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Illinois Mortgage Foreclosure Trends: *Defense, Loan Modification And Bankruptcy Remedies*

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Since 2008, there has been a strong correlation between the number of foreclosure cases filed in the Circuit Court of Cook County and the number of bankruptcy cases filed in the Bankruptcy Court in the Northern District of Illinois, Eastern Division.

Look at the following table:

	Cook County Foreclosures	Northern District, Eastern Division Bankruptcy Cases
2008	48,675	35,883
2009	52,836	49,774

Illinois clients with foreclosure problems generally have two objectives: to maintain occupancy of their home during the foreclosure process, and to obtain mortgage modification in order to retain ownership.

MAINTAINING SHELTER WITH THE VIEW OF ULTIMATE SURRENDER

People who face foreclosure in Illinois fear that they are required to vacate their homes almost immediately. They are relieved to discover that they have the opportunity to retain possession of their homes for almost a year, owing to the seven-month redemption period as well as the rather slow pace of mortgage-foreclosure proceedings in Cook County and other busy foreclosure courts in surrounding counties.

Some homeowners may want to defend their foreclosure cases. They may want to delay the entry of a judgment of foreclosure. They certainly want to avoid entry of a deficiency judgment. Competent counsel can help people attain these objectives. Others have written extensively about defense of mortgage foreclosures in Illinois. However, both offensive and defensive responses are possible, including:

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- Procedural issues;
- Loan origination issues;
  A. Truth in Lending Act violations;
  B. Fraud in the inducement;
  C. Consumer Fraud and Deceptive Business Practices; and
- Servicing issues including Real Estate Settlement Procedures Act claims.

MODIFYING MORTGAGES WITH THE VIEW OF MAINTAINING HOMEOWNERSHIP

Mortgage-foreclosure cases almost always proceed independently of any efforts to obtain mortgage modification. While some courts in states outside of Illinois, particularly Wisconsin, have allowed for a stay of mortgage-foreclosure proceedings to consider a modification under the Home Affordable Modification Program, this has not been the case in Illinois.

There is no need to repeat the litany of frustration which homeowners have experienced in their efforts to obtain loan modifications. Many "trial modifications" commence;few result in permanent modifications. All too frequently, people fail to protect their interests in the foreclosure court, operating under the mistaken belief that the foreclosure has abated while they pursue the loan modification.

Borrowers who seek loan modification have a challenging economic decision to make. In almost every instance, borrowers find themselves owning real estate in which they have no equity. There is no assurance that property values will increase at any time in the near future. Under almost every loan-modification program, the borrower may retain home ownership. Nevertheless, the borrowers must do a calculated economic analysis to make an informed decision. Essentially, they must compare the cost of maintaining home ownership with the cost of renting equivalent property elsewhere.

Regrettably, not every lender will grant a mortgage modification. Moreover, not every homeowner who might be qualified for a mortgage modification receives one.

Illinois homeowners do not want to suffer foreclosure. Their first intention is to honor their commitments. And if they cannot, their next thought is to obtain a mortgage-modification agreement. Borrowers sincerely believe that they can get mortgage-modification agreements. This belief is fueled by massive publicity through both public and private channels. And it is further fueled by scam artists who once sold bogus mortgages and now sell bogus "help" to obtain mortgage-modification agreements.

In theory, a mortgage modification should be rather readily available. One should be able to obtain a mortgage-modification agreement utilizing the freely available resources of HUD-approved agencies. Nobody should have to pay to obtain a mortgage modification. In practice, however, mortgage modifications are difficult to obtain. Banks that have received Troubled Assisted Relief Program funds are theoretically under certain obligations to consider and grant mortgage modifications. Mortgage servicers for securitized trusts that have not received TARP funds do not consider themselves under much, if any, obligation to consider and grant mortgage modifications.

It is possible to obtain a mortgage modification. However, they are rare, at least as of the time of this writing in March 2010. Moreover, mortgage-modification agreements that have been granted are not as aggressive as they ought to be in order to avoid redefault.

Most observers have concluded that mortgage modifications have been severely wanting as a response to foreclosures. Instead, foreclosures have accelerated not only in Illinois but throughout the nation as well. The best that anyone can say is that mortgage foreclosures are accelerating at a decreasing rate. This is of small comfort to homeowners who are becoming renters and even homeless.

Today, however, two important developments can be reported.

HAMP 10-2

The Department of the Treasury has issued the Home Affordable Modification Program Supplemental Directive 10-2. While HAMP remains voluntary, no less of an authority than Mark Zandi, chief economist of Moody's Analytics, has said that HAMP 10-2 will, at least, require every lender to "do the math" to see whether additional mortgage modifications make sense. These changes become effective June 1, 2010.

