Bankruptcy, Falling Home Prices & Just Walking Away From Your Home

By Arizona Bankruptcy Attorney John Skiba

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This past Monday new numbers on home values around the country were released that confirmed a "double dip" in housing prices, falling below the 2009 low. This is frustrating news for people in Arizona that have been holding on to their home, making the payment month after month, but continue to see the value of their house plummet. Most of the people I meet with daily in bankruptcy consultations are upside down in their home, some owing hundreds of thousands of dollars more than their home is worth.

The falling house prices have led many to the decision that it simply is not a good financial strategy to stay in their home. There is a lot of emotion tied up into our homes; it is where we raise our families and where memories are made, but if you set aside the emotional part of it, it doesn't make a lot of sense to stay in a home that is severely upside down in this market.

Bankruptcy and Arizona's Anti-Deficiency Law

The question most people are concerned about is if they do decide to walk away from their home what possible liability will they have from the bank? The answer is it depends on what type of loans you have on the property. If you only have a first mortgage and decide to walk away from the home you will not owe anything additional on that property. When you bought the home the deal was you pay the mortgage and you keep the house; if you don't pay the mortgage the bank gets the house.

The area where most people run into problems is when they have a second mortgage or a home equity line of credit (HELOC). If you refinanced your home and took out a second mortgage or HELOC and used the cash for something other than purchasing your home you will be held liable for any balance owed after the bank auctions off your house.

Arizona has a law known as the Anti-Deficiency Statute that protects many home owners from banks after a foreclosure sale. However, in order to qualify for protection under this statute the loans on your home must be "purchase money," meaning you used them to actually buy the home (not used the cash for something like paying other debt or buying a cabin, etc.). If your second mortgage or HELOC is not a purchase money loan you will still owe money after the foreclosure sale is over.

Bankruptcy can help. You can surrender your home through a chapter 7 bankruptcy and any potential balance owed will be discharged/eliminated through the bankruptcy process. Once your bankruptcy case is filed it typically takes anywhere from one month to five months for the bank to get permission from the bankruptcy court to move forward with the auction of your house.

Eliminate Potential 1099 Tax Liability by Surrendering Your House Through Bankruptcy

Another issue that people deal with when it comes to short sales and foreclosures is the possible tax consequences. Banks can issue a 1099 for any debt that is forgiven. For instance, let's say the bank forgave $100,00, you could receive a 1099 for $100,000 which you would be taxed on as if you actually earned an additional $100,000 of income that particular year.

By surrendering your home through bankruptcy you would not incur any tax liability.

If you are weighing your options on whether to keep your home or walk away, I would be happy to meet with you in my free bankruptcy consultation to discuss your potential liabilities and how bankruptcy can help.

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