

Short Pay Addendum Provides a Wake-up Call
By Bob Hunt
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It is a regrettable sign of the times that the California Association of Realtors® (CAR) is preparing a new form, the Short Pay Addendum, which may be needed with listing agreements.

Sometimes "short pay" refers to what most folks call a "short sale." Usually, people think of a short sale as a situation where the market value of the property is lower than the amount owed to the lender(s). In this case, "short pay" refers to a situation where the total indebtedness, including costs of sale, may be larger than the likely selling price of the property.

For example, the loans might be \$540,000, but the loans, plus the back taxes and penalties, might be \$567,000, whereas the sale value might be \$540,000 -- equal to the loan amount, but less than the debts that must be cleared. For the most part, this is semantics: a short pay, or short sale, occurs when there is more owed than the property is worth.

No one likes a short sale -- neither the lender(s) nor the borrower. So why do they happen? Generally, for both parties it may be preferable to a foreclosure. To the lender, it may be a business decision. They will lose less by accepting a short pay than they will by foreclosing and going through the costs of resale. To an owner, it is more likely to have a personal appeal. At least owners avoid the public stigma of foreclosure; and in some cases it may be better for future credit ratings.

The short pay addendum created by CAR provides advice to the seller in six areas.

First, there is general advice that sets forth in writing that this is likely to be a short sale, and that "in order to sell the Property, Seller may be required (1) to deposit his/her own funds into escrow, or (2) seek an agreement with lender(s) or creditor(s) ("Lender") to reduce the amount of indebtedness secured by the Property (Short Pay) or both."

Secondly, there are "Tax Consequences."

- (a) The seller is advised that debt forgiveness of debt by the Lender may result in taxable income to the Seller.
- (b) In some cases, there may also be capital gains taxes due. Capital gains? How could this be?! Suppose you bought your house a long time ago, and had a basis of \$200,000. Further, suppose you had refinanced it recently for \$450,000. Now, you are in a short sale situation, and you can

only get \$400,000 for it. Guess what? Your sale gives you a capital gain of \$200,000.

Third, there may be "Credit Consequences." Just because your lender(s) will forgive a portion of the debt, and allow the sale to occur, doesn't mean they will not report you as failing "to pay as agreed" and showing a charge off. Even without a foreclosure, a short pay seller may have serious credit dings.

Fourth, there is "Lender Consideration." It is pointed out that, for the lender to approve of a short sale, it may be necessary for the borrower to demonstrate "hardship." They won't accept, "Life is tough; I can't make the payments."

The advisory notes that the lender may require the "... Seller to provide copies of financial statements, tax returns, pay stubs, or other financial information" For many, providing this financial information may be emotionally difficult, but something that can be done. However, there is that large class of people who are finding themselves unable to make payments on loans that they qualified for by providing "stated income" without documentation. Guess what? Much of that income was overstated. People committed fraud on their loan applications. And that is a felony. They are unlikely to have a short pay approved.

Next, there is a "Broker Authority" section that advises the seller that (a) the broker may contact the lender regarding the feasibility of a short sale (Any broker who doesn't would be a fool), and (b) that the property will be advertised as a "short pay." Thus, it will be public.

Finally, there is the boiler-plate notice that brokers can't give tax or legal advice; and that sellers should seek such advice from competent providers.

Unfortunately, the CAR form will not be released until the standard release time of October. It would be a great service to provide this to members sooner. In the meantime, brokers would be well-advised to have their counsel prepare a similar listing addendum.

Short pay sales. They aren't pretty; but they are part of our new reality