

From the Book NOLO Foreclosure Survival
How Chapter 13 Bankruptcy Can Delay or Stop Foreclosure

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Chapter 13 bankruptcy can help you save your house in a number of different ways. How? It gives you time to make up your missed payments, can make your mortgage more affordable in the long term by reducing your overall debt load, and, in some cases, let you eliminate a second mortgage. It also gives you a friendly forum for challenging the legality of your mortgage and any pending foreclosure. And even if you decide to give up your house, Chapter 13 can help you delay your move-out date. You get these crucial benefits by proposing a feasible Chapter 13 debt repayment plan. In most cases, the court will approve a plan if it shows enough income to meet your regular and necessary living expenses (including your mortgage and payments toward any arrearage) and to pay off certain debts, such as back taxes and child support. If you have any money left over, it would go to repaying your unsecured debt such as credit card bills and court judgments. Chapter 13 plan requirements are explained in more detail below. Sticking to a repayment plan for three to five years isn’t easy, but if you can, you’ll be well rewarded. Most of your remaining unsecured debts will be wiped out—and you won’t lose your house. The benefits of Chapter 13 bankruptcy start the minute you file and stops a foreclosure in its tracks. As soon as you file, the federal bankruptcy court automatically issues what’s known as an automatic stay. This is a court order that prohibits most of your creditors, including mortgage lenders, from making any attempt to collect a debt you owe unless they get court permission. And, once the bankruptcy judge approves your repayment plan, you will be safe from foreclosure over the entire plan period as long as you keep making the required plan payments and mortgage loan payments.

RESOURCE More information on Chapter 13 bankruptcy. This chapter gives only an overview, to help you determine whether or not Chapter 13 bankruptcy might help you save your house—or at least keep you living in it longer. To learn more about this powerful remedy, see: • the bankruptcy and foreclosure areas of www.nolo.com • *The New Bankruptcy: Will It Work for You?* by Cara O’Neill, which explains

your bankruptcy options, and • Chapter 13 Bankruptcy: Keep Your Property & Repay Debts Over Time, by Cara O’Neill is a detailed guide to Chapter 13 bankruptcy.

Using Chapter 13 to Keep Your House In a typical Chapter 13 case, the court will protect your property from foreclosure provided you resume paying your normal monthly mortgage payments and pay back your mortgage arrears within your plan period, which will be between three and five years. In this way, the Chapter 13 bankruptcy allows you to gradually bring your loan current, in small affordable steps. This is what makes your Chapter 13 plan such an important tool for saving your home—when the court approves your plan, the lender is ordered to go along with it. If you stick to your Chapter 13 repayment plan, you can: • spread out missed mortgage payments (your mortgage arrears) over the life of the repayment plan, three to five years (this essentially forces your lender to accept a mortgage reinstatement plan) • pay a fraction (or sometimes, nothing) of most unsecured debts during the plan period and eliminate any remaining balance when you complete your plan, freeing up money for you to pay toward your mortgage

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- ask the court to reduce (“cram down”) certain secured debts to the value of the collateral (for example, you might be able to reduce your \$20,000 car note to the actual value of the car, thereby reducing your monthly payments)
- get rid of (strip off) liens on your home created by second and third mortgages, as long as they are wholly unsecured by your home (that is, if your home were sold the proceeds would be insufficient to pay back any portion of the lien)
- remove a judgment lien if it would otherwise mean you’d lose part of your exemption on the property
- postpone the collection of delinquent student loans, and
- resume your regular monthly mortgage payments.

TIP You can get a loan modification during your Chapter 13 case. If you file for Chapter 13 bankruptcy, you can still apply for a loan modification. Many homeowners have gotten loan modifications from their lenders during their Chapter 13 bankruptcy cases, and some courts have started initiating loan modification programs. Check with your local bankruptcy court or bankruptcy lawyer.

Repay Your Mortgage Arrears Over Time If the only reason you are filing Chapter 13 is to get time to get your mortgage current, and you could get a similar deal from the servicer, you’ll be better off not filing for bankruptcy, at least as far as your credit score is concerned. On the other hand, if your mortgage servicer refuses to work with you, then Chapter 13 could be your best option for saving your home.

EXAMPLE: Freddie owes \$3,600 in missed mortgage payments after being laid off from work. He receives a notice of default that gives him a month to pay up or lose his house. His mortgage servicer refuses to work with him

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because of a previous notice of default and because the lender doesn’t think he’s a good credit risk. Fortunately, Freddie is working again. If he files for Chapter 13 bankruptcy and is able to reduce payments on unsecured debt (like credit cards), he’ll be able to afford a repayment plan, under which he will resume normal payments on his mortgage and also make up the arrears over three years. He

proposes to pay down the arrears at the rate of \$110 a month: \$100 for the debt plus \$10 a month for the trustee's fee.

