Home Mortgage Problems Through the Lens of Bankruptcy

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HOME MORTGAGE PROBLEMS THROUGH THE LENS OF BANKRUPTCY

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Thank you for including me in this important conference. I do not study predatory lending but I do study bankruptcy. Commercial law scholars have long scrutinized the intersection between bankruptcy and the ways in which credit products are marketed, distributed, monitored, and enforced.1 The bankruptcy system offers a window into private debtor-creditor relationships as well as a locus for enforcement of legal or equitable principles relating to those relationships. This includes dealings arising from the origination and servicing of purchase-money and post-purchase mortgage home credit. Millions of homeowners and former homeowners have passed through the doors of the bankruptcy system.2 Most bankrupt homeowners have at least one mortgage, and some have two or three.3 Especially when debtors seek to cure and reinstate mortgages in chapter 13 repayment plan cases, problems with mortgage origination, servicing, and third party interventions can be exposed and confronted.4

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3. Alternatively, they have refinanced their mortgages, extracting equity in the process. See generally id. at 77.

To contribute to this symposium, I first will discuss the methodology of and some basic findings from a new national dataset that includes many financially distressed homeowners, the 2007 Consumer Bankruptcy Project. I then will briefly discuss the mismatch between the components of bankruptcy law traditionally thought to be so central to relief – the discharge and property exemptions - and the mortgage-specific problems of some contemporary bankruptcy filers.

The researchers involved in the 2007 CBP are sociologists, physicians, and law professors, offering a multi-disciplinary perspective. The 2007 CBP studied families who had filed chapter 7 and chapter 13 bankruptcy petitions, as these chapters are the primary bankruptcy choices for individuals.

To execute the study, the 2007 CBP was benefitted by a private service that monitors court filings and gives access to that information very quickly. This permitted the research team to draw a random national sample who filed bankruptcy petitions in early 2007, and to contact these individuals shortly after they filed. The team mailed an eight-page questionnaire to the home of each selected filer. A 50% response rate was achieved, producing a core sample of about 2,500 bankrupt households.

5. The 2007 Consumer Bankruptcy Project was funded by the Robert Wood Johnson Foundation, the AARP, and the FDIC, the University of Michigan Vice President Office for Research, Harvard Law School, and was supported in various ways by the co-investigators' respective universities. The principal investigators are David Himmelstein, Melissa Jacoby, Robert Lawless, Angela Littwin, Katherine Porter, John Pottow, Teresa Sullivan, Deborah Thorne, Elizabeth Warren, and Steffie Woolhandler.
6. See 2007 CBP, supra note 5.
9. In terms of distribution of joint filings (for married couples) and single filings, the sample was very similar to the overall bankruptcy population. The sample has a slight underrepresentation of chapter 13 cases, but this can be corrected with weighting when necessary. Robert M. Lawless, Angela K. Littwin, Katherine M. Porter, John A.E. Pottow, Deborah K. Thorne, & Elizabeth Warren, Did Bankruptcy Reform Fail? An Empirical Study of Consumer Debtors, 82 AM. BANKR. L. J. 349, 395
The written questionnaire gathered demographic information such as age, racial identity, educational attainment and student loans, number of dependents, homeownership, marital status, and non-marital partnerships. Filers also answered questions about health insurance coverage and out-of-pocket expense, following up on several prior papers on medical problems and bankruptcy filings. The questionnaire asked respondents to identify coping mechanisms employed during their financial troubles and their reasons for bankruptcy. It also asked people to identify reasons for their bankruptcies from a nineteen-item list (plus one open-ended response) and invited people to tell their stories in their own words. The list included several options relating to home mortgage troubles.

For each questionnaire respondent, the research team extracted information from federal bankruptcy court records on nearly 200 variables. On the petition and accompanying schedules that the federal government provides, filers must report to the court extensive information to the courts under penalty of perjury, including attorneys’ fees, assets, secured and unsecured debts, sources of income and expenses. Absent some need for privacy, the petition and schedules as well as litigation in the cases are accessible through the federal court system’s electronic access site, PACER. Student coders have updated the

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10. 2007 CBP Questionnaire, reprinted in Lawless et al., supra note 9, at 399-402.


