

Saving Homes in Bankruptcy

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Foreclosoure Facts:

- Normally 1 out of every 200 homes will be foreclosed upon. For a city like Washington, D.C., that translates to 3,000 Washingtonians losing their homes to foreclosure each year.
- Every three months, 250,000 new families enter into foreclosure. One child in every classroom in America is at risk of losing his/her home because their parents are unable to pay their mortgage.
- Information from Mortgage Bankers Association

Factors that cause Foreclosure:

- 32% experience a job loss
- 25% experience a health crisis
- 85% have already missed one mortgage payment
- 50% have already missed two payments
- Most have no savings, no available credit, and their extended families have limited resources.
- Most have first-time loans, and most loans are less than three years old.
- They may have already refinanced two or three times.
 - – Homeownership Preservation Foundation data of 60,000 homeowners

Foreclosure doesn't just cost the homeowner:

- Prime Lenders and investors often lose from 20 cents to 60 cents on the dollar. Lenders typically lose \$50,000 or more on one foreclosure. But low- and moderate-income borrowers who enter a repayment plan are 68% less likely to lose their homes. – Dona Dezube, “Heroic Homeownership,” Mortgage Banking, (June 2006) p. 82.
- Subprime loans and rescue scams are designed to make money from foreclosures. A foreclosure results in as much as an additional \$220,000 in reduced property value and home equity for nearby homes. “Collateral Damage: The Municipal Impact of Today’s Mortgage Foreclosure Boom,” May 11, 2005, p. 4.

Attorneys advise the Homeowner and Counsel on

- Whether to file or seek other methods
- Choosing the type of bankruptcy
- Timing considerations
- Seeking alternatives to bankruptcy
- Unsecured creditors are normally paid only a percentage of their debt. Attorney fees often only means that a lower percentage is paid to unsecured.

When the foreclosure is filed.

- When the foreclosure is filed the debtor only has 20 days to answer the complaint or they lose by default and the home may be sold within 21 days after the commissioner starts the advertisement for sale.
- Debtors should consider whether they should catch up the payments by filing a Chapter 13 in Federal court or delay the foreclosure by answering the complaint in state court

Alternatives to bankruptcy

- A mortgage restructure or modification may be offered this normally only reduces the interest or monthly payment and rarely reduces principle owed for the home.
- A short sale allows the mortgage company to take immediate possession and the homeowner immediately loses the property and becomes liable for the deficiency or any income from the debt that is forgiven.
- A deed in lieu offers the same consequences as a short sale.

DEBTORS SHOULD NOT ATTEMPT TO BE LAWYERS

1. Debtors are not attorneys but work with their attorneys to file a Chapter 7 or 13. Clients are primarily required to educate themselves about the process and follow Court Orders
Orders from the court include:
 2. The duty to provide documentation.
 3. Supply an annual budget in most districts.
 4. In most districts income tax refunds are placed into the plan.

The Benefits of Bankruptcy

- Bankruptcy Stays (stops) foreclosure proceedings
- Decelerate loans and can cure defaults
- Can modify some home loans (Primarily Seconds)
- Venue for predatory lending claims
- Avoid transfers in foreclosure rescue scams
- Trustee in bankruptcy can be an advocate
- Free up income by discharging unsecured debt
- Can allow for payment of Priority debts (Taxes and Child support) at the expense of unsecured debt.

Timing Factors

- Pending foreclosure
 - Debtor must act before the sale
 - Debtor may also wish to file an answer to any complaint
 - Costs of default mount if the Debtor delays
- A prior bankruptcy may effect which chapter is filed
- Obtain competent counsel early in the process
- Pre-bankruptcy
 - Credit counseling required
 - You must provide documentation to support scheduled expenses especially high medical, and a history of expenses school tuition or 401k and church donations.

