



Foreclosure and Foreclosure Prevention Guidance Manual

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Community Law and Business Clinic**

2013

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Different Types of Mortgages

A mortgage is a loan to purchase property. The property purchased with the loan proceeds is used as collateral to insure the repayment of the loan obligation. Foreclosure is the legal process through which a creditor acquires the real estate asset pledged as collateral by the borrower in the event of default.¹

Several types of mortgages are available to homeowners. Knowing which type of mortgage your client has will allow you to determine whether the terms of your client's mortgage are fair. Unfair terms in the loan documents could be used as a defense on behalf of your client in a foreclosure action.

Fixed Rate Mortgages

A fixed rate mortgage is a mortgage loan where the interest rate remains the same or fixed throughout the duration of the loan repayment term. The payments made by the borrower towards the principal loan amount and the loan interest will remain the same. However, additional costs associated with the loan such as property taxes and insurance may fluctuate over time. Fixed rate mortgages are the most common form of mortgage loan and the most common terms are 15-year and 30-year mortgages.

Fixed rate mortgages come with several benefits to borrowers. Borrowers with fixed rate mortgages are protected against inflation if interest rates increase and are able to accurately plan their monthly mortgage expenses due to the fixed monthly payment.²

Adjustable/Variable Rate Mortgages

An adjustable or variable rate mortgages is a mortgage loan where the interest rate on the loan fluctuates periodically based on several indices. As a result, the borrower's monthly payment may change over time. Monthly payments may increase or decrease with an adjustment of the loan's interest rate. The borrower with an adjustable rate mortgage risks exposure to unpredictable increases in interest rates. All adjustable rate mortgages

¹ South Carolina Foreclosure Law Manual, page 2

² http://www.freddiemac.com/homeownership/ready_to_buy/choosing_the_right_mortgage.html

have caps. These caps determine how much and how frequently the interest rate can increase or decrease over at each adjustment period and over the life of the loan.³

In recent years, adjustable rate mortgages with adjustments based on the lender's index instead of market indices helped spur an increase in foreclosures.⁴ Many borrowers secured adjustable rate mortgages without being told that their payment would gradually increase to an amount that they could no longer afford.

Balloon/Reset Mortgages

Balloon or reset mortgages are mortgages that have a monthly payment based on a 30-year amortization schedule. However, at the end of 5 or 7 years, the entire mortgage balance will be due (a balloon payment) unless the borrower chooses to reset the mortgage at the current rates. Balloon mortgages are thought of as two-step mortgages. The first step takes place when the borrower secures the 30-year mortgage. The second step takes place after a term of 5 to 7 years when the buyer is required to either pay the remaining balance of the mortgage or reset the loan at current mortgage rates. Once the loan is reset, the mortgage interest rate will remain at the current market's rate for the remainder of the amortization period.⁵

Second Mortgage [i.e., home equity loan]

Second mortgages are mortgages that are subordinate to another loan against the same piece of property. Second mortgages are considered subordinate because in the event of default and foreclosure, the first mortgage is paid off first and then the second mortgage is paid with any remaining proceeds. Second mortgages generally come with higher interest rates. An example of a second mortgage is a home equity loan. To obtain a home equity loan, the borrower uses the equity in their home as collateral. Most home equity loans are used for home repairs or to pay off other large debts.

³ http://www.freddiemac.com/homeownership/ready_to_buy/choosing_the_right_mortgage.html

⁴ Legal Aid CLE on Foreclosures

⁵ <http://www.freddiemac.com/self/factsheets/pdf/balres.pdf>

If a borrower is in default on their second mortgage, the lender holding their second mortgage can still foreclose on the property even if the borrower's first mortgage is current and not in default.

Reverse Mortgages

In regular mortgages, the borrower pays the lender. In reverse mortgages, the lender pays the homeowner money that does not have to be repaid until the home is sold, the homeowner dies, or does not use the home as their primary residence. The money that homeowners receive from the lender is the equity in the borrowers' home turned into cash.⁶

Reverse mortgages are geared towards older people and intended to provide them with greater financial security and to supplement their retirement income. However, due to the sometimes misunderstood nature of reverse mortgages, some seniors have been taken advantage of and robbed of the equity of their home.⁷

Negative Amortization Mortgages

Amortization means reduction in a loan's balance over a period of time. A negative amortization mortgage is a mortgage where for the borrower's monthly payment for an initial period is less than the interest charged over time. As a result, the outstanding balance of the loan increases. The balance of the loan increases because instead of paying down the loan's principal, the monthly payments are only being applied to part of the interest owed on the loan.

One type of negative amortization mortgage is the graduated payment mortgage. Graduated payment mortgages are mortgages whose payments grow along with earning potential. They are beneficial to buyers who have low to moderate incomes and expect their income to increase substantially over the next 5 to 10 years.⁸

⁶ <http://www.hud.gov/offices/hsg/sfh/hecm/rmtopten.cfm>

⁷ <http://www.aging.senate.gov/crs/aging14.pdf>

⁸ http://www.fha.com/graduated_payment.cfm

Interest Only Mortgages

Interest only mortgages are fixed rate mortgages where the term of the loan is divided into two periods. During the first period, the borrower only pays on the interest of the loan and secures a lower monthly payment. During the second period, the borrower pays on both the interest of the loan and the principal and their monthly payment increases.

Interest only mortgages may be beneficial to borrowers looking to free up cash for other purposes during the initial period of interest only payments. However when the current housing crisis began, some people who took out interest-only loans found themselves overextended with their payment increasing to include both interest and principal.⁹

⁹ http://www.freddiemac.com/homeownership/ready_to_buy/choosing_the_right_mortgage.html

Key Documents

There are several key loan documents that all borrowers should have a copy of after obtaining a mortgage. These documents include a promissory note, the deed of trust, and a truth in lending disclosure statement. These documents will outline the borrower's specific loan terms, including information that will be vital in the event of default or threatened foreclosure.

Promissory Note

A promissory note is a signed written promise by the borrower to repay the lender a specified sum of money plus interest. The note also contains many of the loans terms, including the names of both the borrower and lender, the borrower's promise to pay, the manner of payment (time, place, amount), the borrower's right to repay, the lender's rights if the borrower fails to pay, and obligations of the borrower under the note. If a lender is not in possession of the borrower's promissory note, it may have difficulty enforcing the obligation against the borrower.¹⁰

Deed of Trust

A deed of trust transfers legal title to real property from the trustor (borrower) to a trustee who in terms holds it for the beneficiary of the trust (lender) as security for a loan. After execution, the deed of trust is then recorded with the Register of Deeds in the county in which the property is located.¹¹ The deed of trust gives the lender the power to foreclose on the borrower's property if the borrower defaults on the loan and gives the trustee the power to sell the property in the event of default.

