



# A Primer for Distressed Homeowners

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# A Primer for Distressed Homeowners

With the recession now in its fourth year, we still receive a steady stream of calls asking for help facilitating short sales and with preventing home foreclosures, forced sales and sheriff's sales.

To complicate matters, some real estate agents and fly-by-night entrepreneurs are putting themselves forward as specialists who can help homeowners make a pain-free exit from under their troubled properties. It's distressing for me to see how many people fall for these schemes and scams.



I wrote this guide to give readers straightforward information that is grounded in North Carolina law and the federal Bankruptcy Code. If, after reading this, you would like to consult with me about your situation, I would welcome the opportunity.

## Understanding the foreclosure process

The general media have gotten sloppy in the language they use to describe distressed real estate, so let's start with some simple definitions.

- Forced sale is not a common term, but when it is used it would include a sheriff's sale or a foreclosure sale.
- Foreclosure is the process by which the lender repossesses real property upon the borrower's default.
- Short sale is a consensual deal between the lender and the borrower in which the lender agrees to allow a borrower to sell for less than what's owed; a short sale is not a forced sale in the strictly legal sense of the word.

## Step by step through default and foreclosure

Step One. The vast majority of North Carolina foreclosures are "by power of sale" in the loan documents. In this type, the lender files a foreclosure proceeding in the state court in the county in which the property is located, giving notice to anyone legally responsible. Upon proper notice to the responsible parties, a hearing is held at the clerk's office. Note that not all NC foreclosures are by power of sale, just most.

Step Two. A deputy clerk, an assistant clerk, or the clerk of court presides over the hearing for an order of foreclosure; the lender must show only four elements:

1. that there is a valid debt secured by the property,
2. that the borrower is in default on that debt,
3. that there is a power of sale in the security agreement, deed of trust, between the borrower and the lender, and
4. that the responsible parties had ten days' notice or more prior to the hearing.

These four elements can be shown by affidavit and usually are — in other words, there is no live testimony.

As part of the power of sale clause, the lender hires a "trustee" or "substitute trustee" — a neutral party — to foreclose on the property.

Step Three. The trustee/substitute trustee attends this hearing and provides the proof of these four elements. The clerk has no authority to consider anything other than these four elements; if they are met, then the clerk will enter an order of sale, allowing the property to be auctioned on the courthouse steps. It is generally pointless for borrowers to attend these hearings and try to delay the process.

If a borrower believes he has equitable grounds to stay the foreclosure, then he has the right to file a lawsuit in the county's superior court, asking that a temporary restraining order, preliminary injunction, and/or permanent injunction be issued to stop the foreclosure. These lawsuits are expensive and generally are a long shot.

Step Four. In the absence of a successful supe-

rior court suit, or a delay at the lender's discretion, the property will be auctioned on the courthouse steps about 25-30 days after the hearing.

The bank usually places a credit bid at the sale — buying the property back for something short of the full amount of the debt. Anyone can bid, but live bidders are relatively rare.

There is a ten-day “upset bid” period following the sale, in which anyone can file a bid on the property that exceeds the sale price by the greater of 5% or \$750.00. The filing of any upset bid triggers a new ten-day upset bid period, until the period passes with no new filed bids. Once the ten-day upset bid period expires, the sale is final; the trustee/substitute trustee signs a “trustee's deed” giving the property to the winner of the sale, and files documents related to the sale.



## Foreclosure FAQ

### Q: Can I legally prevent a foreclosure?

**A:** First, there is very rarely any defense to a foreclosure. Challenging the note and deed of trust presents a host of legal problems and is extremely difficult and expensive.

That said, homeowners who are about to lose their home may benefit from a private bankruptcy consultation (also called “bankruptcy counseling”), where an attorney can evaluate the entire financial picture, including the home, and advise them of their options and legal right. (see “Bankruptcy and Foreclosure” below).

### Q: Are there governmental programs that might help me prevent foreclosure?

**A:** I generally refer people who want foreclosure defense to these resources:

Mortgage(s) on owner-occupied primary residences

1. State Home Foreclosure Prevention Project (“SHFPP”) – [www.ncforeclosurehelp.org](http://www.ncforeclosurehelp.org) OR 888-995-HOPE
2. President Obama’s Making Home Affordable Program – [www.makinghomeaffordable.gov](http://www.makinghomeaffordable.gov)
  - o Home Affordable Refinance – For those who are current on their mortgages but cannot refinance to a lower interest rate due to a decrease in the home’s value; mortgages must be owned or securitized by Freddie Mac or Fannie Mac
  - o Home Affordable Modifications – For those who are behind on their mortgages or are in imminent danger of falling behind because their mortgage payment is more than 31% of their gross monthly income;

mortgages need not be owned or securitized by Freddie Mac or Fannie Mac

### Q: Can I hire an attorney to just tell the bank they can have the property and avoid the public disgrace of a foreclosure?