The Bankruptcy Automatic Stay

- The Bankruptcy stay is a temporary court order in effect until the permanent stay court order is issued at the end
- Prohibits most efforts to collect debt or enforce liens
- Stops home foreclosures, whether judicial or non-judicial process up to moment of sale
- Automatic, no need for injunction or posting of bond
- There are 27 Exceptions to the Stay! Thankfully you don't have to know them all.
 - Residential tenant evictions
 - Repeat bankruptcy filers must file motions at the start of case
 - Child Support Alimony and Domestic Matters
 - Criminal Restitution

Repeat Filings

PRIOR DISMISSED CASE WITHIN ONE YEAR OF FILING

- Automatic stay expires 30 days after petition date in individual chapter 7, 11, or 13 case
- Court may extend stay as to all or some creditors if motion must be filed before 30 days expires
- Must demonstrate case filed in good faith with respect to creditors to be stayed
- Debtor may need to rebut presumption of bad faith

TWO OR MORE CASES DISMISSED WITHIN ONE YEAR OF FILING

- Automatic stay does not go into effect upon filing

Exemptions

- The Bankruptcy Estate is that property that you own at the time of filing, plus any property you transferred for less than it's value prior to filing and property you may inherit within 6 months after.
- Property Exempted from the Estate
 - Exemptions don't protect against foreclosure of mortgage (Exemptions may allow you to avoid a judgment lien but statutory liens such as tax liens can only be valued and not avoided).

Kentucky uses the Federal Exemptions

- The homestead exemption is limited in Kentucky to approximately 23,000 dollars per person on the residential Deed. Married couple both on the Deed would have about 46,000 allowed in equity. This amount increases annually. The exemption may be used for other property but then it decreases by $\frac{1}{2}$ to 11,500.
 - Other exemptions exist for other property.
 - Kentucky and the Federal exemptions have constant cost of living increases.

Modifying Mortgages in Chapter 13

- Currently a Bankruptcy may not modify long term residential first mortgages: § 1322(c). However residential second mortgage that has no equity may be eliminated by 522(f) motions to strip the mortgage and language in a Chapter 13 plan
 - No “cramdown” or “strip down” of principal
 - No change in interest rate
 - No extension of term
- May not require a lien be released unless the claim is paid in full or until discharge under: § 1325(a)(5)

Modifying Mortgages in Chapter 13

- Although a Bankruptcy may not modify long term residential first mortgages a Chapter 13 can modify a:
 - Short term residential mortgage
 - Commercial mortgage
 - Vacation home mortgage
 - Mortgage for a second home.
 - Loans that include personal property with security agreement. Ex mortgage for trailer and lot.

Language necessary in a Plan

- Currently a Bankruptcy plan may include language in a plan to strip a lien. An example of a plan provision is attached as a file link to our website.
- Some jurisdictions have allowed a 522(f) motion to also strip a second mortgage when a home lacks any equity for the second mortgage to attach to.
- Attorneys may wish to use both methods to eliminate a second mortgage.
- Judicial liens can be removed if they impair the exemptions. Income tax liens are statutory liens and cannot be removed with these methods see the section on income tax lien removal for income tax liens. www.Bankruptcy-Divorce.com

Mortgage Claims in Chapter 13

- Creditor files proof of claim (the amount of debt), including any arrears
- The Debtor must pay allowed secured claims in equal monthly payments in an amount to adequately protect claimant during the plan:
§ 1325(a)(5)(B)
- Claims should always be reviewed because some mortgage companies will inflate foreclosure and other charges or expenses.

Curing Mortgage Arrears

- Arrears include pre-bankruptcy
 1. missed payments,
 2. default costs, and
 3. foreclosure expenses
- “Reasonable” time for cure usually length of Chapter 13 plan (3-5 years)
- Arrears payments made to Trustee but monthly mortgage, insurance and property taxes payments are paid directly to the mortgage company beginning the month the case is filed.