12. 2007 CBP Questionnaire, reprinted in Lawless et al., supra note 9, at 401-02.

13. Id.

14. See Lawless et al., supra note 9, at 395 (explaining methods).


court records since the project was initiated, and further coding updates would be needed to track the chapter 13 cases, which can span several years.

Follow-up telephone interviews were undertaken to offer an additional source of information. The written questionnaire offered respondents $50 to participate in interviews. Over 85% of respondents expressed willingness to be interviewed. Ultimately, over 1,000 respondents participated in telephone interviews within a year after they filed for bankruptcy. The telephone interviews had five segments: general, medical, home ownership, small business, and military. All telephone survey respondents completed the general section, which explores credit cards, employment, student loans, insurance, health situations, financial circumstances after bankruptcy, and the impact of debt on the respondent and her family. Respondents were not expected to complete all four other segments; each such segment began with trigger questions to gauge whether the segment was particularly applicable to the respondent. The median telephone interview length was seventy-five minutes.

More than thirty research and writing projects are underway that use information from the 2007 CBP. At the time of this writing, two have been published. The first focuses on the ages, and aging, of filers. In it, Thorne, Warren, and Sullivan report that the median age of a filer in the 2007 CBP was 43, older than the median in the general population (36.1).

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17. Special thanks to Abbye Atkinson, Stephen Brown, Shelley De Alth, and Lisa Stifler for undertaking this work.
18. 2007 CBP Questionnaire, reprinted in Lawless et al., supra note 9, at 402.
19. Lawless et al., supra note 9, at 396 (reporting in methods appendix on survey response).
20. There were no significant demographic differences between those who participated and those who did not. Id.
21. 2007 CBP Telephone Survey (on file with author).
22. Lawless et al., supra note 9, at 396-97 (explaining telephone survey).
23. For example, respondents completed the homeownership cohort only if they were presently homeowners or had been homeowners in the prior five years. The medical questionnaire was triggered by indicating that medical problems contributed to the bankruptcy filing. 2007 CBP Telephone Survey (on file with author).
24. Lawless et al., supra note 9, at 397.
remain a relatively small proportion of bankruptcy filers: in the 2007 CBP, 7% were 65 and older, and 22% were 55 and older. However, as compared to multi-district CBP studies in 2001 and 1991, the older cohort has increased substantially, while filers 34 and younger have experienced the biggest decrease. Their study echoes more general concerns about the financial stability of older Americans.

In the second paper, Lawless, Littwin, Porter, Pottow, Thorne & Warren analyzed income, debt, and assets. Lawless et al. report that the median household income for the 2007 CBP respondents was under $28,000. To put this in broader comparative perspective, the U.S. national median household income in 2007 was a bit over $50,000 (undifferentiated by household size). About 85% of the 2007 CBP filers had incomes below this amount. The “poverty rate” in the U.S. for a family of four in 2006 was about $20,000. More than three in ten of the households in the 2007 CBP sample had incomes below this amount at the time of filing (again, undifferentiated by household size). Lawless et al. also calculated a median net worth that was substantially negative (nearly -$24,400). About half of the 2007 CBP sample were homeowners when they filed for bankruptcy, and among them, median mortgage debt was just over $100,000. As compared to multi-district CBP studies from 1981, 1991, and 2001, Lawless et al. report that although income has remained stable and assets have increased, 2007 filers were in worse financial shape than their earlier counterparts when

26. Id.
27. Id. The median age of the filers in the 2001 sample was 40.6, as compared to 36.5 in the 1991 sample. Id.
28. Id.
29. Lawless et al., supra note 9, at 359, 404.
30. Id. The mean was under $31,000. Id. at 404.
32. Lawless et al. supra note 9, at 360 fig. 2.
34. Lawless et al., supra note 9, at 360 fig. 2.
35. Id. at 369, 371, 404-05 (reporting median assets of a bit over $53,000, median total debt just over $87,000, median unsecured debt of nearly $34,000, and median secured debt of $35,000).
36. Id. at 365.
they filed as measured by debts, net worth, and debt-to-income ratios.\textsuperscript{37}

