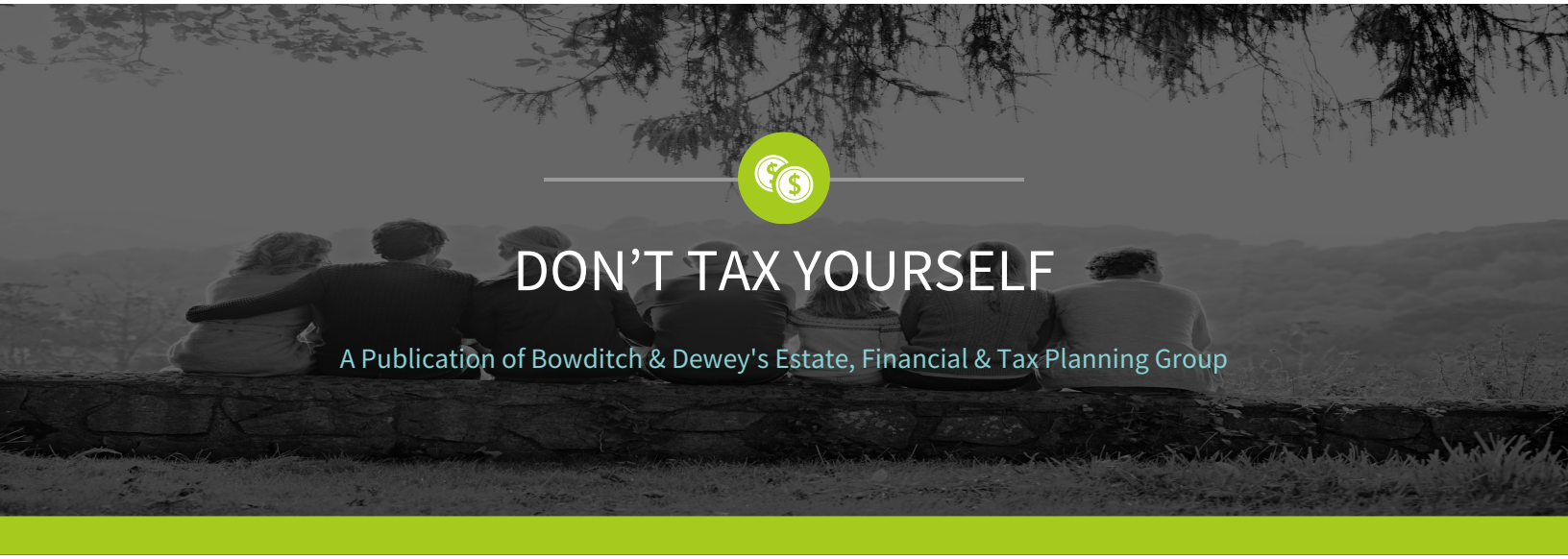

DON'T TAX YOURSELF

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Love It or List It: What to Do With the Marital Home in Case of Divorce

BY LYNETTE PACZKOWSKI • MARCH 23, 2021

Depending on the size of any existing mortgage, the equity in the marital home often represents a significant portion of the marital estate, however illiquid that equity may be. So how do the divorcing parties manage that asset during and after the divorce proceeding?

If neither party is interested in retaining the marital home, the house can be sold, the existing mortgage paid off, and the equity converted into a liquid asset that can be divided between the parties. When one party wants to retain the home, however, there are other factors that must be considered. For purposes of this analysis, we will call the party staying in the home "Spouse 1" and the person vacating the marital home "Spouse 2."

IS THERE AN EXISTING MORTGAGE IN BOTH PARTIES' NAMES?

If so, a simple property transfer is not enough to protect the interests of Spouse 2. That is, Spouse 2's relinquishing of his or her property rights does not extinguish his or her obligations under the mortgage. Thus, any Separation Agreement must specify that Spouse 1 is responsible for paying the mortgage, and should also include a corresponding indemnification provision, i.e., if Spouse 1 defaults on the mortgage obligations, he or she will defend, indemnify, and hold harmless Spouse 2 from any and all liability arising from the same. As set forth below, however, even these provisions might not be enough.

WILL SPOUSE 2 NEED TO QUALIFY FOR A MORTGAGE ON A NEW HOME?

While every situation is different, it can be more difficult to qualify for a mortgage on a new home while still owing on a mortgage for the marital home. Lenders know that regardless of the terms of the Separation Agreement, if Spouse 1 defaults on the mortgage for the marital home, the lender could come after Spouse 2 for payment, jeopardizing his or her ability to satisfy mortgage obligations for the new home. Accordingly, Spouse 2 may want Spouse 1 to refinance the marital home, paying off the existing mortgage and taking out a new mortgage in his or her name only. But…

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CAN SPOUSE 1 QUALIFY FOR A RE-FI ON THE MARITAL HOME?

Lenders often rely on income history in determining eligibility. In the case of divorce, Spouse 1 may be a stay-at-home parent just re-entering the work force or may still be a stay-at-home parent about to start receiving child support/alimony payments. With lenders often wanting several months of consistent income before making a lending decision, the parties may need to anticipate it taking Spouse 1 a period of time to refinance the home. In those circumstances, the parties can, for example, consider setting a deadline by which Spouse 1 must complete the refinance to clear Spouse 2 from any obligations for the marital home. If the refinance is not complete, the agreement can provide for a sale of the home.

These issues can complicate even the most amicable of divorces. If you are facing them in your divorce, we strongly recommend consulting with an attorney who can help you weigh your options and navigate towards resolution.

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