FORECLOSURE... and ways to avoid it!

By Craig I. Kelley, Esq.

Are you behind on your mortgage payments on your primary residence or investment property? You may have heard about "short sales", a "deed in lieu of foreclosure" or a bankruptcy as ways to prevent a property from going into foreclosure. Unfortunately, there is no "one-size-fits-all" approach. The option that is best for you is dependent upon your particular circumstances.

When a mortgage loan goes into default, a foreclosure action will be commenced by your lender in the absence of a resolution. A foreclosure action begins when the lender files a lawsuit seeking the forced judicial sale of your property. This process takes a number of months. Before the property is sold at a foreclosure sale, you have some options. However, once the lender receives a foreclosure judgment in its favor, the property is sold thirty (30) days thereafter at a foreclosure sale under the supervision of the court. The proceeds of sale are then used to satisfy the lien holders in their order of priority. If the lender's mortgage is not fully paid at the sale, then you will be liable for the deficiency balance.


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One option to save the property is a "short sale" in which your lender agrees that you may sell the property for market value, even though it is less than the outstanding balance of the loan. A short sale is merely a negotiated resolution between your lender and you in order to avoid foreclosure. However, a short sale will only release the remaining deficiency balance if this is clearly indicated on the lender's acceptance of the sale offer.

If you are selling investment property in a short sale, it is important keep in mind that the IRS considers forgiven debt to be taxable income, which means if your lender forgives the deficiency balance, it may issue a Form 1099 to you in the amount of the deficiency. If you are contemplating selling investment property in a short sale, then you should consult a tax attorney or CPA to discuss any tax consequences.

Another option is to try to persuade the lender to agree to a "deed in lieu of foreclosure". In this process, you convey all interest in the property to your lender. Any deficiency balance due is often forgiven. The lender usually requires you to have the property listed for sale for a certain period of time and meet other specified requirements.

A short sale or a deed in lieu has some advantages over foreclosure. Both will adversely affect your credit report, but the impact may be less than a foreclosure. While it's possible to work out one of these solutions with your lender on your own, you may have better luck with the help of someone who specializes in the process and who can help you understand the remedies available to you.

A third option is a Bankruptcy proceeding to cure the past payments over a five year term or surrender the home and be discharged from all liability. Another benefit of the Bankruptcy is that it is usually easier to re-establish your credit after a bankruptcy than after a negotiated resolution. stb

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