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Short Sales: The New Wild West

From pushy lenders to aggressive investors, there are many challenges that real estate practitioners must overcome in the new world of distressed sales.

By Robert Freedman | March 2009

Tom Troli's client had already been preapproved by two lenders for a short-sale purchase. It seemed like the deal was moving ahead smoothly. But that's when Troli, CRS®, GRI, was presented with what seemed to be a make-or-break condition by the lender who held the seller's mortgage.

The lender said it wanted to do its own preapproval on Troli's client just to be sure he really could get financing, but then the company proceeded with a hard-sell pitch to originate the new loan. "I've been flat-out told by these lenders, 'We want to sell to someone who uses one of our lenders,'" says Troli, a broker with Prudential Wheeler/Steffen Real Estate in Claremont, Calif. "It seems like a conflict of interest."

The hard sell by lenders is just one of the many challenges sales associates face when working with distressed sales. Other challenges: aggressive investors who try to make money through a "double close and flip" transaction that can leave sellers upset with their listing agent; salespeople who encourage buyers to make offers on several short-sale properties to see which deal sticks; and ineffective third-party negotiators who only complicate transactions.

Welcome to the world of distressed sales. In today's market, short sales and REOs make up more than 40 percent of sales nationwide and far more than that in areas such as Southern California and Florida, where home prices have dropped significantly in the last two years.

The New 'Wild West'

The many challenges involved in buying and selling short sales create what many practitioners are calling a new Wild West atmosphere that's cooling their ardor to get involved in distressed sales. "It turns your hair gray," says Larry Stewart, a sales associate with Deborah Myers Real Estate in San Antonio, Texas.

It's also scaring away buyers at a time when prices and interest rates are low enough for consumers to snap up real bargains. The result is a lost opportunity for the industry to shrink its massive overhang of inventory. "I have buyers who've told me, 'I'm not doing this anymore because I don't want to jump through these hoops,'" says Troli. "So, we're missing out on a big portion of the buyers out there."

Although hard-selling lenders are only one of the problems, they're among the most common, say practitioners.

Troli tells of a different case in which his client, a buyer who had already been preapproved, asked the seller for $10,000 in closing costs—not unusual given today's market conditions. But the lender holding the seller's mortgage wouldn't even consider the request unless Troli's client agreed to use the lender's in-house originator.

The buyer balked, taking with him the seller's hope of getting out from under his troubled loan.

"When lenders do stuff like that, are they truly trying to get the highest price they can for those properties?" Troli says.

Sellers are also the big loser in a "double close and flip" transaction, says Lance Churchill, a short sales specialist who splits his time between San Diego and Boise, Idaho. In this type of transaction, investors tell a listing agent they can help bring a short sale to a speedy close by using their experience to negotiate the deal with the lender. All the listing agent has to do to earn their commission is find a buyer.

But that's where trouble can emerge. Once the agent accepts the investors' negotiating help, the investors talk the seller into turning over the deed to them and—in some cases—giving them power of attorney. Armed with that authority, they negotiate a deeply discounted sales price with the lender. Then, when the agent procures a buyer, the investors buy the property at the discount and flip it to the buyer at the original listed price, pocketing the spread.

This scenario, which is becoming more common, can leave sellers feeling that the listing agent didn't do the job of getting the best price for the home, says Churchill. And that can open the door to lawsuits.

Seeing What Sticks

Apart from dealing with pressures from lenders and investors, salespeople can create their own problems when they encourage buyers to make offers on several short-sale properties at once in the hope of finding one that will make it to closing.

Scott Thompson, a real estate broker and senior vice president at Mortgage Resolution Services, a distressed-sales consulting company in Rancho Cordova, Calif., says such practices create a category of buyers who by definition can't be committed to any single offer. That lack of commitment is a key problem in distressed sales, Thompson says, because buyer commitment is often the only glue that can hold a deal together.

"Even if these buyers want to pay more than other buyers, it damages the market," Thompson says.

The carrot they dangle in front of lenders amounts to a chimera if it's not paired with a commitment to hang tough for the many months it takes to close the deal. And these multiple offers can derail efforts of buyers who *are* committed to that one property.

