

*Article from WSJ originally published Oct, 23, 2007*

## **More Debtors Use Bankruptcy To Keep Homes**

### **Chapter 13 Filings Gain In Popularity Because They Halt Foreclosures**

*By AMY MERRICK*

With loan defaults rising along with many mortgage payments, fast-growing numbers of homeowners are gambling on bankruptcy filings to try to stay in their homes.

Last month, as the nation's housing slump continued, consumer bankruptcy filings increased almost 23% from a year earlier -- representing nearly 69,000 people -- according to the American Bankruptcy Institute, a nonprofit research group whose members include bankruptcy attorneys, judges and lenders. Overall, consumer bankruptcy filings were up 44.76% during the first nine months of this year.

In some areas where the real-estate boom was especially heated, the increase in filings has been even sharper -- especially for a type of bankruptcy that allows homeowners to halt foreclosures on their homes.

The surge in filings hasn't caught up with the flood of bankruptcy cases consumers launched in 2005, as they raced to beat a change in federal law that made it harder for individuals to declare bankruptcy. Even so, it shows the rising sense of insecurity many Americans feel as housing values fall, lending standards get tighter and hundreds of thousands of mortgages with low introductory interest rates "reset" to higher rates, boosting the homeowner's monthly payments.

Most consumers filing for bankruptcy continue to do so under Chapter 7 of the federal Bankruptcy Code. Under that provision, a person must forfeit certain assets if not exempt under their state or federal schedule -- including, in some cases, a portion of home equity. Those assets are sold to pay off debts.

While Chapter 7 filings stop foreclosure proceedings, the break is usually only temporary. As a practical matter, many homeowners who file under Chapter 7 lose their homes except for the equity protected under whatever homestead exemption the filer can lay claim to.

In recent months, however, an increasing number of homeowners have filed for bankruptcy under Chapter 13, which staves off foreclosure proceedings while the homeowner works out a plan to pay off mortgage debt and other obligations over time -- usually three to five years. To qualify, debtors must have a regular income and must stay current on their new bills. About four in 10 filers today are filing under Chapter 13 -- up from three in 10 two years ago. The 2005 change in bankruptcy laws was designed in part to shift more filers to Chapter 13, which forgives less debt than Chapter 7.

In California, one of the nation's hottest markets during the recent real-estate boom, the number of non-business Chapter 13 petitions in the second quarter of the year more than doubled from a year earlier, according to records compiled by the Administrative Office of the U.S. Courts in Washington. Over the same period, such filings increased nearly 40% in the northern district of Illinois, which includes Chicago, and 70% in Massachusetts.

"It's a mess," says William McLeod, a Boston bankruptcy attorney who says he is receiving twice as many calls from debtors as he did a year ago. "This is fed right now by real estate, and what's been this mortgage frenzy in the last several years."

Some bankruptcy attorneys are promoting Chapter 13 bankruptcy in press releases and commercials, and are contacting borrowers whose homes are already in the foreclosure process. But it isn't a strategy that works for everyone. Consumer advocates say the homeowners who are most likely to benefit from Chapter 13 are those facing foreclosure because of a temporary financial setback, but who expect to be able to cover their mortgage payments in the future.

Early this year, 47-year-old Briant Titus saw sales start to lag at his family's vacuum-cleaner sales business. He missed several payments on the two-story Cape Cod home in Pottersville, Mich., that he purchased 15 years ago for \$139,000. When he called his lender to find out why two recent checks hadn't been cashed, a manager told him that foreclosure proceedings had begun. "I was freaking out," says Mr. Titus. "All I was thinking about were my two little kids," who are 9 and 6 years old.

Mr. Titus saw a TV commercial for a local bankruptcy attorney, Gene Turnwald. Encouraged by the suggestion that he could save his home, Mr. Titus hired Mr. Turnwald and filed a Chapter 13 petition about six months ago. Since then, he has paid his regular monthly mortgage bill

of \$950 as well as \$2,000 under his debt-repayment plan, half of which is applied to his past-due mortgage payments and the other half to business creditors. Vacuum sales are still sluggish, but he says he can make his payments by budgeting carefully.

"I think if people knew they had the Chapter 13 option, a lot of people would save their house," Mr. Titus says. He says he can't recall what he paid in legal fees but says he thinks he spent a total of about \$1,200 to file his case.

Of course, there are pitfalls. A Chapter 13 filing stays on a person's credit file for a decade, wreaking havoc on his or her ability to get financing. And the repayment plans leave borrowers with little room for maneuver. Indeed, many Chapter 13 plans fail because of unforeseen problems such as an illness, job loss or expenses for an emergency home repair.

Moreover, for thousands of debtors caught up in the sagging housing market, a Chapter 13 plan can be unrealistic. Mr. Titus benefited from having a fixed-rate mortgage, but many homeowners are facing adjustable-rate mortgages that are resetting to much higher monthly rates. Some can't even afford their new mortgage payments, let alone repay mortgage arrears, overdue credit-card bills or other debts.

Donna Randles of Chicago sought a Chapter 13 filing last year after her brother lost his job and she was unable to keep up with the monthly mortgage payments they had shared: \$775 on a house and \$1,900 on a two-unit apartment building. She also had about \$3,500 in credit-card debt. The bankruptcy-court petition gave her some breathing room, Ms. Randles says. She has started a day-care business to supplement her salary as a service worker for a utility company. But her mortgage payments have increased more than 25% in the past nine months. With a monthly income of about \$5,000, she is paying \$864 a month on the house and \$2,500 on the apartment building, along with \$1,800 on her Chapter 13 repayment plan. Her brother remains unemployed. "As things progress, I'm learning that my income doesn't increase, but my mortgage does," says Ms. Randles, who is 46 years old. "It's still a struggle to try to move money around."

With Congress scrambling to stem foreclosures, a bipartisan group of lawmakers has suggested altering the Bankruptcy Code. The code currently prevents mortgage lenders from changing loan terms on a

filer's primary residence, but not on vacation homes, investment properties, family farms and businesses.

Members of the House and Senate have introduced competing bills that would, to varying degrees, allow bankruptcy courts to modify mortgage terms and extend the time frame for repayment. "All the other markets with debt that can be modified in bankruptcy function fine. It's entirely consistent to have a functioning market and to have the ability of bankruptcy judges to modify loans when necessary," says Eric Stein, senior vice president of the Center for Responsible Lending, a nonprofit consumer-advocacy group based in Durham, N.C. He testified recently before Congress in support of the proposed changes, estimating that the moves could save 600,000 homes from foreclosure.

Bankruptcy attorneys are divided on the proposals. Some believe the changes would indeed ward off foreclosures. Others are more concerned that lenders would become even more reluctant to give mortgages to low-income borrowers. Lenders also worry about ripple effects on the loan portfolios they have turned into securities and sold off to investors. If the terms of the loans in those packages change, it could change their value to investors.

Steve Bartlett, president and chief executive of the Financial Services Roundtable, which represents financial-services companies, told a congressional subcommittee that if the law allows debtors to wipe out a portion of their mortgage debt in bankruptcy court, lenders will increase interest rates on future borrowers. "This will dry up credit for many Americans who may not be able to afford these higher rates," he said.