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The Role of the Bankruptcy Abuse Prevention and Consumer Protection Act in the Real Estate Crisis

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by

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ABSTRACT:

The Bankruptcy Abuse Prevention and Consumer Protection Act prompted significant changes: earnings being below median income for Chapter 7 filers, the increase in costs, the required financial courses, and the obstacles imposed to prevent converting non-exempt assets into exempt assets. These changes did not make it impossible for individuals in financial distress to file for bankruptcy as a way to save his or her home, but it did make bankruptcy a less attractive option. This in turn, made foreclosure a more attractive option.

The findings show that the percentage of bankruptcy filers owning homes has increased from 37.25% in 2003-2004 to 61.22% in 2006-2007. There has not, however, been a corresponding increase in the actual number of bankruptcy filings. With more homeowners being in distress, and bankruptcy being a less attractive option, homeowners likely found foreclosure to be a more attractive alternative.

I. Introduction

The recent focus on the rise of foreclosures in today's economy has raised many questions with regard to the reasons why the foreclosure rate has risen. This paper investigates the role of the Bankruptcy Abuse Prevention and Consumer Protection Act in the real estate crisis. This study proposes that the change in the bankruptcy law has intensified the real estate crisis. It does not propose that the foreclosure problem is due to the change in bankruptcy law. The change in bankruptcy law is one match of many that has fueled the fire of the crisis. Predatory lending, for example, has received a lot of attention as a reason as to why individuals received loans that they could not afford, and therefore defaulted, which instigated foreclosure. Another reason may be the simple fact that individuals obtained loans for homes that they could not afford. While there are many factors that have played a role in the rise in foreclosures, the Bankruptcy Abuse Prevention and Consumer Protection Act has complicated an alternative available to homeowners in distress. This paper will include a discussion of foreclosure and bankruptcy, both in general and as options for homeowners in distress. The findings of the study will then be used to explain which option homeowners are choosing in response to being in distress.

The sample studied included 100 individuals from Cape Coral, Florida, who filed for bankruptcy between 2003-2004 and 2006-2007. These individuals were analyzed to determine which chapter of bankruptcy (7 or 13) was filed, property ownership, and the relationship between the two. As the new bankruptcy law was put into effect in 2005, the two time frames—2003-2004 and 2006-2007—provide a view based on what was happening prior to the passing of the Bankruptcy Abuse Prevention and Consumer

Protection Act, and what happened after the passing of the Bankruptcy Abuse Prevention and Consumer Protection Act.

The findings show that, in general, the percentage of bankruptcy filers choosing Chapter 7 bankruptcy, rather than Chapter 13 bankruptcy, has decreased from 58.82% in 2003-2004 to 48.98% in 2006-2007. It also shows that the percentage of bankruptcy filers owning homes has increased from 37.25% in 2003-2004 to 61.22% in 2006-2007. In addition, the data shows that while 63.16% of homeowners who filed for bankruptcy in 2003-2004 chose Chapter 7 over Chapter 13, only 46.67% chose Chapter 7 in 2006-2007. The data shows that the new bankruptcy law has resulted in a smaller percentage of homeowners filing Chapter 7 bankruptcy in 2006-2007 (as compared to 2003-2004), while the number of homeowners filing bankruptcy, in general, has increased.

The significant changes that the Bankruptcy Abuse Prevention and Consumer Protection Act prompted were: earnings being below median income for Chapter 7 filers, the increase in costs, the required financial courses, and the obstacles imposed to prevent converting non-exempt assets into exempt assets. These changes did not make it impossible for individuals in financial distress to file for bankruptcy as a way to save his or her home, but it did make bankruptcy a less attractive option. This in turn, made foreclosure a more attractive option. Therefore, the Bankruptcy Abuse Prevention and Consumer Protection Act has further increased the foreclosure rate.

II. Background

A. Foreclosures and the Economy

Foreclosures are a very hot topic of discussion these days. The financial crisis we are experiencing is very much related to the option of foreclosures. Homeowners

defaulting on their mortgages seem to be the root of the economy's downfall over the past couple of years. The stock market is dropping because financial institutions are failing. Financial institutions have failed because of poor investment choices, specifically in mortgage-backed securities. The problem with the mortgage-backed securities was that they were backed by mortgages that were held by borrowers who could not afford their mortgage payments. These borrowers defaulted on the mortgages, and the lenders were forced to foreclose. This is a very simplified view of the problem; however, it is the basic foundation of the financial crisis.