You will be able to keep your house through Chapter 13 only if you have enough income to stay current on your mortgage and pay off the arrearage over the life of your plan. And you must propose a plan showing not only that you can make plan payments but also that you can keep current on all your other reasonable and necessary monthly expenses, such as utilities, transportation, car note, insurance, and the like. Further—and this is a deal breaker for some would-be Chapter 13 filers—you must pay some types of debts in full during the course of the plan. For example, if you owe recent back taxes, the court won't approve your repayment plan unless it shows that you can pay off the taxes in full while your plan is in effect. The same holds true for support arrearages. Also, you must be able to pay your unsecured creditors at least as much as they would have received in a Chapter 7 bankruptcy. For instance, if you weren't about to protect a \$15,000 boat with an exemption, the Chapter 7 trustee would sell it and disperse the net sales proceeds to creditors. In a Chapter 13, you'd keep the boat, but you'd have to pay at least that amount to your unsecured creditors. As a result, if you have a significant amount of equity in property that isn't protected by bankruptcy, the required monthly payment might be too high for you to afford. (See the discussion of Chapter 7 bankruptcy in Ch. 6.) Finally, your plan must provide for a payment to the trustee of roughly 10% of the amount of all payments you make to creditors through the repayment plan. This fee covers the operating costs of the Chapter 13 bankruptcy program.

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Make Your Mortgage More Affordable by Eliminating Other Debts It's not uncommon for people of moderate means to have credit card debt exceeding \$15,000. If you are looking to save your house, and Chapter 13 bankruptcy might get the job done, chances are great that you'll also greatly reduce, if not eliminate, your debt load. Chapter 13 gives you three to five years not only to work out your mortgage problems but also to deal with your unsecured debt (debt not secured by collateral, such as credit card balances, medical bills, and personal loans) once and for all. To eliminate credit card and other unsecured debt in Chapter 13 bankruptcy, you must be willing to commit all of your disposable income to repaying all or part of your unsecured debt (taking into account that you must also pay down other debts such as mortgage arrears or recent back taxes) over a three- to five-year period. Any unsecured debt that remains at the end of your plan is discharged (canceled), unless it is one of the types of debt that survives bankruptcy, such as ongoing child support payments or a student loan balance. If you're thinking that a lot of factors go into a Chapter 13 plan payment, you're right. Here's a quick way to get a rough estimate of what you can expect in Chapter 13 bankruptcy: After paying your mortgage and monthly living expenses you'll pay the greater of • your remaining disposable income • the amount your creditors would have received in a Chapter 7 case, or • the total of your secured arrearages (such as overdue mortgage and auto payments), recent tax debt, and support arrearages. You'll spread that amount over either three or five years. If you'd qualify for a Chapter 7 case but are filing for Chapter 13 to catch up on a mortgage, the period is three years; otherwise, it's five. Even though some people qualify for a three-year plan, most people opt to pay a lower amount over five years.

Ask the Court to Reduce (“Cram Down”) Certain Secured Debts Chapter 13 bankruptcy judges can reduce (cram down) certain secured debts to the market value of the collateral that secures the debt. They can also reduce interest rates to the going rate in bankruptcy cases (roughly 1.5 points above the prime rate). If you can get the judge to reduce your payments on a secured debt, you will have more money to pay toward your mortgage—and a better shot at proposing a Chapter 13 plan that the court will confirm.

EXAMPLE: Allison bought a new car for \$24,000, taking a seven-year note for \$38,000 (including the principal and interest), with monthly payments of \$475. Three years later, when Allison files for Chapter 13 bankruptcy, she still owes \$24,000, even though the car’s market value has fallen to \$14,000. As part of her Chapter 13 plan, Allison asks that the note be crammed down to \$14,000 and that the interest rate on her loan be reduced to four to six percent, the approximate going rate in bankruptcy cases. The court approves this cramdown, and Allison’s monthly car payment is cut roughly in half.

A cramdown is usually available only for:

- cars bought at least 910 days before you file for bankruptcy
- other personal property items (furniture, jewelry, computers) bought at least one year before filing
- rental or vacation homes (but not your primary residence), and
- loans on mobile homes that your state classifies as personal property (not real estate).

The catch is that you must repay the entire cramdown amount in your plan. As a result, most people don’t use it to reduce a balance owed on real estate.

