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The Short Pay, NOT Short Sale Is Coming Back

I got a call from a condo owner who asked for a referral to a hard-money lender. If you don't know my feelings about condos, I'll say it again; the best of these deals are like a third-degree sunburn over 100% of your body – painful and ugly! However, I listened intently as he explained his purpose for calling.

The condo was 2 bedrooms, 2 baths in a local retirement community for seniors only. He and his wife had lived there for eight years and their original mortgage was \$65,000 and he was current on his payments. However, he had decided to talk to his lender about a loan modification because he believed the average sales price in his complex was \$35,000. When I looked, the average sales price was closer to \$20,000, but who's counting?

When he spoke to the lender, the representative said they would call or contact him back in a few days. They actually did contact him by letter within a week and offered him a "short pay". A short pay is a principal reduction of the mortgage – if the homeowner (mortgagor) will close for cash in two - three weeks. In this case the offer was - if the homeowner would bring \$20,000 to closing in three weeks he would get his mortgage released. That's a \$45,000 reduction, so much for loan modifications!

This is the second one I have personally seen in the past month and I'm not looking for them. The other one was a townhouse (another allergy of mine) that was originally financed for \$145,000 and the homeowner was offered a short pay to \$55,000. Again, I only found out because the homeowner contacted me looking for hard money to close the transaction. Yes, I saw the letter from the lender confirming this reduction.

All the short pays I have seen have some similarities that are important:

1. They are not from the big 5 national banks but rather smaller regional banks or private lenders.
2. The actual short pay price is "marked to the market" in terms of the actual sales price these lenders could expect to receive if they foreclosed and sold the properties as REOs.
3. They allow the homeowner to be the buyer (definition of a short pay) but with no deed restriction that he has to hold the property.
4. Their documentation has no mention if a 1099 Form C will be issued to the IRS, but it likely will be.
5. All the lenders want cash only and closing in 30 days or less.

The problem with loan modifications is that the lenders know that 75% to 80% of the time, the homeowner will go on to default again on his "new" mortgage payment. So why do the lenders even do loan modifications? Simply because

they are getting paid something and postponing a foreclosure action that will cost them \$40,000 on average; plus it is good publicity.

These lenders doing the short pays are actually making good business decisions and saving the foreclosure expense and time involved. The homeowners believe they are getting a super spectacular deal because their mindset is focused on the original loan amount, not what the property is worth today. So short pays are a win-win for all the parties involved except the foreclosure defense, loan modification and short sale attorneys and investors or realtors doing short sales.

There exists an opportunity here for investors who want to loan short-term money at hard money rates. These short pay candidates are willing to pay hard money rates to get their giant mortgages off their backs. Often they haven't paid their mortgage in months (or years) and have cash to give the new lender funding the property.

These temporary hard-money replacement mortgages are usually for 6 months to one year maximum. Interest rates can be 11% to 15% and closing points from 3 to 5 points. If an investor had \$20,000 in his bank account paying 1% he would earn \$200 for the year. At the hard-money rates above, he would earn \$2,200 to \$3,000 for the year in interest and \$600 to \$1,000 in points at the closing. The homeowner will pay all his closing costs, which could make the mortgage even larger.

As always, consult with someone who knows what they are doing if you are lending money so you don't go afoul of State or Federal lending laws. And if you are thinking about a loan modification for yourself, ask about a short pay. Keep asking until you find someone at your lender who knows what you are talking about!

To your limitless success,

Dave Dinkel