**A:** Many people who are averse to foreclosure and favor a short sale seem to personally know their lending officer or want to give business to a particular realtor. I advise these people to take a breath and consider that at this point in the real estate wind-down, nothing should surprise a banker or mortgage company.

People sometimes ask me, “Will you please tell the bank that they can have the house and don’t need to go to the trouble and expense of a foreclosure?” The problem is, in order to

close their file and convey title to the property, the lender must involve some legal process.

**Q: My home is on the market but is unlikely to sell for what I owe on it. Should I consider a short sale?**

**A:** Many people feel guilty that they can't repay the debt, and want to help the bank; but the foreclosure process is actually usually shorter, simpler and cheaper for the bank than a short sale. People think that a short sale will solve their problems. It will, if the mortgage obligation is their only debt or other debts are small enough for the debtor to pay. The problem is that most folks have a host of other debts in addition to the mortgage.



Here are a few of the shortcomings of short sales to homeowners:

- There may be tax consequences to a short sale<sup>1</sup>
- The lender may reserve the right to sue the borrower for any deficiency left after crediting the proceeds from the sale against the total liability arising from the mortgage

<sup>1</sup> Unless you file for bankruptcy protection, any time you sell or surrender your home for less than the balance due on the mortgage(s) there is a price to pay. That price is something called "debt forgiveness income," and it is considered income for tax purposes. Those taxes are not immediately dischargeable in a bankruptcy (again a very complex issue).

- A short sale generally helps the bank, at a great cost to the borrower in terms of at least time and possibly expense (often, borrowers want legal and tax advice pertaining to a short sale, which is given on an hourly basis)
- Because a short sale is one obvious symptom of financial problems, it is very rare that the mortgage is the borrowers' only financial concern

**Q: Is it true that I might incur taxable income if I enter a short sale with my mortgage company? You must be kidding!**

**A:** Yes. This is an extremely complex area and I always tell my clients to consult their accountants regarding the tax implications of a short sale.

**Q: My realtor says she can help me arrange a short sale, which sounds cheaper than hiring an attorney. Is this a bad idea?**

**A:** Some realtors are holding themselves out as foreclosure and short sale specialists, hoping they will get future business and a commission from the sale. Some Realtor firms are using language like "we can help you stop the foreclosure process" and this simply is not true.

**Remember, a qualified attorney understands densely-worded contracts and is knowledgeable about options that lenders do not have incentive to disclose.**

Realtors are suffering for commissions and this might be a way to replace commission income with fee income. They can call your mortgage

company and save you the agony of directly speaking to your creditor. You're free to spend your money like that, but if you're in financial distress this seems to be an unnecessary expense for no more than it offers you. Moreover, as covered above, there are several potential problems for homeowners who enter into short sales.

## How Bankruptcy Affects a Foreclosure Proceeding

A bankruptcy filing by a borrower stops a foreclosure proceeding through the power of an automatic stay. Until such time as the lender obtains from the bankruptcy court an order giving it relief from the automatic stay, all collections and foreclosure proceedings stop.

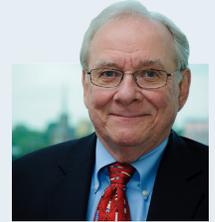
Generally speaking, as long as the foreclosure sale has not become final, a **Chapter 13** debtor can propose a plan that provides for payment in full of pre-bankruptcy mortgage arrearage, and at the same time keep current on post-bankruptcy payments, **and keep the house**. Falling behind on either aspect will likely lead to the lender getting relief from the stay and then having the right to restart the foreclosure process.

Also speaking generally, a **Chapter 7** debtor can't do anything to stop the mortgage company from getting relief from the stay and thus restarting the foreclosure process, unless the debtor is able to do what he couldn't do prior to the institution of the foreclosure — complete a mortgage modification with the lender; refinance; or otherwise come up with a large lump sum to get current

on the mortgage and then keep current with the monthly payments.

Another consideration in favor of bankruptcy: foreclosures are governed by state law and the practice and procedure varies wildly from state to state while bankruptcy is federally regulated. This means that if you own real property in more than one state, consult with a bankruptcy attorney to see if the bankruptcy process may produce a less expensive outcome.

People often tell me that “I just can’t have my credit ruined by a bankruptcy!” and these people have a pending foreclosure, are in default on several credit card obligations, and are past due on other debts. While a foreclosure may be less prejudicial to your creditworthiness than a bankruptcy, the reality is **neither is good, and a bankruptcy may be the only way to get a fresh start.**



**Rick Mitchell**

## Bankruptcy and a delinquent second mortgage

Clients who are in financial difficulty are well advised to consider a Chapter 13 bankruptcy case as an option when they are current on their first mortgage but are not paying, in full and on time each month, their second mortgage (including a home equity loan or other debt secured by the property).