How to Challenge Inflated Claims The Drive by Inspection

PRE-PETITION ARREARAGE



10/05-04/06 (7 x \$637.19)	\$ 4,460.33
Inspections	251.70
Recording fees	7.00
Prior attorney fees – bankruptcy	500.00
Prior attorney fees – foreclosure	1,355.00
Previous servicer expense	1,496.16
BPO	450.00
Restructured interest	454.45
Escrow shortage	377.87
Late charges	1,006.20
NSF charges	25.00
	<u> </u>
	\$10,383.71**

****PLUS INTEREST AT 12.150% AS DETERMINED BY THE TRUSTEE OVER THE LIFE OF THE PLAN.**

Review Your Claims for pre and post filing expenses

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Fixed rate note, P&I payment: \$468.08; Late Fee = 5% of P&I = \$23.40; Assessed Late Fees - 43

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How to Strip Down or Cramdown a Second Mortgage

- Mortgage or liens may be partially secured and partially unsecured Bifurcation of claims under § 506
 - Secured to value of collateral
 - Unsecured (pro rata payment)
- Exception: Claims secured *only* by *real property* that is the *debtor's principal residence*
 - § 1322(b)(2)
 - Nobleman v. Am. Savings Bank, 508 U.S. 324 (1993)

Modification - Strip Down

The Debtor's Principal Residence this includes a mobile home.

- General definition in Bankruptcy Code includes mobile home: § 101(13A)
- § 1322(b)(2) still refers only to real property
- Loans on mobile homes that are personal property under state law may be stripped down

Modification - Strip Off

Stripping of an “Underwater Mortgages”

- Typically 2nd or 3rd mortgages
- Value of senior liens equals or exceeds property value
- Security interest is rendered void on **completion** of the plan
- Amount due to a 2nd mortgage is treated as unsecured in Ch.13 if there is no equity.
- Requires valuation obtain Property Valuation Assessment and any recent appraisal for a motion and/or provision of the Chapter 13 plan.

“Cramdown” legislation

- Has been pending and under debate for years and is unlikely to pass
 - Unlikely due to Special Interest Campaign Contributions
 - Limited to subprimes, with sunset or time restrictions
 - Capacity of courts, trustees, bar to handle increased cases
- 4 kinds of “judicial modification”
 - Reduction in principal
 - Lowered interest rate—benchmark?
 - Freeze on interest rate changes
 - Reamortization up to 40 years
- Costs/risks of filing bankruptcy

Predatory Practices subject to Bankruptcy Adversary, Motions

- TIL, RESPA, HOEPA
- Many claims look at what was done with payments and whether the plaintiff is secured.
- Attack on foreclosure rescue scams involving transfer for no value
- Escape from arbitration clauses
- Faster and more consumer-oriented litigation process

Trustee duties in Bankruptcy

- All cases: review schedules, file reports
- Chapter 7: liquidate non-exempt assets
- Chapter 13:
 - Review repayment plan
 - Collect plan payments
 - Direct v. Conduit Pay of Mortgages
 - Disburse to creditors
 - Point of contact for debtors

Success in Bankruptcy

- Nationally, only 1 in 3 Chapter 13 cases ends in discharge due to continued financial problems or no need later in the plan for the discharge.
 - Is a discharge necessary for success or the right measure of success? Is conversion to a Chapter 7 or an early hardship discharge possible.
 - What predicts whether homeowner saves home?
- Affordability predicts success —more than 70% of debtors continue to spend more than 30% of income (net wages + all other income).

Other Kentucky Resources

- **Don't Borrow Trouble** 1-866-830-7868
www.dontborrowtrouble.com
- **Louisville Metro** Dial 2-1-1 www.louisvilleky.gov/foreclosure
- **Housing Partnership Inc.** 333 Guthrie Green, Suite 404 Louisville, KY 40202 www.housingpartnershipinc.org 502-585-5451
- **Louisville Urban League** 1535 W. Broadway Louisville, KY 40203
502-561-6830 www.lul.org
- **Legal Aid Society** 416 W. Muhammad Ali Blvd., Suite 300
Louisville, KY 40202 502-584-1254 1-800-292-1862
www.laslou.org
- HUD-approved housing counselors to explore your options at **1-800-569-4287** or **TDD 1-800-877-8339**.

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With credit for the original presentation to
Professor Katherine Porter
University of Iowa School of Law

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