ended Oct. 1,** the Labor Department said Thursday, up 6,000 from the prior week's revised 395,000. **U.S. stocks rallied for a third straight day Thursday,** as investors turned optimistic, following the European Central Bank's latest policy measures aimed at boosting liquidity in the European banking system. **The Dow Jones industrial average gained 183 points.**

10/10-10/14 The bond market was closed on Columbus Day. **Stocks shot up 330-points Tuesday** as investors cheered a pledge from European leaders to unveil a plan for solving the Eurozone's debt crisis by the end of the month. **There were 404,000 initial unemployment claims filed in the week ended Oct. 8,** the Labor Department said Thursday, down 1,000 from the prior week's revised 405,000. The Commerce Department reported **retail sales rose 1.1% in September. Standard & Poor's lowered Spain's credit rating to AA-, Friday,** citing risks to economic growth and the banking sector. **The Dow closed up 166-points Friday to record its best weekly gain since the last week of June.**

10/17-10/21 Worries about Europe's debt crisis resurfaced and **U.S. stocks fell 249 points, Monday**. **The Empire State manufacturing index remained in negative territory for a fifth consecutive month.** The index came in at negative 8.5 in October, little changed from negative 8.8 in September. Headlines about Europe's debt crisis have been driving the market's roller coaster for several weeks. **Tuesday proved no exception as the Dow jumped 180 points** on hopes that Europe's bailout fund may get a big boost. **Mortgage defaults in California rose 26 percent in the third quarter from the previous three months** as lenders began working through a backlog of delinquent loans after a nationwide delay, according to DataQuick. **Claims for initial unemployment benefits fell by 6,000 to 403,000** in the latest week. **EXISTING home sales fell to an annual rate of 4.91 million in September** from a revised 5.06 million the previous month, according to a report from the National Association of Realtors.

10/24-10/28 **Home prices rose for a fifth straight month in August,** according to the S&P/Case-Shiller index—a gauge of home prices across 20 major cities. **Prices edged up 0.2% during the month, but remain down 3.8% on a yearly basis. The Conference Board, a private research group, said its index of consumer sentiment came in at 39.8, seven points lower than economist were expecting**. Economists watch consumer confidence closely because consumer spending accounts for about 70 percent of economic activity. The index measures how shoppers feel about business conditions, the job market and the next six months. **The Dow rose 162-points Wednesday on news that European banks agreed to a 50% write down on Greek debt as part of an agreement to end the crisis.**

Stocks soared another 300-points, Thursday, in response to the European Union leaders agreeing to expand Europe's bailout fund and take major losses on Greek bonds.

About 402,000 people filed for unemployment in the week ending Oct. 22, the Labor Department reported.

10/31 U.S. stocks fell more than 1% early Monday, as the dollar rallied following Japan's intervention in global currency markets.

THIS ISSUE'S TOPIC:

Short Sales 2.0

(What follows is a newly edited version of one the one that appeared in October 2007 issue of my newsletter and the reason for the 2.0 appellation).

The media has been filled with stories in recent years about foreclosures. The pre-foreclosure alternative is a "short sale". Hopefully, none of you are facing one, but you may be considering purchasing one. There are a number of pitfalls of which to be mindful. I'll discuss short sales from the perspective of the four principal parties in such a transaction: the lender, the seller, the buyer and the realtor.

WHAT IS A SHORT SALE?

A short sale is one wherein the lender agrees to the sale of a property for a discounted payoff that is "short" or less than that which is owed on it. The usual reasons that a lender agrees to take a loss on a property are because the mortgage is in arrears and if the property were to be foreclosed upon, the lender would sustain an even greater loss. There are other reasons that a lender will agree to a short sale, though they are somewhat rarer, like the homeowner has hardships (e.g., death, disease, disability, loss of job, etc.) and cannot afford the mortgage payments, the area or neighborhood has depreciated in value, the lender is required to keep its REO (real estate owned) inventory below a certain percentage of their assets, or the lender's shareholders are concerned that there are too many defaulting loans on the books. A lender will not consider a short sale if the loan balance is low enough that the homeowner can sell the property and pay off the loan, fees, taxes, etc..

