

There are Three Types of Homes on the Market Today

Each of these types of sales has their own characteristics, both good and bad. Buyers need to be aware of the ins and outs of each. Once those characteristics are understood, savvy buyers can use them to their advantage, make much better decisions, and submit stronger offers. Also, buyers can avoid those pitfalls that might otherwise hurt their desires and derail their plans.

Here is a brief description of each:

Standard Sales

These are the sales we are all most familiar with. In a Standard Sale, the Seller owes less on the loan than the home will sell for in the current market. He has equity. He stands to make some money on the sale. This kind of sale is also called and **Equity Sale**.

Short Sales

Although these have always been around, the current Recession has been responsible for making these kinds of sales a huge part of the market. In a Short Sale the Seller does NOT have equity in the home. The home is worth LESS than it will sell for in the current market. The Seller needs to sell most likely because he realizes that he will lose the home in the near future through foreclosure.

Foreclosures

These sales are also called **Bank-Owned or REO** (Real Estate Owned) sales. In this case the bank has taken the property because the Owner has defaulted on their loan.

Short Sales – *the irony.*

Short sales take much more time to work through the system than any other type of sale on the market, except perhaps probate sales and bankruptcies. They typically take around three months longer to work through than Standard Sales and have been known to take more than six months longer. Therefore **they are not for all buyers**. Buyers that are in a hurry, or are inclined to become emotionally bonded to a property, should probably think hard before submitting an offer on a short sale.

Many buyers are justifiably very excited about the prospect of buying a home that suits them. Once they find one and enter escrow, the process tends to become more emotional and less analytic. That's normal and good. However, since short sales tend to take so long, this can be very unnerving, and can produce much more frustration and anxiety than normally exists in an already tension-filled process.

Here's why the process takes so long. In a short sale, the Seller is asking their lender(s) to accept a scenario where the house is sold at a market price – usually much less than what is owed on the property – and the seller is forgiven the remaining balance. **The Seller is asking to be forgiven the difference between what he owes on the property and what the property can sell for.**

Why would a bank do that? Well, in a situation where the Seller can no longer afford the mortgage payments (usually the Seller is already a few if not several months behind in payments when this process starts), the Seller knows that the eventual outcome is that the bank will wind up taking the home back in a trust deed sale, a foreclosure. The bank needs to know that this is what the Seller sees as the inevitable outcome. The bank will

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spend a great deal of its own money to foreclose on a property, clean it up, and turn it around for a sale. **The foreclosure process is expensive for the bank.**

If the Seller can 1) show that they are not able to afford the house and that a foreclosure is imminent, and 2) that they have already found a buyer willing to pay the current market price, the bank stands to save money by getting the process over now rather than endure the lengthy and expensive foreclosure process.

The irony is that the bank takes several months evaluating both the Seller's hardship and the prospective buyer's offer. Once it has checked out both of these thoroughly, the bank will either approve or disapprove of the sale. If it is approved, escrow opens and the escrow period begins – usually 30 or 45 days – where buyers do their inspections and finalize their loan etc. So **it is only after the approval that the home is actually for sale.** During the evaluation period, both the buyers and sellers sit and wait.

What's in it for the Seller? Since the seller has worked through the process, secured a buyer and done the bank's work, the Seller's credit is hit much less than it would have been if the Seller had been foreclosed on. All things being equal, a seller could expect to be able to reenter the home buying market again in roughly 2 years. Under a foreclosure the seller could be required to sit out for 6-8 years.

Pricing. This is where it gets weird. If you haven't found this a little tough to follow yet, hold on. Remember we said above that the process cannot get started until the bank has both the Seller's financial hardship information *and* an offer from a buyer. From a Realtor's point of view, and from the Seller's point of view what the home sells for is not an issue. Whether the home finally sells for \$300,000 or \$350,000, all the Seller is interested in is that the bank will forgive him the entire balance of the difference between the final sales price and what is owed. **The goal for the Seller is to get the short sale done, and avoid the foreclosure.** Whether the bank forgives the Seller \$100,000 or \$150,000 has little concern for the home owner.

