

# Lifeline to Mobility: Short Sale Process

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*Understanding the Logistics of Short Sales as Part of a Third-Party Homesale Program*



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## Introduction

The U.S. housing market has left many homeowners in a precarious situation. With the continued decline of market values, homeowners are finding themselves locked into loans with outstanding loan balances greater than the present value of the property. For many homeowners required to transfer, consideration may be given to a short sale as one solution as to avoid an out-right foreclosure situation.

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## Lifeline to Mobility: The Short Sale Process

### Short Sale Basics

A short sale is a loss mitigation technique, offering an alternative to foreclosures for homeowners suffering financial hardship. To be eligible for a short sale, the homeowner will not only be in a negative equity situation, but must also demonstrate a lack of assets to effectively close the sale and transfer clear title to a purchaser.

Within a short sale, the homeowner negotiates an offer to purchase with an outside buyer, who agrees to pay a price that is reflective of the current market value that is less than what is owed to the lending institution on the existing mortgage. The offer to purchase is then presented to the mortgage lender in exchange for a release of the lien in order to transfer title to the new purchaser. In addition to the principal balance due on the loan, other factors such as interest, tax pro-rations, and settlement costs may be factored into the final terms of the sale. As a condition of closing, the homeowner/seller will have a zero loan balance at closing. Also, lenders will most often stipulate that the homeowner cannot recognize any equity/proceeds from the sale of the home. While a short sale is not a foreclosure, it may still have negative consequences to the employee's credit score. It is up to the lender's discretion on reporting the short sale to the credit bureaus.

### Logistics of Short sales

A short sale transaction will undoubtedly prolong the overall sale process. However, in the present real estate market, a short sale may be the only option for an employee to successfully complete the relocation. The short sale allows the employee to seemingly walk away with a clean slate. Presently, debt forgiveness for amounts up to the original loan balance of the property is not considered taxable income to the homeowner. Conversely, negative equity as a result of additional lines of credit or refinancing may not receive the same tax benefit. The company may also realize a cost savings as they will not have the

pressure to pay a negative equity or might avoid taking a home into inventory. Still, the pros and cons of a short sale should be seriously weighed by the employee and company.

### **Establishing Equity Position**

For employees who are provided third-party homesale assistance, either Paragon's Relocation Consultant, or the third-party representative, will be actively engaged with the employee throughout the move process. As part of the Home Marketing Assistance program, the Relocation Consultant will work with the employee to establish a baseline of value for the home through the use of independent Broker Market Analyses (BMAs) and in some cases, the Relocation Appraisal process associated with a Guaranteed Buyout Process. With a market value established, Paragon can work with the employee to identify their equity position, uncovering the potential need to consider short sale as an option.

### **Initiating the Process**

Once it is determined that a short sale may be applicable, the employee should contact the lender to initiate the preliminary paperwork required to qualify for a short sale. Due to the time sensitive nature of relocation, the homeowner is encouraged to navigate the lender's short sale department to locate the ultimate decision-maker on short sale approval. While there may be administrative variations between lenders, most will require a Letter of Authorization to begin proceedings.

### **Qualification for Short sale**

In order to qualify for a short sale, the homeowner must demonstrate financial hardship. This is established through various means including submission of a Hardship Letter detailing the circumstances leading to the financial hardship, a preliminary estimated closing statement, a copy of the listing agreement, proof of income and assets including bank statements, disclosure of relocation benefits, and supporting home valuation documents such as the BMA or appraisals. The lender may also order a broker market analysis or appraisal as part of the qualification process.

### **Completing the Sale Process**

Once the employee receives an offer from a potential purchaser, Paragon's Relocation Consultant will assist the employee in negotiating the highest and best offer on the property. After the sale is in place, the employee commences to contact the lender to begin the next negotiation - the short sale. The lender will determine if the sale price is acceptable. The process is time-consuming and all parties involved, including the buyers, attorneys (if applicable), title company, real estate agents/brokers, and corporate client, should be aware and agreeable to the extension in the timeframe prior to beginning the short sale process. Although a short sale may be accepted by all parties, the lender does retain the right to renegotiate terms or cancel the agreement at any point prior to closing.

