ask the servicer

By Ryan LaRose

"If a borrower files for bankruptcy, how does it impact their reverse mortgage?"

As with most questions surrounding reverse mortgages, the answer is, it depends. Essentially, it depends on what the person's definition of "impact" is – which I will explain later in this column.

The decision to file for bankruptcy is painful and difficult for anyone who owns a home – regardless of what type of mortgage they may have. Bankruptcy statistics released earlier in August showed that over 1.2 million Americans filed for bankruptcy protection from June 2008 to June 2009, up 25% from the prior year. From 2007 to 2008, national totals increased a whopping 31.4%. The continuing sluggish economy was noted as the primary factor for the increase, and experts estimate that figure may reach 1.5 million bankruptcy filings over the next 12 months. It's interesting to note in light of the current debate on health care reform that the American Journal of Medicine identifies unpaid medical bills as one of the main reasons in at least 60% of personal bankruptcies in the United States.

When most people read stories or statistics on bankruptcy in the news, images may pop in their heads of a "down on their luck" family. It could be the husband or wife, who have unfortunately lost their job, or they may be going through a divorce, or as stated above, may be facing a medical catastrophe and are now faced with the difficult task of staying on top of their financial obligations with either little or no income.

The senior population is certainly not immune to these types of swings in the economy. Personal issues such as the death of a spouse or medical coverage shortfalls can impact them deeply. As most of you are very aware, a large percentage of this age bracket is on some form of fixed income: monthly social security and, if they are fortunate, some 401(k) or pension funds to help supplement their living expenses.

My next-door neighbor is a perfect example. She is a 74-year-old widow, lives in a modest home, and whose sole source of income is social security. Once she has paid her bills each month, she is left with about $120 of disposable income. Small swings in gas or propane fuel prices may not be of large concern to you and me, but cause her considerable stress over whether she will be able to continue to afford to live in her home. She is literally on the brink at any given point in time, and is just an oil price spike away from having to file for bankruptcy protection.

Bankruptcy filings on reverse mortgages do not differ drastically from those with forward mortgages. The attorney still needs to protect the lender and investor's interest in the property by filing the appropriate documents with the bankruptcy court. Servicers typically have bankruptcy monitoring programs in place – either through an in-house service, or outsourced to a third party vendor. Various software reporting packages are also available that can alert servicers to bankruptcy filings very quickly, so that proper action can be taken. Once the necessary documents are filed, the attorney's primary role is to then monitor the bankruptcy and report to the servicer when it is dismissed or discharged.

It is important to note that the filing of bankruptcy by a reverse mortgage borrower does not result in the loan being called due and payable.

However, as I mentioned in my opening comments, there are still some unique "impacts" when a reverse mortgage borrower files for bankruptcy. Once the servicer is notified of the filing, they must suspend any disbursements from the loan. This includes any scheduled payments as well as unscheduled draw requests from the borrower's line of credit (if they have one). If the servicer were to disburse funds from the loan after the bankruptcy filing, they would be increasing the amount of the borrower's debt – which is not allowed under bankruptcy protection laws. The only exception is if the bankruptcy court approves a motion from the borrower to withdraw funds from their reverse mortgage. Also, in most States, when the bankruptcy is completed, the costs for the bankruptcy attorney fees are capitalized to the borrower's loan balance. Once the bankruptcy is dismissed or discharged, the borrower is then allowed to access any funds they have available on their loan.

Another unique characteristic is how the filing of bankruptcies by the heirs of the borrower (after the borrower has died), can affect foreclosure actions. In cases where the estate was given the maximum amount of time extensions allowed under HUD guidelines (1 year from the date of death) or the executor of the estate was non-responsive, the servicer must initiate a foreclosure action to take title to the property for the investor.

That said, most foreclosure attorneys are very reluctant to proceed with a reverse mortgage foreclosure action if one of the heirs to the property files for bankruptcy. In speaking with one of the foreclosure attorneys we have worked with on several cases like this, there is an argument that could be made that even though the heir does not yet own the property, they may still have a legal interest in the property. Therefore, in their legal opinion, the filing of bankruptcy should suspend the foreclosure action. It is important to note that this may cause delays for servicers in the foreclosure process, but it is eventually resumed once the heir's bankruptcy file is dismissed or discharged.

I look forward to receiving any questions you may have regarding servicing at: ryan@celink.com. Please remember: there is no such thing as a stupid question. No doubt, the question you ask will have been in the minds of other readers as well. If you wish to remain anonymous for my response, just let me know.