CREDIT UNION LEGAL NEWSLETTER

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By

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In This Issue

Chapter 7 Bankruptcy Reaffirmation Agreement for Credit Unions

Download our **free copy** of a fillable WORD Chapter 7 Reaffirmation Agreement for Credit Unions. Our fillable form can be used by Credit Unions who are completing and filing their own Reaffirmation Agreements with U.S. Bankruptcy Courts. Our Reaffirmation Agreement is prepared for the U.S. Bankruptcy Courts located within the State of Michigan and, if you are located in another State, please consult your local attorney for any required modifications, if any. **Download** a free copy at www.harrounpc.com .

Protecting your Home Equity Mortgages

By: Charles R. Harroun

Credit Unions across the country are holding portfolios of Home Equity mortgages and deeds-of-trust of all nature: fixed rate and variable rate of interest, open and closed ended, refinances and balloon payment workout programs and many others.

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Home Equity mortgages and deeds-of-trust of any nature are generally junior in position to a first mortgage/lien holder. As such, the credit union should protect its Home Equity portfolio as securely as possible from collateral damage if a first mortgage proceeds into foreclosure.

Question:

Will the credit union receive a notice if the first mortgage proceeds into foreclosure?

Answer: Maybe, but some state's laws, such as that in Michigan, do not require the first mortgage holder to provide any type of notice to the junior mortgage holder and, the foreclosure could proceed to sheriff's sale without the credit union becoming aware that their junior mortgage interest was extinguished at the sheriff's sale.

Many attorneys processing foreclosures provide a *courtesy notice* to the junior lien holder, however, some of those notices arrive at the credit union only days prior to the sheriff's sale date, thereby placing the credit union on somewhat short notice as to determine if immediate action is required for the sheriff's sale date. Other issues entail the redemption period for the credit union to exercise its statutory right to reinstate its mortgage by paying the entire amount required to redeem.

Question:

How can we find out if a member's property is in foreclosure?

Answer:

A regular internal credit union process of monitoring Home Equity borrowers' general credit union account activity is an essential factor. Erratic payments on loans or credit cards issued by the credit union, plus verification from a credit reporting bureau or other source to confirm first mortgage payments will enhance the credit unions ability to anticipate potential first mortgage foreclosure issues.

Monitoring these accounts for possible first mortgage foreclosure activity is cumbersome for the credit union.

A foreclosure by publication could proceed to sheriff's sale within a period of as little as four to five weeks in some jurisdictions and, as long as the member is timely paying the credit union on the credit union Home Equity Loan, there are no flags that alert the credit union of a first mortgage default and/or foreclosure.

The junior lien holder would literally need to either contact the first mortgage company/lender, or otherwise verify the first mortgage payments by other means,

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such as a new credit report obtained every few weeks, to fully monitor the possibility of a first mortgage proceeding into foreclosure.

The credit union should not proceed with the assumption that the *first* mortgage payments are being timely made, even though the credit union Home Equity loan and all other loans at the credit union are current.

For myriad reasons, none with malice, some members continue to pay their credit union Home Equity mortgage payments even though their first mortgage is in foreclosure. The credit union could unknowingly experience a superior mortgage foreclosure proceeding to sheriff's sale and extinguishing the credit union's junior Home Equity or Second Mortgage, all without any knowledge of the credit union.

If the first mortgage proceeds into foreclosure, the credit union has multiple options available to protect its interests in the property.

Home Equity Mortgage Modifications in Bankruptcy

By: Charles R. Harroun

Question:

Are credit union Home Equity and/or Second Mortgages subject to modification by a debtor's Chapter 13 Plan?

Answer: Yes.

In the U.S. Bankruptcy Courts located within the Sixth Circuit Court of Appeals, this issue is currently governed by the rulings in the case of George E. Lane and Sherry A. Lane, Appellants, vs. Western Interstate Bancorp, 280 F 3rd 663 (6th Cir. 2002).

In this case, the court held that Chapter 13 debtors are allowed to modify the rights of a creditor with a mortgage secured by the debtor's principal residence if the outstanding security interest is, in effect, wholly without equity securing the Home Equity mortgage beyond the outstanding balance owed on the superior first mortgage, thereby rendering the credit union claim to the Chapter 13 Trustee as a wholly "unsecured" loan to be re-paid by the Chapter 13 trustee at whatever low percentage rate the other unsecured creditors receive.

Question: How can the credit union protect its mortgage from being modified and classified as an unsecured claim?

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Answer: The credit union has several options.

The Debtor's Chapter 13 Plan and schedules will reveal if the Debtor's Chapter 13 Plan is going to attempt to classify the credit union mortgage as an "unsecured claim."

Debtor's estimated "appraisal" amount or other valuation provided by the Debtor may not be reasonably relied upon by the credit union as reflecting an accurate valuation of the property and, the credit union should, therefore, obtain a full interior/exterior appraisal of the Debtor's residence. The Debtor will be required to permit the credit union appraiser access to the property. The nominal cost for this appraisal could save the credit union thousands in losses. The appraiser obtained by the credit union must be willing to testify in court as to the findings.

Here's How:

If the appraised market value of the property exceeds the debtor valuation and creates *any* equity, regardless of the amount of equity, then the entire credit union mortgage may be classified as totally secured and not subject to this type of modification.

The court noted that: "If the lien were only partially under water (*i.e.* if the second mortgagee's claim had a secured component, being unsecured only in part), the Supreme Court's decision in *Nobelman v. American Savings Bank,* 508 U.S. 324, 113 S.Ct. 2106, 124 L.Ed.2d 228 (1993), teaches that the rights of the lienholder would not be subject to modification."

It is incumbent upon the credit union to promptly supply your attorney with a copy of the notice of bankruptcy filing when received by the credit union, so that the Chapter 13 Plan may properly be analyzed to determine if this type of procedure should be implemented so that, if not resolved, the court would conduct a hearing on the principal residence valuation to determine if the entire balance owing will be classified as secured or wholly unsecured. Such a determination could significantly reduce or eliminate an otherwise unnoticed prevention of a significant loss to the credit union.

> **"If a claimant's lien on debtor's homestead has a positive value, no matter how small in relation to the total claim, the claimant holds a ``secured claim'' and the claimant's contractual rights under the loan documents are not subject to modification...." See Lane vs. Western Interstate Bancorp., 280 F 3rd 663 at 664.**

It is important to note that the prohibition against modifying the interests of a secured creditor's mortgage applies only to the debtor's "principal residence." Thus, mortgages held on vacation/second homes, rental property and vacant land may be "crammed down" the same as other assets, subject to other limitations as set forth in §1325(a) of the Bankruptcy Code.

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