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Contest the Foreclosure You might be able to fight a foreclosure in your state’s courts whether or not you file for bankruptcy. But if you file for Chapter 13 bankruptcy, you can ask the bankruptcy court to decide whether the facts upon which a proposed foreclosure is based are erroneous. For example, suppose you contest the foreclosure on the ground that your mortgage servicer failed to properly credit your payments. A bankruptcy court decision in your favor on this point would eliminate the basis for the foreclosure should you later drop your Chapter 13 case or convert it to a Chapter 7 bankruptcy. Unlike some state courts, the bankruptcy court is a comparatively friendly forum for homeowners challenging foreclosures. (See Ch. 7 for more on the grounds for contesting a foreclosure.) The ability to stop a foreclosure action in Chapter 13 is powerful, but it can be abused by people hoping to defraud creditors. Some people file, keep the case alive as long as possible, file again as soon as it’s dismissed, and so on. This can land you in big trouble down the line. Merely filing a case puts the automatic stay into effect, without any review of your filing history by the judge, so it takes a while for the court to spot you as a bad-faith filer. But when it finally does, not only will you be banned from further filings, but you might be referred to the U.S. Attorney for a perjury prosecution if you made any significant misstatements in your paperwork.

CAUTION Don’t file for bankruptcy unless you can do so in good faith. Because Chapter 13 provides such an excellent opportunity for hanging up a foreclosure action, it has become a favorite means to that end. Some people file, keep the case alive as long as possible, file again as soon as it’s dismissed, and so on. This can land you in big trouble down the line. Merely filing a case puts the automatic stay into effect, without any review of your filing history by the judge, so it takes a while for the court to spot you

as a bad-faith filer. But when it finally does, it can ban you from further filings— and refer you to the U.S. Attorney for a perjury prosecution if you made any significant misstatements in your paperwork.

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Turn a Second or Third Mortgage Into an Unsecured Debt If you're like many homeowners, your home is encumbered with a first mortgage, a second mortgage (often used for the down payment in an 80-20 financing arrangement), and even a third mortgage (maybe in the form of a home equity line of credit). Most likely, the holder of the first mortgage is pushing the foreclosure. But if you have fallen behind on your first mortgage, you are probably behind on your second and third mortgages as well. Would it help you keep your house if you no longer had to pay the second or third mortgage? You likely know the answer: Reducing your overall mortgage debt load could help if you have enough income to meet your first mortgage obligation. One of the great features of Chapter 13 bankruptcy is you can get rid of (strip off) mortgages that aren't secured by your home's value. Let's say that you have a first mortgage of \$300,000, a second mortgage of \$75,000, and \$50,000 on a home equity line of credit. Presumably, the value of your home when you took on these debts was at least equal to the total value of the mortgages, or \$425,000. But if the house is now worth less than \$300,000, as a practical matter the house no longer secures the second and third mortgages. That is, if the house were sold, there would be nothing left for the second or third mortgage holders. If your second and third mortgages were considered secured debts, your Chapter 13 plan would have to provide for you to keep current on them. However, when they are stripped off, they are reclassified as unsecured debts. This means you have to repay only a portion of them—just like your other unsecured debts. And as explained earlier, the amount of your disposable income, not the amount of the debt, determines how much of your total unsecured debt you must repay. You'll pay the same amount whether or not the mortgages are included in the unsecured debt group.

EXAMPLE: Sean files for Chapter 13 bankruptcy and proposes a threeyear plan to make up his missed mortgage payments. He also owes \$60,000 in credit card debt and has disposable income of \$300 a month. His house's value is \$250,000. He owes \$275,000 on his first mortgage, \$30,000 on the second, and \$15,000 on a home equity loan.

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Because his house's value has fallen below what he owes on the first mortgage, there is no equity left to secure the second mortgage or home equity loan. So his Chapter 13 plan would classify these two formerly secured debts as unsecured. When they're added to the \$60,000 in credit card debt, he's got a grand total of \$105,000 unsecured debt. Because all he has is \$300 per month in disposable income, his plan would repay a little more than 10% of his unsecured debt—including a little over 10% of his formerly secured second and third mortgage debt.

This also means that under your Chapter 13 plan you won't have to make up payments missed on your second or third mortgages. And because you're no longer making current payments on the second or third mortgage, the total amount you pay each month will be reduced by a considerable amount. Finally, because the lien has been completely removed from your property, if later on your home value

increases so that you have more equity, the former second mortgage holder would still be out of luck. Because the lien is gone, the former lender doesn't have any right to the equity in your property.

