



## **Home Equity Loans – Plan Your Strategy Before Filing That Proof of Claim**

Banks, creditor's and lienholders with home equity mortgages must be careful when handling their secured claims after their borrowers file for bankruptcy. Texas home equity loans are designed to be non-recourse except in the case of fraud. Filing a proof of claim in a bankruptcy case when the debtor is not personally liable on the debt is an attempt to collect that debt from the estate when the estate is not responsible. If the home equity loan is more than four years old and the borrower has raised possible violations of the home equity laws, filing a proof of claim could have the reverse effect of allowing the debtor to challenge the validity of the home equity lien based on defenses that would be barred by the statute of limitations.

The Bankruptcy Code does not require a creditor with a lien to file a proof of claim. The law is well established that ordinarily liens pass through bankruptcy unaffected. A secured creditor can ignore the bankruptcy case and look solely to his collateral in satisfaction of the debt subject to be stayed during the pendency of the case. The filing of a proof of claim is the means through which a creditor elects to be paid as a personal liability of the debtor from the debtor's estate funds. The filing of a proof of claim is no different than taking action on the underlying note. As noted earlier, a borrower is not personally liable on a home equity note. The remedy is to file a petition to begin the foreclosure process.

If the debtor poses an objection to the stay because the lien documents are invalid then the bankruptcy court may not lift the automatic stay to allow foreclosure but will determine whether the home equity lien is valid. In the case of *In re: O'Neill*, the bank filed a proof of claim in the amount of \$282,588.56. The property was valued between \$218,000 and \$240,000. The court denied relief from the stay when it found that the debtors were willing to make adequate protection payments of \$2,200 per month and to maintain homeowners' insurance and flood insurance on the property. The court found that if the lender did not have a valid home equity lien then it was not entitled to have the automatic stay lifted because there was no valid lien to foreclose.

Home equity lienholders who have lost their liens in bankruptcy court litigation have been because of incurable violations of the Texas Constitution. Some examples of violations that the lender could not cure were (1) where the borrower used agricultural property to secure the loan, (2) where the lender required the borrower to apply the home equity loan proceeds to other loans with the lender, (3) where the lender was not an authorized home equity lender in Texas, (4) where the lender conducted a non-judicial foreclosure of the property instead of seeking a court order approval of the sale, (5) where the lender failed to provide required documentation for the loan, and (6) where the lender took a second lien home equity lien.

Because of the potential of lien forfeiture a home equity lender should consult with an attorney to develop an exit strategy in recovering on their loans before filing a proof of claim. Examining whether the loan is more than four years old and whether the borrower has raised constitutional issues are important issues in determining how to respond to the debtor and how best to proceed in recovering the loan by foreclosure or through repayment when the debtor chooses to keep the home equity loan current and not attempt to invalidate the lien.