

Wiping Out Your Second Mortgage In Bankruptcy

I would say that the majority of clients I deal with who own homes have more than one mortgage on their property. Whether it is a fixed rate second mortgage or a [Home Equity Line of Credit \(HELOC\)](#), individuals and families rely on these loans for various reasons. Home repairs, education expenses and/or emergencies sometimes require large sums of money up front and people depend on the equity in their homes to meet these financial obligations.

While all homeowners have been hit by the [housing crisis](#), the snowball has avalanched for those with second mortgages. Plummeting values have caused many recently purchased homes to go “under water.” Many times, these homes are worth less than the mortgages securing these properties.

There are few remedies available to these homeowners, but bankruptcy can provide some relief. Wiping out a second mortgage in bankruptcy may be getting easier.

Lien Stripping in Chapter 13

In this context, lien stripping is essentially the process of removing a second mortgage from your home through the [chapter 13 bankruptcy](#) process. This is no easy task and certain requirements must be met, but the good news is that it is permitted and it is possible.

In order to “strip” the lien from your property, you must first prove that the value of your property is less than the principle owed on the first mortgage. This creates a situation where the second mortgage is completely unsecured, meaning there is no value in the property securing the loan. All the value is securing the first mortgage.

Assuming this hurdle is reached, and you complete the repayment of your entire chapter 13 plan, the second mortgage will be discharged along with all of your other unsecured debt at the culmination of your case. This assumes that your lawyer filed the appropriate motions, but an [experienced bankruptcy lawyer](#) should be able to take care of this without issue.

In Re McNeal

In Re McNeal (No. 11-11352) is a recent case decided by the [United States Federal Appeals Court for the 11th Circuit](#). This decision may signal a change in direction for other courts and open up opportunities for distressed homeowners.

Without getting into too much detail, the court allowed Ms. McNeal (the debtor) to “strip off” the second mortgage on her property. Her home was well under water so the court ruled that the second mortgage was “wholly unsecured” and therefore permitted the lien to be wiped out. Why is this important? ...because this was a [chapter 7 bankruptcy](#) case and it was the first time a Federal Circuit Court has reached such a determination.

Why is this Good News?

11th Circuit decisions have no control over bankruptcy decisions in New York as we are located in the [2nd Circuit](#). However, this decision could spring challenges to lower court decisions and spark a precedent for change. The ability to completely wipe out a second mortgage through the [chapter 7 bankruptcy](#) process could be a huge benefit to potential debtors.



Chapter 13, while extremely beneficial in certain situations is long, costly and requires a huge financial commitment on the part of the debtor. On the other hand, Chapter 7 is neat, relatively quick and more affordable. It is typically the chapter 7 filer that needs the most relief and being able to wipe out a second mortgage upon discharge (typically around 90 days after filing) could be a huge incentive.

There is existing precedent for this in our local Bankruptcy Court for the Eastern District of New York. In the case, *In Re Lavelle (No. 09-72389)* the Bankruptcy Court in Long Island permitted the Lavelles to completely avoid the second mortgage lien on their home.

The important thing to remember is that while your options are limited with regard to second mortgages, you could be the next McNeal or Lavelle and pave the way for future changes. With [no end in sight to this housing crisis](#), well intentioned second mortgages have become more burdensome than ever and maybe, just maybe, bankruptcy can provide the relief needed.

Image courtesy of [laudu](#).