## **Third-Party Homesale Transactions**

With the increasing number of market challenges presenting obstacles for transferring employees who need to sell their principal place of residence to retain their job, their focus becomes how to sell the home. If the employee is offered a form of third-party homesale assistance (Guaranteed Buyout Offer, Amended Value Sale, and Buyer Value Option), it is likely a short sale may be an option when the employee receives an offer for less than the mortgage balance, a price reflective of the current market value. The third-party homesale options above provide for a tax-safe transaction – meaning the closing costs and broker commission paid on the employees’ behalf are not considered taxable income to the employee.

By using an “arms-length” transaction, the employee negotiates the offer with the purchaser, and is then given a contract by Paragon for the offer price. Upon final agreement of terms, Paragon executes the contract with the transferring employee and then the subsequent purchaser. If the sale type is a Guaranteed Buyout Offer, Paragon manages the property by listing it reflective with the current market value, realizing a much greater opportunity for a timely resale and closing since a large portion of the loss in value has already been resolved through the short sale process.

The “arms-length” transaction is a necessary part of the third-party homesale process in order for the closing costs to be considered excludable from income. Worldwide ERC has yet to establish a definitive position on short sales as they relate to the 11-Key Steps. Some argue that the short sale process compromises the third-party homesale process due to the level of involvement on the part of the employee. However, others suggest the payoff of a short sale is no different than the loan payoff during a standard resale closing. Similar to the process of managing an employee in a negative equity position, financial considerations must be resolved before proceeding with acquisition by the third-party homesale company. Because the payoff process works the same, Paragon maintains that the short sale process does not impact the tax-favorable status of the third-party homesale process.

### **Finalizing the Sale**

The employee is ultimately responsible for negotiating the terms of the short sale and will act as the liaison between the lender and Paragon. Paragon will provide documentation within the scope of the homesale program to the employee to facilitate lender requirements. Once finalized, Paragon will request the employee to obtain the confirmed mortgage payoff information on the remaining loan balance. Paragon will then be in a position to acquire the property, paying off the existing mortgage loan within a timeframe designated by the lender in order to avoid renegotiation of the short sale. At time of Paragon’s acquisition, the transferee equity statement will reflect a zero balance and loan(s) will be paid in full.

### **Other Considerations**

The proposed Bankruptcy Act of 2009 would allow judges to modify terms of existing mortgages (commonly referred to as “cram-downs”) of primary residences during Chapter 13 proceedings; providing an alternative to short sales. In addition, attention needs to be focused on the fine print. “Claw-back” provisions may arise in cram-down or short sale negotiations which may violate the terms of the third-party homesale process. Claw-backs may allow lenders to recoup some of the

appreciation from the sale of property which was subject to a modified mortgage. This may compromise the third-party relocation process as it may tie the employee back to the transaction.

### **In Closing**

For now, Paragon maintains the ability to effectively manage client third-party homesale programs in conjunction with short sales. Pending legislation will be monitored closely and Paragon will keep clients informed of any additional developments.

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## About the Author

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Karen has over 10 years of professional experience including positions in account management, recruiting, and event planning. Her relocation experience includes 8 years with leading service providers in operations and consulting. She has successfully designed and implemented new relocation programs for numerous client organizations by applying her front-line experience to cultivate approaches to policy design that both appeal to the client's bottom line while providing relevant benefits to increase employee satisfaction. In addition, Karen's portfolio includes research projects and benchmark studies, as well as recently being published in Mobility Magazine. Karen holds a B.A. in English with an emphasis in Technical Writing from Northern Illinois University in DeKalb, IL. In addition, she has continuing education credits in Illinois Real Estate Practices, Real Estate Appraisals and is presently pursuing her Project Management Professional (PMP) designation.

### **About Paragon Decision Resources**

Originally founded as a relocation consulting company in 1987 specializing in domestic and international relocation and global assignment program development consulting, our mission is to develop cost-effective mobility programs that offered more services to the transferring employee at less cost to the organization. Today we maintain an extensive consulting practice focused on global mobility issues in their entirety.

Paragon Decision Resources Inc. (PDR) is a wholly owned subsidiary of Paragon Global Resources, Inc. that is dedicated to strategic US domestic and global corporate relocation consulting services targeted at the executive level of organizations desiring to fully analyze their corporate relocation spending as well as supplier relationships.

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