An Overview of the Chapter 13 Bankruptcy Process When you file for Chapter 13 bankruptcy, your court papers must disclose what you own (real estate and personal property), your debts, and your financial transactions going back several years. You also will have to show that you've filed income tax returns for the previous four years. But before you can even file for bankruptcy, you must complete some basic credit counseling. And you'll have to get some personal financial management counseling after you file but before you get your Chapter 13 discharge.

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Coming Up With a Repayment Plan The heart of a Chapter 13 bankruptcy is your repayment plan. It shows how much income you have to repay your debts, how long the plan will last, and what debts (and what proportion of them) you propose to repay. There is no set percentage of your debt that you must repay. It all depends on how much disposable income you have available for this purpose. (Disposable income is the amount that remains after subtracting allowable expenses.) Keep in mind that courts will consider income you receive from roommates, domestic partners, and other members of your household if they are chipping in to help you save your home. A Chapter 13 repayment plan lasts several years: three if your income is below the median income for your state and five if it is over. (See Ch. 6 for how to determine whether your household income is above or below your state's median.) Your plan must show that your income (plus proceeds from any property you plan to sell) will let you do all of the following:

- stay current on all your contractual obligations, such as a mortgage and car note unless you plan to voluntarily give the house or car back to the lender
- pay off any arrears you owe on these contractual obligations
- meet your normal monthly expenses
- pay off certain priority debts, such as back taxes and child support or alimony, in full over the life of your plan (if the delinquent family support was assigned to a third party for collection, you don't have to pay it in full during the plan; the remaining balance won't be discharged though)
- devote all of your disposable income to repayment of a percentage of your unsecured debt, such as credit card and personal loan debt
- pay your unsecured creditors at least as much as they would have gotten had you filed for Chapter 7 bankruptcy—that is, the value of your assets that would be sold in a Chapter 7 bankruptcy to

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pay your creditors (see Ch. 6), and pay the bankruptcy trustee (the official who collects the money you pay under your plan and distributes it to your creditors) a fee of about 10% of all payments you make under the plan (this amount can be large or small, depending on whether you pay your current mortgage payments directly to your lender or through the trustee). Not everyone can propose a plan that the court will approve. For example, a plan must provide for paying most types of priority debts in full. So if you owe \$50,000 in back taxes, and your disposable income would pay only \$25,000 of the taxes over the life of your plan, the judge will refuse to confirm the plan. Many of these roadblocks to plan confirmation, however, can be overcome. Be sure to talk to a bankruptcy attorney before you scrap your plan to file for Chapter 13.)

RESOURCE More information on repayment plans. See www.nolo.com for more on the requirements for Chapter 13 bankruptcy plans.

The Creditors' Meeting About a month after you file for Chapter 13 bankruptcy, you are required to attend a creditors' meeting conducted by the trustee assigned to your case by the court. At this meeting the trustee will go over your proposed plan and explain how the trustee thinks it should be changed.

TIP Know when your first Chapter 13 payment will be due. It's common to think that you won't need to make a payment until after the court approves your plan, but that's not how it works. Not only will you be required to make your first payment soon after filing your case, but, if you fall behind, your matter will likely get dismissed. To avoid this pitfall, find out your payment due date before you file and, of course, budget accordingly.

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The Confirmation Hearing About a month after the creditors' meeting, your case will be set for a confirmation hearing in the bankruptcy court. At the confirmation hearing, the bankruptcy judge will decide whether or not to approve your proposed plan. Before the hearing, the trustee and your creditors will have an opportunity to file an objection to your repayment plan with the court. If the objection raises a valid point, you might want to continue the hearing date, correct the problem, and file an amended plan. If you don't agree with the objection, you can file a response stating your reasons. Ultimately, the court will review all of the submitted documents, listen to any argument presented at the hearing, and then do one of the following: confirm (approve) your plan; give you a chance to fix an issue; order your case to be dismissed; or allow you convert your case to Chapter 7 bankruptcy.

The Typical Chapter 13 Timeline Day 1 Papers filed to start the bankruptcy Day 14 Repayment plan must be filed Day 31 First plan payment must be made (check with your court) Day 46 Creditors' meeting held Day 76 Confirmation hearing held Day 106 Second confirmation hearing held, if necessary

Completing the Plan It's tough to complete a Chapter 13 repayment plan. Not only is a person who files for Chapter 13 bankruptcy in a fragile economic condition to begin with, but all discretionary income goes into the plan. All it takes is a layoff, medical emergency, divorce, or simply fatigue at living within a strict budget to cause someone to fall behind on plan payments. If your income does drop significantly during the course of your Chapter 13 bankruptcy, you might be able to modify your plan or get a

