

KEEPING YOUR HOUSE THROUGH MORTGAGE LIEN STRIPPING

Mortgage lien stripping is a little-known but highly useful mechanism that can help a debtor to keep his/her home without paying second mortgages or liens. When a second mortgage or other lien is wholly unsecured it can be stripped away and treated like an unsecured debt – a credit card or medical bill – and paid pro rata with the other unsecured debt instead of being paid off in full. A lien is “wholly unsecured” when a senior (first) mortgage, lien, or deed of trust encumbers the property for more than the property is worth.

This is most often done in association with a foreclosure, but you don’t have to be in foreclosure or even in distress to take advantage of lien stripping. You do have to file a Chapter 13 bankruptcy though – which is usually enough deterrent that a debtor thinks twice about trying it unless absolutely necessary.

I believe that mortgage lien stripping is necessary more often than many people like to admit. Some people do not want to file bankruptcy or do not want to deal with the problems they face. Perhaps it is easier just to keep making the payments. That is fine, but I question whether you want to keep paying a first, second, and sometimes a third mortgage where you have no hope of paying it off and where there will be no value in it for years, if ever. I do not see a point in paying mortgages that are double what the house next door rents for when the homeowner is not gaining equity and is stretched as far as he/she can go just to stay afloat.

Some of my clients have told me that they “feel bad” about agreeing to pay and then not following through. I point out to them that the bank does not feel bad when they kick up your interest rates. The bank does not feel bad when it forecloses, and the bank does not feel bad when they screw up so badly that the government has to bail them out. The banks even have an advantage over most consumers – knowledge – and were still knocked down by our real estate bubble. If your lender is going to take advantage of all remedies at its disposal – and then additional remedies created after the fact for them by a pliant Congress – then as I see it, so should you.

Remember you can stop a foreclosure by filing bankruptcy at any time before the foreclosure sale.

Mortgage lien stripping was seldom seen in bankruptcy before the economic downturn. This is because the mortgage(s) to be stripped must be “wholly unsecured.” For example, if you bought a house for \$200,000 with 80/20 financing, you have a mortgage for about \$160,000 and another for \$40,000. If your property dropped in value to \$150,000, your first mortgage is mostly secured but your second mortgage is now wholly unsecured and can be stripped. The second mortgage is secure on paper, but in practical terms the sale of the home would not pay a penny to the second mortgage, and as a result it is seen as unsecured in bankruptcy. In a market with accelerating home values this never happened. In fact, one could simply sell the home at a higher price to the next seller, pay the mortgages, and profit. Obviously, this is not the case today.

If you own real estate with a second or other mortgage or lien after your first, it may be possible to remove that lien in a Chapter 13 bankruptcy case.

There are also several other ways to avoid second mortgages in bankruptcy. A debtor can strip a lien when:

- The second mortgage is wholly unsecured, which is the most common occurrence today and was discussed above;
- There is a balloon payment due on the mortgage during the life of the Chapter 13 case;
- The second mortgage is secured by other assets in addition to the house; or
- The property is not the “debtor’s principal residence.”

Generally speaking, debtors leave bankruptcy and the mortgage lien stripping process without a second mortgage, with their home, and with a more affordable mortgage payment. Of course if you cannot afford your first mortgage payment by itself you may still have a problem and you will probably want to consider surrendering your home and using the Chapter 7 liquidation process instead. But for many debtors mortgage lien stripping can be highly useful and effective.

Before you decide to do nothing and just surrender your real estate back to your lender, consider discussing this option with an attorney who works with these issues.