

Short Sale Definition

So here is your short sale definition - a lender of a property allows the property to be sold for less than the remaining balance on the mortgage loan. It's as simple as that. But a short sale definition should not stop there.

Currently, short sales represent a small segment of mortgage defaults. But that could be changing. Lenders generally don't view short sales as a good alternative and are clearly not openly advertising that they may consider accepting a short sale. Most lenders focus on loan modifications and work with homeowners in an effort to avoid foreclosure. But in certain struggling markets, the opportunity to complete a short sale is increasing.

So how did all this happen?

Well there are several issues that contributed to the rise in short sales and hence the expanding short sale definition. After the huge run up in real estate prices that occurred in the recent housing boom, many homeowners were caught off guard when the market slowed. But financial institutions were also caught off guard.

Many lenders issued mortgages with low teaser interest rates to high-risk borrowers without sound underwriting. Many of these borrowers had little or no documentation of their financial capacity to make the mortgage payments and often these loans allowed minimal or no down payment. Accordingly, borrowers had limited equity and few choices when faced with financial hardship or decreasing real estate prices.

Years ago subprime borrowers would typically have been denied credit. But the 1980 Depository Institutions Deregulatory and Monetary Control Act eliminated all usury controls on first-lien mortgage rates, permitting lenders to charge higher rates of interest to borrowers who posed elevated credit risk, including those with weaker or less certain credit histories. This change encouraged further development and use of credit scoring and other technologies in the mortgage arena to better gauge risk and enabled lenders to price higher-risk borrowers rather than saying no altogether.

Given the greater credit risks, the obvious disadvantages involve elevated rates of foreclosure and of the incidence of households seriously delinquent on their mortgages. The short sale is just a new spin on an old issue – homeowners that are upside down on their mortgages.

So how does this impact the real estate market? No one knows for sure, but some estimate that the short sales and foreclosures will do substantial harm to the housing sector, even lead to a recession. Now I imagine that the impact on the real estate market will be far less than that. However, the rise in short sales is still an alarming issue. Remember - when a short sale goes wrong the result is often foreclosure.

So maybe the short sale definition needs to be expanded. Any short sale definition should include the fact that foreclosure was avoided. But in the end, this may be of little comfort to the homeowner.