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What is Chapter 7 Bankruptcy and How Will it Affect Home Ownership

The number of bankruptcy cases has skyrocketed during the past decade as more and more Americans have found themselves overwhelmed by debt. In some cases this debt is a result of unexpected medical bills, divorce, job loss, or other unforeseen financial crises. Other times it is spawned from the assumption of too much personal consumer debt with high-interest credit cards. If you are a homeowner and come under a crushing burden of debt, you should know exactly what bankruptcy means for you and your future before filing.

Chapter 7 Bankruptcy is the most common form of personal bankruptcy. It is also known as straight bankruptcy or liquidation, because the process includes liquidating or selling all your assets to pay off your debts. Declaring Chapter 7 Bankruptcy is one of the fastest ways for a debtor to erase his debts and start over (although not all debts are completely dischargeable, like student loans or income taxes.)

The process begins by having an attorney file a bankruptcy claim for you. You must then be determined by the government to be eligible for bankruptcy. For example, to be eligible you must not have a previous bankruptcy on the record within the past six years. It must also be shown that you truly do not have enough money left over from necessary living expenses to repay your debts.

Once you are deemed eligible, all of your property and possessions are categorized into exempt and non-exempt categories. In some cases, large assets like your home, a car, and even retirement savings may be classified as exempt. The verdict will depend on things like your age and your family situation, whether you have dependents or not. Yet there is a chance, because the process is called "liquidation," that you may lose all of your property in the deal. You should consult your attorney about the likelihood of this before you file.

After your property is divided into categories, the government will appoint a trustee to oversee the sale of all of your non-exempt property. The trustee will then distribute the profits of the sales among your various creditors to repay your debts. At this point you are cleared of your debts and may start anew financially.

The problem is that you do not truly start with a clean slate. A bankruptcy on your record lasts between seven and ten years will seriously damage your credit score during that time. If you lose your home because of bankruptcy, it will be almost impossible for the next several years to find a lender to finance you for a new home purchase. Even after a few years, if you are approved for funding it will likely be at a much higher interest rate because of your credit history. You may also find that other lenders like banks, car dealers, and credit card companies will charge you much higher rates for funding.

With a Chapter 7 bankruptcy, the bottom line for home owning is that you may or may not be able to keep your existing home. In either case, a bankruptcy will make it harder and more costly to obtain financing for any other home purchase within the following ten years. Bankruptcy should only be your option of last resort after searching out all the possible alternatives.