

Short Sale Outcomes

This is critical information. If you are about to be engaged in a short sale transaction you **MUST** understand this important fact: *Short sales are **type of short payoff outcome**.*

The term short sale is loosely used to refer to any negotiation in which a secured creditor accepts as payment less than what is owed. The terms of this acceptance have distinctive debt relief, collection and tax implications. This brief article explains this critical subject.

Note: For precision, in this article professional level terminology is used.

- The property owner will be referred to as the *debtor*
- Banks will be referred to as *creditors*
- *Secured creditor* is a bank that has a mortgage on a property
- *Releasing an interest* in a property is removing the mortgage. This is needed to make a property marketable. Without this, the property is difficult to sell.

Short Payoffs

In real estate, a *short payoff* is an arrangement in which a secured creditor releases its interest in a property that is collateral for debt, by accepting less than full payment. Since the creditor is getting paid *short* of the full debt *payoff*, this phenomenon is called a *short payoff*.

There are two types of short payoffs: Short Sale & Release of Lien. Although they are similar, these two types of short payoff are extremely different.

Short Sale: In a short sale a creditor accepts less than full payoff for the debt, releases its interest in the property and forgives the debtor for any short fall. *The property owner no longer owes anything to the creditor.* Because of this, a short sale is debt relief. According to the IRS, debt relief is financial betterment. Therefore a short sale is a taxable event. Because of this, and to be able write off the loss, the creditor will issue the property owner an [IRS 1099 C, Cancellation of Debt](#). Typically, if the property owner is insolvent, and with the use of a good



EACH OFFICE IS
INDEPENDENTLY OWNED AND
OPERATED

9220 SW Barbur Blvd
Suite 119; Box 159
Portland, OR 97219

CPA, there is no increase in tax burden to the property owner. The debtor should also look at the [Mortgage Debt Relief Act](#)

Release of Lien: In a release of lien, the creditor releases its interest on a property for less than owed, but does not forgive the unpaid debt caused by the short fall. *The property owner still owes to the creditor.* Typically the property owner and the creditor arrange for some sort of payment plan. A release of lien is not debt forgiveness, so there is no 1099. However, the property owner will no longer be able to apply debt payment interests as tax write-off.

Off course most property owners prefer a short sale over a release of lien; however that is not always possible. The type of short payoff available to the property owner depends mostly on the property owner's financial situation, ability to pay, and how easy a collections target the debtor is.

By far, the most common type of short payoff is the release of lien. The term short sale is liberally use in reference to any type of short pay off. As such, the fact that someone mentions the term "short sale", does not necessarily mean a true short sale. Through the years this has led to plenty of disappointment, disputes, personal financial disasters and a bad end to lots real estate careers.

When Short Sale? When Release of Lien?

Whether a property owner will get a short sale or a release of lien depends on the type of debt secured by the property and the chances of the creditor successfully collecting the debt.

When a Short Sale: Typically a creditor will allow the short sale of a property when it is impossible, or very difficult to collect any further funds from a debtor. This extreme example illustrates the situation. An older property owner, now living on social security income, in a rented apartment, and just discharged from bankruptcy Chapter 7 is impossible to collect on. In this case creditor will either approve a short sale or foreclose.



EACH OFFICE IS
INDEPENDENTLY OWNED AND
OPERATED

9220 SW Barbur Blvd
Suite 119; Box 159
Portland, OR 97219

When a Release of Lien: Typically a creditor will insist on a release of lien if the debtor has present and/or future ability to pay, and is a good collections target. This extreme example clearly illustrates matters. A younger doctor going through a nasty divorce may presently be totally insolvent. However, as soon as the divorce situation is resolved, chances are that the doctor will be financially fit again. So he will have ability to pay. Not only that, for a collections company, such a professional is easy to locate and harass. It would be very easy for a collector to attempt garnishing wages. To make it worse, such actions can have huge negative effects in the doctor's career (increase insurance premiums, stigma, etc). Therefore, most likely the young doctor will end up only with a release of lien, and most likely be almost happy to make payments.

Most releases of lien take place with cash-out second mortgages and home equity lines of credit (HELOC). In these cases, typically the creditor with the first mortgage forecloses, gets paid most of the debt at foreclosure sale or ends up owning the property. After the foreclosure, the junior creditors (second mortgage, HELOC, etc), are no longer secured by the property. However, the property owner still remains indebted to these creditors. These creditors will attempt to collect. Collection efforts will be aggressive if the size of the debt is large enough, and the chances of collecting of very good. So going back to the extreme example of the young doctor, such individual has no escape. He will be collected anyway. The question is how. With a release of lien, the young doctor will right away be in a payment plan he can handle. With a foreclosure, the young doctor will be chased by aggressive collectors. For a professional like him, with a lot to lose, this would be a terrible situation.

Hopefully this article clearly illustrates short payoffs. I used extreme examples because they are easier to visualize. Most individuals fall in a category somewhere between these two extremes. Just remember: A short payoff is when the creditor lets the debtor sell for less than what is owed. In the short sale the remaining debt is forgiven. In the release of lien it is not.

Copyright Reserved

Oscar Morante, Advanced Real Estate Concepts, LLC
Un-authorized reproduction prohibited



EACH OFFICE IS
INDEPENDENTLY OWNED AND
OPERATED

9220 SW Barbur Blvd
Suite 119; Box 159
Portland, OR 97219