

## **WHY TAKING REAL ESTATE IN A DIVORCE SETTLEMENT IS A MOST DANGEROUS CHOICE THESE DAYS \***

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Whether the real estate you choose to acquire as part of a divorce action or settlement is the residence where you have lived during the latter part of your marriage, the house previously owned by your spouse or is commercial property, you should be very careful and utilize due diligence prior to agreeing to the transfer of real estate in a property settlement agreement in a pending divorce. Some of the factors that need to be considered are as follows:

1. Condition of the house;
2. Financial security of the house;
3. Title;
4. Anticipated repairs in the next five years;
5. Annual expenses for maintaining the property;
6. The current real estate market conditions and the true value of the property.

### **CONDITION**

Most real estate purchasers obtain a home inspection prior to purchasing their residence. It may also be imperative that a divorcing spouse get a homeowner's inspection prior to accepting sole control of the residence. Why would a divorcing spouse who has lived in their home for 25 years or fewer, or more, need a homeowner's inspection? The reasons are multiple:

1. What is the physical condition: structure, construction, and mechanical systems?
2. What items need to be repaired or replaced?
3. What is the estimate of the remaining useful life of the major systems, equipment, structure, and finishes?

Not only does the acquiring spouse need to know the condition of the residence for purposes of a future resale, but also for purposes of its maintenance costs. HVAC systems may be very expensive to repair and/or replace. They are also an important component in the resale of a residence. The appliances may have been recalled by the manufacturer. See [www.recalls.gov](http://www.recalls.gov) for such information.

One real life nightmare scenario occurred where one spouse occupied the residence during the pendency of a three-year-long divorce suit, yet the other spouse acquired it as part of the divorce. The unsuspecting spouse failed to get an inspection of the home, and acquired a

residence that had been substantially damaged/destroyed by termites in the three years duration of the divorce process.

If you are going to purchase your spouse's equity share, a fair market value appraisal is necessary and required in most every case. If, however, you are choosing to sell the residence on the open market, then a Comparative Market Analysis (C.M.A.) by a licensed realtor could be sufficient for purposes of knowing what the threshold asking price should be.

As part of your due diligence inquiry as to the residence, you may also need to be aware of the Comprehensive Loss Underwriting Exchange (C.L.U.E.). A C.L.U.E. report is the equifax or carfax for your house. Your homeowner's insurance carrier utilizes this report, and it will follow the house for any number of years resulting in a determination of the cost of your homeowner's insurance premiums. Generally, the C.L.U.E. report is a seven year history. The worst red flag on such a report is a fire claim or water damage claim. A fire claim will follow the house for at least five years.

The homeowner may request one free C.L.U.E. report on his house which may be obtained at [www.choicetrust.com](http://www.choicetrust.com). Requesting this report may be a "soft" hit on one's credit report. The C.L.U.E. report can also lead to the discovery of unknown bank accounts where insurance proceeds may have been deposited for a property damage claim and which was not spent on repairing the damage.

Remember a fair market appraisal is an appraisal of your residence made by a licensed or certified appraiser, not by a licensed realtor. The appraisal differs from the C.M.A. and the tax assessment. The tax assessment is a tool for taxation, not for house valuation. Tax assessed values may be average values, or may be out-of-date values.

An appraisal, as compared to the tax assessed value or a C.M.A., will cost you a fee, which is money well spent. Remember an appraisal is only a snapshot in time. It is no guarantee that there exists an actual potential purchaser willing to pay that amount for the home.

### **FINANCIAL SECURITY**

While it may be unusual for a spouse to request a title search of the residence in which he or she has joint ownership, it may be prudent so as to disclose any judgments or liens against either spouse which may affect title to the property, especially if the transfer happens after a divorce or the spouse did not hold title as tenants by the entirety. It should not be unusual, however, in the instance when a spouse is acquiring real estate that was not originally titled to him or her. The title search will certainly reveal any deficiencies in the links of the chain of title, as well as any liens on record. Liens on record, however, are available by inspection, free of charge, in the clerk's office where the deed is recorded. Some liens that may attach to the property are state or federal tax liens, as well as attorneys' liens associated with an earlier divorce of one of the spouses. These liens follow the title of the residence, not the debtor.

