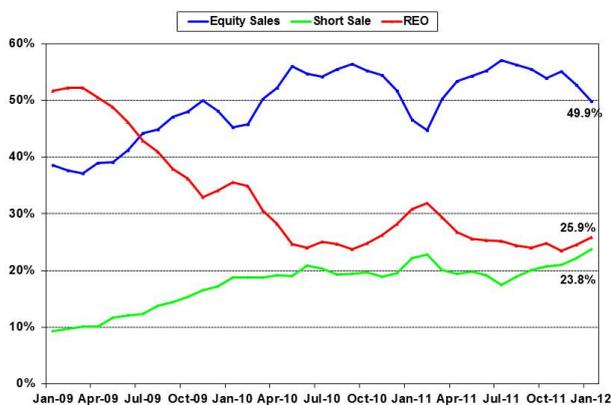


### Short Sale or Foreclosure? What to Consider Before Making the Decision

With distressed properties, including foreclosures (or REOs) and short sales, making up about half of all single-family home sales in California in January, according to the CALIFORNIA ASSOCIATION OF REALTORS®, many underwater sellers will face the tough decision between a foreclosure or a short sale.

Some of the most important factors to consider before making the decision include deficiency judgments, tax implications, credit consequences and timing.

#### Share of Distressed Sales Climbed in the Last 2 Months Following Seasonal Trend



SOURCE: California Association of REALTORS®

### Deficiency Judgements and Tax Implications

The good news is that California offers some protections for consumers against deficiency judgments after short sales and foreclosures. A homeowner is generally protected against a deficiency judgment after short sale for a one-to-four residential unit property. The instances in which a homeowner is generally protected against a deficiency judgment following foreclosure include, among other things, a non-judicial foreclosure or a loan that is all of the following: 1) owner-occupied, 2) secured by a one-to-four unit dwelling and 3) purchase money. Homeowners are also protected against deficiency judgments after foreclosure of seller financing.

Sellers may be responsible for taxes on, among other things, cancellation of debt (COD) income, which is approximately the difference between the outstanding loan balance and the fair market value. The exceptions to being taxed on COD income include bankruptcy, insolvency and forgiveness of a nonrecourse debt after foreclosure.

Nonrecourse debt in California is when a loan is made to purchase a one-to-four unit, owner-occupied property or when the seller carries back financing. In the case of a short sale or foreclosure, the Mortgage Forgiveness Debt Relief Act of 2007 also provides an exception from federal taxation when the following conditions are met: 1) property must be a qualified principal residence as defined, 2) loan is secured by the residence, 3) income relief is capped at \$1,000,000 for married couples filing separately and \$2,000,000 for all others, and 4) loan is discharged after January 1, 2007 and before January 1, 2013. Additional rules apply under California law.

### Credit Consequences and Timing

Credit may be adversely affected regardless of the type of sale—foreclosure or short sale. Credit score declines can vary and the negative mark may remain on the credit report for seven years. Both foreclosures and short sales might affect the ability to qualify for a loan to purchase another home. In some short sale cases where the seller may have even been current with mortgage payments but sold the home for less than the outstanding loan amount, the credit report could indicate that the debt was settled for less than what was owed and the impact may be less severe.

In the event of a foreclosure, a borrower may not be able to qualify for another home loan for seven years without any extenuating circumstances, or five years with extenuating circumstances, under current Fannie Mae guidelines. The wait may be less with short sales. If payments are in arrears in a short sale, buyers may qualify to purchase another home within about two years for a Fannie Mae backed mortgage, or approximately three years for a FHA loan. If payments were current, consumers may qualify for another loan immediately, but it can be difficult to find a lender.

Exceptions and additional considerations apply to the conditions discussed, depending on individual circumstances. For consumers facing these difficult choices, it is advisable to seek professional assistance from an attorney and/or an accountant who can evaluate your specific situation.

*This information is believed accurate as of February 2, 2012. It is intended to provide general answers to general questions and is not intended as a substitute for individual legal advice. Advice in specific situations may differ depending upon a wide variety of factors. Therefore, readers with specific legal questions should seek the advice of an attorney.*

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