The lender's incentive to give a loan to a person buying a house is that should the borrower default, the lender can take the property to satisfy the loan. The problem with taking the property is that the lender wants to satisfy the loan with cash, not property. Lenders are not in the residential sales business; they are in the cash business. The lender is therefore willing to take a loss on the sale of the property, to see the cash from the sale more quickly. Hence, properties tend to sell for less at a foreclosure sale than they would in a normal market.

The increase in foreclosures causes home values to drop. With home values falling, many homeowners who are in distress and want to sell their homes—to avoid getting any deeper into debt—cannot attract sales prices high enough to cover the mortgage. So now the issue becomes the value of the mortgage exceeding the value of the home, so borrowers have no financial incentive to continue making mortgage payments. If borrowers are in financial distress and have no incentive to continue making mortgage payments, then defaults will continue to increase, which results in

foreclosures and causes the cycle to start all over again ("Mortgage Crisis Bailout: Relief for Some, Risk for Other").

B. Loose Lending Standards

Part of the reason why such a high number of homeowners are defaulting has to do with the increase in mortgage lending. The Joint Center for Housing Studies of Harvard University refers to the fact that Congress and other regulators have pushed for lending to "low-income neighborhoods" (The State of the Nation's Housing 2008, 17). This study also theorizes that the housing boom occurred prior to 2004 and the escalation of the less than acceptable lending practices (The State of the Nation's Housing 2008, 17).[1] While the poor lending practices have definitely fueled the fire of the housing crisis, at the root of the problem is the loosening of lending standards to lend to those who cannot afford to pay back the loans.

It is not only the low-income that are receiving loans that they cannot afford. The Joint Center for Housing Studies of Harvard University states, "the markets most exposed to cutbacks in loans with interest-only and payment-option features are the country's most expensive" (The State of the Nation's Housing 2008, 19). The increase in lending, however, has been without an increase in qualifications. Lenders have increased the lending to individuals of all income levels by offering loans with options to defer paying.

C. Tight Lending Standards

Now that the problem has been recognized, lenders have tightened lending standards. This has made it more difficult for both potential and current homeowners to

[1] Less than acceptable lending practices refers to what the Joint Center for Housing Studies of Harvard University calls "affordability loans"…which are interest only, payment-option, etc. (19).

obtain loans. Even if a buyer was willing to pay a seller's asking price, banks do not want to lend to anyone who does not have a high credit score and a significant down payment. This would prevent the seller from selling the house, not from lack of demand, but from lack of financing for the buyer. In addition, it is unlikely that current homeowners would be able to refinance to obtain more favorable loan terms without great qualifications. Further escalating the problem is the lack of willingness among banks to renegotiate loans.[2] Homebuyers become stuck with a house that they cannot afford.

D. Foreclosure

Foreclosure is one option that begins to look promising for distressed homeowners. Foreclosure is a fairly simple concept. If a person borrows money to purchase a home, then he signs a mortgage, which is basically a contract promising to give the property to the bank if the borrower cannot pay back what he borrowed plus interest. Failure to pay results in the initiation of the foreclosure process—the lender takes the property as repayment for the loan. As mentioned above there are a few ways to avoid foreclosure—renegotiation of the loan, refinancing, or selling the home—but these are not always available options.

There are a few states that have received a substantial amount of press concerning the foreclosure problem. Certain areas in Florida—specifically Lee County, which is the county of the bankruptcy filers in this study—are becoming well known for having high

[2] Refer to White (2008 4) for a discussion of the reasons why lenders will not renegotiate loans, such as the holders of mortgage-backed securities and second mortgage holders preventing the renegotiation.

foreclosure rates. Florida has a judicial process that lenders must follow for a foreclosure, which usually takes about five months.[3]

Foreclosure is not a pleasant process for the lender or the borrower. The lender bears the costs of the foreclosure process, and may possibly take a loss on the sale of the property, which will likely result in a loss on the mortgage. The borrower loses his home, and may possibly still owe the lender if a deficiency judgment is ordered.

Florida does allow deficiency judgments. According to §702.06 of the 2008 Florida Statutes, "the entry of a deficiency decree for any portion of a deficiency, should one exist, shall be within the sound discretion of the court, but the complainant shall also have the right to sue at common law to recover such deficiency" (The 2008 Florida Statutes). While it is in the discretion of the court to grant a deficiency judgment, a lender could potentially sue the borrower for any amount not collected from the foreclosure sale of the property. This means that even after a borrower's property is taken away, he or she may still be responsible for paying the lender.