As I have mentioned, I do not currently have data relating to unscrupulous or negligent lending and servicing practices on which most other participants in this conference are focusing.\textsuperscript{38} The survey instruments did elicit information about mortgage loan shopping, use of brokers, and loan term comprehension that other researchers and I are currently evaluating.\textsuperscript{39} Furthermore, respondents were asked to discuss refinancing activity and home equity loans because these have become common methods of financial management for households.\textsuperscript{40} This will enable independent analysis of the origination and effect of post-purchase mortgage transactions.\textsuperscript{41}

In addition, questionnaire data will reveal debtors’ perceptions of whether mortgage products and problems contributed to their decisions to file. For example, as mentioned earlier, three of the nineteen discrete optional responses on reasons for bankruptcy related directly to home mortgages.\textsuperscript{42} Those responses were “a lender threatened to foreclose on your house,” “you wanted to refinance your mortgage to lower your mortgage payments, but you couldn’t,” and “your mortgage payment increased beyond what you could afford.”\textsuperscript{43} Among current and recent homeowners, about half listed one or more of these three reasons.\textsuperscript{44} But the fact that a homeowner was facing

\textsuperscript{37} Id. at 365-75.

\textsuperscript{38} Debtors could indicate trickery and aggressive creditor collection as reasons for filing but these options were not limited to home mortgage lenders. 2007 CBP Questionnaire, reprinted in Lawless et al., supra note 9, at 402. Further analysis will be needed to observe any connection between homeowners’ indications of these reasons for bankruptcy and specific mortgage problems.

\textsuperscript{39} 2007 CBP Telephone Survey (on file with author).

\textsuperscript{40} Respondents were asked what they did or tried to do to make ends meet during the two years prior to filing, with twelve specific responses, including refinancing or taking out a home equity loan. 2007 CBP Questionnaire reprinted in Lawless et al., supra note 9, at 401. Respondents who participated in the housing telephone survey were asked separate questions about actual use of refinancing and home equity loans. 2007 CBP Housing Telephone Survey (on file with author).

\textsuperscript{41} As a future paper will explore, many filers in our telephone dataset engaged in post-purchase mortgage borrowing, and significant numbers of filers in the overall core dataset reported that they used post-purchase mortgage borrowing or attempted to do so to make ends meet.

\textsuperscript{42} 2007 CBP Questionnaire, reprinted in Lawless et al., supra note 9, at 402.

\textsuperscript{43} See id.

\textsuperscript{44} 2007 CBP Results (on file with author). Breaking them down individually,
mortgage delinquency or the threat of foreclosure does not by itself signal the presence of an unscrupulous lender, broker, or servicer. Significant portions of the general population have major income fluctuations at some point in the lifecycle. Trigger events such as job loss or medical problems play some role in mortgage delinquency outside of bankruptcy even though they do not fully explain the patterns. Mortgages originated on more flexible underwriting standards have higher default rates even the actual terms of the products do not create special risks. And some level of mortgage distress reflects questionable policies and advice that overstated the financial security likely to be achieved by “stretching” to buy a house or using home equity borrowing and cash-out refinances to pay unsecured debt. Closer analysis in future work will seek to disentangle these issues.

Whatever the circumstances we find from the empirical study of bankruptcy filers, the presence of large numbers of homeowners in bankruptcy raises the question of whether and how bankruptcy law can help stabilize homeownership, particularly for those with mortgage-specific problems. The nearly a third of current and recent homeowners reported a threatened foreclosure, nearly 30% reported wanting to refinance but couldn’t, and about a quarter reported that mortgage payments increased beyond what they could afford. Id.


46. For a literature review, see Melissa B. Jacoby, Home Ownership Risk Beyond a Subprime Crisis, 76 FORDHAM L. REV. 2261, 2267-69 (2008).

