

Protecting Your Client's Home from Creditors

by Trev E. Peterson, J.D. and Jessica C. Sidders, law student¹



In today's economy a number of people are at risk of losing their homes through foreclosure proceedings. In Nebraska, those proceedings generally involve the exercise of the power of sale under a deed of trust. Since the mid-1980's, lenders have rarely used real estate mortgages to secure home loans in Nebraska and judicial foreclosure of deeds of trust is very rare.² For a discussion of the foreclosure procedure under deeds of trust and mortgages, see Dennis Collins' article published in the January 2001 edition of *The Nebraska Lawyer*.

What options are available to clients whose home is at risk? The options depend on how soon, or how late, the client is in seeking legal advice. The sooner a client consults with his or her attorney, the more likely it is that the attorney can find some solution other than bankruptcy. However, most clients do not contact their attorney until the sale has been set, and then expect the attorney to perform a miracle. Options to prevent a sale under a deed of trust include negotiating a reinstatement with the lender, selling the house privately, or seeking a second (or third) loan and using the proceeds to cure the default under the first lien. There may be an option to enjoin the sale in the unlikely event that the trustee under the trust deed has failed to comply with the Nebraska Trust Deeds Act (the "Act"),³ and the borrowers' attorney should always read the trust deed; there may be cure provisions set out in the trust deed that do not give the lender any options about accepting a cure.⁴ Frequently, however, the home loans in foreclosure are six to nine months delinquent before the client seeks legal advice, so there is very little short of bankruptcy that an attorney can recommend to a client.

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If the client contacts the attorney early in the foreclosure process, begin by determining whether the client has any right to reinstate the trust deed under the language contained in the trust deed, or the promissory note. Many trust deeds contain language permitting reinstatement up until the time of the sale. The contractual language in the trust deed will mandate that the lender accept reinstatement, even if the lender would prefer not to reinstate the loan. The lender's failure to accept reinstatement properly tendered under the Act, should be a basis for enjoining the sale.

The attorney should also determine whether the trustee has complied with the relevant provisions of the Act. Areas to look for technical defects include comparing the filing date of the notice of default with the postmark on the notice from the trustee (or the trustee's attorney).⁵ Of course, it is likely that the client threw the envelope away, but you may be able to determine when the notice was mailed from the notice itself or a cover letter. The copy of the notice of default served on the borrower **must** contain recording information and have been mailed⁶ by certified mail to the borrower no more than 10 days after the notice of default was recorded.⁷ The publication and

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mailing of the notice of trustee sale is another area where the trustee can make a mistake. The Act requires that the notice of sale be published once a week for five consecutive weeks with the last publication at least 10 days but not more than 30 days before the sale.⁸ The Act requires that the sale notice be mailed, by certified mail, to the borrower at least 20 days before the sale.⁹ The proper manner to raise the failure of the trustee to proceed under the Act is by injunction. However, at best the trustee's failure to comply with the Act will afford temporary relief; a competent trustee will simply start over and do the proceeding the correct way the second time around.

Assuming that there are no technical defects to rely on, the next step is to determine whether the client has exhausted all means of restructuring the debt with the existing lender. Normally, the matter is not referred for collection by the lender until after the lender has exhausted internal collection measures. Frequently, that means that the client has made and breached one or more cure plans. The advantages of seeking a cure plan with the lender are that the lender does not usually requalify the borrower for the loan, does not require points, closing costs (although your client will be paying for the lender's attorney's fees) or new title insurance, and the interest rate will be more favorable than the client will be able to obtain from a home equity or high interest rate lender. Many lenders have departments specializing in client counseling, and those departments can help borrowers save their homes.¹⁰ Most reinstatement plans will have to provide to cure the default over a short time period. Lenders will not generally add the missed payments on to the end of the loan. Normally, a lender will require a cash down payment with the cure payments equaling one and one-half a monthly payment.

One caveat, however, is that if you strike a deal, the client must perform. Reinstatement is usually a one-time arrangement, and if the client breaches the deal, no matter how good the client thinks the excuse is, the lender will probably not permit multiple reinstatement.

A second, and very important, caveat is that you should always document the settlement with the lender. Ask for everything in writing. A sophisticated collector will require that the client sign an agreement that recites the default and usually provides that the reinstatement does not fully reinstate the loan until the last payment is made. That protects the lender from an argument that by accepting partial performance under a reinstatement plan, the lender waived the earlier default.