We mentioned above that most Sellers are behind on their mortgage payments when they begin this process. That means that a foreclosure is looming. Now, one would think that the bank would stop the foreclosure process while it evaluates the short sale. However, sometimes the foreclosure timeline continues on one side of the bank while the short-sale is being evaluated on the other. **It is in the Seller's best interest that the short-sale process begin as soon as possible.**

That said, Realtors will often put the home on the market far below market price in order to get an offer in quickly to the bank along with the Seller's financials. What many buyers are not told is that when the bank is evaluating the short sale, it will send out appraisers to gauge the value of the home. As the approval process winds down, **if the offer from the buyer is far below the market price, the bank will counter the buyer with a price closer to market and will not approve the short sale if the buyer does not agree with that price.**

Here's a breakdown of pros and cons from a buyer's perspective –

Short Sale Pros –

- **Short Sales sell for around 3-5% below market.** Although banks are getting more aggressive about getting closer to market value, they still recognize that they must offer a discount if they hope to lure any buyers into enduring the excruciating process of the short sale.
 - But remember, it is often the case that the price the Realtor has listed the home at is less, sometimes *far* less, than its true market value and, if so, will be less than the bank will accept.

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Make sure your Realtor gives you an honest evaluation of what the home is worth so you can be ready if the bank counters for more.

- **Buyers should not be under obligation while the bank evaluates the Short Sale.** Until the bank approves the short sale, the contract expressed in the offer from the buyer is basically inert. That said, it is easy enough to craft the offer so that it remains very clear that until the sale is approved by the bank, you, the buyer, have no obligation to stay in the deal. Make sure your Realtor knows how to craft an offer that will keep you protected and unobligated while awaiting approval. A correctly crafted offer protects the buyer in that –
 - **No deposit monies are actually deposited.** Escrow is not opened during the evaluation period. So, buyers are not at risk for loss of their deposits.
 - **Buyers can continue to shop for homes.** If they find another that suits them better, they can immediately withdraw their offer(s) on any number of short sales pending approval.
 - This is not how Standard Sales work. One offer at a time here.
- **Short Sales tend to be in better shape than foreclosures.** The longer a home sits empty, the quicker it deteriorates. Since the Seller is typically occupying the home at the time of the evaluation by the bank, the home tends to be kept up.
- **Like Standard Sales and Foreclosures, buyers do not pay commissions.**
 - In fact even the Sellers do not pay commissions in a short sale. The short sale Lender, the bank, does. Short sales should not cost the Seller anything.

The down side of Short Sales –

- Obviously, **the wait and uncertainty.** There is no guarantee that a short sale will be approved. It is possible that the bank will take the home in foreclosure at any time in the process.
 - Although emotionally hard, and a huge waste of the buyer's time, as noted above, the buyer does not lose any money with a failed short sale. Once the home is in escrow, the bank cannot foreclose on it.
- **The bank could counter for more money.** As we said above, if the fair market value of the home is far above the offer price, the bank will almost certainly require the buyer to come up with an offer more in line with the market value.
- **The bank could require the Seller to pay more, and that could fall to the Buyer.** Usually this happens in connection with the second trust deed or equity line of credit. The holder of the second trust deed may demand more money as a pay-off than the first has agreed to pay. Say, for instance, that the Seller owes \$50,000 on a line of credit. During the short sale evaluation period, the holder of the first trust deed, the mortgage, may agree to pay the holder of the line of credit \$3,000 as a payoff. The holder of the second, however, may demand another \$10,000. There are only two places the holder of the second can go for that extra money – the Seller, or the Buyer. There are various ways to negotiate through this, but it can happen that the only acceptable solution is for the buyer to pay it, particularly if the Seller has no means whatsoever. If the buyer refuses, then the home goes to foreclosure and the deal is off.
- **Termite and Home Warrantee.** In a standard sale it is most often negotiated that the Seller pays for termite inspection and certification as well as for a Home Warrantee to cover the buyer for the first year after the sale. In both Short Sales and Foreclosures, this is not typically the case. The bank is already losing tons of money, writing off the Seller's short fall, so it is seldom the case that the bank will pay for termite work – or they limit their commitment to, say, \$500 or \$1,000 – and they almost never provide

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a home warrantee. So you, the buyer, have to figure those costs into the purchase. Remember, almost all lenders will require a termite certification. And forget asking for repairs. Not going to happen.