In some instances, when the foreclosure sale brings in less than the value of the mortgage, the lender may not pursue the borrower for a deficiency judgment, and may "forgive" the debt. This simply means that the lender will just take the loss, and the borrower will no longer be responsible for the debt. Until December of 2007, a forgiveness of mortgage debt was considered income. If a house was foreclosed on, sold for less than the mortgage balance at the foreclosure sale, and the lender forgave the debt, then the borrower would be responsible for paying taxes on the amount of debt that was forgiven. The Mortgage Forgiveness Debt Relief Act of 2007 excludes "up to $2 million

[3] Refer to RealtyTrac, "Florida Foreclosure Laws" and "Foreclosure State Laws by RealtyTrac" for a more thorough explanation of the foreclosure process in Florida.

of forgiven debt …directly related to a decline in the home's value or the taxpayer's financial condition" ("Home Foreclosure and Debt Cancellation).[4]

Foreclosure will result in the loss of the property, and possibly a deficiency judgment. If the lender forgives the debt, the borrower will no longer be responsible for paying taxes on the forgiven debt. This provision helps to make foreclosure a more attractive option, but previously it may have been better to declare bankruptcy than to allow a lender to foreclose on a one's property.

E. Bankruptcy Alternative

Bankruptcy is a way for a person in financial distress to either reorganize or eliminate the debt that is causing the financial distress. There are two different types of bankruptcy that an individual can file: Chapter 7 or Chapter 13. In Chapter 7, the filer's non-exempt assets will be liquidated, and the funds generated from that liquidation will be distributed to the creditors, but the filer's future income will be exempt from repayment. In Chapter 13, the filer's assets will not be liquidated, but his future non-exempt earnings will be used to repay creditors, the details of which are set forth in a repayment plan. Each chapter comes with advantages and disadvantages. There are also some limitations as to which debts can be discharged. The purpose of filing bankruptcy is to have some debts discharged, so regardless of which chapter a filer chooses, in the end he will not have to pay all of the debts that he had prior to filing.

Prior to 2005, anyone could file for either chapter of bankruptcy regardless of income. Exempt assets would be those assets that the filer is allowed to keep after bankruptcy. Each state has its own limitations for exemptions. For example, in Florida,

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[4] Refer to the IRS article "Home Foreclosure and Debt Cancellation" for a discussion of The Mortgage Forgiveness Debt Relief Act of 2007.

a home can be exempt to an unlimited value (Elias, 272).[5] This would mean that if a filer filed Chapter 7 bankruptcy, in Florida, he could own a million dollar home and have credit card debt discharged after he liquidated his non-exempt assets.

Elias and Leonard explain that a Chapter 13 repayment plan must be equal to at least the value of non-exempt assets that would have been liquidated in Chapter 7 (Elias, 26). If this were not the case, then it would be possible for someone following through with a repayment plan to propose to pay less than if that same person was going through liquidation. There are many options available to homeowners in financial distress: renegotiate the loan, refinance, sell the house, foreclosure, Chapter 7 bankruptcy and Chapter 13 bankruptcy. In most of these options, it is typically assumed that the homeowner in financial distress will experience a loss; however, sometimes it is possible to experience a financial gain, especially in bankruptcy.

F. Change in Bankruptcy

In response to the abuse of the bankruptcy system, Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. White (2005) discusses the trends in bankruptcy over the past couple of decades—there has been a large increase: "241,000 in 1980 to more than 1.6 million in 2003" (White 2005, 44).[6] There has been a large move toward filing bankruptcy as a way out of debt. Not only does it eliminate debts, it provides an opportunity for financial gain, if the filer plans ahead. For example, one way to use the bankruptcy system in one's favor would be to

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[5] Refer to Elias and Leonard's <u>Chapter 13 Bankruptcy: Repay Your Debts</u>, page 272, for a list of all of Florida's exemptions.

[6] Refer to White (2005 II) for more statistics of bankruptcy filing trends.

convert non-exempt assets into exempt assets.[7] The purpose of the new law was to attempt to force the intended use of bankruptcy: for those who are seriously struggling with debt to receive a fresh start—not to be used as a means of financial gain.

