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Monday, Feb 2, 2

Posted on Mon, Feb. 02, 2009

Why the lender may not OK your short sale

By CYNTHIA RIDDELL

At Riddell Law Group, we focus on real estate matters primarily. Thus most of my time is spent negotiating workouts, shorts sales and defending foreclosures. In the course of my practice we have had many success stories. Many short sale transactions are being approved and closed these days in Sarasota and Manatee counties. In fact NAR (the National Association of Realtors) stated that "Pending home sales activity surged as buyers took advantage of low home prices and affordable interest rates."

Much of these sales are short sales. But what about the short sale offers presented to lenders that do not get approved. Many of these offers are substantially more than what the lender may see a year from now when they receive a property back in foreclosure.

Thus when a short sale approval does not occur, the question posed by many borrowers, real estate agents and the like is: "Are the lenders just crazy?"

Well, it may not be the soundest fiscal response when a lender rejects a short sale offer at first glance. Or it may just be that the offer is an insufficient offer. But what about the offers that are substantial and can be corroborated through comparables? One must look further for the answer to this question; one must look to the Pooling and Servicing Agreement (PSA) that a particular loan is part of.

As many of us know, most mortgages were sold on the secondary market the "day after" closing and pooled with a group of mortgages held in trust as collateral for the issuance of a mortgage-backed security. Some mortgage-backed securities issued by Fannie Mae, Freddie Mac and Ginnie Mae are known as "pools" themselves. These are the simplest form of mortgage-backed security. These assets were pooled together so that Wall Street could package them as Mortgage Backed Securities. Each of the pools of mortgages are governed by this pooling and servicing agreement.

Most of the agreements have provisions for when an asset goes into default. The servicer, must elect to identify the asset as non performing and place it into the foreclosure process. Once this is done the servicer is now entitled to receive two times its servicing fees. It also opens up a multimillion dollar escrow fund that the servicer can reach to for payment of foreclosure attorney fees upfront. This may very well be the reason that borrowers that attempt a workout via short sale or a deed in lieu of foreclosure never get anywhere but foreclosure.

Another reason that the short sale process for approval stagnates is because of competing interests and private mortgage insurance at the investor level. Many of the securities sold have different terms for different beneficial interests or Tranche as they are known. Some are high risk with possible great returns and others are low risk conservative returns.

Investopedia defines a certain type of Tranche by writing: "A special type of bond class in a sequential pay collateralized mortgage obligation. This class of bond does not receive any interest or principal payments until all other Tranches have been completely paid off. In a Z-tranche, the interest that is not paid is accrued and added to the principal for future interest calculation purposes."

Moreover, many of the more senior beneficial interests, or Tranches, may have mortgage insurance to look to for payment in the event of foreclosure. Thus for them a workout seems a moot point if they can look to insurance to make them whole. Whereas the lesser beneficial interests may not be able to look to insurance but rather a pro rata share of the proceeds from a sale. Thus within the pool there is conflict among the beneficial interests as to how to proceed: workout or foreclosure?

Cynthia A. Riddell, an attorney whose practice primarily focuses on real estate foreclosure, short sale and bankruptcy issues. is a member of the Florida bar and admitted to practice in the U.S. District Court for the Middle District of Florida. She practices in Sarasota, Manatee, Pinellas and Lee counties.