47. See generally Michael Barr, Credit Where it Counts: The Community Reinvestment Act and its Critics, 80 N.Y.U. L. REV. 513, 584 (2005) (reporting on studies showing different delinquency profile for CRA loans, but arguing that they were not the deeply unprofitable loans that critics predicted).

48. As I have argued elsewhere, these approaches often undermine the justifications for government promotion of home ownership and robust mortgage markets. Jacoby, supra note 46, at 2278-80.

49. For recent discussions, see Porter, supra note 4, at 129-31, 171-78; Jean Braucher, Rash and Ride-Through Redux: The Terms for Holding onto Cars, Homes, and other Collateral under the 2005 Act, 13 AM. BANKR. INST. L. REV. 457 (2005); David Gray Carlson, Cars and Homes in Chapter 13 after the 2005 Amendments to the Bankruptcy Code, 14 AM. BANKR. INST. L. REV. 301 (2006); Eric Nguyen, Parents in Financial Crisis: Fighting to Keep the Family Home, 82 AM. BANKR. L. J. 229 (2008); R. Stephen Painter, Jr., Subprime Lending, Suboptimal Bankruptcy: A
prominent late Harvard Law School professor Vern Countryman once observed that the discharge was the most important feature of a personal bankruptcy law.\textsuperscript{50} Scholars have dedicated considerable efforts to exploring this key component of the “fresh start” in American bankruptcy.\textsuperscript{51} Professor Countryman identified property exemptions, another heavily studied subject, as the second most important feature for debtors.\textsuperscript{52} These legal tools are generally thought to be useful to filers regardless of their housing tenure. An honest individual chapter 7 debtor of modest means has high odds of receiving a discharge of at least some debts, and probably within a few months.\textsuperscript{53} Chapter 13 debtors likewise may work toward a discharge, although receipt is suspended until the end of a repayment plan.\textsuperscript{54} Assuming a debtor is able and willing to finish the plan, this can take as long as five years.\textsuperscript{55} Also, although homeowners and renters often get

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\textsuperscript{50} Vern Countryman, \textit{For a New Exemption Policy in Bankruptcy}, 14 \textit{Rutgers L. Rev.} 678 (1960) (“The exemption policy is second only to the discharge policy in importance to the debtor”).


\textsuperscript{52} Countryman, \textit{supra} note 50.


different property exemptions, conceptually both are entitled to this protection, just as their creditors are entitled to the value of non-exempt property of the bankruptcy estate. In chapter 7, creditors are entitled to the value of any property of the estate not covered in type and amount by an applicable property exemption. Chapter 13 debtors are not required to forfeit non-exempt property, but their payment plans must provide creditors at least the present value of what they would have received from a liquidation of those assets. In either event, state laws shape the generosity of the property exemption, including the homestead exemption, in bankruptcy cases.

For filers with significant mortgage debt problems who hope to keep their homes, however, neither of these traditionally core features is directly responsive. The bankruptcy discharge affects personal liability and not a lender’s in rem rights against collateral. Thus, on its own, receiving a discharge does not prevent a foreclosure once the automatic stay is lifted.

56. Future income is excluded from the bankruptcy estate entirely. 11 U.S.C. 541(a)(6) (2006). The property exemptions are described in 11 U.S.C. § 522(a), (d) (2006) (providing that states may opt out of federal exemptions and provide their own, or give citizens who file for bankruptcy a choice between state and federal exemptions, and setting forth federal exemptions).