Truth in Lending Disclosure Statement

The Real Estate Settlement Procedures Act (RESPA)¹² requires that lenders provide borrowers with a Good Faith Estimate (GFE) disclosure statement and a Truth-In-Lending disclosure statement within 3 days after

¹⁰ <http://www.time.com/time/magazine/article/0,9171,2032110,00.html>

¹¹ http://www.forsyth.cc/ROD/real_estate_recording.aspx

¹² Effective July 21, 2011, RESPA is administered and enforced by the Consumer Financial Protection Bureau (CFPB).

the borrower applies for a mortgage. The GFE disclosure explains the basic loan terms and the costs the borrower is likely to pay at the closing for the loan. The Truth-In-Lending disclosure contains a good faith estimate of the loan's annual percentage rate, the finance charge, the amount financed, the total payments required, and the payment schedule. For many mortgage loans, the lender must also provide the borrower with a Mortgage Servicing Disclosure that tells the borrower whether the lender may sell the servicing rights of its loans.¹³

¹³ <http://www.consumerfinance.gov/askcfpb/145/what-happens-after-i-apply-for-a-loan.html>

Key Parties

There are several key parties involved in the foreclosure process. First, there is your client who has come to you for help in a very critical time in their life. Next, there is the lender. The lender is the institution that loaned the borrower the money to purchase the property. Next there is the note holder and the note owner. The note holder may be the original lender or another institution that has purchased the note from the original lender. Lastly, the servicer is a public or private entity employed by the lender to collect, monitor, and report loan payments, handle property tax, insurance escrows, and late payments, foreclose defaulted loans, and remit payments.

In more recent times, mortgage loans are being sold and securitized resulting in bundles of mortgage backed securities which makes the parties more difficult to identify. The process begins when the borrower goes to the lender and signs the promissory note and deed of trust. The lender then sells the notes and assigns the mortgage to an entity that securitizes the note by pooling the note with hundreds and thousands of similar obligations. The result is a package of mortgage backed securities which are then sold to investors.¹⁴

For an interactive explanation of how mortgages are bundled and resold:

http://hosted.ap.org/specials/interactives/_business/mortgage_process/index.html?SITE=MIDTN

¹⁴ WHERE'S THE NOTE, WHO'S THE HOLDER: ENFORCEMENT OF PROMISSORY NOTE SECURED BY REAL ESTATE

Possible Client Goals

Every client's goals will be different as will be our approach to their housing crisis. Knowing up front your client's goals will be invaluable to your problem solving on their behalf. Listed below are several possible client goals.

1. Permanent reduction of monthly payments
2. Temporary reduction of monthly payments
3. Permanent interest rate reduction
4. Conversion to a fixed rate mortgage
5. Elimination of delinquency
6. Secure the sale of their home
7. Prevention of foreclosure
8. Remaining in the home as long as possible if displacement is unpreventable

Where are We?: The Foreclosure Process

Pre-foreclosure

The foreclosure process does not automatically begin when a homeowner fails to make a mortgage payment. Often, default on a mortgage loan is the result of some type of hardship that the homeowner is experiencing. Knowing your client's hardship will not only help you to determine which steps to take next, but will also determine if your client may qualify for different relief programs. Hardships may take several forms, including unemployment, unplanned for retirement, sudden disability, or underemployment of the self-employed.

Homeowner's facing imminent default have not yet missed a mortgage payment, but are at a high risk for entering into default. Generally, lenders require homeowners to be in default (2-3 months delinquent) before they are eligible for a loan modification. However, some lenders will consider modifications when the homeowner is facing imminent default, if the homeowner can show that they have an adjustable rate mortgage that is about to adjust to a higher payment or that their income has been reduced but they have been able to remain current due to their dependence on savings. In summary, imminent default is applicable to homeowners who are current as well as to those who are less than 2-3 months behind.

Once a homeowner becomes delinquent by missing a mortgage payment several steps take place before the foreclosure process begins. First, the lender sends the borrower a notice of delinquency. Usually multiple notices of delinquency are sent to the homeowner. Next, the lender sends the borrower a demand letter. In this demand letter, the lender demands the total amount due including late fees for all the missed monthly payments together with all fees and interest that have built up. The borrower can either cure the default by paying the amount demanded or continue to be delinquent by not paying the amount owed.

When a loan is past due by 60 days or more, the lender may begin an optional acceleration process. During the acceleration process, the lender can refuse to accept partial payments or even the full amount due and

instead demand the entire balance of the loan due in full. Usually, these letters will give the borrower 45 days before the lender will begin the foreclosure process.

The Foreclosure Process In North Carolina

After the commencement of the acceleration process, the foreclosure process begins. The lender refers the loan to their foreclosure department who then hires an attorney or law firm to begin court proceedings against the borrower. When an attorney is hired to act on behalf of the lender, the attorney's fees are added to the balance owed by the borrower.

Once the foreclosure is handed over to an attorney, most creditors will substitute the original trustee under the deed of trust with the person or law firm handling the foreclosure. This trustee substitution is then filed with the Register of Deeds where the property is located.¹⁵ The substitute trustee has a fiduciary duty to both parties to be neutral, however trustees frequently advocate for the lender providing the borrower with grounds for challenge to the foreclosure proceedings.

After appointment, the substitute trustee files a Notice of Hearing in the Superior Court in the county where the property is located. The Notice of Hearing must be served on the homeowner not less than 10 days prior to the date of the hearing or 20 days prior to the date of hearing if notice by publication is required.¹⁶ The Notice of Hearing that the homeowner receives must disclose the nature of the default claimed, any right of the debtor to pay the indebtedness or cure the default if such is permitted, a detailed written statement of the amount owed, a complete explanation of a borrower's procedural rights as specified in the statute, and a statement regarding whether a borrower has requested information from a servicer and whether the request has been fulfilled.¹⁷

¹⁵ <http://www.poynerspruill.com/publications/Pages/NorthCarolinaRealEstateForeclosureProcedure.aspx>

¹⁶ N.C. GEN. STAT. § 45-21.16(b)(1).

¹⁷ N.C. GEN. STAT. § 45-21-16(c), check the deed of trust to insure the borrowers right to cure, etc. are the same as those listed in the notice of hearing.

Once the homeowner receives the Notice of Hearing, they must appear before the Clerk of Superior Court for the foreclosure hearing. At the hearing, the lender is required to prove four narrow issues:

1. whether there is a valid debt held by the lender
2. whether there is a default
3. whether there is a right to foreclosure under the mortgage instrument
4. whether proper notice is given

If the lender successfully proves all four elements, the Clerk of Superior Court will enter a judgment authorizing the substitute trustee to sell the homeowner's property. If the lender does not successfully prove all four elements, it will lack a sufficient basis for its claim and be unable to foreclose on the borrower's home. The lender or the homeowner can appeal from an adverse ruling within 10 days of the entry of the Clerk's order to sell the property. Pursuing an appeal does not stop the sale of the property unless the homeowner posts a bond in an amount determined by the Clerk to protect the opposing party from any probable loss by reason of the appeal. On appeal, the four issues are then heard by a Superior Court Judge.

If appeal proceedings are unsuccessful for the homeowner and result in the sale of the property, the substitute trustee must post a Notice of Sale at the County Courthouse and mailed to the borrower 20 days before the sale date. On the date stated in the Notice of Sale, the foreclosed property is sold to the highest bidder at the County Courthouse. After the sale, there is a 10 day window of time or "upset bid" period during which others can outbid the previous highest bidder. During this 10 day period, the borrower can redeem their property by paying the full amount due to the lender including court costs and attorney fees.

