Most Often, Bankruptcy's Not A Threat

Such Filings Are Annoying, But Can Be Deficient In Defenses

BY BRUCE J. BERGMAN

There is a temptation to observe that the bane of a lender's or servicer's existence is encountering wild and dilatory defenses. Those surely tend to take time and increase the accrual of interest. But mortgage holders suffer such a host of annoyances in the foreclosure process that untoward defenses are just one of many.

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Certainly high on the list of pesky ripostes to the foreclosure process is the bankruptcy filing. Portentous though that is, lenders and servicers recognize that most often the bankruptcy does not pose a real threat. (Yes, of course multiple filings *are* a dilemma.)

Chapter filings

For example, if the borrower (now debtor) files a Chapter 13 position, he is obliged to both begin remitting mortgage payments on a current basis and present a plan to amortize all arrears. Because a valid plan must provide present value interest, compliance with Chapter 13 dictates is not particularly unwelcome to the lender. Failure to adhere to the requirements is a basis for the lender to apply for lifting of the automatic stay which was imposed by the initial filing.

In the instance of a Chapter 11 filing, the debtor must provide, or the lender will seek, "adequate protection." Because that concept is so difficult to define, it may not be correct to state that a secured lender is immune from damage when faced with a bankruptcy, but theory is that an appropriate modicum of comfort is to be afforded.

For the Chapter 7 situation - the traditional "straight bankruptcy" - if the value of the property exceeds the mortgage, the premises will likely be sold through the bankruptcy court and the mortgage holder will be made whole. In the reverse scenario, with the mortgage debt greater than the value of the property, the lender or servicer has a solid basis to vacate the stay and proceed with the foreclosure.

Not a fatal action

In part because a bankruptcy filing can add considerable delay to the foreclosure case, and also because the bankruptcy code is subject to the abuse of multiple filings (what else is new), it would be inaccurate to suggest that lenders and services treat bankruptcy filings as inconsequential. But a filing is certainly not fatal to a foreclosure.

However, should a borrower (again, denominated a "debtor" once a bankruptcy petition has been filed) be discharged in bankruptcy, personal liability for a mortgage obligation is extinguished. (There can be exceptions to the rule, such as where fraud is involved, but the exceptions are infrequent enough so as not to merit attention for our purposes.) That does not mean the foreclosure cannot proceed, only that the discharged party cannot be the subject of a deficiency judgment motion.

In a recent case decision in New York, a borrower tried to transmute that accepted concept into a sword to defend the foreclosure. ***[Republic National Bank of New York v. Schweky, N.Y.L.J., May 19, 1994, at 32, Col. 6 (Sup. Ct., Kings Co., Kramer, J.)]***

Because the guarantors' debt had been discharged, they interposed an

in the application process that these companies typically ask the borrowers to complete.

Imply credit relief

The second benefit that these companies heavily promote, but do not guarantee, is relief from derogatory credit reports.

The companies imply that they will use their expertise to negotiate short sales with lenders, but that even if this fails and a foreclosure ensues, it is highly unlikely that a foreclosure will appear on the borrower's credit record.

New England Financial's corporate counsel, Andrew M. Smith, tells borrowers in "the vast majority of cases, the foreclosure is either deleted from the homeowners' credit report or never entered." Credit reporting agencies have stated that, in fact, the negative credit report is not deleted without the lender's authorization.

Also, the servicing guidelines from both Fannie Mae and Freddie Mac require that the lender report the foreclosure under the borrower's name, thus precluding the lender from even considering not reporting the foreclosure.

The prospects for these companies to negotiate short sales also appear to be dim.

In most cases, the unauthorized transfer of the property by the borrower is a separate event of default under the loan documents. Thus, lenders are often hostile to negotiating a short sale with a new entity that they perceive having been brought in by the borrower to help the borrower avoid his obligation to the lender.

> *Some critics have voiced concern whether these companies are fully licensed and are giving borrowers all of the disclosures that they are entitled to receive under California law.*

One company, Homes America, has reportedly negotiated only three short sales out of the two dozen properties it has acquired.

How much benefit?

The cost of receiving questionable benefits can be substantial for the borrower.

Boston Harbor charges 1% of the original loan amount, with a minimum of $1,000. But, says CEO Fagan, when you transfer the property to Boston Harbor, "your cares about this property are over."

Whether the property has to be lost at all is not an issue that Fagan raises. In his video, Fagan tells borrowers who can't make their payments that they have only two choices — a short sale or foreclosure. In fact, loan modifications, forbearance agreements and deeds in lieu of foreclosure are all options open to many borrowers.

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The office of the Los Angeles District Attorney has reportedly begun research into the practices of these companies.

A clear definition

In California, statutorily defined "foreclosure consultants" must give clients a number of disclosures, including written notice of a three-day right to cancel the contract and notice that no money can change hands until the consultant finishes doing everything he said he would do.

Under California Civil Code §2945.1, a foreclosure consultant includes any person who makes any solicitation, representation or offer to any owner to perform for compensation, among other things, the following:

- stop or postpone a foreclosure sale,
- avoid or ameliorate the impairment of the owner's credit resulting from the recording of a notice of default or conduct of a foreclosure sale, and
- save the owner's residence from foreclosure.

This definition appears to make these companies subject to the rules of foreclosure consultants.

Further, Boston Harbor may have to be licensed as a real estate broker. California Business and Professions Code section 10131 includes in its definition of real estate broker one who "solicits borrowers or lenders for or negotiates loans or collects payments or performs services for borrowers or lenders or note owners in connection with loans secured directly or collaterally by liens on real property. . . "

This definition would appear to include the activities conducted by Boston Harbor.

In short, borrowers would be well advised to approach such companies warily. They may not be able to deliver the supposed tax benefits nor ameliorate the borrowers credit problems. Borrowers expecting relief should first consult with tax, legal or financial advisors of their own choice before making any commitments. SM