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The second option is seeking re-financing of the home from another lender. Of course obtaining a traditional bank loan is probably not an option for a debtor with payment problems. There are, however, several sub-prime lenders, most of whom are represented on television by washed up quarterbacks, that will provide home equity loans up to 125% of the assessed value of the home, less prior liens. While the lure of a second (or third) lien may be great, attorneys should caution their clients that the lenders who make high risk loans to troubled borrowers charge high interest rates, and may offer short terms with high balloon payments. Furthermore, a client that has had difficulty paying a traditional lender, in all likelihood will ultimately default on the second loan and that second lien holder will foreclose its deed of trust and wind up owning the house. A second loan on the homestead is an available tool in proper circumstances, but should be used carefully, and only when the client understands the risks inherent in second liens.¹¹

A third alternative is to list the home for sale with a realtor and get the property sold and closed before the trustee's sale. This option has the advantage of protecting the client's equity interest, if the home is sold in time. If the client brings the case to you three days before the sale, this alternative will not work. Lenders that I represent generally will not stop a trustee's sale except where the closing

of the sale occurs prior to the trustee's sale date. The rationale is that the potential sale of a home is too speculative to cancel a sale. Many lenders may not entertain canceling the sale when the borrower has a written agreement with a purchaser. Again, if there are contingencies, the deal looks too speculative to a lender with a sale scheduled. In order for this alternative to work, the lender has to be willing to permit the borrower a short, yet reasonable, time to get the house sold. Frequently, the private sale alternative is coupled with a cure plan to keep the lien in place and permit the borrower time to get the house sold.

Assuming that none of the previous alternatives are possible, or have been exhausted, an attorney can suggest the final solution to the foreclosure dilemma, relief under the Bankruptcy Code.¹² The typical homeowner would qualify for relief under either Chapters 7, 11 or 13 of the Bankruptcy Code.

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While a homeowner probably qualifies for Chapter 11, Chapter 11 cases are typically used for business reorganizations and only in unique circumstances would an individual be in a Chapter 11 case. Chapter 11 cases are complicated and very expensive, so most bankruptcy practitioners use either Chapter 7 or Chapter 13 for individual debtors.

When a bankruptcy case is filed, an automatic stay of any act against the debtor or the debtor's property or property of the bankruptcy estate is created under section 362 of the Bankruptcy Code.¹³ The stay applies in any bankruptcy proceeding and expires when such property is no longer property of the estate,¹⁴ or when the case is closed, dismissed or discharged.¹⁵ The automatic stay is one of the greatest benefits accorded debtors under the Bankruptcy Code. The stay freezes the parties' positions as of the date of the filing of the case and gives the debtor and the Chapter 7 trustee time to determine how to deal with claims without the press of other collection activities.

While the automatic stay provides protection to the debtor, the Bankruptcy Court can grant relief from the stay¹⁶ on the motion of the secured creditor. Typically, relief hearings are held on affidavit or written declaration evidence and relief is granted or denied based on the contents of those affidavits. Relief can be granted "for cause," including cases where the lender's lien is not adequately protected, or where the debtor has no equity in the property and the property is not necessary for an effective reorganization of the debtor.¹⁷ If the home is worth more than the secured debt and is valued that way in the schedules filed in the bankruptcy case, the secured creditor will have to obtain an appraisal of the property to establish that there is no equity in the property. Practitioners should note that the debtor is, under Nebraska law, competent to testify about the value of the debtor's property, including the debtor's home. The weight, however, that the Bankruptcy Court will give to the

debtor's opinion of value when confronted by an appraisal is another matter. In any affidavit or declaration, the debtor should include all relevant comparable sales to substantiate the debtor's estimate of value. If the appraisal and the debtor's estimate are close, the Bankruptcy Court will probably give the debtor the benefit of any issue raised on valuation, especially in a Chapter 13 case.



Chapter 7 is what most people think of when they think about bankruptcy. Under Chapter 7, a trustee is appointed who collects the nonexempt assets owned by the debtor, sells those assets and distributes the sale proceeds to the creditors. The Chapter 7 debtor generally receives a discharge, which will discharge the individual debtor from most debts, within four months after the date of the filing of the case. There are certain debts that are not dischargeable in a Chapter 7 bankruptcy case, including debts for student loans, alimony, maintenance, support, some property settlement debts, debts for fraud, larceny, certain tax obligations, and other claims.¹⁸ Generally speaking, however, if an individual does not owe a student loan or have unpaid income taxes, most debts will be discharged in a Chapter 7 case. A discharge means that the debtor does not have to pay the debt after the entry of the discharge order.¹⁹ However, a creditor who has a secured position, such as a lienholder on the debtor's home or a lienholder on the debtor's car, can foreclose its security interest after the bankruptcy unless payment arrangements are made.²⁰


In a typical home foreclosure, a Chapter 7 will merely delay the sale of the real property. To afford the greatest delay, the attorney should wait until the lender has set a sale date and started publication before filing a case. By delaying the filing of the bankruptcy case until shortly before the sale, the debtor gets the benefit of both the 5 week publication delay under the Act and the benefit of the automatic stay. Where a sale under either a trust deed or a judicial sale is involved the sale can be delayed anywhere from 8 to 12 weeks, depending on what steps the secured creditor takes after the bankruptcy is filed. After the discharge the debtor/homeowner will not be liable for any difference between the balance of the debt on the date of the sale and the amount received by the creditor at the sale. The homeowner will, however, lose the home.