Under this directive, servicers may not refer a mortgage for foreclosure without having made reasonable efforts for solicitation. This would include at least four phone calls and two letters over a 30-day period.

Even after a homeowner has been turned down, a lender should wait another 30 days prior to referring to foreclosure. Once a borrower is in a trial modification based on verified income, all foreclosure activity will have to cease. This is in complete contravention to prior practice and policy.

Unfortunately, HAMP 10-2 only applies to new foreclosures and will not help those already in foreclosure cases. However, it is anticipated that there will not be careful compliance with HAMP 10-2 and knowledgeable counsel will be able to invoke HAMP 10-2 as a defense in many state court foreclosure cases.

National Homeownership Retention Program

Another development worth noting is Bank of America's National Homeownership Retention Program to reduce principal in up to 45,000 loans. This program sounds attractive but will have little impact given its relatively small size.

Bank of America will offer this only to those borrowers who had Countrywide Option adjustable rate mortgage loans (so-called "Pay-Option" loans or negatively amortizing loans) that originated before Jan. 1, 2009. The borrower must be at least 60 days behind in payment or in imminent danger of default. Only loans with less than 75 percent loan-to-value ratio are eligible.

For eligible borrowers, Bank of America will reduce interest rates, extend terms and in some instances reduce principal. Frequently asked questions are answered on Bank of America's Web site, http://www.bankofamerica.com.

Frequently, aggressive defense of a mortgage foreclosure either in the state court or in bankruptcy proceedings can offer encouragement to the lender to offer a favorable modification to the borrower.

BANKRUPTCY RESPONSES

Historically, homeowners have sought refuge in bankruptcy in order to protect equity when they temporarily were unable to pay their mortgage. The standard practice would be to file a "cure and maintain" plan whereby the arrearage would be satisfied over the three- to five-year plan period. In the meantime, the debtor would be required to make the normal monthly payment.

At the end of the plan period, the court would declare the mortgage cured and affirm that there are no further defaults. This was not always sufficient. Lenders frequently declared post-petition defaults and borrowers found themselves back in foreclosure even after having fully performed their obligations under Chapter 13 of the Bankruptcy Code.

Today, debtor's counsel frequently finds that the borrower has no equity in the real estate. This is understandable since so many people acquired real estate within the past five years with 100 percent financing and no money down. Yet even under this circumstance, a variety of remedies are available in the bankruptcy court.

Objections to Claim

It is much easier to object to a mortgage-related claim in a Chapter 13 case than it is in the mortgage-foreclosure court. In a Chapter 13, the debtor schedules the debts of the lender as disputed. The dispute can be for a variety of reasons, including:

- Identity of the lender;
- Standing of the claimant;
- Challenge as to principal due;
- Challenges to a variety of charges, such as:
  A. Late charges;
  B. Force-placed insurance;
  C. Escrow disputes;
  D. Attorney fees;
  E. Title charges;
  F. Inspections; and
  G. Appraisals.

An objection to claim is a contested matter. Discovery is available. This takes time and costs money. While aggressive debtor's counsel objects to claims, lender's counsel has two options: defend, or encourage modification. Intelligent debtor's counsel will use the time gained by challenging a claim as an opportunity to see a favorable modification as a part of a consensual Chapter 13 plan.

Adversary Proceeding

Frequently, an objection to claim is an insufficient forum within which to adjudicate the exact extent of a mortgagee's secured claim. That is because the borrower might find it advantageous to pursue counterclaims against the lender. These might include:

- Truth in Lending Act;
- Real Estate Settlement Procedures Act;

- Fair Debt Collection Practices Act;
- Illinois Consumer Fraud and Deceptive Business Practices Act;
- Fair Credit Reporting Act; and
- Other consumer protection claims.

Such claims have been received with increasing interest by bankruptcy judges throughout the United States. Illinois bankruptcy judges are likely to consider these claims with care and receptivity as they see them more and more frequently.

Lien Stripping

Congress failed to enact legislation that would have allowed courts to bifurcate undersecured mortgages into a secured loan and an unsecured loan. Nevertheless, there remains an important opportunity to recharacterize a mortgage as an unsecured claim in Chapter 13 bankruptcy proceedings.

Under Chapter 13, a loan secured by a mortgage that is junior to an undersecured mortgage is fully unsecured. Since such a loan is a lien upon the debtor's residence, it is nevertheless an unsecured loan within the meaning of Section 506(a) of the Bankruptcy Code. So, pursuant to Bankruptcy Code Section 506(d) and Federal Rule of Bankruptcy Procedure 3012, the bankruptcy court can determine that the junior mortgage is fully unsecured and thus treated as an unsecured claim for purposes of the debtor's Chapter 13 plan.

