Foreclosure and the Bankruptcy Stay

While there are many reasons for the rise in bankruptcy filings, with working families falling victim to job losses, the collapse in the real estate market and plunging home values is one of the principal reasons for the rise in filings.

Over the last three years, as the economic recession lingered and the recovery became more and more tentative, 4 million consumers filed for bankruptcy matching the records levels reached before the 2005 changes in the Bankruptcy Act made it more difficult and costly for Americans to seek Bankruptcy protection.

One of the significant reasons for this spike in bankruptcy filings is the record foreclosure rates that have existed since the 2008 crash. These record foreclosures have forced homeowners and investors alike to seek the protection of Bankruptcy Act and in particular the protection afforded by the automatic stay provided for in 11 U.S.C. 362.

The filing of a bankruptcy case, under any chapter of the Bankruptcy Code, automatically triggers an injunction against foreclosure by a bank or other secured lender against the debtor’s property, including the debtor’s home or other real estate. 11 U.S.C. 362.

The stay stops foreclosure and provides a breathing spell for the debtor, during which negotiations can take place to try to resolve the difficulties in the debtor's financial situation, subject to the oversight of the bankruptcy judge.

The injunctive relief provided by the automatic stay, however, is not without limits. A court may give a creditor relief from the stay if the creditor can show that the stay does not give the creditor "adequate protection" or if it jeopardizes the creditor's interest in the property.

This means in the context of a foreclosure on real property, that in order for the stay to remain in effect the homeowner or other real property owner, must demonstrate that the interest of the creditor in the property is not damaged by the stay.

Practically speaking, this means either of two things. The first, is that there is so much equity in the property that a temporary stay will not impair the creditors security. In a world of “underwater” real estate, however, most debtors do not have sufficient equity to provide “adequate protection” to the secured creditor. In these situations, in order for the stay to remain in effect the debtor will be required to make periodic cash payments in the form of monthly payments to the creditor so that the creditors’ interest in the real property is not further impaired by bankruptcy and its stay.

If the debtor is unable to provide “adequate protection” to the secured creditor, creditor can obtain an order from the court granting permission to continue the foreclosure.

Creditors are granted relief from stay when the debtor has no equity in the property and the property is not necessary for an effective reorganization. In such cases, the court will lift the stay to permit the creditor to foreclose on the property.   11 U.S.C. § 362(d).

Moreover, in “single asset real estate” cases the Bankruptcy Code provides circumstances under which creditors of a single asset real estate debtor may obtain relief from the automatic stay which are not available to creditors in ordinary bankruptcy cases. 11 U.S.C. § 362(d)

The term "single asset real estate" is defined as "a single property or project, other than residential real property with fewer than four residential units, which generates substantially all of the gross income of a debtor who is not a family farmer and on which no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental." 11 U.S.C. § 101(51B).

In a “single asset real estate case” a secured creditor with a claim secured by the single asset, will be granted relief from the automatic stay unless the debtor files a feasible plan of reorganization or begins making monthly adequate protection payments to the creditor within 90 days from the date of the filing of the case, or within 30 days of the court's determination that the case is a single asset real estate case.

The adequate protection payments required in a “single asset real estate case” must be equal to the non-default contract interest rate on the value of the creditor's interest in the real estate. 11 U.S.C. § 362(d)(3).

More information on the subject of real estate, foreclosure, and bankruptcy can be found at the website of attorney Mitchell Reed Sussman www.palmspringslitigationattorney.com