



Short sales are a better alternative to foreclosure and REOs because they save legal and administrative costs necessary to foreclose; get someone out of a home; and then sell it, often after some repairs. But do they also result in a higher price? Most brokers suggest that occupied homes will sell at higher prices than empty homes, especially if they are nicely furnished. Occupied homes are also more likely to be better maintained, with grass trimmed, plants watered, swimming pools filled with clear water and broken windows repaired. Short sales are also likely to avoid the kind of destruction and desecration of properties committed by resentful subprime borrowers. Our initial thought was that short sales would not be as deeply discounted as REOs. Knowing in advance that, even if short sales observed the same kind of discount as REOs, most lenders would be ahead on transaction and carrying costs and most borrowers would feel more in control of their destiny, we decided to examine a host of metro markets and compare the various prices.

Collateral Analytics used sales data from the past several years through the present to track median home prices on a per-square-foot-of-living-area basis for non-distressed residential single-family homes and compared these to REO sales and short sales, where the seller was engaged in the marketing and sale transaction. The result of this analysis for a number of major U.S. counties is as follows:

In markets that have been hit hard by foreclosures and where many homes are underwater by a significant margin, i.e., Phoenix and Las Vegas, we find little difference in price between REO sales and short sales. In other markets, where there are many healthier submarkets and the underwater gap is less, we find a significant price advantage for short sales, i.e., Palm Beach, FL; and Chicago. We also find some markets that have been hit hard by unemployment, like Detroit, where short sales are significantly higher than REO sales. In these markets REO sales prices are much lower than short sale prices.

Another factor that could play into the difference between short sale and REO prices could be the change in attitudes about default. Ruthless or strategic default is defined as borrowers walking away from negative equity situations even when they can pay. Normally borrowers will not default unless they are significantly underwater because of

Do Short Sales Save Lenders Money?

Occupancy and attitude can make a difference.

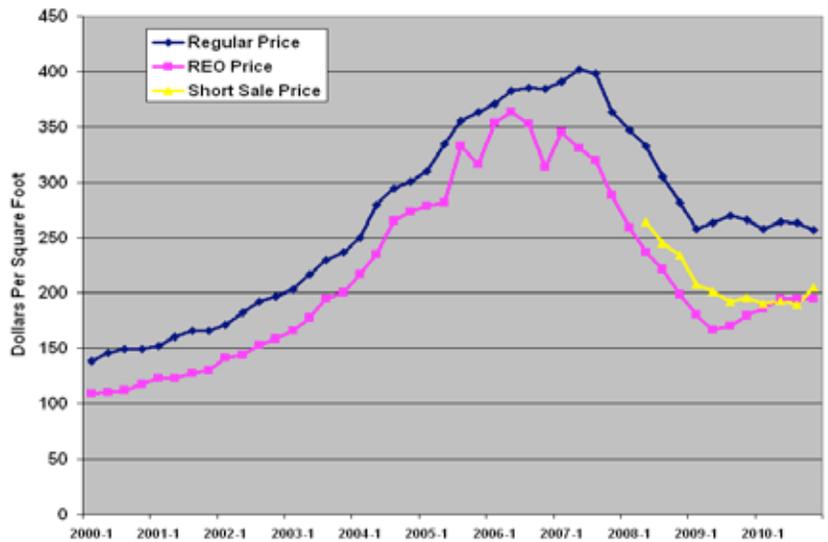
MICHAEL SKLARZ PH. D. / PATRICK CALLISON, CRA

the effects on their credit rating, the inability to buy a home and the loss of put options in the future as well as the stigma attached to being foreclosed upon. But in a paper by Guiso, Sapienza and Zingales (2009) from the European University Institute of Economics¹, the authors surveyed those who were underwater on their mortgages and found that if you knew of others who had strategically defaulted, you were more likely to default. That is, the more people in your situation who walked away when they could have paid their mortgages, the less social stigma attached to the default. Taking the implications of this study further, if borrowers knew of neighbors who had successfully completed a short sale, they may be more willing to try and avoid damage to credit ratings.