White (2008) gives a clear explanation of the ways that Chapter 7 and Chapter 13 bankruptcy can be used to help homeowners who are unable to afford the mortgages that they have on their homes along with the rest of their debt. The requirement to be particularly aware of with regard to filing Chapter 7 is that a filer must not be late with any mortgage payments in order to use Chapter 7 to keep his home. Chapter 13 is a bit more relaxed with regard to mortgage payments. Chapter 13 can actually be used to stop foreclosure—filing keeps the lender from foreclosing on the property. It also helps because it incorporates the mortgage payments into the repayment plan, while discharging other debts.[8] The basic premise behind both is that filing bankruptcy discharges other debts, so that a homeowner can use the funds that they do have to make mortgage payments. The more attractive idea behind Chapter 7 is that it does not require any payments beyond the discharge, whereas Chapter 13 requires a debtor to pay from post-bankruptcy income.

G. Foreclosure, Bankruptcy, or Both?

If a homeowner does not wish to keep his or her home, and the issue causing the most financial distress is the mortgage, foreclosure may be the better option to choose. The burden of cost is on the lender and there is nothing for the homeowner to do, but wait

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[7] White (2007) outlines some of the techniques used to convert non-exempt assets into exempt assets, and the measures taken by the BAPCPA to make those techniques more difficult to achieve, which can be found under *The Bankruptcy Abuse Prevention and Consumer Protection Act*.

[8] White (2008 3) explains how to use Chapter 7 and how to use Chapter 13 to help financially distressed homeowners.

for the lender to take action. Now that there is the provision that excludes the taxes on the forgiveness of debt, bankruptcy is less attractive to a person who is simply looking to free himself of mortgage payments.

Bankruptcy is less attractive than it once was for a few reasons. The most talked about is the new means test, which forces anyone who earns above the state's median income to file for Chapter 13 bankruptcy if he or she wishes to file for bankruptcy. This means that Chapter 7 bankruptcy is no longer available to just anyone. The attempt is to require those who can afford to repay their debts to repay their debts. While Chapter 7 liquidated non-exempt assets, Chapter 13 requires debtors to repay for about five years. If a homeowner no longer wants his home, filing for Chapter 13 is just going to reorganize his payments, not get rid of them. If he allows foreclosure to happen, then the debt—along with the house—will be gone.

Two new provisions are increasing costs. One is actual cost: Chapter 7 went from $600 to $2,500, and Chapter 13 went from $1,600 to $3,500 (White 2007, 12, 16). The other is the course requirement: a filer must take a course before filing, and a course before discharge—the filer must also pay for these courses himself (White 2007, 15). The increase in cost of filing is a significant increase, as is the cost of the courses, and the time and inconvenience of having to take the courses. For a person who is simply trying to get rid of the mortgage payments, these costs are high relative to foreclosure, in which the lender does all of the work. There is a laundry list of reasons as to why a person attempting to free himself from mortgage payments should choose foreclosure over bankruptcy, including attorneys' fees, court dates, and the overall inconvenience of filing.

Things may be a little different when the distressed homeowner wishes to keep the home. Obviously, a homeowner who wishes to keep the home should not choose foreclosure. If possible, the homeowner should attempt a reorganization of the loan or a refinance. As discussed above, this is not always option. Chapter 13 would allow a debtor to prevent foreclosure by enacting the automatic stay, which prevents creditors from initiating any collection process until the repayment plan is in effect (Elias 16). By incorporating the mortgage and past due payments into the repayment plan, the borrower is able to discharge some other debts, so that he or she can make the mortgage payments. The Bankruptcy Abuse Prevention and Consumer Protection Act did not change this strategy, except that fees are higher and the debtor is required to take courses. Chapter 13 basically allows a homeowner to freeze time, so that he can catch up. White (2008) highlights that a mortgage payment is one of the first debts that must be repaid, so if the non-exempt income only covers that debt, then the filer's remaining debts would be discharged (White 2008, 13).

The major changes to filing bankruptcy as an alternative to foreclosure can be found in the changes to Chapter 7 bankruptcy. Chapter 7 has the same changes as Chapter 13 with regard to the increase in fees, and the required courses. As discussed above, only those earning below the state's median income can file for Chapter 7 bankruptcy, so earning too much is a disadvantage. It is possible to file for Chapter 7 bankruptcy and keep a home. As White (2008) pointed out, it is necessary that the filer not be behind on mortgage payments. In Florida, a home is exempt from the assets that are liquidated to repay creditors. The filer could work out an agreement with the lender to continue making mortgage payments as usual, and should the filer be capable of

making the payments (once the other debts are discharged), it would be in the lender's interest to make the agreement. Foreclosures can be very expensive for lenders, and if the lender has good reason to believe that the borrower will continue be able to make the payments, then it can save the lender both time and money to allow the mortgage to commence as usual. Using Chapter 7 to discharge debts, as well as keep a home—in Florida—was a very sound strategy, especially for those who had a decent income. Now that there is a restriction on income, Chapter 7 may not be as useful to wealthier individuals.

