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Real Estate Financing Options for Your Bankruptcy Clients

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We have now seen several straight years of rapid real estate appreciation on Long Island. With the current real estate boom, most home prices have doubled in the past six years. Buoyed by low interest rates and a hot real estate market, the mortgage industry has become incredibly competitive and has relaxed many previous requirements that have acted as impediments to former bankruptcy debtors seeking to obtain a new mortgage or refinance an existing one. You can help your prior bankruptcy client purchase their first home, or take advantage of increased equity in their existing home, by helping them with refinancing.

Homeowners with Bankruptcy Histories Are Often Able to Get Mortgages, Sometimes at Respectable Rates. With over a million and a half consumers filing bankruptcies each year, many mortgage companies have tapped

into the lucrative market of offering mortgages to those who recently sought Chapter 7 bankruptcy protection, and even those still making payments in open Chapter 13 cases. Just a few years ago, debtors seeking to obtain mortgages under such circumstances found it difficult, if not impossible. Today, however, mortgage lenders actively solicit the profitable sub-prime market of recent home-owner debtors. A "sub-prime" mortgage is one where the borrower has a blemished credit history. Lenders, in their drive to maximize profits, have actually become quite lenient with the sub-prime market and have relaxed some previous requirements. Some lenders even specialize in providing financing to recent debtors. A former Chapter 7 filer can qualify for a mortgage one year after the bankruptcy is over.

Mortgage Companies Offer Various Mortgage



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Programs Depending on Financial History. Although the borrower may not qualify for the best rates (known as "A" paper) if there was a recent bankruptcy filing, they may nevertheless qualify for sub-prime rates, (known as "B," "C" or "D" paper). Lenders with programs for recent debtors will typically offer something like a two-year hybrid adjustable rate mortgage in which the mortgagor has the option of converting to a more conventional mortgage with better interest rates after a two year period of time, provided that the borrower makes timely payments and keeps his new credit history clean. Even former debtors who developed additional negative credit information after their bankruptcy was concluded can qualify for financing if they have a

healthy loan-to-value ratio of 70% or less.

Debtors May Become Eligible for “A” Paper Mortgages Sooner Than They Think.

According to some published guidelines, a former Chapter 7 debtor may be eligible for the best rate FHA mortgage just two years after the discharge if the borrower has re-established good credit or has not re-established any new credit. If more than two years have elapsed since the Chapter 7 bankruptcy was discharged and the borrower is applying for a VA mortgage, then the bankruptcy will not even be considered. If the borrower is applying for a conventional mortgage, then they will be considered for the best rate after four years, although some lenders will consider them after three years, if there is a good reason. For Chapter 13 debtors, the provisions are even better for FHA and VA mortgages. In such instances, debtors need only wait 12 months from the date of filing and may even be in an open case.

Debtors Should Consider Consulting a Mortgage Broker.

Ordinarily, I steer my real estate clients directly to banks. However, when it comes to borrowers who have blemished credit histories or previous bankruptcies, I sometimes suggest that they consult with a mortgage broker, who will have access to many potential lenders, and who should be keenly familiar with the various sub-prime financing issues. As a variety of lenders offer different programs to borrowers with prior bankruptcies, a mortgage broker catering to this customer base should have a good familiarity with what program might be best for a

particular borrower. Savvy brokers should also be able to give tips to clients in advance about improving chances for qualifying.

Chapter 13 Debtors in Open Cases Who Seek to Refinance Must Either Obtain a Court Order or Withdraw Their Case.

If the borrower is still a debtor in a pending Chapter 13 case, refinancing a home will require seeking court approval of the refinance by bringing a motion. Consider discussing this issue with the Chapter 13 trustee if refinancing becomes a possibility. Alternatively, you may consider withdrawing the debtor’s petition, although you would only want to do this if the conditional mortgage commitment permits it, and the debtor can handle the unsecured debt after the case is dismissed. Also remember that the debtor loses the protection of the bankruptcy stay once the case is dismissed. Therefore, you should only withdraw a case if it appears absolute that all closing conditions have been met, and the closing will definitely occur.

Consumers Should be Cautious with Adjustable Rate Mortgages.

Previous bankruptcy filers may have no choice other than obtaining an adjustable rate mortgage hybrid. At some point, the monthly payments for all adjustable rate mortgages increase. As your client previously got into a financial bind resulting in the prior bankruptcy filing, it is important that you advise them about preparing realistic future budget projections so that they do not end up in a future financial bind when the rate increases.

Many Abstract Companies Do Not Understand How Prior Bankruptcies Discharge Debts.

Several times a year I deal with a lender or abstract company who insists, incorrectly, that certain discharged debts actually remain for various reasons. This usually happens when the client refinances without the aid of legal representation or uses an attorney who is unfamiliar with bankruptcy law, and I get a frantic call from the client while they are sitting at a closing table. In-house title examiners at abstract companies are notorious for their lack of knowledge about the implications of a bankruptcy filing. You should persuade former bankruptcy clients that it is advisable to utilize counsel for all real estate financing transactions. Then, if the lender’s abstract company raises a bankruptcy-related problem, insist on speaking directly with underwriting title company’s clearance department or legal department to clear up any bankruptcy-related title exceptions.

Practice Pointer for Helping Debtors with Mortgages and Re-financing:

Be aware that financing is often available, advise your client of the options, and suggest that your client retains legal counsel for real estate transactions.

Editor’s Note (revised 2008): Craig D. Robins, Esq., a regular columnist, is a bankruptcy attorney who has represented thousands of consumer and business clients during the past twenty years. He has offices in Medford, Commack, Woodbury and Valley Stream. (516) 496-0800. He can be reached at CraigR@CraigRobinsLaw.com. Please visit his Bankruptcy Website: CraigRobinsLaw.com.