A title search will reveal what loans are secured by the property, not only the first mortgage but any home equity line of credit ("HELOC"). It should be remembered that a

HELOC does not close until it has been paid in full. Therefore, if a HELOC remains open after a division of the real estate, there may be post divorce charges on that loan. In addition, some HELOCs require authorization prior to refinancing the original superior first mortgage loan.

It is always advisable that prior to agreeing to refinance any residence in one's name alone, the acquiring spouse should seek mortgage counseling to see if he or she will qualify for a mortgage in his or her name alone. Pre-divorce mortgage counseling is highly recommended. Most mortgage companies today will require a paper trail of three to six months of support payments if the purchaser is relying on support as income to qualify for a refinanced mortgage. This paper trail may require cooperation by the payor spouse. To avoid having to get cooperation from the payor spouse, one may request that support payments be paid through the Division of Child Support Enforcement ("DCSE"). DCSE can automatically provide the paper trail for such support payments.

Mortgage lenders may also require that the support order be at least three years in duration after the closing date on the refinancing.

The only way to get a spouse off a joint mortgage is to: (1) either refinance it individually in the spouse's name who is retaining the house ("house" spouse), (2) obtain an assumption of the mortgage or (3) obtain a release of the "non-resident" spouse by the mortgage holder, or (4) sell the house.

Hold harmless language in a separation agreement may not be enough when the parties have not refinanced the house in the "house" spouse's name alone. If the "house" spouse defaults on the joint mortgage payments and that spouse is holding harmless the "non-resident" spouse, the "house" spouse may be judgment proof. Therefore, the hold harmless language will be effectively worthless in this circumstance. Remember, the hold harmless language does not bind the bank; it only applies between the spouses.

A quit claim deed does not remove one from a mortgage or relieve one from the mortgage liability. If the "house" spouse fails to pay the mortgage on time and is late just once, the "non-resident" spouse's credit report, as the joint mortgage holder, may drop by 50 points. If the "house" spouse is late two times, it may take 12 months to repair the "non-resident" spouse's credit score after such an event.

If your separation agreement does not provide additional language above and beyond hold harmless language, then the "non-resident" spouse may not be able to force the refinance or resale of the residence. A court is more likely to opt for that language in the event the "house" spouse defaults on the mortgage payment when that language is specified. The "non-resident" spouse may also be dragged into bankruptcy if the "house" spouse takes that route. The bankruptcy may result in the foreclosure of the residence. These catastrophic events will affect the credit rating of the "non-resident" spouse who has remained on the joint mortgage. The joint mortgage may be titled as joint and several liability, for which the "non-resident" spouse remains liable even though he or she didn't go through bankruptcy. The "non-resident" spouse may not qualify in the future for refinancing because the "house" spouse's late payments or foreclosure will show up on the "non-resident" spouse's credit report even though he or she wasn't

responsible for the mortgage payments. A foreclosure will remain on an individual's report for at least seven years.

Another option for the "non-resident" spouse is to obtain his or her own deed of trust for the mortgage payments that the "house" spouse has agreed to take over. This deed of trust, however, will be in line behind any prior secured loans, i.e., the original first mortgage and HELOC.

### **TITLE**

Title insurance covers the chain of title in acquiring real estate. If a divorcing spouse acquires real estate that was solely titled to the other spouse, the acquiring spouse will not have the benefit of any title insurance policy in the name of the other spouse. Important, an owner's title insurance policy only protects an owner; a lender's title insurance policy only protects a lender.

When spouses own real estate as joint tenants with rights of survivorship, it means that, pending the change in title pursuant to the terms of the separation agreement, either party may inherit the whole real estate upon the death of the other party. Joint title with rights of survivorship can also be changed without both parties' signatures. If one spouse wishes to give up the right of survivorship and hold the property merely as a joint tenant so that his or her estate inherits his/her share, that can be done with one signature alone.