Once the "upset bid" period has ended, the trustee collects the purchase price of the property from the purchaser and issues the deed to the property to the purchaser. With the money received from the sale, the trustee pays the costs associated with the sale of the property. Next, they

pay the lender the debt owed by the homeowner. If the sale brings in less money than what is owed to the lender, then the borrower owes the difference. The lender goes to court to obtain a deficiency judgment against the borrower for the balance on the loan remaining after the sale. Any excess funds from a sale can be deposited with the Clerk of Court to be made available to the homeowner's other creditors. In the rare instance, that the borrower has equity in their foreclosed home, the excess funds from the sale will be given to the borrower.

Within 30 days of receipt of the purchase money, the trustee must file a Report of Sale to the Clerk of Court to account for all the sale money. The Clerk of Court will then approve or disapprove the report. Once the Clerk of Court approves the report, the matter is closed.

Information Gathering

When meeting with a client for the first time, there are many things you will not know about their housing situation. Talking with your client may reveal potential solutions or additional issues that need to be addressed. It is important that you gain substantive information about the client's situation. To fully assess their situation, you should ask the following questions:

1. Are YOU the owner of the home you live in? Is the home owned with another person?
2. Are you behind or close to being behind on your mortgage?
3. What has caused your financial hardship? a. Is this hardship permanent or temporary?
4. If you are behind on your mortgage, how far behind are you?
5. Who is your lender?

When communicating with a client's lender, persistence is key. After consulting with your client for the first time, have your client sign a consent form that will allow their lender to discuss their mortgage loan with you as their representative. Fax this form to the lender as soon as possible after it is signed by the client. Typically, it will take several days for the consent form to be applied to the borrower's account. After submitting the consent form to the client's lender, keep a copy of the consent form in the client's file in case the lender requests it again.

Before you call a lender, have accessible the borrower's name, address, loan number, and social security number. Lender representatives may request this information along with your name before discussing the client's account with you. When speaking to a lender's representative on the phone, always document the name of the person you speak to and their title or department. Knowing this information is helpful if you are disconnected or are told conflicting information when speaking to another representative.

The Client File:

- Key Documents
- Consent Form
- Recent Taxes Bank statements
- Pay Stubs
- Benefit Statements

Potential Solutions to Avoid Foreclosure

Loan Modification

There are several solutions available to help prevent foreclosure. One of the most popular solutions is the homeowner obtaining a modification of their loan terms from their mortgage lender. There are several types of loan modifications available.

Traditional bank modifications are usually available to homeowners who have experienced some type of financial hardship. Lenders usually require this hardship to be a permanent change in the income of the borrower. Traditional bank modifications are given to borrowers at the sole discretion of the lender. The borrower submits a modification application to the lender along with other documents such as bank statements, proof of income, recent tax returns, social security benefit verification letters, and utility bills. After receiving these documents, the lender reviews the application and decides whether or not to modify the terms of the borrowers loan. A loan modification, if granted, can result in a decreased monthly payment and/or a lower interest rate. The borrower is usually required to abide by the new terms for a short trial period before the terms become permanent for the life of the loan.

The Homes Affordable Modification Program (HAMP) is a federal program that is designed to help homeowners struggling financially to avoid foreclosure by modifying their mortgage loan to terms that will be sustainable over the long term. In order to be eligible for HAMP loans, borrowers must meet several requirements¹⁸:

1. Borrower obtained his mortgage on or before January 1, 2009.
2. Borrower owes up to \$729,750 on his primary residence or single unit rental property
3. Borrowers up to \$934,200 on a 2-unit rental property; \$1,129,250 on a 3-unit rental property; or \$1,403,400 on a 4-unit rental property

¹⁸ <http://www.makinghomeaffordable.gov/programs/lower-payments/Pages/hamp.aspx> and <http://www.makinghomeaffordable.gov/faqs/homeowner-faqs/Pages/default.aspx>

4. The property has not been condemned
5. The borrower has a financial hardship and is either delinquent or in danger of falling behind on his mortgage payments
6. Borrower has sufficient, documented income to support a modified payment
7. Borrower has not been convicted within the last 10 years of felony larceny, theft, fraud or forgery, money laundering or tax evasion, in connection with a mortgage or real estate transaction.

If a borrower meets these requirements, they may be eligible for a HAMP modification. To apply for a HAMP modification, the borrower must submit a complete package of documents to their mortgage servicer.¹⁹ This package must include the following documents:

1. A HAMP modification request form providing the borrower's servicer with information about the borrower's home and financial situation
2. Tax form 4506T-EZ- giving servicer permission request a copy of the most recent tax return filed with the IRS (Borrowers who did not file a tax return should complete Tax form 4506-T.)
3. Proof of income documents²⁰ verifying your income to ensure that the modified payments will be affordable to the borrower
 - a. Borrower who receives a salary or hourly wages: Submit a copy of the borrower's two most recent pay stubs that show year-to-date earnings.
 - b. Borrower who is self-employed: Submit a copy of the borrower's year to date profit/loss statement.
 - c. Borrower who receives government benefits: Submit a copy of the borrower's benefit letter from the provider stating the amount, frequency, and duration of the benefit AND a copy of the borrower's two most recent bank statements showing receipt of such payment.
4. Dodd Frank Certification Form certifying that the borrower applying for the HAMP modification has not been convicted of any crimes

¹⁹ <http://www.makinghomeaffordable.gov/get-assistance/request-modification/Pages/default.aspx>

²⁰ <http://www.makinghomeaffordable.gov/get-assistance/request-modification/Pages/checklist.aspx>

- associated with a mortgage or real estate transaction with the past ten years
5. Send the Documents to the Borrower's Mortgage Servicer (Note: not every mortgage servicer participates in the HAMP program. Even if the borrower's servicer does not participate in HAMP, the servicer may offer its own foreclosure prevention solution)

To create an affordable monthly payment for the borrower, the loan servicer may take several steps in the following order: recapitalizing the arrearage and accrued fees (which has the benefits of bringing the loan current), rate reduction to as low as 2%, term extension up to 40 years, and principal forbearance or deferral. HAMP modification evaluations are required for Freddie Mae and Fannie Mac loans and encouraged for all other types of loans. Like traditional bank modifications, after a modification is granted, homeowners must complete a trial period of three to four months to demonstrate their ability to make their reduced payments before their mortgage will be permanently modified. Homeowners who participate in HAMP and make their permanent modification payments on time are also eligible for an incentive of \$1,000 each year to reduce the amount of principal they owe, up to \$5,000.

The Federal government also provides assistance for homeowners who are having difficulty paying their mortgages due to a second mortgage. Under the Second Lien Modification Program,²¹ borrowers who have secured HAMP modifications on their first mortgage may be eligible for several types of assistance on their second mortgage if the servicer of their second mortgage is a participant in the Second Lien Modification Program. The second mortgage servicer may reduce the interest rate for liens that pay both principal and interest, reduce the interest rate to two percent for interest-only second loans, extend the term of the second loan to 40 years, defer the second loan to coincide with a deferment on the first loan, or forgive a portion of the second loan to coincide with the forgiveness of a portion of the first loan.

