THE WALL STREET JOURNAL.
WSJ.com

U.S. NEWS | March 5, 2013, 7:42 p.m. ET

Help for Underwater Homes

Short Sales Forestall Foreclosures, Buoying Property Prices as Recovery Plays Out

By CONOR DOUGHERTY

The number of American homes that end up in foreclosure has started to decline, a welcome development that partly reflects an improving housing market.

But a look at data that tracks distressed home sales reveals another reason why foreclosures are becoming less prevalent: More homeowners are turning to so-called short sales—where they sell their homes for less than what they owe in mortgage debt and the bank typically eats the difference.

Brandon Sullivan for The Wall Street Journal

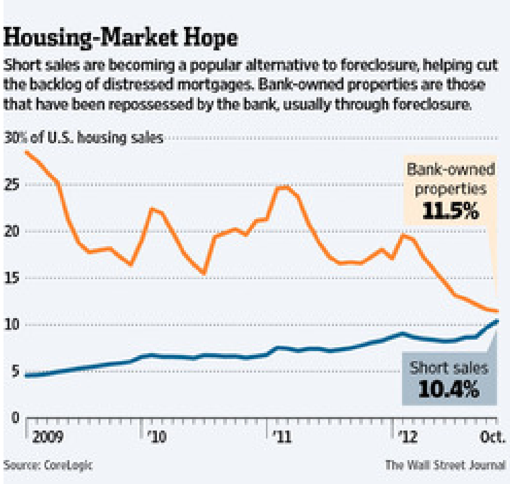
Phoenix-area resident Cesar Rivera, shown at his rental home, credits the short-sale process with helping him move past his mortgage woes.

In the past, short sales were rare. Now they are becoming increasingly common in part because lenders, homeowners and real-estate agents have become more experienced at marketing and pricing the properties, and because short sales are considered a more efficient way than foreclosure to sell underwater properties.

The shift is helping the housing market pare the backlog of distressed mortgages while cutting the amount of time vacant homes sit empty. That has helped keep home prices firm at a time when the real-estate industry is still healing from its multiyear slump.

Cesar Rivera is one beneficiary of the shift. Mr. Rivera paid about $290,000 for a four-bedroom, 2,200-square-foot house in Phoenix in 2003. After he was laid off in 2008 and got divorced, it became difficult to make the nearly $2,000 monthly mortgage payment. He stopped paying in 2009 and abandoned the home.

Late last year, a real-estate agent helped arrange a short sale for about $220,000. Waiting for foreclosure felt like "I was frozen in time," said the 41-year-old Mr. Rivera, who now rents in the Phoenix area. The short



More

Heard: Back to the Future for Housing?

Related Video

Despite the slow recovery on the housing market there were still nearly 750,000 homes in foreclosure as of February 2013. MarketWatch's Jim Jelter discusses the three banks foreclosing the most home loans. (Photo: Getty Images)

sale was "a huge ton of bricks off my back. I'm just relieved."

Foreclosures accounted for 11.5% of total home sales in October, down from 17.3% in October 2011 and close to 30% during the depths of the recession, according to CoreLogic, a real-estate research firm that tracks foreclosure and home-sales data.

Over the same period, short sales have climbed to 10.4% from 8.1%. There also has been an increase in other foreclosure alternatives, such as a deed in lieu of foreclosure—where an owner gives up a home and the bank agrees to forgive the mortgage debt—though the numbers are so small that CoreLogic says they can't be measured precisely.

Short sales also generally fetch more than foreclosures. In December, short sales cost 24% less than a comparable house that wasn't in financial distress, whereas foreclosures had a 64% discount, according to CoreLogic.

From an economic perspective, short sales leave everyone better off: Banks and investors see narrower losses, homeowners incur less damage to their credit while their neighbors' homes are less likely to be dragged down in value because of the typically higher sale prices and reduced vacancy times.

"Short sales change hands much more quickly," said Sam Khater, senior economist at CoreLogic. "That's a good thing for the economy and society."

Luis Solis, the Phoenix real-estate agent who helped Mr. Rivera with his sale, notes that short-sale homes are usually in better shape than foreclosures because they generally sit vacant for a few days or weeks versus several months or longer for foreclosures. That leaves less time for a home to fall into disrepair and reduces the threat of vandalism. "The owner is still living there—it's still their home and they usually take care of it right up to the point of sale," said Mr. Solis, who adds that over the past year his business has shifted focus from marketing foreclosures to marketing short sales.

Banks also have become more adept at processing short sales quickly. Bart Vincent, national short-sales manager for a unit of Wells Fargo & Co., says over the past few years his bank has reduced the amount of seller documentation needed to complete a short sale. It also built a software system that allows real-estate agents to quickly figure out what documents a seller needs and, based on that, about how long it should take to close the deal. Today, Wells Fargo says it takes 10 days to make a decision on 80% of its short-sale requests, compared with around 15 days a year ago.

After a five-year decline, home prices are finally moving upward. U.S. home prices rose 6.8% in December from a year earlier, the largest year-over-year gain since 2006, according to the

Standard & Poor's/Case-Shiller 20-city home price index released last week. The rise has been fueled by low interest rates and a flurry of investor activity that has drastically reduced the number of homes for sale.

Despite that progress, there are still millions of homeowners who are in some form of pre-foreclosure distress—a "shadow inventory" that could hit the market and spell trouble for the housing recovery.

Ivy Zelman, chief executive of research firm Zelman & Associates, estimates the market needs to absorb about three million homes before the shadow inventory is reduced to its level before the housing bust. She calls them "the pig in the python." While there is still a long way to go, short sales help speed up the process, she says. "At least you're getting some of the pig moving."

—Dawn Wotapka contributed to this article.

Write to Conor Dougherty at conor.dougherty@wsj.com