About Short Sales And Real Property Foreclosures

Short sale, while not totally new to the real estate industry, are certainly not as familiar a term, or has the history and tradition as foreclosure; but the short sale has rapidly come into prominence in the last decade during which the real estate and mortgage industry suffered what was perhaps the most devastated meltdown in history, and led to the great recession – the worst economic disaster to hit this country since the great depression. As a result of this meltdown, the rate of real property foreclosures increased exponentially and gave rise to the popularity short sales.

Real property foreclosures have been in existence for as long as real property owners have been agreeing to give mortgages against properties they owned, or properties they wished to own, in exchange for money from private lenders or banks to finance other projects, repair and rehabilitation, or to purchase a particular property; Throughout the decades mortgage financing has undergone many changes but mortgage foreclosure, which remained mostly unchanged, was generally understood to be a process during which ownership of the subject property was taken over by the entity (bank or private lender) that owned the mortgage note – the mortgage bond of yesteryear – and therefore owned the recorded lien.

Until the 1980s there was little a home owner could do when facing foreclosure, except to get the delinquent amount from a well-to-do relative – which seldom happened – or file a Chapter 7 bankruptcy, which only served to forestall the inevitable foreclosure sale, or Chapter13 bankruptcy (the working man's plan?), which allowed the home owner an opportunity to catch up and bring the mortgage current pursuant to a court-approved repayment structure.

In the mid-nineteen eighties – circa 1985 – there was a very creative and astute equity lender (a Flushing, NY-based savings bank) which sought to increase its mortgage portfolio by introducing a program known as the "family sale." The program allowed struggling home owners to transfer their property title (in effect, sell the property) to a relative under the terms of a new mortgage issued by this equity lender, thereby satisfying the existing mortgage and saving the home from foreclosure.

The family sale program served a worthwhile purpose while it lasted, but was soon modified and subjected to restrictions that limited the program and rendered it useless for the purpose it was originally intended. The "family sale" program was subsequently discontinued and it would be several years after the family sale was discontinued by this equity lender that FHA-approved lenders began to utilize the FHA-insured "gift-of-equity" loan, and almost a decade before the short sale became a viable tool among real estate professionals.

Fast forward to present day and we see the short sale being used in the same capacity as a family sale was used in the early days of its existence; except with wide ranging acceptance, defining guidelines, and no financial gain for the delinquent home owner. According to Wikipedia, "a short sale is a sale of real estate in which the proceeds from selling the property will fall short of the balance of debts secured by liens against the property, and the property owner cannot afford to repay the liens' full amounts, and whereby the lien holders agree to release their lien on the real estate and accept less than the amount owed on the debt."

Short sales might not have been as popular as they had become if not for the enactment of 'The Mortgage Forgiveness Debt Relief Act and Debt Cancellation' in 2007 (The Act), a law which gave cover to many home owners who were concerned with the tax liability which would result after having had a portion of their debt forgiven by the mortgage lender agreeing to a short sale in lieu of foreclosing on the property. The Act clearly states that a taxpayer can "...exclude income from the discharge of debt on their principal residence. Debt reduced through mortgage restructuring, as well as mortgage debt forgiven in connection with a foreclosure, qualifies for the relief."

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Why was it necessary to have this law instituted? The simple answer is, when dealing with the IRS and items of value changing hands – including cash gifts in excess of $10,000 – it is best to get written authorization from the IRS, because in the absence of the The Act, short sale participating home owners would have been subject to this section of the IRS statutes: "If you owe a debt to someone else and they cancel or forgive that debt, the canceled amount may be taxable." You can therefore understand why a home owner would've been reluctant to enter an agreement to sell his/her property pursuant to the terms of a short sale if there wasn't some kind of assurance from the IRS that the Tens of Thousands of dollars forgiven by the lender would not have generated a substantial federal tax debt.

It's therefore reasonable to conclude that, in the absence of such a timely and beneficial law as The Act, short sales would probably not be serving the purpose they are on such a large scale and the double shock of losing one's home PLUS having to pay tax on the lost equity would have been like "adding insult to injury" for those homeowners, especially since many of them ended up in the predicament through no fault of their own.

During the period between 2007 and 2009 US home owners lost more than Sixteen Trillion Dollars in household wealth due to drastically reduced property values caused by the catastrophic real estate and mortgage meltdown – which set the stage for the great recession – a recession such as we have never seen during our lifetimes. One might surmise that without the short sale option, circumstances would have been much worse – if such circumstances could even be fathomed – and the rate foreclosures, without such a workaround, leading to nightmarish economic consequences. The short sale will most likely be around for as long as there are foreclosures, and as long as The Act remains in-tact.

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