- **HOA dues.** Buying a home/condo/townhome in an HOA regulated community poses its own challenges these days. When most Sellers get to the place where they are not able to pay their mortgage, they frequently have not been paying their HOA dues for some time. The HOA has the right to put a lien on the property. In a foreclosure, the bank has already resolved this issue, but in a short sale, it may be a lingering problem and could kill the deal. Any short sale of a home with an HOA obligation should be evaluated carefully to be sure clear title will not be threatened and so the buyer does not get surprised by what could be thousands of dollars of unpaid HOA dues, fines, fees, and interest.
 - **Another issue for Condos and HOAs.** Many condo/townhome associations are going broke. Many people are having a hard time making ends meet and HOA dues become just another one of the bills that don't get paid. If you buy a property in a community with a suffering HOA you will be paying dues and getting no service. Eventually, one would hope, as the economy stabilized and recovers, those associations will become property funded. But until then you may see the community degrading, and see little service for your dues.

This is not an exhaustive list of pros and cons, but it's enough to get started with.

Foreclosures – *Down and Dirty.*

Sales of foreclosures (“REO” and “Bank-Owned” are other names for the same thing), bear little similarity to the hassle of Short Sales. **The process for sales of foreclosures is similar to standard sales.**

In this case the bank has taken possession of the home and now owns it outright. The process of the bank taking legal possession of the home usually takes many months and *can* go on for years. By the time the bank has put a home on the market as a foreclosure, it has spent a ton of money on it. The bank's chief aim at this point is to unload the property as soon as possible. The speed and confidence of a final sale are the chief aims of the bank, and can even be more of a priority than price.

The Benefits of a Foreclosure Sale –

- **Price.** These are typically the cheapest homes on the market, often listed 7-10% below market value.
- **Speed.** These homes come off the market and move into escrow far quicker than any other homes on the MLS.
- **HOA.** The bank will have resolved any title issues including HOA liens.
 - **However,** that doesn't mean that the HOA the property belongs to is healthy. Make sure your Realtor checks it out thoroughly.

The Challenges of a Foreclosure Sale –

- **Price.** Because the motivation of the bank is well known and the under market price of a typical foreclosure is well known, there is more competition in the market for these homes than for any other.
 - **These homes are more likely to be bid up than with any other kind of sale.**
- **Speed.** Because the bank is desperate to assure that the sale will close and close quickly, it favors offers that bring that kind of assurance. For instance, a very motivated all-cash buyer can waive both the appraisal and the property inspection and virtually promise a close of escrow in a matter of days, rather than weeks. A conventional buyer (a buyer with 20% or more down) will have a lender that requires

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inspections, appraisals and termite work. Currently most lenders take around 45 days to fund. If the property has suffered damage (see “Condition” below), the chances of a lender hindering the closing of the deal increases greatly. If the deal falls out, then the bank has to go back to market and spend more money. All the while the clock keeps ticking. Therefore Cash is king in this arena. The all-cash buyer has a great deal of pull here.