This means that the debtor can fully satisfy the junior mortgage claim by making all necessary payments during the plan period. Upon having done so, the debtor gets a discharge. The debtor's plan can provide that upon the discharge, the debtor has fully satisfied this undersecured mortgagee's claim and that the lien upon the property is therefore deemed to have been released.

Since there are so many properties that were acquired with so-called 80-20 loans, and since property values have declined by substantially more than 20 percent in many areas, innumerable junior mortgages might be stripped in Chapter 13 cases.

In Illinois bankruptcy courts, there is a split of authority as to whether lien-stripping proceeding must be accomplished by motion or adversary proceeding. More judges require an adversary proceeding.

Another issue that has not been authoritatively decided is whether a debtor can obtain lien stripping in a Chapter 13 case having previously discharged the junior mortgage debt in a Chapter 7. In bankruptcy the lien survives a Chapter 7 discharge even though the debt can no longer be collected against the debtor personally due to the discharge.

Lien stripping in a Chapter 13 is a device that may be used to get rid of a lien which is not supported by any value in the collateral. There is no issue that a lien might be stripped in a Chapter 13 if it is fully unsecured. However, the unsecured claim is paid in the Chapter 13 as part of the other claims addressed under the plan. On completion of the plan, the debt is discharged and the lien is eliminated.

A Chapter 13 following a Chapter 7 does not have to deal with the debt. It has already been discharged. So the question is whether you can strip a lien if there is no personal debt to be discharged in a Chapter 13.

This so-called "Chapter 20" procedure has been met with a degree of skepticism by many judges. However, theoretically, there is no reason why a lien could not be held to be fully unsecured in a Chapter 13, even if the underlying debt has been discharged in a Chapter 7. Completion of the Chapter 13 plan should be sufficient to strip the lien in the successive Chapter 13 case even if a discharge is not available. The discharge from the prior case has already discharged the debt relating to the lien sought to be stripped.

At the cutting edge in the area of lien stripping are those who seek to strip a lien in a Chapter 7 case. The Supreme Court's decision in *Dewsnup v. Timm*, 502 U.S. 410, 112 S. Ct. 773 (1992) would seem to preclude lien stripping in Chapter 7 cases. However, this issue too has not been authoritatively decided. Lien stripping in Chapter 7 cases has not been allowed in Illinois. But it has been allowed in a few bankruptcy courts around the country.

Chapter 13 is presently the best venue for effectively restructuring residential mortgage loans in Illinois. If a debtor has adequate income to sustain a Chapter 13 plan, he should certainly consider utilizing Chapter 13 as part of his arsenal of weapons in seeking to maintain homeownership.

David P. Leibowitz is managing member of **Lakelaw**, with offices in Chicago, Waukegan and Kenosha, representing people and businesses throughout Illinois and Wisconsin. He is a member of both the Illinois and Wisconsin bars and has practiced in bankruptcy courts throughout the country

Mr. Leibowitz is certified as both a Consumer Bankruptcy Attorney and a Business Bankruptcy Attorney by the American Board of Certification. He has become nationally recognized for his work in mortgage related issues arising in consumer bankruptcy cases having published articles on this topic in both 2008 and 2009 Norton's Annual Survey of Bankruptcy Law. He is also an author of Inside the Minds, Best Practices For Filing Chapter 13¸ published by Aspatore.

Mr. Leibowitz is the editor in chief and a principal author of the American Bankruptcy Institute Fraud Manual. He is a frequent speaker at national, state and local bar associations on bankruptcy and foreclosure related issues. He is a member of the Board of Directors of the National Association of Bankruptcy Trustees and associate editor of its publication NABTalk. Mr. Leibowitz is the 2010 winner of the Liberty Bell Award of the Circuit Court for the Nineteenth Judicial Circuit (Lake County). This award recognized his organization of and training for the Court's Mortgage Foreclosure Help Desk as an outstanding contribution to the administration of justice.

He was the recipient of the "Excellence in Pro Bono Service Award" from the United States District Court for the Northern District of Illinois and the Chicago Chapter of the Federal Bar Association in 2006. Mr. Leibowitz holds a B. A. in Economics from Northwestern University and received his J.D., cum laude, from Loyola University of Chicago School of Law, where he also served as Note Editor of the law review. While at Loyola, he became a member of the Alpha Sigma Nu Jesuit Honor Society.

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