²¹ http://www.makinghomeaffordable.gov/programs/lower-payments/Pages/lien_modification.aspx (listing servicers participating in the Second Lien Modification Program)

Refinancing

The Basics of the Refinancing Process:

The refinancing process very closely resembles the process for obtaining the initial mortgage. The borrower must apply for new financing, qualify, and close the loan. The effect of refinancing is to pay off the original mortgage and create a new mortgage.

Choosing a Mortgage Refinance:

Considerations: Refinancing is not advantageous for all borrowers. To determine if refinancing is a good option for your client, consider the client's goals as well as future plans, the terms of the current mortgage, and how long the client has been in the current mortgage.

Goals Refinancing May Achieve

- Lowering monthly payments
- Moving from an Adjustable Rate Mortgage (ARM) to a Fixed Rate Mortgage
- Changing the duration of the mortgage
- Consolidating a first and second mortgage

Factors That Affect Whether Refinancing Will Achieve Client Goals

- The breakeven point [how many months will it take until the savings realized from the refinance exceed the associated costs/fees (application fee, appraisal fee, title inspection fee, title insurance fee, origination fee, etc.)?]
- The amount of the client's monthly payment being applied to principal under the current mortgage [refinancing will restart the client at the beginning of an amortization schedule]
- Imminence of foreclosure [the refinancing process often takes at least several weeks]
- Mortgage prepayment penalties

Types of Refinancing:

No Cash Out: When the borrower's goal is more advantageous terms, the borrower is seeking a "no cash out" refinance. No cash out means that the amount financed does not exceed amount of existing debt. However, the refinancing lender may also roll the costs associated with the refinance into the balance of the new mortgage debt.

Cash Out: When the borrower's goal is to take equity out of the home, the borrower is seeking a "cash out" refinance. Here, the value of the borrower's home exceeds the amount of the debt. For example, Borrower owes Lender 1 \$100,000 and the value of his home is \$150,000. If Borrower can obtain a \$150,000 loan from Lender 2, he can satisfy the \$100,000 debt to Lender 1 and walk away with \$50,000.

Special Refinancing Programs:

The federal government's Home Affordable Refinancing Program (HARP)²² is designed to help homeowners who are current on their mortgage payments but cannot obtain a traditional refinance because their home value has declined. However, the current mortgage can be no more than 80% of the market value of the home. If approved, the homeowner's current loan will be refinanced so payments are more manageable. A borrow may be eligible for HARP if the borrow meets all of the following criteria:

- The borrower has a mortgage owned or guaranteed by Freddie Mac or Fannie Mae.
- The mortgage must have been sold to Fannie Mae or Freddie Mac on or before May 31, 2009.
- The mortgage cannot have been refinanced under HARP previously unless it is a Fannie Mae loan that was refinanced under HARP from March-May, 2009
- The current loan-to-value (LTV) ratio must be greater than 80%.

²² <http://www.makinghomeaffordable.gov/programs/lower-rates/Pages/harp.aspx>

- The borrower must be current on the mortgage at the time of the refinance, with a good payment history in the past 12 months.

For homeowners who are struggling with a second mortgage payment, see the Second Mortgage Refinance Program discussed in the section on North Carolina Homeowner Assistance Programs.

Finding a Lender:

Credit Unions: As member (customer)-owned, non-profit entities, credit unions are often able to offer better terms and customer service than traditional banks. Dividends a credit union pays to members are paid out of the interest earned on loan products, so the member/borrower is essentially returned a portion of the interest he paid in the form of a dividend. To qualify for credit union membership, the applicant must fit within one of its “fields of membership” (i.e., professional/occupational group, employment with a particular employer, geographic area).

Traditional Banks: With national, regional, and local options available, the client has a large pool of potential lenders. National banks have the advantage of “brand” recognition and many branch locations. Local community banks may offer more personalized service and are often willing to consider subjective factors along with objective data as part of their qualification criteria.

Mortgage Companies: Mortgage companies have a relationship with a number of lenders and employ brokers who act as intermediaries between the borrower and various lenders. Therefore, a borrower can accumulate multiple lending options by using a mortgage company broker. However, brokers do not guarantee that they are giving the borrower the best deal, or even a good deal, and they can also receive “points” (a kickback) for brokering a loan at a higher interest rate than the par rate.

Shopping Around: To ensure your client receives the best possible deal, shopping around is essential. By comparing the terms and costs associated with multiple loans, the client will be able to assess which best suits their goals and achieves the greatest savings.

Applying for a Mortgage Refinance:

Documentation: Borrowers will have to provide much the same documentation to refinance an existing mortgage as they did when they applied for the original mortgage. This includes:

- Photo ID
- Social Security Number Proof of Address
- W-2s
- Recent Paystubs
- Account Statements (savings, checking, retirement, and/or investment)
- Documentation of Existing Debts Current Mortgage Papers Homeowner's Insurance Policy Title Insurance

Appraisal: A refinancing appraisal is based entirely upon data concerning the home (improvements, size, features/conditions of the property, etc.), data about the neighborhood, and comparable sales data. Unlike appraisals performed for the sale of a home, the appraiser does not have a sales price to use as a benchmark against which to measure the appraised fair market value.

The home appraisal is an important step in the application process because if the appraised value of the home is too low, it may prove very difficult to refinance the existing mortgage debt. Many homeowners are currently underwater on their mortgage, but lenders obviously do not want to refinance \$200,000 of debt if it will have a house that is now worth only \$150,000 as collateral. In the current real estate market, banks are taking a much more conservative approach to lending and the appraisal weighs heavily on the determination whether to refinance.

Qualifying for a Mortgage Refinance:

Considerations:

1. Employment status/Income
2. Value of the home compared to the amount debt to be refinanced
3. Creditworthiness

Refinancing References:

<http://www.federalreserve.gov/pubs/refinancings/refinancing.pdf>

http://www.vacu.org/Loans_Mortgages/Home_Refinancing/Educational_Resources/Why_Refinance.aspx

<http://www.icba.org/communitybanking/index.cfm?ItemNumber=556&sn.ItemNumber=1744>

<http://www.cuna.org/>

http://www.ehow.com/list_7393083_checklist-documents_refinancing.html

http://www.ehow.com/list_6516894_refinance-appraisal-faqs.html

Forbearance

In addition to loan modification programs, some lenders offer borrower forbearance programs. Forbearance programs usually suspend or reduce the borrower's mortgage payment for a short period of time during which the borrower is experiencing a hardship. The most common hardship for which forbearances are granted is unemployment. Oftentimes, lenders will offer a borrower a forbearance if the hardship that the borrower is experiencing is not considered permanent enough to obtain a permanent loan modification. The Federal government has expanded HAMP to compel all servicers participating in the Making Homes Affordable Program to provide eligible homeowners a forbearance period while they seek re-employment.²³ Eligible borrowers must be receiving or eligible for unemployment benefits and must not be more than three months past due on their mortgage.