In one transaction Thompson recalls, a buyer came in with an 11th-hour offer that was higher than an already pending offer. The original buyer had been talking with the lender holding the seller's mortgage for two months. The late-comer's offer was attractive to the lender because it offered a higher purchase price—but it was one of just several properties the buyer was bidding on.

"This buyer was working with an agent who'd written for him seven offers, and he's only going to buy one property," says Thompson. "He wants to have his offer leapfrog over a buyer who's been trying to do the responsible thing and stayed committed to the property for 60 days."

Agents can also derail transactions simply by not preparing well. One-third of homes listed as a potential short sale have no business being called that, Thompson says. In many cases, the seller really can't make a qualifying hardship case to the lender. To save everyone time and effort, agents should carefully qualify sellers upfront to be sure they have a genuine hardship, he says.

Agents can also derail transactions involving sellers who have a legitimate hardship by simply being unprepared and submitting an incomplete proposal. The property might have several junior liens that the listing agent never took the time to learn about, creating a snag later in the process and raising a question in the lender's mind about the preparation of the agent. At a minimum, agents should go to a lender only after they've prepared a complete, well-organized proposal to the lender, because absent that the deal is unlikely to survive the rigors of the process, he says, creating a bad experience for everyone, particularly buyers.

"We've got to start creating an experience that reasonably resembles a traditional buyer experience or we are doing damage to our industry," Thompson says.

Using Short Sales 'Consultants'

Some salespeople may think calling in a short-sale expert is the answer—but that's not always the case. For every credible, competent short-sale specialist in the market, there's one that's anything but that.

Short-sale specialists seek out practitioners who have either little experience or little time to deal with these types of sales and offer their services as a way for practitioners to focus on obtaining listings and finding buyers while they handle communications with lenders.

When a consultant company operates professionally, its services can make a difference in the success or failure of distressed sales, practitioners say. "They've been trained, they have relationships with banks, they provide good follow-up, and they know who to talk to," says Carolyn Gjerde-Tu, a sales associate with Lyon Real Estate in Davis, Calif. "They can also prequalify sellers and since they work with lenders and are on top of lenders' policy changes, they know what sales are likely to be approved."

But when the companies don't operate professionally, they can "convolute the conversation and entangle transactions," says Suzie Capuzzi, a sales associate with Coldwell Banker Seal in Lake Oswego, Ore. "A colleague of mine had to back off working with one because of inaccuracies, wrong dates, misfiled paperwork—so she just washed her hands of it," she says.

Capuzzi worked with outside negotiators on distressed sales during the sales boom, when she needed to keep her time focused on buyers and sellers. But now, with sales down, she handles all communication with lenders on her own.

Churchill says that some short-sales specialists have simply taken on too much business too quickly and are either unable or unwilling to staff up with the necessary expertise to handle their workload. "You leave it to them only to find out weeks later that no one's even opened the file," he says.

Practitioners say the best way to separate the good from the bad is to get referrals from colleagues you trust rather than accept face-value promises made by a company you're not familiar with.

Tom Bernardo, GRI, a sales associate with Keller Williams World Class Realty in Ft. Myers, Fla., says he relies on an attorney he's worked with for years to handle lender communications and has had great success with the relationship.

"I attempted to negotiate one short sale very early in the short-sale craze, and I learned many valuable lessons on how to negotiate with banks," he says. "The most valuable thing that came out of it was the realization that I would prefer to not do the negotiating myself."

Bernardo's attorney puts his fees on the seller side of the settlement statement. "The banks are willing to pay it from the proceeds," Bernardo says.

Given the growing share of the market distressed sales represent, it might be just a matter of time before you must get involved with short sales and REOs. Yet these and other complications make clear that it's a market segment you want to enter into only with your eyes wide open.

LISTEN TO SHORT SALES WEBINAR

Learn more about mastering short sales from a 20-year real estate industry veteran who's been actively engaged in distressed sales since 2006. REALTOR® Magazine's webinar, "Short Sales: Finding Income in a Tough Market," features Scott Thompson of Mortgage Resolution Services, a distressed-sales consulting company in Rancho Cordova, Calif.

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