TIME IS MONEY

For anyone who has braved the housing market in the past four years, short sales have become synonymous with high risk and high reward. But with so many discounted properties on the market today, are they really worth a buyer's trouble? Maybe—if you have a lot of time and a strong stomach. You can get a below-market price, but it's going to take patience because these deals are slow and difficult.

Unlike foreclosures, in which the owner has walked away and the bank is looking to unload a vacant and sometimes, vandalized property, a short sale isn't a distressed home that will sell at a rock bottom price. The homeowner is underwater (meaning he owes more on his mortgage than the property is worth), and he has a financial hardship such as a job loss. But to limit the damage to his credit rating, he has agreed to stay in the house (often continuing to pay his mortgage bills) and to help sell it, at which point the bank has agreed to eat the loss. According to RealtyTrac, short sales typically went for nearly 10 percent less than the market price in the first quarter of 2011. (Foreclosures sold at a 35 percent discount.) What makes the

transaction tricky for the buyer is that you're negotiating not only with the homeowner but the bank—and that creates three big headaches:

1. It takes a long time.

Normally, when you make an offer on a house, you'll hear back within days, or even hours. But banks move very slowly these days because their representatives are overloaded with cases. You might wait 30 to 60 days for a response, perhaps longer if there's a second mortgage on the property and therefore a second bank. The total process can easily take as long as six months from start to finish.

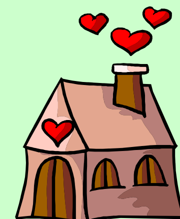
2. Your offer can't be contingent on selling your current home.

Banks generally won't accept offers on short sales if they're contingent on selling your current house to get the funds you need. So unless you're a first-time homebuyer, you don't need the equity from your current home, or you're a real estate investor, it's unlikely that you can make a short sale work.

3. It's an "as-is" sale.

Banks also typically won't consider short-sale offers that have inspection contingencies in them. So you can either do your inspection before you make your offer—which would mean spending $500 to $1,000 on the outside chance that you can make a deal (and less than a quarter of short-sale offers lead to a purchase)—or do what most people do, and go without an inspection.

As long as you're prepared for these hurdles, you may just land yourself a bargain. But make sure to work with a veteran Realtor because you want someone who knows the ins and outs of the process and can protect your interests throughout the negotiations. And since short sales aren't necessarily identified on Realtor.com or the part of the MLS data sheet that buyers see, always ask your agent whether any house is a short sale before bothering to look at it.



Then, if you fall in love with a house that's a short sale, get yourself a mortgage pre-approval -- another short-sale requirement—and make a lowball offer. Sometimes you can do that without putting down any money, but if the bank requires a deposit, have your Realtor put language in the offer letter stating that if you don't have a response by a certain date (perhaps 60 or 90 days out—however long you feel like you can wait), you have the option of retracting the offer and getting your deposit back. That gives you an out, just in case. When the bank finally replies, it will more than likely counter with whatever value its appraiser gives the house. Offer them 15 percent less than that and see what happens.

To the lender, a short sale is by far preferable to a foreclosure which has costs and risk for the Lender in terms of lost payments, eviction, property maintenance, insurance, taxes, fees and the like—or a loan modification with the associated lack of certainty. So, anything that could lessen the cost and shorten the foreclosure process should be welcome in the eyes of the lender. Lenders are in the business of lending out money, not acquiring real property. Also, the now vacant property may have fallen into a state of disrepair. An REO (Real Estate Owned) is a liability, not an asset. Too many liabilities will cause any business to go under if not dealt with quickly.

MOTIVATIONS

Now, let's take a look at the motivation of the seller/owner. A short sale benefits the owner that is in default in that it mitigates the negative impact on his or her credit. When a borrower fails to pay his loan as agreed and falls 30-60-90 days behind he is considered in default. When the lender files a "Notice of Default", which is recorded with the county recorder, this begins the foreclosure process. By this point, much of the damage to one's credit has been done. A foreclosure, like a bankruptcy, will show up on one's credit report for the next 10 years. (Obviously, if one is able to effect a short sale in lieu of foreclosure, the borrower is much better off because the adverse impact of 30, 60 or even 90 day "lates" will diminish after 2 years).

As for the buyer, he or she would seem to be in an enviable position from the standpoint of having a grateful seller and a lender who is willing to take less than is owed on the property, and one who in all likelihood should be willing to entertain offers that are 10-20% below market price to get this non-performing asset off its books, not to mention avoiding the expense of foreclosure and repairs that may be required to be made before it's saleable.

