

Am I Responsible For Mortgage Debt After Bankruptcy Discharge?

Question:

My daughter and her husband filed bankruptcy 2 years ago. Their home was in the bankruptcy and the first mortgage reports as such but the second mortgage does not. They did not reaffirm the debt. They can no longer make the payments, are they okay to give the home back; should they do a short sale?

Answer:

A bankruptcy will discharge an individual's personal liability for mortgage debt, but not the security interest (or lien). When a person takes out a mortgage (or other secured debt), the person actually creates two instruments: (1) the security interest, and (2) the loan or note. The security interest gives the lender the right to foreclose or repossess the house (collateral) in the event the borrower defaults on the loan. The loan is the borrower's personal promise to pay the loan. In bankruptcy, regardless of the debtor's intent to keep or surrender the house (collateral), a chapter 7 bankruptcy discharges the loan (the personal guarantee). However, if the debtor wishes to keep the house, the debtor must keep making payments.

The result of a chapter 7 bankruptcy for the borrower is that she can walk away from the house at any time after the discharge without any financial consequences. The lender cannot come after the debtor for the difference between what the house is worth and what is owed on the property. So, the borrower can simply walk away and allow the house to foreclose. This scenario is now commonly referred to as a strategic default. Since foreclosure takes so long to complete, the homeowner stops paying the mortgage, lives in the house rent free for many months (a [recent article](#) estimated that borrowers live in their homes on average 469 days after the first missed payment; but foreclosure timelines vary from state to state), and moves out around the time of the foreclosure sale date. The borrower may short sell or sell the property after bankruptcy. In fact, the chapter 7 bankruptcy may make it easier for the lender

to agree to the short sale. However, in the short sale scenario, the bank must still agree to the short sale.

Keep in mind, a person's credit report is not a legal document that is intended to be the final word on the status of debt; the bankruptcy code trumps a credit report. Assuming the second mortgage was listed in the bankruptcy, and your daughter received a discharge, the second mortgage is presumably discharged and she can walk away from the house if she wants without financial consequence. However, you should have your daughter run her situation by her bankruptcy attorney to verify that all the conditions have been met for a strategic default with consequence.

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