Your Home Equity Loan - or Second Mortgage - May Now Be Unsecured. Here's Why.

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When the housing bubble popped, most homes went down in value. Some went way down!

As a result, your home's value may be equal to (or even less than) the amount of your first mortgage. This means, for practical purposes, that your home equity loan - which is usually a second mortgage - is no longer secured because your home has fallen so much in value.

For example: Let's say that your home is now worth $300,000 - the amount you owe on your first mortgage is $300,000 - and the amount owed on your second mortgage is $50,000. Since your home's value equals the amount of your first mortgage, there is no equity left to secure the second mortgage.

Here's how this works in bankruptcy:

A Chapter 7 Bankruptcy will erase your personal liability to pay the second mortgage. But it won't erase the mortgage itself.

A Chapter 13 Bankruptcy will erase both your personal liability as well as the mortgage itself. This process, called lien stripping, allows you to erase a lien that is not secured by your home's value. But if your home's value secures even part of the lien, then you cannot strip it from the property.

Beware!

For example: Let's say your $300,000 home has a first mortgage against it of $290,000. And let's say your second mortgage is $60,000. You cannot lien-strip the second mortgage because at least $10,000 of your home's value secures it.

Now, back to a Chapter 7 Bankruptcy.

In this case, your second mortgage remains on the home. But in your bankruptcy, the court discharged this debt so you don't have to pay it - and no one can sue you for it.

And since the home's value leaves the second mortgage essentially unsecured, the lender would not profit from foreclosing because all of the money from the sale would go to the first mortgage lender.

If the home market improves - and your home increases in value - the second mortgage could once again be secured by your home's value. At that point, you could sell your home to pay off both mortgages. Or, the second mortgage lender could foreclose against you because the lien remained even after Chapter 7 Bankruptcy.

Home foreclosure by the second mortgage lender is unlikely if your home is substantially under water. But if the home's value is roughly equal to the sum of the two mortgages, then the likelihood of a foreclosure by the second mortgage lender increases.

So - you might benefit more from a Chapter 13 Bankruptcy because the second mortgage can be lien-stripped. Even so, if your home is substantially under water, you could also get a good result from a Chapter 7 Bankruptcy.

Respected as Chicago's financial rescue and bankruptcy lawyer, Rich Fonfrias of the Fonfrias Law Group is an expert in bankruptcy law and offers a complete range of financial legal services in all areas of finance law and financial rescue, including bankruptcy repair, Illinois credit repair, foreclosure, tax reduction and tax lien services. Let an experienced Chicago bankruptcy attorney work for you to find the best solution to solve your money problems and help to repair your finances and rebuild your credit score.

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