SHORT SALES: A WIN-WIN-WIN SITUATION?

It should seem to be a win-win-win situation all the way around and yet... it rarely is. This is one of those classic cases of "it's fine in theory, but a different matter in practice." One would think that the party that had the most to lose and the most experience in these matters, namely, the lender, would be the savviest and ready to make a deal, but ironically, it's rarely the case.

EIU, ALM, & PFC = MISSING IN ACTION

Lenders' Loss Mitigation Departments go by a variety of names: Early Intervention Unit (EIU), Accelerated Loss Mitigation (ALM) department or Pre-ForeClosure (PFC) group, etc. and they rarely live up to their appellations.

The personnel are usually too overburdened and/or under-trained to be effective. The "specialists" in these departments are responsible for between 125-175 files per month which perhaps serves to explain why so often "the buck gets passed on" from one person to another with seemingly little or no understanding of the process or what is in the company's best interests—they just want to get the file off their desk or the phone call on to someone else.

Since loss mitigation departments will never be profit centers for a lender, one would think they would be more predisposed to arrive at a solution space that benefited the bottom line rather than pushing things through the system and tallying up another foreclosure. Yet, it's been my experience and that of many others, that this is the norm.

LIEN HOLDER APPROVALS = REALTOR ROADBLOCKS

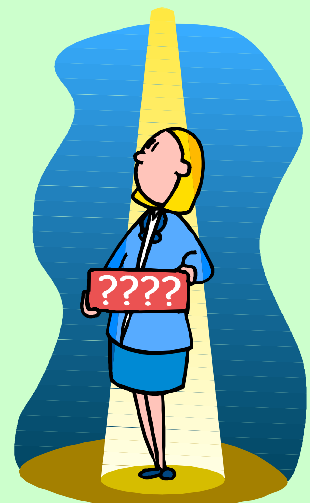
With a normal real estate transaction it can close at will once the contract is "four cornered" or that all signatures are affixed and there has been a meeting of the minds. In the short sale, all agreements are subject to lien holder approval. Since the seller is requesting a discounted payoff from the lender, all parties must allow the lien holder to complete an evaluation to determine the value of the home and determine if the loss is justifiable. The lender wants to mitigate his losses so the process of evaluation must be completed before the approval is granted. This process can delay closing for several months.

HOWEVER...

The lender won't work directly with the homeowner because when a borrower signed the original note, he agreed to pay the money back as outlined in the mortgage note. Regardless of the circumstances, he is still obligated to pay the full amount. The lender cannot negotiate with the homeowner; hence, the need for a realtor's services. When faced with the decision to liquidate the property, a lender must hire a professional to evaluate all of the marketing costs and value of the property. This is often called a BPO (for Broker's Professional Opinion) or CMA (Comparative Market Analysis). Both of these are little more than a cursory appraisal reflecting market conditions.

Sometimes, sellers ask if it's possible to sell a property that has multiple liens. The answer is an unequivocal yes. Liens against a property are prioritized according to date and time of recording. When a property is sold "short" the loan in first position is paid the majority of the proceeds. All others are pretty much happy to get what they can. All lien holders can be negotiated with. Here again, the requisite need for a realtor's service are vital.

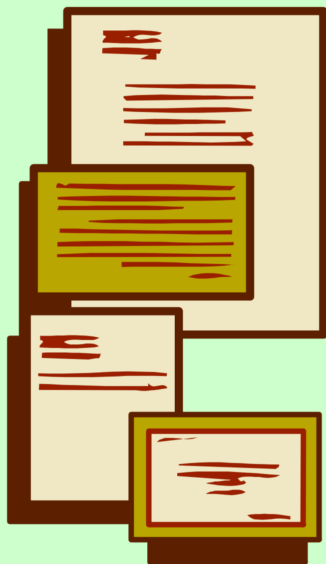
SOME REALTORS ARE.... "NOT READY FOR PRIME-TIME" WHEN IT COMES TO SHORT SALES



Despite having a signed purchase and sales agreement, one-third of these transactions fail to complete because, on average it takes lenders 4.5 weeks to provide an answer on a potential short sale, resulting in many potential buyers walking away. The lender (because they're taking less than what is owed on the property) has to approve the short sale, not the seller and lender's Loss Mitigation Departments are notoriously slow because they are geared for foreclosures, not short sales. Other common reasons for failed transactions are tied to problems with home inspections or damage to the property, seller refusal to sign a deficiency note, and

the seller's inability to pay a real estate commission or closing costs.