61. This assumes, as is usually the case, that a mortgage will be honored. Bankruptcy law gives the trustee in bankruptcy the power to avoid a mortgage under some circumstances. For example, a trustee in bankruptcy steps into the shoes of a hypothetical bona fide purchaser and may seek to avoid a mortgage if a bona fide purchaser would have had priority over the mortgage. See 11 U.S.C. § 544(a)(5) (2006). Generally, this power is used to police compliance with state law formalities necessary for the strongest mortgage protection. See, e.g., Gregory v. Ocwen Fed.
Homeowners who have engaged in post-purchase mortgage borrowing to consolidate unsecured debt have further limited the utility of the discharge because they have replaced regular unsecured debt with a mortgage obligation that will continue to encumber their homes. Likewise, exemptions do not protect debtors’ property against their consensual secured lenders. They protect from other creditors the equity that would be remaining in collateral after mortgage creditors take their share. For many bankrupt homeowners, particularly those who have engaged in post-purchase borrowing in a declining real estate market, there is little or no home equity to protect in any event. On at least an ex post basis, therefore, property exemptions play a less central role for those in mortgage arrears using bankruptcy explicitly as mortgagor protection.

Bankruptcy does offer a tool for debtors who have both mortgage problems and lenders or servicers who do not wish to cooperate in a voluntary workout. A debtor may cure a mortgage arrearage in a chapter 13 repayment plan and resume regular payments, even if the lender already had accelerated the loan and even if the lender would prefer to foreclose. This differs from the reinstatement right that some state laws provide in that it permits curing the arrearage in installments rather than in a lump sum. To take advantage of this chapter 13 reinstatement right, the debtor must file for bankruptcy before the property has been sold at a foreclosure sale conducted in accordance with applicable non-bankruptcy law. The curing of arrearages must be accomplished within a “reasonable time.”

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62. See Bahchieva, \textit{supra} note 2, at 74.


64. Jacoby, \textit{supra} note 46, at 2273-74.


66. The Bankruptcy Code does not define “reasonable time,” but it cannot be longer than the plan period. See U.S. v. Easley, 216 B.R. 543, 546-47 (W.D. Va. 1997). Courts have considered a variety of factors to determine whether a proposed...
trying to save their homes through reinstatement, some filers seek to pursue predatory lending claims. However, chapter 13 does not offer reinstatement as a standalone benefit; debtors must comply with many other requirements to get the plan approved, and must pay substantial fees to the government, the lawyer, and the trustee. Nonetheless, chapter 13’s cure and reinstatement option stands in contrast to chapter 7: if a lender or servicer is unwilling to cooperate with a chapter 7 debtor already in arrears on a valid mortgage, the debtor probably will not be able to prevent a foreclosure after the case is over.

The possibility of reinstating a mortgage likely helps explain the high rate of homeownership chapter 13 filers, as well as perhaps the high repeat filing rate. Elsewhere, I have listed reasons why we must be cautious about assuming that chapter 13 promotes sustainable homeownership. Several important issues
should be highlighted or added to that list for this discussion. First, some loan servicers are overcharging debtors in various ways and thus decrease the feasibility of becoming and staying current on the mortgage.\(^{73}\) Second, an increasing number of people have mortgages that have become unaffordable because of the loan terms rather than from changed circumstances, but the right to cure and reinstate a mortgage does not permit a unilateral change in those terms.\(^{74}\) Third, given the state of the housing market, more homeowners have mortgages exceeding the value of the homes that secure them, giving borrowers less of an incentive to fight to maintain ownership.\(^{75}\) A chapter 13 plan often can modify the loan balance of debts secured by other property, but usually not debts secured primarily by a principal residence.\(^{76}\) To help manage rising default and foreclosure, lawmakers proposed legislation in the 110\(^{th}\) Congress to address all three of these concerns to some extent, and have again done so in the 111\(^{th}\) Congress.\(^{77}\) But passage cannot be guaranteed, and the legislation may include strict limits on the applicability of the new rules.

In closing, studying bankruptcy filers helps us understand the circumstances under which homeownership and mortgages might denigrate the household financial security that homeownership was supposed to promote. Furthermore, the traditionally important protections of bankruptcy law are not necessarily well matched to overcoming distressed homeownership or the mortgage borrowing patterns of contemporary homeowners.

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74. J. Rich Leonard, A Win-Win Bankruptcy Reform, WASH. POST, Nov. 28, 2008, at A29 (providing example from real case and proposing change to law).
75. Bachchieva et al., supra note 2, at 77.