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Bankruptcy and Your Home¹

By: Trev E. Peterson

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. Real estate mortgages are almost never used in Nebraska and judicial foreclosure of deeds of trust is very rare. For a discussion of the foreclosure procedure under deeds of trust and mortgages, see the following article on this Website: The Nebraska Trust Deeds Act.

If you are delinquent on your home loan payments, the creditor has the right to commence actions under the Trust Deeds Act to exercise the power of sale. Typically, the creditor's attorney will substitute himself or herself as trustee under the deed of trust and will then file a notice of default and election to sell. The notice of default will be served upon you and if you do not correct the delinquency within 30 days after the recording of the notice of default, the trustee may begin advertising your home for sale. Advertising takes place once a week for five consecutive weeks and the sale must occur at least ten days after the last advertisement, but no more than thirty days after the last advertisement.

As a property owner, you have rights under both state law and under the federal bankruptcy code in situations where your home is being sold at trustee's sale. It has been my experience that the attorneys exercising the power of sale under deeds of trust have done it enough that they generally do not make any mistakes on the procedure for exercising the power of sale. However, it is always a good idea to review the actions taken by the trustee to be certain that those actions do comply with the provisions of the Trust Deeds Act.

If there is a violation of the Trust Deeds Act, it may be possible to obtain an injunction against the trustee conducting the trustee's sale. In my view, however, this remedy is both difficult and expensive to achieve and would at best require the trustee to cure the procedural defect. Once the procedural defect is cured, the trustee could go forward with the sale.

As I noted in the article on trustee's sales, the lender under a trust deed is merely concerned with obtaining the balance due on the obligation and cares nothing about obtaining the highest or best price for the property. If there is competitive bidding, and that occurs in less than 10-15% of the cases, the bidders frequently partner before the sale so there is not real

¹ The services or benefits mentioned in this article are with respect to bankruptcy relief under Title 11 of the United States Code. We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code.

competitive bidding, merely the creditor bidding and a third party bidding a minimal amount more than the creditor's bid to obtain title to the property. The lesson from all of this is that a homeowner with significant equity in the home should seek to sell the home privately to reap any of the equity. Nebraska law provides a homestead exemption in the amount of \$12,500.00 for heads of households who live in their homes. A head of household is defined under Nebraska law to be a person with a child or certain other relatives, who is living or has lived with the head of household at the homestead. Once a property is a homestead, it remains a homestead even if the children or other qualifying relatives move off of the property.

If your house is being foreclosed, you should immediately consult with an attorney to determine and protect your rights. You should also shop the rental market to determine the cost of a replacement rental house or apartment. Many homeowners are shocked when the rent equals or exceeds the home payment they were making prior to the foreclosure action. Delaying the move to a rental unit for 8-12 weeks could save the homeowner thousands of dollars. This is particularly true if changes in family circumstances would permit the homeowner to rent a smaller home or an apartment instead of a larger home to accommodate a family. Delay may also benefit the homeowner's attempt to find replacement rental accommodations, or to save up the damage deposit required by most residential landlords.

The only final solution to the foreclosure dilemma is relief under the bankruptcy code. The typical homeowner would qualify for relief under either Chapters 7, 11 or 13 of the bankruptcy code. 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.

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 alimony, maintenance, support, some property settlement debts, debts for fraud, larceny, certain tax obligations, and other claims. 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. 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.

In a typical home foreclosure, a Chapter 7 will merely delay the sale of the real property. Where a trust deed 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. 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 their home. 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 a Chapter 13. 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 to the home lender and 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 example above is a simple example and 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 homeowner. Regular monthly payments have to be made to the Chapter 13 trustee and to the home loan lender or the case could be dismissed and the lender would be able to complete its sale of the property. 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.

If you are interested in discussing your options under the bankruptcy code, please contact Trev Peterson (tpeterson@knudsenlaw.com), Jeanelle Lust (jlust@knudsenlaw.com) or Rick Reier (rreier@knudsenlaw.com), the attorneys in our office who handle bankruptcy cases, to discuss the options available to you. The initial half-hour consultation is free and the firm handles bankruptcy cases on a fixed fee for all but the most unusual cases.

For further information, you may contact:

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