Short Sales: The new HAFA

It has become common knowledge that many hard working people are struggling to keep their homes in this economic climate. The nightly news is full of stories of despair as the foreclosure rate continues to rise. Many of those who are fortunate enough not to be facing foreclosure are dealing with the reality that they may owe more on their mortgages than their real estate is actually worth. Rising unemployment rates spurn by tens of thousands of lost jobs, add to the dilemma as people are faced in using credit to pay for basic necessities. These are hard times.

While the current administration has attempted to provide some relief to desperate homeowners, the relief has been slow in coming. Assuming that people even qualify under the Affordable Home Act, the delay in relief does not address what homeowners are to do in the meantime.

It is not a secret that real estate market values have decreased dramatically. Your house may not be worth what you paid for it just a few years ago. If you are experiencing difficulties keeping current on your mortgage, there are several options for you. One is a short sale. The other option may be seeking protection under the Federal Bankruptcy Code.

If you are in the market to sell and have secured an arm-length buyer, the first option may be what is called a short sale. A short sale is the lender accepting less then what is owed for full payment on a loan. For example, if you borrowed $250,000 and now sell your home for $200,000 and the lender agrees to accept the $200,000 as full payment on the loan, then that is a short sale.

The success of a shirt sale is not a property right. The ultimate decision is up to the lender. You must be in a hardship. Hardship is defined by the Lenders as circumstances out of one's control. Some examples would be: job loss, job relocation, family illness, divorce, significant increase of mortgage payment due to an interest adjustment, and an unforeseen increase in living expenses.

It is more likely than not that the Lender does NOT want your house and will be willing to consider a short sale. In today's market, Lenders are flooded with inventory of homes. You have to prove your hardship. Lenders require that homeowners submit a monthly budget which demonstrate why you can't afford your mortgage payment as well as other financial documents.

The Mortgage Debt Forgiveness Act of 2007 allows gains on a short sale to be forgiven up to $1 million on a primary residence if sold in 2007 through 2010. Believe it or not, if you sell your $250,000 home for $200,000 and the lender accepts that amount for full payment, it is considered a gain of $50,000. Prior to the Mortgage Debt Forgiveness Act of 2007, you would have to pay income tax on that gain. On the other hand, if you have refinanced and used that money to pay off debt or purchase items, the $50,000 will be reported as income. Of course you should always consult a accountant for details and eligibility

In my legal practice, people are very often concerned with the impact that a short sale or a foreclosure may have on their credit score. A successful short sale may bring your FICO credit score down 80-100 points, whereas a foreclosure may bring your credit score down 200-250 points.

Another credit score concern for people is the impact of filing bankruptcy. A lot of people are uncomfortable talking about the “B” word. It appears that there is a lingering stigma to filing for protection under the federal Bankruptcy Code, the current economic climate continues to drive a substantial increase in the number of bankruptcy filings due to the debt relief it provides. More and more “solid” middleclass individuals are now filing and are part of a 32% increase in filings. The people of Maine are no exception. Due to the economic reality of living in this state, the percentage of bankruptcy filings may pass the national average. Corporations, counseled by a bevy of lawyers, have long utilized protection from their creditors by filing bankruptcy. Many people do not understand the fact that the same protection and relief are available for individual consumer debtors as well.

The Bankruptcy Code has two main objectives. The first objective is to provide debtors with a fresh start in their financial lives. Whether it is the crushing interest, late or over-limit fees of credit cards, foreclosure or mounting arrearages from adjustable rate mortgages, there comes a point where it is virtually impossible to overcome that mountain of exponential debt. The second objective of the Bankruptcy Code mandates an equitable return to the creditor and is evident in the Code’s 2005 changes.

There is a significant emotional component when facing bankruptcy. People believe that they have somehow financially failed. Nothing could be further from the truth. Those individuals who contemplate filing bankruptcy often do so out of necessity and are held to a federal standard that attempts to mitigate any abuse of the system. Contrary to public opinion, it is not the intention of the federal Bankruptcy Code to leave you without a home or a vehicle to get to work. Many times, depending on your circumstances, those items, as well as others, fall well within Maine’s exemptions and are retained by the debtor.

There are two options available to individual consumer debtors under the Bankruptcy Code. The first is Chapter 7, which is a complete liquidation or what is termed as a straight bankruptcy. The second is Chapter 13, which is a reorganization of your debt. A Chapter 13 bankruptcy filing often allows homeowners who are in arrears on their mortgage, to enter into a plan to pay on the arrearage while keeping their homes.

It is important that people educate themselves on a variety of options while we ride out this economic storm.

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