Short Sale

When foreclosure of a borrower's home is imminent, another option for the buyer is to offer the lender less than the full amount due on the loan to avoid foreclosure. The servicer will allow the borrower to list and sell the

²³ MHA Brochure

mortgaged property with the understanding that the net proceeds from the sale of the home may be less than the borrower owes. For example, if the borrower owes the lender \$100,000, the borrower may offer the lender \$60,000 obtained through the sale of the property as full payment of the loan. If the lender agrees to accept a short sale, the borrower should request that the lender not report the foreclosure on the borrower's credit report. The borrower should also insure that the lender agrees to not obtain a deficiency judgment against the borrower for the excess owed the lender.

Deed in Lieu of Foreclosure

When foreclosure of a borrower's home is imminent, another option for the buyer is to offer to the lender the property's deed in lieu of foreclosure. Offering the home's deed in lieu of foreclosure is usually advisable when the borrower has no equity in their home and is having difficulty selling or refinancing the property. If the bank agrees to accept the property's deed in lieu of foreclosure, the borrower's home will not be foreclosed, a foreclosure will not be reported on the borrower's credit report, and the borrower avoids a deficiency judgment.

The Home Affordable Foreclosure Alternatives (HAFA) Program was created by the Federal government to assist homeowners who want to avoid the negative effects of foreclosure.²⁴ Under HAFA, homeowners are given incentives for completing a short sale or deed in lieu of foreclosure. A homeowner can receive \$3,000 to help with relocation costs or to assist with the release of liens from second mortgages. HAFA is available to homeowners who meet all of the following criteria:

1. The homeowner has a documented financial hardship.
2. The homeowner has not purchased a new house within the last 12 months.
3. The homeowner's first mortgage is less than \$759,750.
4. The homeowner obtained his mortgage on or before January 1, 2009.

²⁴ <http://www.makinghomeaffordable.gov/programs/exit-gracefully/Pages/hafa.aspx>

5. The homeowner has not been convicted with the last 10 years of felony larceny, theft, fraud, forgery, money laundering or tax evasion in connection with a mortgage or real estate transaction.

HAFAs are available for mortgages that are owned or guaranteed by Fannie Mae and Freddie Mac or serviced by over 100 HAMP participating mortgage servicers.

Foreclosure Litigation

Once your client has received a Notice of Hearing from the Clerk of Court, you should start preparing for your client's foreclosure hearing. It is best to begin by gathering all pertinent information about your client's loan in order to put forth appropriate claims and defenses. If your client is missing key documents (see the Key Documents section for more information) that may help their defense, you should make a Qualified Written Request (QWR) to their lender receive these documents. Under the Real Estate Settlement Procedures Act,²⁵ if any servicer receives a qualified written request from the borrower for information related to the servicing of their loan, the lender must acknowledge the request within 20 days from receipt and take action with respect to the request within 60 days after receipt of the request.

This qualified written request must be in writing and include a statement of the reasons why the borrower believes there has been an error made to their account. In this request, the borrower can ask that the lender provide copies of the following documents:

1. Copies of all documents pertaining to the origination of the loan including the loan application, Right to Cancel, Deed of Trust, note, adjustable rate note, addendum to the note for the interest only payment period, Truth in Lending statements, Good Faith Estimate (GFE), HUD 1, appraisal, and all required disclosures and rate sheets associated with this transaction for the above referenced loan.
2. A copy of the life of loan history including all payments made, all fees incurred, what has been paid out of the escrow account, and how all payments were applied.

The borrower is entitled to certain damages if the lender fails to respond to a qualified written request.

²⁵ Title 12, Chap. 27, §2605(e).

Claims and Defenses

In addition to the defense that the lender is unable to establish the four elements needed to force a sale of the borrower's home, there are several other claims and defenses under North Carolina and Federal law that may arise to help combat foreclosure.

High Cost Loans:

North Carolina law²⁶ prohibits lenders from including certain terms in high cost loans and requires lenders to certify that high cost loan borrowers have received counseling prior to closing. High cost loans are loans that incorporate financed loan fees that exceed 5% of the total loan amount, loans that exceed statutory APR thresholds, and loans that involve oppressive repayment penalties. A lenders inclusion of certain prohibited loan terms may result in a claim against the lender for their violation. High cost loans should not contain the following:

1. Call provisions: a provision which permits the lender, in its sole discretion to accelerate the indebtedness
2. Balloon payments: a required payment that exceeds more than twice of the regularly schedules payment
3. Negative amortization
4. Increased interest rate
5. Advance payments: a provision requiring two payments be paid in advance
6. Modification or deferral fees

In addition to excluding certain types of provisions, the lender is required to provide loan counseling for the borrower from a counselor approved by the North Carolina Housing Finance Agency that the borrower has received counseling. The lender is also required to consider the borrowers' ability to repay the loan prior to lending.

²⁶ N.C. GEN. STAT. § 24-1.1E.

Rate-Spread Loans:

North Carolina law²⁷ also requires certain protections for rate-spread loans. Rate spread loans are loans in which the difference between the APR for the loan and the yield on U.S. Treasury securities having comparable period of maturity is either greater to or equal than 3% for a first mortgage and 5% for a second mortgage. For rate-spread loans, prepayment penalties are prohibited, lenders must determine that the borrower has the ability to repay the loan at the full indexed rate not the tester rate, and lenders must verify and document the borrower's income. Violations by lenders are considered acts of usury and penalized as such.

Usury:

Usury is a crime in North Carolina. In order for a usury claim to be successful, the following four elements are required:

1. There must be a loan. (express or implied)
2. There must be an understanding between the parties that the money lent shall be returned.
3. For such loan, a greater rate of interest than allowed by law shall be pair or agreed to be paid.
4. There must exist a corrupt intent to take more than the legal rate for the use of the money loaned.

There is a two-year statute of limitations for a usury claim that runs from the date of the last payment of the usurious interest. The penalty for a usury violation is recovery of double interest paid or recovery under the North Carolina Unfair and Deceptive Acts and Practices.²⁸

North Carolina Mortgage Lending Act:

The North Carolina Mortgage Lending Act prohibits anyone from engaging in the business of making or brokering residential mortgage loans secured by North Carolina real estate without being licensed by the North Carolina Commissioner of Banks. This law also requires brokers to disclose certain

²⁷ N.C. GEN. STAT. § 24-1.1F.

²⁸ N.C. GEN. STAT. § 75-1 (see the section on Consumer Protection for more information).

information to the borrower, offer loan terms indiscriminately, and make reasonable efforts to secure a loan that is reasonably advantageous to the borrower. The statute does not explicitly provide a private right of action, but could give rise to a cause of action under the North Carolina Unfair Trade Practice Act²⁹ because violations of this statute may constitute unfair and deceptive practices.

North Carolina Residential Mortgage Fraud Act:

This North Carolina law³⁰ creates the crime of residential mortgage fraud. A person is guilty of this crime if:

1. A person knowingly makes or attempts to make, or uses, any material misstatement, misrepresentation, or omission within the mortgage lending process
2. With the intention that a mortgage lender, mortgage broker, borrower, or any other person or entity that is involved in the mortgage lending process relies on it, or
3. Derives profits from a known violation of the act.

²⁹ N.C. GEN. STAT. § 75-1 (see the section on Consumer Protection for more information).