As frustrating as lender's Loss Mitigation Departments may be to deal with and at the risk of alienating many of my readers who are realtors, **THE #1 PROBLEM WHEN DOING SHORT SALES IS THAT MOST REALTORS DON'T KNOW HOW TO SUCCESSFULLY NEGOTIATE THE SALE WITH THE LENDER OR LIEN-HOLDER.** Most realtors do not fully understand the process and what should be included in a short sale package. It is crucial that the realtor spells out the obvious to the lender (in terms of dollars and cents) just how much more beneficial to the lender a short sale is as compared to a foreclosure. Realtors, also, often leave out critical components (usually of a financial nature), which if they're not there, the lender's Loss Mitigation Department isn't likely to aid them in their cause given that those personnel are, as previously mentioned, over-burdened and under-trained. A realtor's package should include:



1) a Borrower's Statement of Authorization which allows them to talk to the lender

2) a Hardship Letter telling the real story of why the property needs to be sold

3) Supporting Documents: e.g., divorce papers, tax returns, etc.

4) Listing Agreement

5) a BPO with Market Trend Analysis, Time on Market, Months Inventory & Rising/Falling Trend

6) Copy of Purchase Agreement and Addendums

7) Repair Estimates, if any

8) Copy of Estimate of Seller's Charges (a.k.a. Net Sheet or HUD-1) with Lender, Escrow, Broker Commission/Fees, etc.

9) Seller's current financial profile e.g., pay stubs, recent bank statements, disability benefits, unemployment benefits (Freddie Mac form #1126 'Borrower's Financial Information is useful)

10) Explanation of your Request for a Short Sale.

If all these items are included, the lender should approve the short sale as opposed to waiting months for a response and having the buyer tire of waiting and look elsewhere "for a deal".

SELLER POINTS TO PONDER

Salvaging the seller's credit is important because it affects their ability to purchase a new home. Credit is only one consideration though. Where there has been minimal credit damage as a result of a short sale clients have been able to purchase a new home within six months with little down and with an excellent rate. A lender is most interested in the borrower's ability to repay the loan. If the problems that led to the Short Sale are behind him or her and there are at least 12 months of good credit with three or more credit accounts one should be able to purchase with minimal down payment at a competitive interest rate.

There are some points that sellers should be aware of when considering a short sale: they usually can receive NO MONEY, the seller may still owe the difference between the mortgage balance and the amount of the short sale via a "deficiency judgment". If granted, this judgment will affect the seller's credit as any other judgment would. It is important to get the lender to accept the short sale amount as "payment in full without pursuit of any deficiency judgment" such that the seller's credit report shows "Paid as Agreed" or "Satisfied". Obviously, this agreement should be written on the contract. Also, the I.R.S. deems this Forgiveness of Indebtedness, as it's termed, miscellaneous taxable income (form 1099) i.e., the difference between the mortgage balance and the short sale is considered earned income. Very often a letter from one's CPA to the I.R.S. showing Proof of Insolvency will remove the seller's tax liability of miscellaneous income.

ADDITIONAL SELLER CONSIDERATIONS

If a seller files bankruptcy, it is still possible to have the home released from the assets included in the bankruptcy, thereby allowing the agent to complete the sale. One of the main goals in the completion of the short sale is to minimize the damage to the credit of the individual. While a bankruptcy is disastrous to one's credit, adding a foreclosure is financial suicide. Such a seller should be spared the latter.

BUYER CONSIDERATIONS

Buyers sometimes think that short sales abound in every price range, but that's simply not true. Bad things happen to good people in all walks of life and price ranges —for a variety of reasons. The rich, however, are more insulated from the financial depredations that face lower income borrowers. Consequently, it's certainly possible to buy a very nice home as a short sale because of the many reasons already alluded to but there are far fewer in the million-dollar plus range.

