

Foreclosures and Short Sales

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Types of Foreclosure

- Foreclosure by Advertisement
 - More common
 - Non-judicial; notice of sale published prior to sale; certain parties given notice
 - Typically, lender is high bidder at the sale
 - Lender gives up rights to a deficiency judgment against the borrower/owner
- Foreclosure by Action
 - Foreclosure occurs in a district court lawsuit
 - Typically non-residential property
 - Court issues order to allow sale to be scheduled
 - Used when loan value greatly exceeds property value
 - Lender can obtain a deficiency judgment against the borrower and execute other non-exempt property, if any

Redemption Period

- Once the sale occurs, the owner has possessory interest for a period of time (most typical = 6 months; can be longer or shorter depending upon the circumstances).
- Junior creditors have successive 7 day redemption periods after owner's redemption period expires.
- Lender does not own clear title to the property until expiration of all redemption periods.

Foreclosure Alternatives

- Voluntary Foreclosure: statutory option; redemption period is shortened to two (2) months
- Deed In Lieu of Foreclosure: transfer of fee ownership of property to lender; no foreclosure needed (used where no other liens exist)
- Short Sale: ...

Short Sales

- A short sale is a sale of property for less than the aggregate balance of all loans against the property
- Short sales require consent of all mortgage lenders and, if applicable, other lienholders
- Advantage for borrower: in some instances, a lender will waive rights to deficiencies as part of a short sale consent.
- Advantage for lender: no need to wait out redemption periods to get paid.

Tax Implications

- To the extent that a lender forgives any portion of the debt, the amount forgiven is income to the borrower. This is true in a foreclosure or short sale.
- Whether this cancellation of indebtedness income is included as taxable income to the borrower depends upon nature of the indebtedness and whether borrower is insolvent.
- NOTE: no inclusion of cancellation of indebtedness income for the primary residence; issue arises primarily on investment/rental properties.