### **UNDERWATER SCENARIO**

What happens when your house is financially underwater or there is more mortgage associated with the property than the fair market value of the property? Foreclosure alternatives may be found at [www.MakingHomeAffordable.gov](http://www.MakingHomeAffordable.gov). Generally speaking, a mortgage lender may be reluctant to foreclose on a residence for many reasons:

- (1) a vacant house is not a profitable house;
- (2) a foreclosure increases expenses;
- (3) a bank-owned house carries with it holding costs and property preservation costs;
- (4) the bank or mortgage lender does not want to be in the real estate business.

Some options that the debtor may seek with the mortgage company are: forbearance; a new repayment plan; a rollover of the delinquency into a new loan; a three month or limited term for the loan modification or a new permanent loan modification.

A short sale is one in which the bank cooperates in agreeing to sell the property to a third party for less than is owed on the residence. The bank or mortgage holder will need a hardship letter to consider the short sale option. Divorce is a qualifying hardship. In asking the bank to agree to a short sale, you are arguing that the costs that would be incurred by the bank to foreclose and own such property would be spared in the short sale.

A deed in lieu of foreclosure means turning over the deed to the mortgage holder, and simply saving the lender the cost of going through the foreclosure process. Generally speaking,

a mortgage holder will not take a deed in lieu of foreclosure, if there are other liens on the property.

The advantage of a short sale over a deed in lieu of foreclosure is that the lender is not going to incur the cost of owning the property. The critical question that the homeowner needs to have answered is whether or not the bank will forgive the deficiency created by a short sale, that is, the difference between the mortgage balance and the lower short sale price. The owner needs to obtain a written commitment from the bank agreeing to relieve the owner from any further liability on the note. That deficiency may be recognized in a 1099-C form. The residence and homeowner must qualify under the Mortgage Debt Relief Act of 2007 to avoid paying taxes on the deficiency. If the mortgagee company issues a 1099-C form, then the separation agreement better specify which spouse is paying the tax consequences. The clause in the property settlement agreement should address how the tax consequences will be treated in the event of a short sale or debt forgiveness.

Forms for a hardship letter in either the short sale or deed in lieu of foreclosure sale may be found at [www.forecloseddreams.com/sample-short-sale-letter](http://www.forecloseddreams.com/sample-short-sale-letter) or [www.forecloseddreams.com/sample-deed-in-lieu-letter](http://www.forecloseddreams.com/sample-deed-in-lieu-letter). An owner should consult an attorney in pursuing a short sale or deed in lieu of foreclosure.

When the homeowner is considering the financial impact of losing the home that is in financial distress, there are several other matters to also consider. A short sale may take four months, more or less, to process. Whatever the shortfall is in the sale, if it is paid out of the homeowner's pocket, there will be no impact on the homeowner's credit report. If, however, the homeowner goes through a short sale, there probably will be a negative impact on his credit score for at least two to three years. This negative impact may affect one's future mortgage applications for a similar period of time.

A deed in lieu of foreclosure is considered a significantly negative event in one's credit score and lasts for seven years. It may take as many as four years before one can apply and receive a future mortgage. The uniform mortgage application requests a seven-year foreclosure history.

Bankruptcy, on the other hand, has a ten-year significant negative effect, and it may be three years before you will be successful in applying for a new mortgage.

There are many helpful resources available to the consumer. Any person is entitled to one free annual credit report, and it may be obtained at [www.annualcreditreport.com](http://www.annualcreditreport.com) or telephone (877)322-8228. IRS Publications regarding these matters may be found at [www.irs.gov/individuals](http://www.irs.gov/individuals); IRS form 982 - Reduction of Tax Attributes Due to Discharge of Indebtedness; IRS publication 4681 - Cancelled Debts, Foreclosures, Repossessions and Abandonments; IRS publication 908 - Bankruptcy Tax Guide; IRS publication 971 - Innocent Spouse Relief; IRS publication 504 - Divorced or Separated Individuals; IRS publication 523 - Selling Your Home; IRS publication 544 - Sales and Other Dispositions of Assets.

In summary, before accepting real estate as part of a settlement, a divorcing spouse must give prudent consideration to the wisdom and effect of becoming the sole title owner. At any time, particularly in a turbulent business market, careful inquiry and planning by the spouse is required. Careful crafting of separation agreements by counsel is mandated.

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