³⁰ N.C. GEN. STAT. § 13-118.12.

Consumer Protection – State and Federal

North Carolina Unfair and Deceptive Trade Practices Act³¹

North Carolina's UDTA is a "little FTC Act." A UDTA claim requires (1) an unfair or deceptive act or practice, (2) in or affecting commerce, which (3) proximately caused actual injury to the claimant. The statute of limitations for a cause of action under the UDTA is four years from the time cause of action accrues. Predatory lending could be the basis for a claim under the UDTA if plaintiff can prove that the lending was "unfair or deceptive" within the meaning of the statute. This is a fact specific inquiry.³²

North Carolina Homeowner and Homebuyer Protection Act³³

This Act was designed is to prohibit home foreclosure rescue scams. A foreclosure rescue transaction occurs when the homeowner is in default or foreclosure proceedings have been initiated and he conveys his principal residence to a transferee who has represented that the conveyance will enable the homeowner to prevent, postpone, or reverse the foreclosure and remain in the home. The homeowner retains some legal, equitable , or possessory interest in the property (i.e., tenancy interest, lease- to-purchase agreement, option to reacquire). A violation of this Act is a per se violation of the NC UDTA. The homeowners remedies include damages, voiding the foreclosure rescue transaction, and declaratory or equitable relief.

North Carolina Predatory Lending Law³⁴

This statute prohibits certain lending practices in consumer home loan transactions. Under the predatory lending law, prohibited lending practices include (1) financing, directly or indirectly, any credit life, disability, or unemployment insurance, or any other life or health insurance premiums; (2) refinancing an existing consumer home loan when the new loan does not have reasonable, tangible net benefit to the borrower considering all of

³¹ N.C. Gen. Stat. § 75-1.1.

³² Concrete Serv. Corp. v. Investors Group, Inc., 79 N.C. App. 678, 686, 340 S.E.2d 755, 760 (1986).

³³ N.C. Gen. Stat. § 75-120.

³⁴ 29 N.C. Gen. Stat. § 24-10.2.

the circumstances (known as “flipping”); (3) recommending default on an existing loan or other debt prior to and in connection with the closing of a consumer home loan that refinances all or any portion of such existing loan or debt. These practices are usurious per se and violate the NC UDTA.³⁵

North Carolina Reverse Mortgage Act³⁶

The purpose of this statute is to make reverse mortgages available to elderly homeowners while providing protection to the elderly who are engaging in these transactions. The statute sets out numerous provisions to which reverse mortgage lenders must adhere. It also prohibits certain acts by the lender. A homeowner damaged by a lender’s violation may bring an action for actual and punitive damages.

Truth in Lending Act³⁷

The purpose of TILA is to help borrowers make informed choices by requiring that lenders disclose specific costs (APR, fees, etc.) associated with borrowing. In addition to the disclosures required generally under TILA, there are special regulations for certain types of mortgage transactions. Borrowers have the right to rescind the loan if the creditor fails to provide the disclosures required under TILA. Borrowers’ potential monetary remedies for TILA disclosure violations by the creditor include statutory damages and actual damages.

Mortgage Reform and Anti-Predatory Lending Act [Title XIV of the Dodd-Frank Wall Street Reform and Consumer Protection Act]³⁸

Regulations promulgated pursuant to the Act require that mortgage originators not lead borrowers into loans (1) they cannot reasonably repay, (2) with predatory characteristics, (3) that is not a qualified mortgage (a mortgage that meets certain criteria giving it “safe harbor” status), or (4) based on mischaracterization of the borrower’s credit history or the property’s value. This Act amends TILA by requiring that mortgage

³⁵ N.C. Gen. Stat. § 24-10.2(e).

³⁶ N.C. Gen. Stat. § 53-255.

³⁷ 15 U.S.C. § 1601 et seq.

³⁸ Pub. L. No. 111-203 § 1400 et seq., 124 Stat. 1376 (2010).

originators make a reasonable and good faith determination of the borrower's ability to repay before making a loan. If a mortgage originator violates the Act, the borrower can bring an action for damages. Violations of the regulations promulgated under the Act also give rise to a defense against foreclosure.

Mortgage Servicing under RESPA (Regulation X) and TILA

As of January 17, 2013, the Consumer Financial Protection Bureau (CFPB) has issued final rules implementing the provisions of the Dodd-Frank Act regarding mortgage servicing. These new rules go into effect on January 10, 2014.

The new rules³⁹ require mortgage servicers to provide information about mortgage loss mitigation options to delinquent borrowers; to establish policies and procedures for providing delinquent borrowers with continuity of contact with servicer personnel capable of performing certain functions; and to evaluate borrowers' applications for available loss mitigation options.

³⁹ http://files.consumerfinance.gov/f/201301_cfpb_mortgage-servicing-rules_what-it-means-for-consumers.pdf

Homeowner Assistance Programs – State and Federal

North Carolina Foreclosure Prevention Fund Programs

Note: applications for all NCFPF programs must be done through a HUD-approved housing counselor. Currently NCFPF is offering two programs, as its website no longer lists the Permanent Loan Modification Program.

Minimum Eligibility Requirements (both programs):

http://www.ncforeclosureprevention.gov/am_i_eligible.aspx

A homeowner may qualify if the homeowner—

1. Owns the home, the home is in North Carolina, and the home is the homeowner's primary residence.
2. Currently owes no more than \$300,000 on all mortgages.
3. Has lost his job or experienced a reduction in income through no fault of his own, or is facing a temporary financial hardship such as a divorce, serious illness, or death of a co-signor and needs to find new employment.
4. Experienced his job loss or temporary financial hardship after January 1, 2008.
5. Has an acceptable mortgage payment history prior to your recent unemployment or income loss.
6. Demonstrates an ability to resume his mortgage payment once assistance ends.
7. Is a legal U.S. resident.

NCFPF Mortgage Payment Program Summary:

http://www.ncforeclosureprevention.gov/get_help_mortgage_payment.aspx

In addition to satisfying the minimum eligibility requirements, the homeowner must be behind (or at risk of getting behind) on his/her payment, or in foreclosure to participate in this program

After the eligibility determination but before loan qualification, the N.C. Housing Finance Agency may seek a temporary stay of foreclosure pending full review of the application.

This program provides interest-free loans up to \$36,000 to cover mortgage payments for no more than 36 months while the homeowner looks for or trains for a new job.

There are three types of loans: (1) lump sum payments to bring the mortgage current, (2) short-term payment assistance during the job search process, or (3) long-term payment assistance while participating in job retraining.

Whether and how much the homeowner must repay depends upon how long the homeowner remains in the home. If the homeowner remains in the home for ten years, the loan is forgiven. After the homeowner has lived in your home for five years, the loan is reduced by 20 percent a year for years six through 10 until the homeowner owes nothing. The homeowner repays the total amount only if the homeowner sells or refinances the home in the first five years, and only if the sale proceeds are sufficient to repay it.

Second Mortgage Refinance Program Summary⁴⁰:

In addition to satisfying the minimum eligibility requirements except unemployment, the homeowner must (1) be employed but earning less than in the past, (2) fail to qualify for the federal Second Lien Modification Program, and (3) can no longer afford the payment on a second mortgage. Prior participation in the Mortgage Payment Program does not exclude a homeowner from participation in this program.

