STATE OF CALIFORNIA -BUSINESS, TRANSPORTATION AND HOUSING AGENCY EDMUND G. BROWN JR., GOVERNOR

DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT
DIVISION OF FINANCIAL ASSISTANCE
FEDERAL PROGRAMS BRANCH
HOME INVESTMENT PARTNERSHIPS PROGRAM
1800 Third Street, Suite 390-3
P.O. Box 952054
Sacramento, CA 94252-2054
(916) 322-0356
FAX (916) 322-2904

HOME Management Memo #12-01

Date: April 3, 2012

To: **HOME State Recipients**

From: **Tom Bettencourt, Branch Chief, Federal Programs Branch**

Re: **HOME Short Sale Policy**

Introduction

This Management Memo supersedes Management Memo #09-02 regarding short sales.

What is a Short Sale?

A short sale occurs when the sales price of a home is less than the total amount of liens encumbering the property. To close, a short sale must have approval from all lenders, acknowledging that the sales price is not sufficient to cover a portion (up to the total amount) of their existing loan payoff amounts. Usually, short sales are initiated when borrowers contact listing agents to sell (maybe due to the borrowers' difficulty in making mortgage payments) and it is determined that the likely sales price will not satisfy all liens. The listing agent will want to continue the process, assuming they can get one or more of the lienholders to "forgive" a portion or the entire lien amount. This may or may not be the best answer for the borrower.

Short Sale Policy

State Recipients may approve short sales without state approval. However, when conducting routine monitoring, the State will review the files for short sale requests to ensure the requirements of this memo have been met.

The State Recipient has three major sets of responsibilities. First, the State Recipient must counsel the borrower as to their best interests. Second, the State Recipient must be a prudent lender. Third, the State Recipient must follow federal regulatory requirements. The State expects the State Recipient to fulfill all three sets of responsibilities.

In their first set of responsibilities, to counsel the borrowers as to their best interests, the State Recipient must take the following actions:

- Assist the borrower to retain their home. This involves a discussion with the borrower of the reasons why the borrower is requesting a short sale, a discussion of alternatives to short sale such as loan modifications, and counseling the borrower about the possible tax consequences of a short sale. This discussion does not replace professional foreclosure counseling.
- Discuss with the borrower the advantages of remaining in the home (such as having, stable, affordable housing payments) versus other options such as renting where the rent may be higher than the mortgage payments and may go up over time.
- Discourage the short sale if borrowers have affordable housing payments and appear to be seeking a short sale simply to escape what may be a temporary "under-water" situation.

In their second set of responsibilities, as prudent lender, a State Recipient asked to approve a short sale must take the following actions:

- If it is not possible for the borrower to retain their home, recover loan proceeds to the extent possible
- Verify that the proposed sales price is approximately fair market value
- Negotiate the best possible "deal" with the first lender, e.g. some communities have reported that first lenders routinely allow $2,000 to $3,000 of the first lender's proceeds to go to the State Recipient in short sale situations
- Ensure the following documentation is in the file for later State review:
    - A description of the State Recipient's discussions with the borrower, addressing all of the issues identified above.
    - An estimate of fair market value
    - A description of the State Recipient's negotiations with the primary lender
    - Documents pertaining to the escrow

In their third set of responsibilities, as a recipient of federal HOME funds, the State Recipient must not take any actions contrary to the following provision of the HOME Final Rule at 24 CFR 92.254 (a) (5) (ii) (A):

> "…the participating jurisdiction is subject to the limitation that when the recapture requirement is triggered by a sale (voluntary or involuntary) of the housing unit, and there are no net proceeds or the net proceeds are insufficient to repay the HOME investment due, the participating jurisdiction can only recapture the net proceeds, if any. The net proceeds are the sales price minus superior loan repayment (other than HOME funds) and any closing costs."
>
> The Final Rule can be found at:
> http://www.hud.gov/offices/cpd/affordablehousing/lawsandregs/regs/finalrule.pdf

In the State's view, this language requires the State Recipient, after exhausting all reasonable efforts to counsel the borrower and recover loan proceeds, to allow a borrower to sell their home without having to repay the State Recipient any more than net proceeds. In a short sale scenario, other lenders, realtors and escrow agents will require the State Recipient's approval for the short sale to proceed. This approval cannot be withheld if the State Recipient has provided the necessary counseling and has worked to recover loan proceeds to the extent possible.

If a mortgage debt is cancelled or forgiven, the canceled amount may be taxable for the borrower. The State Recipient should direct the borrower to seek the assistance of a tax consultant or attorney who can provide qualified advice regarding the potential taxable obligation. The Mortgage Forgiveness Debt Relief Act of 2007 (currently applies to debt forgiven in 2007 through 2012) may allow the borrower to exclude all or a portion of the canceled debt from taxation. A link to IRS' website that discusses the Act is: http://www.irs.gov/individuals/article/0,,id=179414,00.html. California has a similar forgiveness law that excludes forgiven debt from state tax and conforms to the federal act. The State Recipient must file IRS Form 1099-C for each loan that is canceled or forgiven.

Short Sale Alternatives

Although HCD approval of short sales is not required, the primary consideration for the State Recipient should be to assist the borrower in retaining their home. State Recipients should continue to work with borrowers to access assistance for avoiding a short sale.

The following contains some alternatives that exist, which should be reviewed with the borrower. Since additional alternatives may become available in the future, State Recipients should explore all alternatives that exist at the time the short sale is being considered.

- Direct the borrower to http://www.makinghomeaffordable.gov/pages/default.aspx to explore the two federal Making Home Affordable programs (HAMP: Modification with the current lender vs. HARP: Refinancing up to 125% combined-loan-to-value with the current or another lender). The main goal of these programs is to get the monthly house payments (PITI) at or below 31% of their monthly gross income, which should be affordable to most owners.

- Suggest (or assist) that the borrower attempt direct loan modification with current lender.

- The borrower may seek advice from a HUD-approved free counselor at:

  http://www.hud.gov/offices/hsg/sfh/hcc/fc/index.cfm?&webListAction=search&searchstate=CA&filterSvc=dfc

- Direct the borrower to Freddie Mac and Fannie Mae's websites for technical advice and resources: http://www.freddiemac.com/avoidforeclosure/

- Advise them of upcoming foreclosure avoidance workshops in their area: http://www.freddiemac.com/avoidforeclosure/workshops.html#CA.

- Direct the borrower to CalHFA Mortgage Assistance Corporation to determine their eligibility for programs, such as Unemployment Mortgage Assistance, Mortgage Reinstatement Assistance Program, Principal Reduction Program and Transition Assistance Program: http://www.keepyourhomecalifornia.com/.

For additional information or questions, please contact your HOME Program Representative.