Removing Second Mortgages though Lien Stripping

In the present economic times many individuals are living with financial decisions causing them to hold assets, such as houses, automobiles and boats, whose values have plummeted. Individuals are living in properties whose values have dropped far below the mortgages or driving cars, which are valued at a third of the loans. Those individuals with financial difficulties are looking for assistance through the bankruptcy courts in an attempt to get out from underneath all of the debts and liens acquired, which now vastly exceed their current assets.

There are two types of liens, which can be attached to an individual's property or assets. The first is a voluntary lien, which is basically a situation where you have agreed to use the asset as collateral for a debt, i.e. mortgages and auto loans. A non-voluntary lien is one that a creditor imposes on you and that gives them the right to force you to sell the asset so that they can be paid, for example: judgments against you or tax liens. These liens are either secured or unsecured as to the asset they are attached to.

The most common issue for an individual nowadays is the situation where a homeowner who has a first and second mortgage on a primary residence is facing bankruptcy and wondering if they have the ability to save the family home. As real estate markets fall and the fair market values of the homes fall, homeowners are left with mortgages that far exceed the current fair market value of their homes. There is a process which could be of help to many in this situation and it is called "lien stripping".

"Lien stripping" refers to the process of reducing a secured claim to the value of the underlying collateral. It uses the combined effect of 11 U.S.C.A. § 506(a) and 11 U.S.C.A. § 506(d) to bifurcate the lien into secured and unsecured. The secured lien is allowed in the amount up to the fair market value of the property at the time of the stripping. The balance of the lien, which exceeds the fair market value of the property, is now deemed unsecured.

Liens can be stripped off of the debtor's assets in Chapter 11 or Chapter 13 when there is not enough equity in the assets. Section 506(a) and 506(d) of the Bankruptcy Code acknowledges that a lien is only a secured claim to the extent there is value in the asset to which it attaches. To the extent that the claim exceeds the value of the collateral, that portion of the lien is now unsecured. The most common application of lien stripping is the reduction of car loan liens to the present value of the vehicle however it is currently used more often with home mortgages in bankruptcy situations. Lien stripping with car loans has been limited to vehicles purchased over 910 days.

The Bankruptcy Code does permit a bankruptcy plan to "modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence". Section 1322 (b)(2). This section provides protection to the holder of a claim secured only by a lien on the debtor's principal residence by prohibiting any modification of the terms, however the issue arose as to if this section precluded "lien stripping" of undersecured residential mortgages in the face of Bankruptcy Code section 506 which appears to permit bifurcation of undersecured mortgages and voiding of unsecured portions of the mortgage lien. At least two bankruptcy court judges sitting in Massachusetts have permitted such bifurcations, see *In re Brown, 175 B.R. 129* and *In re Richards, 151 B.R. 8.*

In any event, there is an exception as to the lien on a principal residence lien and that is if there is a second or third lien on the same property. In this instance those liens, lien stripping is available to render them totally unsecured if the first mortgage balance equals or exceeds the value of the personal residence. The exception is only if there are two distinct mortgages on the property, not a refinancing situation. It should also be noted that the limitation of lien stripping of first mortgages only apply to personal residences, it will be allowed for a mortgage on a building used for business or renting.

As always, all situations relative to a strategy for bankruptcy and lien stripping should be discussed in detail with a bankruptcy attorney to understand all your avenues open to you.