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EARLELAW NEWSLETTER

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“Short Sale” or Short Detour to the Courthouse?

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You are in a difficult situation: The home you purchased several years ago has declined in value and, in accordance with the terms of the “teaser-rate” loan you obtained to purchase or refinance the property, your monthly mortgage payments have increased dramatically. To make matters worse, you are all but certain that your income will not increase in the foreseeable future; furthermore, your spouse’s income has actually declined slightly, due to an involuntarily-reduced work schedule. You know you will not be able to continue making monthly mortgage payments on your home.

You have heard about other people who were in a similar situation. You are not certain of the details, but you remember someone mentioning the term “short sale”. You are not exactly sure what a short sale is, but reluctantly, and with more than just a little bit of embarrassment, you muster the courage to call a real estate broker whose name and number someone had given you.

The real estate broker assures you that your situation is not unlike that of many other of the broker’s clients and explains that a “short sale” is simply an agreement by the lender to accept less than the full amount owed on a mortgage loan. The broker tells you that many lenders, recognizing the realities of the current economic recession, understand that the fair market value of many residential properties is now less than the face amount of the loans which are secured by those properties and that because of this situation, lenders sometimes agree to accept in full satisfaction of a loan, less than the amount owed on the loan.

Not quite believing what the broker is saying, you ask “Are you telling me that even though

I owe \$600,000 on my house, the lender may accept \$400,000, as payment in full, if \$400,000 is the most that someone will pay for my house?” The broker responds, “That’s exactly what I am telling you!”

Thinking this is too good to be true, you ask the broker, “What about the \$200,000 difference between what I owe on the house and the sale price of the house?” The broker says the lender would rather write-off a \$200,000 loss than foreclose on the house and then be responsible for reselling the property.

Still not quite convinced, you ask the broker whether you will experience any adverse consequence as a result of a short sale. The broker explains that the negative effect of a short sale on your credit rating will be less than that of a foreclosure or bankruptcy. The broker also explains that although forgiven debt is usually considered income for tax purposes, there is a special federal law, called the Mortgage Forgiveness Debt Relief Act of 2007, which will allow you to exclude from your income the \$200,000 of forgiven mortgage debt.

Feeling better about the idea of a short sale, you and your spouse decide to list your home for sale and see if a successful short sale transaction can be completed. Several months pass. Finally, you receive a short sale purchase offer from a qualified buyer. You accept the offer, subject to the approval of your lender. Over the month or so that follows, you respond to your lender’s many requests for documents, requests which concern every aspect imaginable about your financial situation. Finally, after many sleepless nights and a few tense moments with your spouse, a notification from your lender arrives which communicates your lender’s agreement to the proposed short sale.

You are filled with anxiety as you wait for escrow to close. Finally, the broker calls and tells you that escrow has closed and that you no longer own the house – and that you just “saved” \$200,000.

You breathe a sigh of relief. You no longer own a home you cannot afford and which was starting to ruin you financially. No longer having to worry about making a mortgage payment every month, you are confident that you can now maintain a balanced budget.

Several months pass. Life is proceeding normally and you have almost forgotten about the short sale. Then, one day, you go to the mailbox and, mixed in with the usual assortment of envelopes is one which looks very formal: the return address is that of the law firm Dewy, Cheatem & Howe.

Your level of anxiety builds as you open the envelope. You read the letter from the law firm and are shocked; you can barely believe what you are reading. The letter informs you that the law firm has been retained by your now former mortgage lender to collect from you the \$200,000 you supposedly owe the lender as a result of the short sale.

You are stunned. You refuse to pay the \$200,000 demanded by your former lender. A few weeks later, a process server appears at your front door and serves you with a lawsuit which seeks a judgment against you in the amount of \$200,000, plus interest and attorney fees.

Cases in which lenders have inserted repayment clauses in what borrowers understood were short sale agreements which amounted to loan forgiveness, are becoming more prevalent. Although each case is different and thus must be resolved on its own facts, there may be many claims and defenses a borrower might be able to successfully assert in defeating such claims.

EARLE LAW OFFICES is available to assist borrowers in negotiating short sale transactions and, where legal representation was not obtained prior to concluding a short sale transaction, to defend borrowers in the subsequent litigation of cases in which a lender seeks to recover short sale losses from borrowers.

Earle Law Offices provides trial and appellate litigation, as well as non-litigation, legal services in the areas of business law, family law, real estate law, tax law, and trusts and estates.

* Mr. Earle is licensed to practice law in all California state trial and appellate courts, the United States Supreme Court, the United States Court of Appeals for the Fourth and Ninth Circuits, federal trial courts in the Northern District of California, and the United States Tax Court. He has served as a Judge Pro Tempore for the Santa Clara Superior Court, and is also a licensed Real Estate Broker.

Mr. Earle received his law degree from the Santa Clara University School of Law, where he served as an Editor of the school's Law Review, and where he received awards for academic excellence. He received his undergraduate degree, with honors, in business administration from the University of La Verne.

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