This program helps the homeowner refinance an unaffordable second mortgage by paying off up to \$30,000 of the mortgage with a zero-interest, deferred payment loan.

Homeowners who have participated in the Mortgage Payment Program and are now re-employed may be eligible for the Second Mortgage Refinance Program if they still have a demonstrated financial need.

NCFPF does not indicate under what circumstances, if any, a homeowner could be eligible for loan forgiveness under the Second Mortgage Refinance Program.

⁴⁰ http://www.ncforeclosureprevention.gov/payoff_second_mortgage.aspx

North Carolina Homeless Prevention and Rapid Re-housing Program⁴¹

This program is only an option for clients who cannot avoid foreclosure and loss of housing is imminent.

NC HPRRP came into existence in 2009 with the passage of the American Recovery and Reinvestment Act of 2009, which included \$1.5 billion for a Homelessness Prevention Fund. Funds are distributed to states who allocate the funds among communities.

NC HPRRP assists those who are (1) homeless or at imminent risk of becoming homeless, (2) below 50% of the Area Median Income, (3) lack other sources of support, and (4) have barriers to getting and keeping housing that HPRRP can be addressed through a housing plan.

Funds are used to enable beneficiaries to find or maintain stable housing. However, funds cannot be used for foreclosure prevention. Instead, funds are used for rental assistance (including arrearages), utilities, deposits, and/or moving expenses. Rent and utility assistance lasts up to 18 months.

The Housing Relocation & Stabilization Services provided through NC HPRRP include (1) Case Management, (2) Outreach and Engagement, (3) Housing Search and Placement, (4) Legal Services, and (5) Credit Repair, each of which can only be provided for up to 18 months.

Federal Assistance Resources for Homeowners

Many federal assistance programs for homeowners have already been discussed in other sections. Listed below are a few online resources⁴² from the federal government to provide assistance to the homeowner.

1. Department of Treasury: Making Home
 - www.makinghomeaffordable.gov
2. Department of Housing and Urban Development: Avoiding Foreclosure

⁴¹ <http://www.ncceh.org/2009homelessnessprevention/>

⁴² http://federalreserve.gov/consumerinfo/foreclosure_consumers.htm

- http://portal.hud.gov:80/hudportal/HUD?src=/topics/avoiding_foreclosure
3. Department of Justice: Approved Credit Counseling Agencies
 - http://www.justice.gov/ust/eo/bapcpa/ccde/cc_approved.htm
 4. Federal Reserve System: Avoiding Foreclosure
 - http://www.federalreserve.gov/consumerinfo/fivetips_foreclosure.htm
 5. Federal Trade Commission: Facts for Consumers
 - <http://www.consumer.ftc.gov/articles/0187-when-paying-mortgage-struggle>
 6. Internal Revenue Service: Home Foreclosure and Debt Cancellation
 - <http://www.irs.gov/uac/Home-Foreclosure-and-Debt-Collection>
 7. Internal Revenue Service: Mortgage Forgiveness Debt Relief Act
 - <http://www.irs.gov/uac/Newsroom/Important-Facts-about-Mortgage-Debt-Forgiveness>

Bankruptcy

Types of Individual Bankruptcy

Chapter 7:

In a Chapter 7 bankruptcy, all of the debtor's unencumbered interests in property at the time of the petition flow into the bankruptcy estate for distribution to unsecured creditors. Any interest in property the debtor acquires post-petition is not property of the estate, with a few exceptions. At the end of the bankruptcy, the bankruptcy trustee liquidates the debtor's interests in property and distributes it to unsecured creditors. Often, the debtor has no equity in property to distribute. Whether or not there was any property to distribute, any remaining balances on unsecured debts after distribution will be discharged at the end of the bankruptcy. If a creditor had a secured debt, that lien survives the bankruptcy and can be vindicated in state court after the bankruptcy ends.

A Chapter 7 debtor who owns a home that is encumbered by a mortgage lien is not required to surrender his home. A Chapter 7 debtor can retain property if he (1) redeems the collateral, or (2) reaffirms the debt, which puts the debtor back on the hook post-bankruptcy for the full amount of the debt and eliminates the benefit of the discharge for debts that exceed the value of the collateral (i.e., an underwater mortgage). However, the most courts have held that a debtor who is current on payments on debt secured by real property can also retain the property via "ride through" without surrendering the collateral, redeeming the collateral, or losing the benefit of the discharge through by reaffirming the debt.⁴³ "Ride through" means that the debtor retains the collateral post-petition and continues to make payments as scheduled. Since the debtor has not lost the benefit of the discharge, even if the debtor defaults after the bankruptcy and the lender forecloses on the home, the lender can only turn to the collateral for satisfaction of the debt and cannot seek recourse for a deficiency against the debtor personally.

⁴³ See In re Linderman, 435 B.R. 715 (M.D. Fla. 2009) (describing how the "ride through" operates).

Chapter 13:

In a Chapter 13 bankruptcy, all of the debtor's unencumbered interests in property at the time of the petition flow into the bankruptcy estate. Unlike in a Chapter 7 bankruptcy where the debtor gets to keep post-petition property and earnings, any interest property or earnings the debtor acquires post-petition is also property of the estate in a Chapter 13. However, also unlike in a Chapter 7 bankruptcy, the Chapter 13 debtor stays in possession of all of his property.

The Chapter 13 debtor proposes a plan through which he will pay his debts and the Chapter 13 trustee administers the plan over a 36- 60 month period. The Chapter 13 plan must provide for the full amount of secured claims. Although the amount of most secured claims are stripped down to the value of the collateral rather than the actual amount of the outstanding debt, the value of the claim of a lender who has a lien on the debtor's primary residence is the full amount of the debt, even if the home is worth significantly less. A debtor with a home mortgage can use the Chapter 13 plan to make monthly payments as well as cure arrearages. The entire mortgage debt is not rolled into the Chapter 13 plan. Rather, the monthly payments plus any arrearages will be paid during the life of the plan and the debtor will continue to pay as scheduled after completion of the plan. The Chapter 13 plan need only provide unsecured creditors at least the amount they would have received had the debtor filed a Chapter 7 bankruptcy. Rather than paying debts with pre-petition property, the debtor's future income is used to make plan payments. Income the debtor receives is paid to the trustee, who then disperses it among creditors. The debtor retains the residual amount for his living expenses.

Secured Creditors and the Automatic Stay

Effect of the Bankruptcy on the Secured Creditor

Liens survive the bankruptcy discharge. Thus, unless the debtor surrenders or redeems the collateral, the mortgage lien will continue to encumber debtor's property after the discharge.

Operation of the Automatic Stay (§ 362)

Upon the filing of the bankruptcy petition and throughout the duration of the case, the automatic stay enjoins creditors from taking any action against the debtor, the property of the estate, or the debtor's exempt property. This covers all collection activity from collection calls to foreclosure actions. Thus, the secured creditor cannot initiate the foreclosure process in state court while the stay is in place and any pending foreclosure action cannot proceed any further.