- **The illusion of first come, first served.** You would think that the best way to get a foreclosure, and get a home at a super price, would be to slam an offer in as soon as the home hits the market. Not so here. Banks require their agents to leave the home on the market for two to four weeks typically in order that all the really sweet offers come in. You won’t get to jump the line by putting in a quick offer.
- **Condition.** Foreclosures are the most likely homes to need serious repairs. They have been vacant a long time and of all the types of homes on the market they are the most likely to have been neglected or vandalized by their previous owners or by anyone. So a buyer has to figure into the cost of the home, the associated cost of bringing it back up to an acceptable standard. Another problem with this is that while many buyers don’t mind doing the fixes if the trade off is getting the home at a big discount, their lenders feel otherwise. For that reason many foreclosures do not even qualify for FHA backed loans.
- **Termite and Home Warrantee.** As with short sales, don’t expect much here. The bank has already taken a bath on this property and is not eager to spend another dime. Maybe a little on termite, nothing on Home Warrantee, and nothing on repairs. “As Is” means **as is** here. Take it or leave it.
- **Qualifying.** It is common for bank-owned properties to require a buyer to cross-qualify within their own lending arm. A buyer can always use whatever lender they want, but a seller can require a buyer to pass inspection, so to speak, with their own lending requirements.

Standard Sales – *I remember when...*

These days 40% or more of most Real Estate markets are distressed homes – either foreclosed homes or short sales. The Standard Sale is one where the Seller has equity in the home and stands to make money upon selling it.

The Benefits of a Standard Sale –

- **No hassle from banks** – your own lender excluded. The only people you’ll have to dicker with will be the Seller.
 - The standard seller will, however, be particularly motivated by the price.
- **Qualifying.** Although a buyer will have to work it out with their own lender, the Seller usually takes little interest, whereas in a foreclosure, buyers are often required to cross qualify, and in general make the selling bank nervous.
- **Condition.** As one might expect, these homes are the best kept of the market place.
- **Termite, Home Warrantee, and Repairs.** Is it customary in this market that the Seller pay for all the termite inspections and work required to provide the buyer’s lender with a certification. Also, Sellers seldom resist a request to provide a Home Warrantee for the buyer for the first year. And, after the property inspection, repairs can be negotiated whereas with Short Sales and Foreclosures, the bank will not even discuss them.

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The Biggest Bummer of a Standard Sale –

- **Price.** For the most part, standard sellers are the least in touch with the value of their homes in the current market. They are understandably frustrated that they have lost so much value in their homes and attempt to recoup that by entering the market usually far above what homes are actually selling for. It may be necessary to let a standard sale sit on the market for some time in order for the seller to start thinking more realistically about price (or remove the home from the market altogether).
 - It is fair that they should expect to receive a premium for saving the buyer a long or brutal hassle with a bank, like a buyer would find in a short sale or foreclosure. A good Realtor would make it clear that, in order to stay competitive, an offer should reflect that benefit.

That sums up a brief, non-exhaustive, analysis of the ins and outs of the big three classifications of homes on the market. And, as market conditions change, we can expect the details noted above to change, if for no other reason than the banks – responsible for two of the three classifications of sales above – are constantly changing their tactics, trying to figure out how best to handle the massive inventory of homes that are worth far less than is owed on them.

A few other notes – *Things to keep in mind:*

New Construction. If there has ever been a wholesale market in real estate, this is it. Buying a new home is and has always been buying retail. The only difference now is that builders realize that they must stay competitive.

- **Go in with your agent first.** If you trust your agent and rely on their advice and support, make sure that the very first time you visit their office that you bring your agent. This is the only way your agent will be allowed to negotiate for you and the only way they will get paid. Once you've gone in the first time, they own you and will not allow your agent to represent you.
- **Get some concessions.** Builders know that these days they have to compete. They will offer concessions like closing costs, heavy upgrades for the property like wood floors or a gourmet kitchen, or extended home warranties – sometimes for 3-5 years. These are valuable concessions and increase the value of your purchase.

Lenders. If a deal falls out of escrow, the chief reason it does is because of the buyer's lender. **Shop your lender.** Do not take it for granted that they are all about the same. Also, they are very competitive. Many people do not know this because they don't take the time to go in and fill out all that paperwork with several lenders. But if you do, you will find that their rates and their ability to connect with lenders that have competitive loans vary widely.

A basic rule, an axiom, perhaps the single unchanging principle that you can always count on with the banks, is that **the banks will never act against their own interests unless forced to.** Do not ever expect them to be nice.