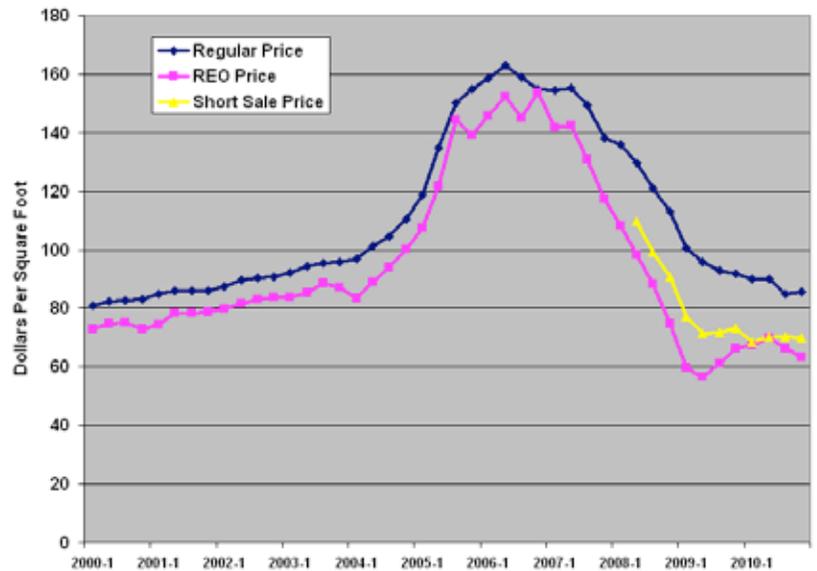
It is a sad but important fact to consider, but in communities where economic conditions may propel borrowers through the foreclosure process so rapidly, >>



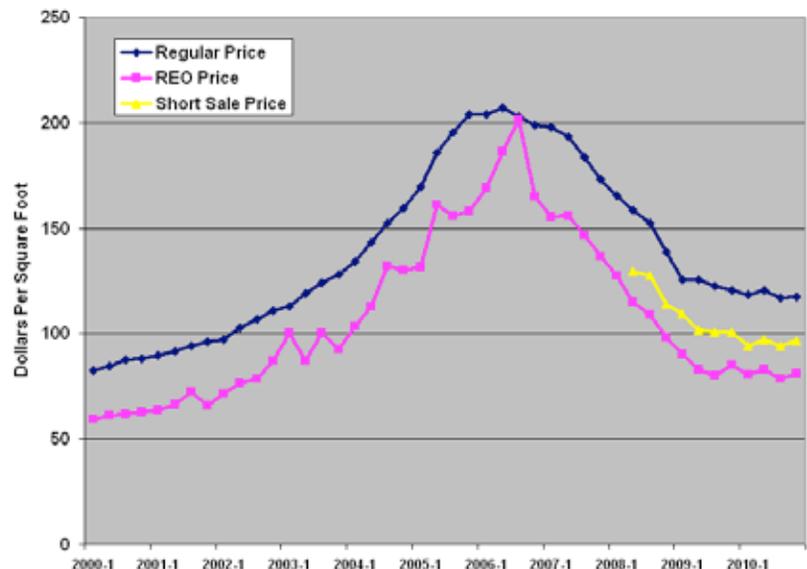
Los Angeles County CA Single-Family Median Sold Price Per Living Area



Maricopa County AZ Single-Family Median Sold Price Per Living Area



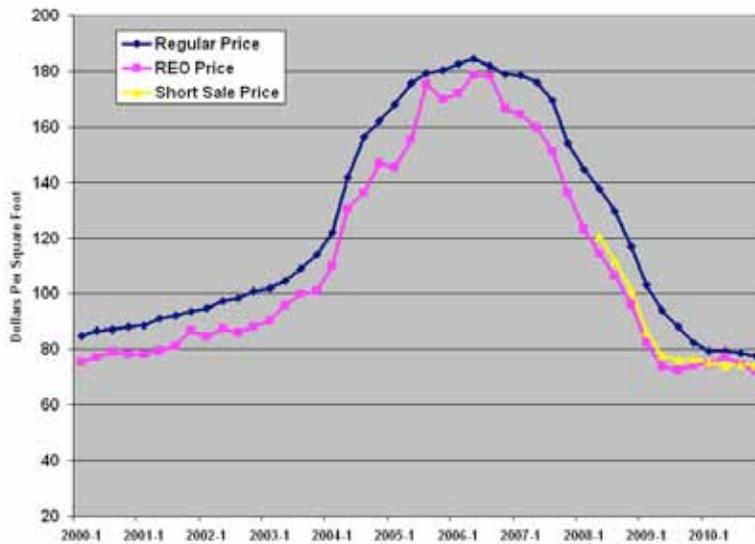
Palm Beach County FL Single-Family Median Sold Price Per Living Area