Chapter 13 of the Bankruptcy Code provides a homeowner who has the ability to continue to make loan payments with an opportunity to cure defaults and retain the home.²¹ In a Chapter 13 case, the debtor proposes a payment plan to deal with debts owed to the debtor's creditors. Generally, the debtor proposes to keep the debtor's home, and perhaps other secured property, like vehicles, and make payments to the debtor's creditors over the 36 to 60 month term of the Chapter 13 plan. The Chapter 13 trustee receives plan payments and forwards those payments to the creditors as specified in the Chapter 13 plan. Chapter 13 specifically permits debtors to cure defaults on secured debts, such as home loans, during the term of the Chapter 13 plan. Once the debtor has made the payments and otherwise performed under the Chapter 13 plan, the debtor receives a discharge, discharging the debtor from most debts. Please note that certain debts, such as student loans, alimony, child support, income taxes, and property settlements are not subject to being discharged under Chapter 13.

For example, if a person has a job, or other source of regular income, owns a home worth \$100,000 with a \$90,000 lien on the home and a car worth \$10,000 with

a \$10,000 lien on the car, and has unsecured debt of \$50,000, that person would qualify for Chapter 13.²² If we assume that the homeowner was behind on the home loan by \$2,000 and behind on the car loan by \$1,000, the homeowner would be able to cure the defaults by paying the deficiency through the Chapter 13 trustee's office and by making regular monthly payments directly to the home lender and, through the Chapter 13 trustee's office, to the car lender during the Chapter 13 case. At the end of the Chapter 13 case, the home loan would be current and the trustee's sale would be prevented. The Chapter 13 also protects the \$10,000 in equity in the home from the creditor's claims and will protect any increase in the equity (either through appreciation of the home or the payment of the lien) in the home generated during the Chapter 13 case from the claims of the homeowner's creditors.

The options available under Chapter 13 for each individual's situation have to be carefully reviewed by an experienced attorney to craft an appropriate Chapter 13 plan. Chapter 13 also requires a certain amount of diligence and commitment on the part of the client. Regular monthly payments have to be made to the Chapter 13 trustee and to the home loan lender or the case could be dismissed or the lender could seek relief from the stay to complete its sale of the home.²³ Assuming that the homeowner is committed to saving the home and is in a position to generate sufficient income to make payments, Chapter 13 is the preferred way to save a home in bankruptcy.

The potential loss of a home presents a client with difficult choices, all of which are disturbing to the client's life style. If the attorney is involved too late in the process, the only realistic alternative open to clients is bankruptcy relief. A Chapter 7 case can delay a sale; a Chapter 13 case can, with commitment on the part of the client, preserve the client's interest in the client's home. From the bankruptcy practitioner's perspective, the issues are the client's goals and the client's ability, or desire, to alter their spending habits to perform under a Chapter 13 plan. 

APPENDIX
(Sample Request for Order)

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN RE:)	BK NO.
)	Chapter 7 Proceeding
_____)	
)	
Debtor.)	REQUEST FOR ORDER

COMES NOW _____, a creditor secured by the Debtors' interest in _____, (the "Real Property") and requests that the Court enter an order stating that no stay exists in this proceeding (as to the exercise of the power of sale under a trust deed) pursuant to 11 U.S.C. §362(c)(1) as the Trustee filed his Report of No Distribution and Notice of Intended Abandonment on or about _____ and the Court entered an Order Approving Trustee's Report of No-Assets and Closing Estate.

Dated: _____

_____, Secured Creditor,

By: KNUDSEN, BERKHEIMER,
RICHARDSON & ENDACOTT, LLP
1248 "O" Street
1000 Wells Fargo Center
Lincoln, Nebraska 68508
(402) 475-7011

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By: _____
Trev E. Peterson - #16637
One of Said Attorneys

CERTIFICATE OF SERVICE

The undersigned hereby certifies that he caused a true and correct copy of the foregoing Request for Order to be served on the Debtors, _____; Debtors' counsel, _____; the Chapter 7 Trustee _____ and Patricia Dugan, U.S. Trustee, Roman L. Hruska Courthouse, 111 South 18th Plaza, Suite 1148, Omaha, NE 68102 on this ____ day of _____, 2001..

Trev E. Peterson

(Sample Order)

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN RE:) BK NO.
) Chapter 7 Proceeding
_____,) Filing No. ____
)
) **ORDER**
Debtor.)

Upon the filing of a Request for Order by
_____.

IT IS ORDERED:

The trustee has filed a notice of abandonment. The automatic stay no longer applies.

Dated: _____

BY THE COURT:

Chief Judge

Endnotes available upon request. Contact Kathryn Bellman or Pamela Jo Moore at NSBA (402) 475-7091 or (800) 927-0117; E-mail: kbellman@nebar.com or pmoore@nebar.com