REALTOR TIP

If a lender's Loss Mitigation department is unresponsive, I am not above"Fed-Ex"ing the realtor package to the CEO or President of the lending institution and have enjoyed considerable success with this approach.

If one wishes to deal with the lender in a less dramatic fashion I would, at the very least contact, the V.P. of their Loss Mitigation Department.

From the above, one can see there are a variety of problem areas that need to be avoided and/or negotiated. My recommendation: only entertain short sales when dealing with experienced pros.

(The title of the January issue of my newsletter was "The Annual Forecast for 2011 or We're Turning Japanese". Now CNN/Money seems to have picked up on the same notion. The parallels between what happened in Japan in the 90's and our current economic situation are eerily similar. What follows is a reprint of its interview with Richard Koo).

ARE WE THE NEXT JAPAN?

There's no shortage of debate as to whether the Obama administration and Congress have done the right things in attempting to avert a debt crisis and revive the stalled economy. Richard Koo, the chief economist for the Nomura Research Institute, a Japanese think tank, says that government spending is the key to getting the economy back on track—and that 2009's massive stimulus package didn't go far enough.

While Koo's kind of thinking is decidedly unfashionable, there are good reasons to listen to him. A Japanese-born Taiwanese-American, he worked at the Federal Reserve Bank of New York in the 1980s. For the past 27 years he's lived in Japan, studying its economy in depth and writing what many consider the definitive analysis of Japan's "lost decade"—"The Holy Grail of Macroeconomics: Lessons From Japan's Great Recession." Koo, 57, recently spoke with MONEY senior writer Kim Clark.

Why do you say that this recession is different from others the U.S. has had?

Typical recessions are part of normal business cycles, when overconfident businesses overproduce and then have to cut back. This is what I call a balance-sheet recession. It's caused by an overload of debt.

Why banks won't lend

It's a very rare type of recession that happens only after the bursting of a nationwide asset bubble, like a real estate bubble. Once the bubble bursts, the debt remains. The assets, in this case, homes, are underwater; their prices are way down, but all the consumers' original debt remains.

The Federal Reserve recently said it won't raise interest rates for two years. Won't that help?

No. Monetary stimulus doesn't work until balance sheets are repaired.

Right now consumers are using their cash to pay down their debt. The economy is depressed because no one is borrowing or spending. Consumers don't want to borrow, even at [very low] interest rates. And lenders don't want to make loans to consumers who will struggle to pay them back. You need fiscal stimulus. That means the government should borrow and spend the money in the private sector.

When Japan fell into recession about 20 years ago, we had no idea what was happening. Interest rates were lowered to zero, but the economy still did poorly.

Every time the government stimulated the economy, it rebounded nicely. Then when they pulled back, it lost steam again.

Some people look at Japan and say the government spent huge sums on public projects and there was no real growth, so spending didn't really cure the economy.

The early '90s recession in Japan was far worse than people realize. Commercial real estate prices nationwide in Japan fell 87% from the peak. Imagine U.S. housing prices down 87%. The fact that the Japanese government halted what could have been an enormous drop in GDP in the early '90s speaks to the success of its economic policies.

But Japan did suffer a major recession again in 1997.

The Japanese made a horrendous mistake in 1997. The Organization for Economic Cooperation and Development and the International Monetary Fund said to Japan, "You are running a huge fiscal deficit with an aging population. You'd better reduce your deficit."

When the government cut spending and raised taxes, the whole economy came crashing down.

I see exactly the same pattern in the U.S. today. If the government acts to cut the deficit while people are continuing to pay down their debts, then we could have a second leg of decline that could be very, very ugly.

Since 2008 the Fed has been trying to boost the economy—and prevent price deflation—by buying Treasury bonds. What has that done?

The Fed's so-called quantitative easing has failed to contribute to economic growth. By taking the new Treasury supply away, it forced the private sector to put its money into equities, commodities, or real estate.

With real estate in a tailspin, the money went to commodities and equities on the assumption that the economy or profits would pick up. The effect was to push stock prices to higher levels than could be justified by genuine cash flow or corporate growth.

Now, with fiscal stimulus disappearing and GDP growth slowing, people have realized that equity prices are essentially overvalued, and that is the correction we are currently seeing.

So are you saying that the stimulus package didn't go far enough?

Obama kept the economy from falling into a Great Depression. But you never become a hero avoiding a crisis.

