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When your home is in foreclosure – should you file for bankruptcy?

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"A banker is a fellow who lends you his umbrella when the sun is shining and wants it back the minute it begins to rain."

(Mark Twain)

One of the most important assets an individual has is his home. People instinctively will do whatever they can to protect it for themselves and their family. So what happens when the mortgage payments are missed and the lender starts a foreclosure proceeding?

The commencement of a foreclosure proceeding is usually a sign of deeper rooted debt problems. It would be highly unlikely that a homeowner would stop paying their mortgage if they did not have other debt issues. Most borrowers know when the mortgage payment is due and they will also know when they have missed their payments. So, if you are going to miss a payment, what should you do?

Talk to your lender as soon as you know you are going to miss a payment. Before any foreclosure starts, a borrower likely has more options of dealing with their debt than after the foreclosure starts. A phone call to, or a meeting with, the lender to explain why you are going to miss a payment should be made. Be prepared to provide full and frank disclosure of your financial situation. As well, a lender may be more willing to provide some short term relief if they know your circumstances in advance.

The lender may be willing to work with you to make some form of accommodation such as a modification to your mortgage, interest only or deferral of payments until such time as you can start making the full monthly payments again. The lender may also be willing to provide you with additional funding to get you through this temporary period. Another alternative is to obtain a second mortgage provided you have equity available in your home to lend against. However, do not borrow any additional funds unless you are sure you can pay them back.

The lender may be less willing or unable to make an accommodation after payments are missed and certainly after a foreclosure has been started. A lender would almost always insist that any arrears and legal costs be paid before embarking on a revised payment plan. Ultimately, the only thing that will stop foreclosure proceedings is repayment of the debt. Everything else is only going to delay the inevitable, the sale of the property. Therefore, if the lender is not able or unwilling to work with you, then you must explore other options.

So when the foreclosure papers arrive what should you do?

1. Immediately, contact a Licensed Trustee who can explain the options available to you with respect to dealing with your debt. As previously stated, when a foreclosure is started, it is usually a sign of other financial problems.

   The Trustee will explain to you that bankruptcy is not the only option available and there may be a way of preserving some or all of your assets.

2. Co-operate with the lender or their agents during the showing of the property, keeping the yard clean and so forth. There is a lot to be gained by cooperating with the lender during the foreclosure process. If there is some prospect of any equity being available for the debtor, cooperation will assist in keeping the costs down and maximizing the sale price.

   If the debtor does not cooperate and is an undischarged bankrupt, the Trustee is obliged to report conduct that is subject to censure, which could have an impact on the bankrupts discharge.

An assignment in bankruptcy or a proposal may free up sufficient funds in order for the debtor to meet their monthly mortgage payment (including property taxes and other attendant costs). This is accomplished as the debtor would no longer be paying their other debts. However, an integral part of the process is that the debtor must also budget to ensure that his monthly expenses can be met as well as any obligations he may have to the Trustee and his creditors. Besides the possibility of being able to keep one's home, this will allow an unfortunate and honest debtor a fresh start.

Reaffirmation of debt

One misunderstood aspect of bankruptcy is known as reaffirmation of debt. When an individual declares bankruptcy and subsequently agrees to continue on with the mortgage payments, the effect is, in practical terms, a new contract that occurred after the date of bankruptcy. If the debtor is unable to keep the mortgage payments current, and a subsequent foreclosure happens, the debtor will remain responsible for any shortfall that arises as a result of the foreclosure. In other words, that debt will not be discharged by the bankruptcy.

Mortgage maturity or renewal

If an individual is bankrupt or has previously declared bankruptcy, there is a likelihood that there could be some difficulty renewing their existing mortgage or finding a new mortgage. A lender may opt not to renew the mortgage, and if this is the case, the debtor will have to seek alternative financing and may end up with less favorable mortgage terms. If the individual cannot qualify for a mortgage, bankruptcy or not, they are then faced with the possibility of selling their house.

Personal Exemption

In British Columbia, the *Court Order Enforcement Act* provides that an individual declaring bankruptcy is allowed to keep equity in a home located in the Metro Victoria and the Metro Vancouver areas to a maximum value of $12,000 ($9,000 for homes located elsewhere in the province).

When determining whether there is equity in real property, the Trustee must go through a process that is subjective and requires his or her professional expertise. Firstly, if possible, a review of the title is helpful. The Trustee can then use the assessed value of the property as a starting point to determine value and calculate what, if any, equity exists. This is only a preliminary indication of value and has risks associated with it, particularly in a rising market.

After deducting the mortgages and the provincial exemptions, the Trustee then must consider what allowances should be made for selling costs (commissions and legal fees).

This is where the Trustee must use his or her expertise and balance that with the practicalities of realizing on real property while continuing to balance the interest of all parties. This can be particularly difficult in a rising market, where the equity is marginal, where title is not in the debtors name only and so forth.

Regardless, a bankruptcy may be a way for an individual to preserve some of his assets through the exemption.

Conclusion

One cannot definitively say that when your house is in foreclosure that you should go bankrupt. Generally though, it may be that your options are very limited at that point. Any debtor facing financial difficulty should immediately seek the advice of a Licensed Trustee to determine what their options are, their rights and their responsibilities.

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