Strategic Defaults on Mortgage Loans & Bankruptcy

By Arizona Bankruptcy Attorney John Skiba

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On the way in to the office this morning there was a news story on the radio about homes in Arizona. A full 50% of home owners owe more on their home than it is worth here in Arizona. You may have the same thought I did — is that it? Who are these people that have positive equity, or at least are not upside down, in their home? The story went on to state that strategic defaults (i.e., just walking away) on home loans are increasing and further lowering the housing prices here in Arizona. The reality of it is many home owners are doing the math, and staying in a home and continuing to pay a mortgage payment each month when the likelihood of you seeing positive equity in your home is at least 10-15 years away, is not very enticing. In fact, it doesn't make sound financial sense. In most cases your credit will completely rebound in less time than it will take you to turn the situation with your house around.

So how can bankruptcy help you in a strategic default? First, you need to know what your liability truly is on your home loan. If you have a second mortgage or home equity line of credit (HELOC) then you need evaluate whether you will still be held responsible for those loans after you walk away from your home.

Arizona's Anti-Deficiency Statute

In Arizona we have a law that states that if you lose your home to foreclosure, you will not owe anything on the balance owed (the "deficiency") so long as the following are true:

- Your home is a single family home or a duplex
- Your home is on less than 2 1/2 acres
- You or someone has actually lived in the home
- The loan on your home was purchase money (i.e. actually used to buy your home)

If all of the following are true, you will be able to walk away from your home and not owe any additional funds and not be subject to any law suits. However, if any of the above factors are not present, then you could get sued after your home forecloses for any deficiency owed. The most common area where I see this is people who took out second mortgages or HELOCs and used the cash to pay other debt, buy other homes, etc. In short, the money was not used to buy their home, but used for something else. In these scenarios you can still be held liable for the balance owed even after a foreclosure. The bank will have 90 days after the foreclosure sale to sue you.

It is important to note that Arizona's anti-deficiency statute does **NOT** apply to short sales. I am working in bankruptcy cases with many people who either misunderstood the law or were given bad advice during a short sale. If you short sell your home and you have a second mortgage or HELOC, and the bank doesn't agree to waive or forgive the amounts owed, they can – and usually do- sue you for the balance owed.

<u>Bankruptcy</u>

During a chapter 7 bankruptcy or a chapter 13 bankruptcy you can surrender your home back to the bank and have no future liability on the home – even if it doesn't qualify for protection under the anti-deficiency statute. Further, in a chapter 13 bankruptcy if you want to keep your home we can often eliminate the second mortgage or HELOC through a process called "lien stripping. The debt is discharged through the bankruptcy.

If you are in a situation where you house is so far under water that it no longer makes financial sense to stay there, you may want to consider surrendering it through a bankruptcy filing. You will be able to get out from underneath the home and avoid any potential law suits down the road on any balance owed.

I offer a free bankruptcy consultation where we can discuss your specific situation.

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