The economy is still struggling, so people say that money must have been wasted. Not true. The expiration of that package is behind the economy's weakness right now. Yes, the Bush tax cuts were extended last year, but tax cuts are the least efficient way to support the economy during a balance-sheet recession because a large portion of the cut will be saved or used to pay down consumer debt. Government spending is much more effective.

MONEY recently interviewed Carmen Reinhart, an author of what's now thought of as the authoritative history of financial crisis. She warned that economies that build up gross deficits in excess of 90% of GDP weaken significantly. The U.S. recently passed that mark.

Before the next balance-sheet recession comes, you'll have plenty of time to cut the deficit.

Of course, Congress recently committed to slash our deficit by $2.5 trillion as part of the agreement to avoid default.

It is good that Congress managed to avoid default. But they should keep in mind that Japan's deficit actually increased when the government tried to cut the budget while the private sector was paying down debts. The cutback caused a second recession.

Think about the Great Depression; war spending is what finally pulled the economy out.

The Japanese government didn't do enough spending in the early 1990s and added another 10 years to the problem. If the U.S. avoids that mistake, maybe in a couple of years you will be out of this mess.

UPSIDE DOWN? THERE'S NEW HOPE FOR HOMEOWNERS

On October 24th, President Obama announced changes in the government's Home Affordable Refinance Program, aimed at making it easier for homeowners to capitalize on current low-interest rates by refinancing their old, high-interest mortgages.

More than 890,000 Americans with underwater mortgages have already utilized the HARP program to reduce monthly mortgage payments but millions more have not. Among the reasons: Many are unaware of Fannie's DU Refi Plus and Freddie's Open Access loan programs and the other is that under current rules severely underwater borrowers [more than 125% of the combined loan to value (CLTV)] are excluded from participation. The new rules will allow homeowners who owe MORE than 125% of the market value of their homes to get new loans.

For example, a homeowner who has a $200,000 balance on their 30-year mortgage with a 6.5% rate and a home value of $160,000, for example, currently makes payments of $1,264 a month. If they refinance to a 30-year loan at 4.5%, their monthly payments will be quite a lot lower, $1,013.

Two Stipulations: To qualify for a new loan borrowers must still be current on their payments for the past six months with no more than one missed payment in the past 12 months. The loans must have originally been issued before May 31, 2009 and purchased by Fannie Mae or Freddie Mac.

The program will also streamline the refinancing process for those who have been current on their mortgage payments and it will reduce or remove fees such as those for appraisals, title insurance and closing costs.

The changes should allow banks to refinance loans without fear that Fannie Mae and Freddie Mac will force them to repurchase those loans if the borrower defaults.

RATE SUMMARY: The Dow rose 12% in October, posting its best gains since January 1987. As investors pumped more money into stocks and mutual funds than bond funds, bond prices dipped and yields rose which caused mortgage rates to worsen by an eighth to a quarter of a point for the month.

FOR CURRENT INTEREST RATES FOR THE 16 MOST POPULAR PROGRAMS GO TO:
www.mortgagestraighttalk.com Then, click on the menu tab labeled "RATES". The rate sheets are updated every Friday.

SPECIAL(S) OF THE MONTH:

*Conf. 5/1 ARM & 5/1 I/O ARM @ 2.50% & 2.625%
*H. B. Conf. 30 yr. fixed @ 4.00%
*HomePath Conf. 30 yr. fixed @ 3.75%
*Jumbo 5/1 ARM @ 3.125%
*Home Ownership Accelerator @ 3.339%

MORTY'S MAILBAG

There were no letters in the mailbag this month.

Recipients of the newsletter are invited to Ask Morty any real estate or financing questions. The answer to the question will be answered either by phone or email and posted in the next issue for the benefit of all. Questions may be forwarded via mail phone or fax. Due to the high incidence of spam, if you email me a question it needs to identified as "real estate question" on the subject line of the email. (See front of issue for phone and fax numbers). Morty's email address is....
morty@mortgagestraightTalk.com

MORTGAGE MIRTH

If electricity comes from electrons, does that mean that morality comes from morons?

If you'd care to share one that you've heard, please email it to me at.... **rod@mortgagestraightTalk.com**

NEXT ISSUE'S TOPIC:
REALTORS—SOME OF THE BEST