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hardship discharge. More likely, however, you will be given the choice of converting your case to a Chapter 7 bankruptcy or having it dismissed entirely. Most people faced with this choice opt to convert to Chapter 7 bankruptcy and discharge what's left of their debts. But you might choose to let the court dismiss your Chapter 13 case instead if you have nonexempt property you would be forced to part with in a Chapter 7 bankruptcy (for example, your family grand piano, which the trustee could sell for \$5,000). Just because you might not complete your Chapter 13 bankruptcy doesn't mean you shouldn't start it. If and when you do default, you might be in a better situation to keep your house or at least sell it for a profit. If you do complete your plan and meet the other Chapter 13 requirements (such as giving

the trustee an annual financial report and keeping current on your taxes and any child support obligations), you will receive a bankruptcy discharge. It usually cancels whatever nonpriority unsecured debt balance (but not student loans) remains. There are a few exceptions to a Chapter 13 discharge, the most common of which are: • debts you didn't list in your bankruptcy papers • civil judgments arising from willful or malicious acts • debts for death or personal injuries arising from drunk driving • back child support or alimony not paid off as part of your plan • taxes first due less than three years prior to your bankruptcy filing date, for which a return was filed less than two years before your bankruptcy filing date, and which were assessed within 240 days of your bankruptcy filing date (other conditions might apply) • debts arising from your fraudulent acts (if proven by the creditor in bankruptcy court), and • court-imposed fines and restitution.

Relief Under Chapter 13 After a Chapter 7 Discharge The bankruptcy code prohibits you from receiving a Chapter 13 discharge if your case is filed within four years of the filing of a prior

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Chapter 7 case (in which a discharge was granted). However, according to most courts that have ruled on this issue, you are entitled to file a Chapter 13 bankruptcy at any time after a Chapter 7 even if you won't qualify for a discharge of your debt. Why would you want to file a Chapter 13 bankruptcy if you can't discharge debt under it? Simply, many Chapter 7 debtors are left with liens and debts that survive the Chapter 7 bankruptcy, and Chapter 13 provides a structured way to deal with them. Because, by definition, your Chapter 7 bankruptcy has discharged all (or most) of your debt, you don't really need the Chapter 13 discharge. For instance, a number of homeowners who file Chapter 7 are left with second mortgage liens on their home—because liens aren't discharged in Chapter 7 bankruptcy. Chapter 13 would provide a way to pay off such a lien over the life of the plan, or in some instances get rid of it altogether. However, some courts will not allow lien stripping in a Chapter 13 bankruptcy if you are not eligible for a discharge. Check with a local bankruptcy attorney to determine the rule in your jurisdiction.

Why You Need a Lawyer in a Chapter 13 Case

- Chapter 13 bankruptcy can require negotiating with creditors and the bankruptcy trustee to reach agreement on an acceptable repayment plan.
- Chapter 13 bankruptcy requires at least one appearance in court before the bankruptcy judge (the confirmation hearing) and often several more.
- Chapter 13 cases can have many variables, such as valuation of property, reducing liens to the value of the collateral, creating a plan that doesn't discriminate among debtors, and often, requests for plan modifications or hardship discharges.
- An experienced lawyer can help you understand the specifics of your case, including the types of debts you have and the amount or percentage you must repay.
- Local rules, court procedures, and how judges interpret the law vary by jurisdiction and court. A knowledgeable local bankruptcy attorney will know what's standard in your area.

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Another reason: Suppose you come out of Chapter 7 owing a lot of back child support (which is not discharged in Chapter 7). You can file a Chapter 13 and propose a repayment plan that would be considerably more affordable than what you are being offered by the child support enforcement agency.

Again, you wouldn't be discharging the child support but rather obtaining protection from the court against unreasonable repayment demands, garnishments, and the like.

Will You Need a Lawyer? It's hard to handle your own Chapter 13 bankruptcy; you most likely will need an attorney to represent you, especially if you are trying to save your house. An involuntary dismissal (a greater possibility if you are representing yourself) would greatly set back your plans to keep your house. However, you do have the right to represent yourself, and you might have to if you can't afford to pay the attorneys' fees. (See Ch. 10 for information on finding, choosing, and working with a lawyer and other helpful resources.)

An Attorney Might Be More Affordable Than You Think

If you currently are not paying anything on your mortgage but could afford to pay at least some of it, it might only take you a couple of months to save enough money to pay a lawyer to represent you in Chapter 13 bankruptcy. Most attorneys will take a down payment—sometimes even as low as \$100—and allow you to pay the remaining attorney fees through your repayment plan.

RELATED TOPIC How to find a good attorney. Ch. 10 provides tips on how to choose a Lawyer

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