

A Tale of Three Houses
or
Why (Not) File Bankruptcy?

The mortgage meltdown has left many clients in shock, or worse. Do-it-yourself books, document preparers, debt reduction services, and attorneys all promise frightened homeowners an immediate fix for all of their financial problems. However, are bankruptcies and debt reduction services appropriate for our clients?

Case Study #1: David and Mary are in their 30s with two home-schooled children. David is an author who earns approximately \$150,000.00 per year. His work is in demand and it is anticipated that he may sign a movie deal during the next few years for a book in which he and a collaborator own copyrights.

Unfortunately, the home they purchased is a classic money pit. The seller did not disclose major defects and the cost to fix the home was staggering. The home has a first mortgage which is \$125,000.00 under-secured. There is a \$75,000.00 second and a \$50,000.00 third which are completely unsecured. Moreover, the family incurred approximately \$200,000.00 in consumer debt to pay attorneys to fight with the sellers and to pay contractors to fix the home. If they had only the first mortgage to deal with, they could keep their home.

In desperation, David and Mary paid a debt consolidation company approximately \$10,000.00 to help them, only to find out that the company will do nothing but allow them to default on their loans, then "attempt" to have the credit card companies reduce their debts. Of course, by that point, David's and Mary's credit ratings were destroyed.

Acuña & Casas, P.C., filed a Chapter 13 bankruptcy for these clients. Reductions in principal are not available for residential mortgages. However, Chapter 13 and Chapter 11 cases permit "lien stripping", which is the ability to convert mortgage debt with completely valueless security into non-priority unsecured debt. By presenting a carefully crafted Chapter 13 plan, David and Mary will pay \$1,000.00 per month for 60 months to the bankruptcy trustee. At the end of the plan, the second mortgage, third mortgage, and all credit card debt will be extinguished. All that will remain is their affordable, fixed rate first mortgage.

In effect, David and Mary will eliminate \$325,000.00 in debt and save their home for \$60,000.00, paid over five years. They will receive the fresh start promised by our bankruptcy laws.

Case Study #2: Jack and Peggy are recent retirees who bought their dream home during 2005. Their retirement accounts were healthy. They had budgeted carefully and thought they had enough. However, during the meltdown, their home value plummeted by 50% to \$200,000.00. Because of a health crisis earlier this year, they incurred \$75,000.00 in debt on their credit cards. Their only other asset is the \$150,000.00 remaining in Jack's retirement account. Their retirement income is under the median income for their county. They are unable to make their \$2,700.00 mortgage payment, but could afford the \$1,500.00 it would take to rent an equivalent house. Consumer credit counseling advised them to take a distribution from their retirement plan to pay off their credit cards.

Taking a distribution from a retirement plan to pay off credit cards is the absolute wrong advice. If Jack and Peggy filed a bankruptcy petition, they would be able to shelter up to \$1,000,000.00 in their retirement plan from creditors. Their mortgage was non-recourse acquisition debt and cancellation of debt income is not a problem because they are truly "bankrupt"; \$350,000.00 in asset value against \$475,000.00 in debt and unable to pay their lawful debts as they became due.

The better solution was to voluntarily surrender their home to their lender. Attorneys at Acuña & Casas, P.C., drafted a letter to all of their credit cards issuers, attaching documentation that Jack and Peggy are "judgment proof." The creditors accepted that further collection efforts were futile and agreed to write off the clients' accounts.

Case Study #3: Lynn and Larry are a dual income, no children couple in their late 20s. Like so many others, they were advised to buy a home at the top of the market and they did; their dream home in a family neighborhood with good schools. All of their savings went into a ten percent down payment. Their \$540,000.00 adjustable rate loan has just adjusted and, while they are able to make the payments now, their plan is to raise a family. But, any break in either of their earning ability will destroy their dream of raising children in the house. Moreover, the home is worth, at a maximum, \$250,000.00 in today's market.

Lynn and Larry decided to stop making mortgage payments and attempted to renegotiate their home loan with their lender; later discovering this major lender had earned a reputation as the most notoriously difficult lender in the country. They were stonewalled over seven months.

Acuña & Casas, P.C., made one final attempt to negotiate in good faith with the lender. Restructuring the loan as a full principal loan at a 2.0% interest rate would have brought the monthly principal, interest, taxes, and insurance payment to 34% of their income; an amount that they could afford even on only one income and squarely within Making Home Affordable Modification Program guidelines. However, the lender would offer only one

thing: to renegotiate their mortgage at some point in the future. No written commitments were offered and the bank's insistence that Lynn and Larry cure the entire default within 60 days seemed would have forced them into bankruptcy in any case.

After the lender's response, Acuña & Casas, P.C., examined all of the couple's options. Fortunately for the couple, Lynn's parents had the ability to borrow at very low fixed interest rates. Her parents could purchase a fixer-upper in the same neighborhood for \$150,000.00. Our firm drafted agreements enabling Lynn's parents to purchase a new home, then re-selling the home to Lynn and Larry, without gain. The interest rate paid by Lynn and Larry permitted her parents to service the loan. At some point in the future, after time has passed and conventional loans are again available to Lynn and Larry, her parents will be paid in full.

Conclusion: Each of these cases is based on actual facts. Only the names have been changed to protect client confidentiality. Each was counseled separately by Acuña & Casas, P.C., during this past month.

Clearly, bankruptcy is not for everyone. However, experienced attorneys with a knowledge of bankruptcy, real estate, and tax can help clients find resolution and relief.

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