Why Banks accept Short Sales

By Graham and Donna Treakle

Banks are highly regulated to keep consumer confidence up. Our government can not afford to have poor public confidence in the banking institution, our economy depends on it. Now let's examine how these strict regulations affect the lending policies of banking institutions.

Banks are held accountable to several different groups: shareholders, account holders, and regulatory agencies. The shareholders are owners of the bank. When the bank performs as well as or better than expected, the shareholders get paid through dividends. This occurs at regular intervals either quarterly or yearly. Account holders provide the funds that the bank lends to borrowers. Account holders get paid for the use of their money through interest earned on their deposits. Regulatory agencies oversee the lending process and help to ensure that the bank is not taking unacceptable risks with the shareholders investment or the account holder's deposits.

Managing this process is a very considerable task. To make managing this process easier banks bundle large groups of loans together. For instance, a lender will group 1000 individual loans, each worth $100,000, into a single loan portfolio valued at $100,000,000.

Each loan portfolio has a manager. It is the manager's responsibility to manage the performance of the entire portfolio. This includes managing performing assets (loans where the borrower is making payments), at risk assets (loans where the borrower is late on payments), and non performing assets (loans where the borrower is no longer making payments).

Each loan portfolio of $100,000,000 has performance standards that must be met. These performance standards are often called return on assets (ROA), or return on investment (ROI). This means that banks are expected to make a certain return on the dollars that they put to use. In our case, these dollars are lent to the general public in the form of first and second mort gages.

When the performance of a loan portfolio falls below an acceptable performance level an internal audit is triggered because the bank has a fiduciary type responsibility to the shareholders and deposit holders to protect their investment. The purpose of the internal audit is to find the specific problems that are causing the poor performance of the portfolio. There are several reasons why a loan portfolio may be failing: the credit quality of the loans in the portfolio may be poor, the portfolio may be in a geographic location that has had several economic shifts which have caused the local economy to slip and people lose jobs, fraud in loan applications may cause unexpected losses, or the value of collateral (houses) may not be as high as originally appraised.

If the internal audit is not successful in finding the cause of the poor performance, and the performance of the portfolio does not increase, an external audit may be triggered. At this time, an outside auditor of a regulatory agency would come to the bank to examine the portfolio. It is the auditor's job to find reasons why a portfolio is not performing and then make the appropriate disciplinary recommendations regulatory agency. This can be costly to the bank if lending guidelines have not been followed.

The bank may be fined for not following regulatory guidelines. They may have increased oversight (micromanaging) by a regulatory agency, or they may have their credit rating lowered. If a banks credit rating is lowered they would see a drop in their stock price, and have an increased chance of getting bought by another bank.

One way banks prevent this from happening to a loan portfolio is to replace their non-performing assets with performing assets. To do this, they sell off their non performing assets, sometimes by selling them short of the balance owed. By taking such a loss, the bank is able to recapture most of its money that is not performing and lend it out again.

Increase your real estate profits by negotiating successful short sales. To learn more insider secrets as to why banks accept short sales, visit us on the web at www.myinvestorlink.com and www.successfulshortsales.com. -Graham and Donna Treakle *By Graham and Donna Treakle*