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REAL ESTATE'S NEW RULES: Get key insights into home buying and selling in SmartMoney's new e-book.

REAL ESTATE by Lisa Scherzer (Author Archive)

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Recession, Divorce and Home: They Don't Mix

A RECESSION IS A bad time to get divorced – especially if your home has sunk in value along with the rest of the housing market.

Last year, the divorce rate in the U.S. fell 4% after rising 7% in 2007, according to a report released last week by the National Marriage Project. While the news might cheer family advocates, it suggests something else to project director W. Bradford Wilcox: That couples with depreciated home values might be waiting to split until the market rebounds.

For most people, the house is one of their two biggest assets along with their 401(k). Right now, home values are down substantially from 18 months ago. In fact, according to Moody's Economy.com, 31.8% of owners with a first mortgage are underwater meaning their house is valued at less than what's owed on the mortgage. That means couples who decide to get divorced – and not live separate-but-together under one roof, an approach many have resorted to – are splitting liabilities instead of assets.

"It used to be that couples fought over the house because of continuity and stability for the children," says Fadi Baradihi, president of the Institute for Divorce Financial Analysts. "That's not happening anymore. Now everybody wants to run from it."

But when a property has lost significant value, running isn't so easy.

When it comes to the dilemma of selling or keeping the family home, the issue is if either spouse can actually qualify and refinance the home as a single, one-income household. With negative equity so prevalent today, it's virtually impossible to get refinancing, says Leslie Thompson, a certified financial planner and partner at Spectrum Management Group in Indianapolis.



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If the couple isn't selling the house, the spouse who is staying has to refinance the mortgage – that's the only way the bank will let the other go, says Richard Iglar, an attorney with Skoloff & Wolfe, P.C., a Livingston, N.J., law firm that focuses on matrimonial and real estate law. Otherwise, the departing spouse is liable for the entire mortgage; and, if the spouse that's in the house misses a mortgage payment, the other is liable to pay but has no claim to any equity in house. But when there's negative equity, it's pretty much impossible to refinance. "It doesn't make sense for the bank to make the loan," he says.

That doesn't leave a divorcing couple with many good options. Here are a few to consider.

Wait it out

In this scenario, the couple continues joint ownership with an agreement to defer the sale of the house. They can agree to sell the house in, say, four years or when their children finish high school in the hope that home values will rise, says Iglar. Under this arrangement, one spouse usually moves out.

One thing to watch out for: If both spouses are on the mortgage, the one who moves out won't be able to get another mortgage should he or she want to buy another home. "The bank doesn't want to loan him money because he owes money on the first mortgage. His assets are tied up," says Iglar. He can go into a rental, and when the couple ultimately sells the house, the husband would get half the proceeds at the time of sale (not at the time they got divorced). If the wife has been making mortgage payments, she should get credit for the amount of the principal she paid down over the four years, says Iglar.

Rent the house

"We see more people renting the house to buy themselves some time" until the market recovers, says Baradihi. In this arrangement, both spouses move out of the home and rent the house to someone else. They're more likely to pay less for a rental than what they had been paying on the monthly mortgage.

A big caveat here: This set-up makes it difficult for either spouse to buy another house and move on. It forces them to be in transition for a long time – they're stuck with the house and the payments, says Thompson of Spectrum Management Group. "And they're still in a financial relationship with the ex-spouse," she says.

Consider a short sale

Oftentimes, it's just best to sell the house, accept the loss and move on, says Thompson. The couple negotiates with the lender to pay the difference between the sale price and the amount they owe or a lesser amount – in which case they will have to determine how the debt will be paid. The lender might also agree to take the entire loss.

A short sale, though, will likely hurt the couple's credit score. To read more about the pitfalls of short sales, click here.

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