I see situations where people whose incomes have been cut will forego paying the second mortgage while staying current with the first. When they are able to resume payments on the second mortgage balance but the mortgage company is unwilling to modify their mortgage so that they can catch up on the missed payments, Chapter 13 is a court-supervised way to accomplish the goal.

## Bankruptcy consultation

**Q: Can I count on realtors and my mortgage company to give me good advice on the legal effects of a short sale?**

**A:** The Western District NC Bar’s Chapter 13 trustee (Warren Tadlock) has warned that he is seeing short sale agreements that specifically include provisions wherein the bank reserves the right to sue the borrower for the deficiency. I have seen them ourselves; Bank of America’s short sale agreements include it.

If your short sale agreement isn’t properly structured you could end up being in no better shape with a short sale than with a foreclosure or in bankruptcy protection.

**Q: Is there a reason to consult with a bankruptcy attorney if I do not intend to file for bankruptcy but I can’t pay the mortgage?**

**A:** Yes! A bankruptcy attorney has the training and experience to evaluate your situation holistically. I’ve had married couples in my office filing for bankruptcy protection who had voluntarily moved out of their marital residence, knowing that they were behind in payments and would probably face a foreclosure at some point. If they had consulted with me before doing so they would have learned about the North Carolina homestead exemption, which is up to \$35,000 per person. There are qualifications, including that your name must be on the deed, this must be your primary residence (not an investment property), and you must actually live there in order to claim it.

If you move out, then you cannot claim the North Carolina homestead exemption in a bankruptcy. Imagine how these couples felt when learning that an important door had been closed behind them.

Now, if there is absolutely no equity in the home, then the homestead exemption is irrelevant. Exemptions cover equity. For example, if you owe

\$150,000.00 on a house that is actually worth \$150,000.00, then there is no equity and thus nothing to exempt. But if you owe \$100,000.00 on a \$150,000.00 house, then there is \$50,000.00 in equity there; the homestead exemption means that the bankruptcy debtor (that's YOU) gets paid first, before creditors.

You are probably thinking, who would be in foreclosure if they have significant equity in their house? I see it more and more these days because real estate is not as easily bought and sold as it was five and ten years ago.

**This primer scratches the surface of considerations for distressed homeowners. There are no one-size-fits-all solutions but there are unscrupulous operators out there hyping so-called solutions that benefit only them.**

# Richard M Mitchell

My 30+ years as an attorney representing creditors, bankruptcy trustees, and debtors in consumer and business bankruptcy cases, gives clients a wealth of practical and legal knowledge to draw upon. In addition, the North Carolina State Bar has certified me as a specialist in consumer and business bankruptcy.

Individuals in need of Chapter 7, 11, 12 and 13 bankruptcy protection often begin searching for a law firm on the internet. Most find this to be a confusing endeavor at best. The troubled economy has created demand for bankruptcy lawyers faster than the lawyers have been able to get up to speed with this complex area of the law. How do I know this? Because I sometimes find myself unwinding the messes that Johnny-come-lately practitioners have created for their clients, and in my role as a Chapter 7 trustee, I see all manner of errors and omissions.

I welcome the opportunity to discuss your situation. Picking up the phone to make an appointment with me is the most difficult step in the process of finding a legal resolution to your financial difficulty.

## Professional Affiliations

American Bankruptcy Institute

American Bar Association

Bankruptcy Court for the Western District of North Carolina

Mecklenburg County Bar

National Association of Bankruptcy Trustees

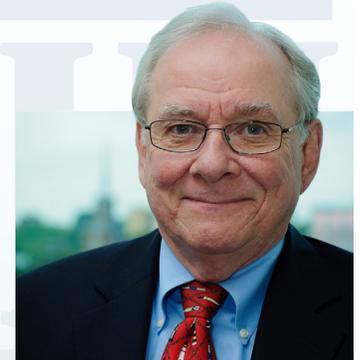
North Carolina Bar Association

North Carolina State Bar

Member: American Bankruptcy Institute, American Bar Association, Mecklenburg County Bar, National Association of Bankruptcy Trustees, North Carolina Bar Association, North Carolina State Bar

Admitted: NC State Bar, US 4th Circuit Court of Appeals, US District Court for the Eastern District of NC, US District Court for the Middle District of NC, US District Court for the Western District of NC, US Tax Court

## Consult with an experienced bankruptcy lawyer before making decisions about liquidating property and vacating your home.



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