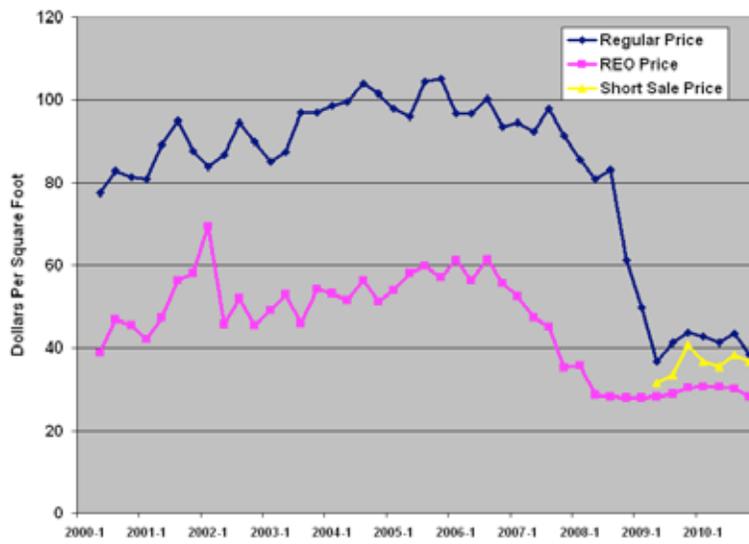
¹ Working papers # ECO2009/27



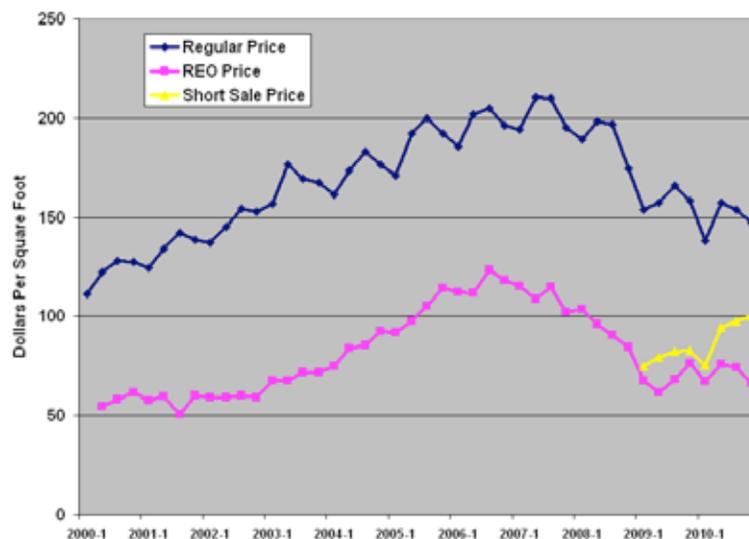
Another point to consider as residential appraisers is our responsibility to direct our client's attention to neighborhood trends known to impact the subject property value. Using data collected within the subject's market area, we may accurately infer that if short sales and non-distressed transactions are occurring to a greater extent than the REO, it is more likely the neighborhood will present well to prospective purchasers.



Clark County NV Single-Family Median Sold Price Per Living Area



Wayne County MI Single-Family Median Sold Price Per Living Area



Cook County IL Single-Family Median Sold Price Per Living Area

it may leave a volume of vacant homes as REO that may take months or even years to be absorbed by the shrunken fraction of qualified buyers. Clearly, any lender will suffer less by accepting reasonable terms for a short sale rather than allow the borrower to give up and, in a moment of anger or retaliation, strip or otherwise damage the home as they leave. Additionally, the short sale generally does not leave the home vacant for any significant amount of time, mitigating opportunity vandalism.

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