The stay goes into effect immediately and is effective against creditors whether or not they have notice of it. A creditor who violates the stay would be divested of any advantage obtained by the violation and could also be subject to damages, depending on the nature of the violation.

Relief from the Automatic Stay (§ 362(d))

Creditors may request that the bankruptcy court lift the stay in order to proceed against the debtor in state court.

In a Chapter 7 liquidation, creditors typically request for relief from the stay on the sole basis that that D has no equity in the specific collateral and, therefore, the property of no use to the bankruptcy estate. If the creditor can prove that the debtor has no equity in the property, the court is required to grant relief from the stay. However, if the debtor is current on payments on the secured debt, the creditor has no reason to move to lift the stay.

Since Chapter 13 plans are reorganizational in nature, most courts require that the creditor prove not only that the debtor has no equity in the property but also that the property is not necessary to for an effective reorganization of the debtor. In the case of the debtor's primary residence, it would be very difficult for a creditor to lift the stay since shelter is necessary to rehabilitate the debtor.

Exemptions

The debtor may take property back from the estate by using exemptions. Most often exemptions are defined by state law. The homestead exemption enables a debtor to exempt equity in a home up to the statutory limit.

Discharge

Chapter 7:

In a chapter 7 liquidation, all of the debtor's interests in property that flowed into the estate are distributed to unsecured creditors. After distribution of the estate to unsecured creditors, any remaining balance on unsecured debt is discharged at the end of the bankruptcy. It is important to note that often the Chapter 7 debtor often does not have any interest in property (equity) to flow into the bankruptcy estate for distribution because the debtor's property is fully encumbered ("liened up"). Thus, the value of the bankruptcy estate is zero and there is nothing to distribute to unsecured creditors. Thus, the entire unsecured debt is discharged. In the case of a home mortgage, if the debtor surrendered his home but the home's value was less than the debt, the deficiency would be treated as unsecured debt subject to discharge. As discussed above, secured creditors' liens survive the bankruptcy. So, after the discharge and the end of the bankruptcy, the stay is no longer in effect to prevent state court foreclosure action by a secured creditor if the debtor remains in possession of the home and is in default.

Chapter 13:

In a chapter 13 individual "reorganization," the debtor makes payments on unsecured and secured debt through the Chapter 13 plan. Chapter 13 plans where the debtor pays 100% of the unsecured debt are rare. Thus, although at the end of the plan unsecured creditors will not be paid the full amount of their claims, the debtor only has to pay creditors as provided in the plan and any remaining unsecured debt will be discharged. The discharge also affects most secured creditors who are undersecured because the unsecured portion (the amount by which the debt exceeds the

value of the collateral) of the debt may be subject to at least partial discharge. Although many undersecured creditors may face discharge of at least some of the unsecured portion of the debt, recall that a creditor with a mortgage on the debtor's primary residence cannot have its claim stripped down to the value of the collateral. However, if the residence is a vacation home, for example, the creditor faces having the secured claim stripped down to the value of the collateral and receiving only partial payment on the unsecured portion through the plan.

Probate

“Opening Probate”

Following death and upon application to the clerk of the court, the clerk will assign “letters” to the personal representative of the estate authorizing that person to handle the affairs of the estate. If the decedent had a will, the personal representative was named by the decedent and is called the Executor (or Executrix). If the decedent did not have a will, the personal representative is appointed by the court and is called the Administrator. The responsibilities of the personal representative include notifying creditors, inventorying all of the decedent’s real and personal property, determining how to use those assets for the payment of debts and claims against the estate.⁴⁴

What Happens to the Decedent’s Home?

What if the Home was Devised by Will?

When the decedent’s home is encumbered by a mortgage and the decedent devised the home by will, after probating the will, title vests in the beneficiaries subject to the mortgage lien and relates back to the time of decedent’s death.⁴⁵ As a result, the lender has the full measure of rights and remedies against the beneficiary in the event of nonpayment either while the will is in probate or later by the beneficiary himself. Beneficiaries cannot use any property of the estate to satisfy the mortgage debt unless the will provides for the assets of the estate to be used for that specific purpose.⁴⁶ Vesting of title in the beneficiaries is “immediate” (via relation back to the time of death) once the will is proven valid, but the will must be admitted to probate to determine validity before a beneficiary is entitled to his devise. However, if the beneficiary disclaims (renounces) the devise, it passes and vests as if the disclaiming beneficiary predeceased the decedent.⁴⁷

⁴⁴ N.C. GEN. STAT. § 28A-20-1; N.C. GEN. STAT. § 28A-15-1.

⁴⁵ N.C. GEN. STAT. § 28A-15-2(b).

⁴⁶ N.C. GEN. STAT. § 28A-15-3.

⁴⁷ N.C. GEN. STAT. § 31B-1; N.C. GEN. STAT. § 31-42.

What if the Home was not Devised by Will?

If the home is not devised by a validly probated will to beneficiaries or the estate itself, then title immediately vests in the decedent's heir(s) (next of kin) subject to the mortgage lien.⁴⁸ Because heirs step into the shoes of the decedent, the lender has the full measure of rights and remedies against the heir(s) in the event of nonpayment. Thus, the probate process is not a condition to vesting of title and title passes automatically to the decedent's next of kin, known or unknown.

Foreclosure Proceedings:

The beneficiaries or heirs are necessary parties to a foreclosure action because they have succeeded to the decedent's interest in the property and become the holders of the equity of redemption.⁴⁹ The heirs are necessary parties whether foreclosure proceedings are initiated before or after the decedent's death.⁵⁰

Can the Personal Representative Sell the Home?

No. Unless directed to sell the property by decedent's will, the Administrator or Executor does not have authority to sell the home for the payment of debts and other claims except with court approval, and only if it is in the best interest of the estate.⁵¹ Because title to decedent's real property vests in his heirs or devisees, not with the personal representative, heirs and devisees are necessary parties to this proceeding and will have an opportunity to defend.⁵²

What if the Beneficiaries or Heirs Need to Sell the Home?

Sales, leases, or mortgages on the home by heirs or beneficiaries are subject to the requirement of notice to creditors and approval of the final account.⁵³ Mortgage or sale can prove impossible in practice when there are multiple heirs or beneficiaries who now own the real property as

⁴⁸ N.C. GEN. STAT. § 28A-15-2(b).

⁴⁹ Baker v. Murphy, 250 N.C. 346, 349-50 (1959).

⁵⁰ Id.

⁵¹ N.C. GEN. STAT. § 28A-17-1; N.C. GEN. STAT. § 28A-15-1(a)/(c).

⁵² N.C. GEN. STAT. § 28A-17-4.

⁵³ N.C. GEN. STAT. § 28A-17-12.

cotenants, unless all parties agree to sell, since a cotenant's partial interest in the property, though alienable, is not very marketable. Owners of partial interests could initiate a special proceeding for (1) partition, which severs the common property into parcels,⁵⁴ or (2) a sale in lieu of partition, which forces the sale of the entire property based on the theory that division of property would cause "substantial injury" to the interested parties.⁵⁵

⁵⁴ N.C. GEN. STAT. § 46-1.

⁵⁵ N.C. GEN. STAT. § 46-22.