Another option available to homeowners would be to combine foreclosure and bankruptcy. The main advantage here would be to receive free rent. Filing bankruptcy first may allow the debtor to postpone foreclosure, by discharging other debts or reorganizing debts to help debtors make the mortgage payments. If the filer determines that he or she cannot make the payments, or no longer wishes to make the payments, then he or she could simply stop making the payments. At this time, the lender would be able to foreclose on the property. By doing this, a debtor would be able to extend the time they are able to remain in the home. If, however, the failure to pay the mortgage payment is the result of failing to make a payment in a Chapter 13 plan, "the court may dismiss the case or convert it to a liquidation case under Chapter 7" ("Bankruptcy Basics: Chapter 13"). The combination may or may not be beneficial to a Chapter 13 filer with other debts included in the repayment plan.

Using foreclosure, bankruptcy, or a combination of the two can provide relief for financially distressed homeowners who are having trouble making mortgage payments, and do not have the option to refinance or renegotiate his or her loan.

III. Data

A. Methods of Study

In this study, 100 bankruptcy filers were analyzed. LexisOne, a data research firm for small law firms, was used to obtain records of filings between January 1, 2003 to December 31, 2004, and January 1, 2006 to December 31, 2007. Those filings between January 1, 2005 and December 31, 2005 were excluded because the Bankruptcy Abuse Prevention and Consumer Protection Act passed in October of 2005, so there would have been a large increase in filings in the months preceding the passing of the Act.

Cape Coral, Florida was chosen as the location from which to gather filings. This area has received a large amount of publicity for having a foreclosure problem. A random zip code from Cape Coral was chosen, as the program needed a more definitive standard than the large city of Cape Coral to run a search.

The filings were analyzed as of their statuses in November 2008. The random zip code chosen was entered into the zip code search field on the LexisOne search page, and all of the filings from that zip code were obtained. This study was only interested in studying the filings that were discharged, so any files that held the statuses *dismissed*, *converted*, or *vacated*, were excluded. A file that was not assigned a status as of November 2008, was included.

In order to determine whether a filer owned a home, the name of the bankruptcy filer was entered into the Lee County Clerk of Court Public Records. Deed was selected as the type of document, and the filer's name was typed into the name search field. A search was run from January 1, 1900 to December of 2008. A filer was considered to own a property if the name on the bankruptcy filing matched the name on the deed: First

Name, Middle Name or Initial, Last Name, and Jr./Sr. (if applicable). At this point more filers may have been excluded from the study. If a filer owned more than one property, it was not possible to determine the primary residence, so he or she would have been excluded. If it could not be determined that the filer owned the property, i.e. the name did not match exactly, then he or she would have been excluded.

Statistics were calculated for various measures. Filers were separated into categories of whether they filed Chapter 7 or Chapter 13; when they filed—2003-2004 or 2006-2007; and which chapter they filed and when they filed: Chapter 7: 2003-2004, Chapter 7: 2006-2007, Chapter 13: 2003-2004, and Chapter 13: 2006-2007. The data from these statistics are shown in Exhibit 1. Exhibit 2 shows the data for those who owned property and those who did not own property for each of the categories: 2003-2004 or 2006-2007; Chapter 7 or Chapter 13; and Chapter 7: 2003-2004, Chapter 7: 2006-2007, Chapter 13: 2003-2004, and Chapter 13: 2006-2007.

The time between purchasing a property and filing for bankruptcy—for those who owned property—was also analyzed. This data is shown for Chapter 7: 2003-2004, Chapter 7: 2006-2007, Chapter 13: 2003-2004, and Chapter 13: 2006-2007, in Exhibit 3. The number of filers in each range of time is shown and separated by year and chapter filed.

Exhibit 4 shows the number of foreclosure sales among the filers who owned property at the time of filing for bankruptcy, which is broken down by 2003-2004 or 2006-2007; Chapter 7 or Chapter 13; and Chapter 7: 2003-2004, Chapter 7: 2006-2007, Chapter 13: 2003-2004, and Chapter 13: 2006-2007.

Exhibit 5 shows the number of days between the filing of foreclosure and the date of the foreclosure sale for the applicable filers. Each of the following four categories are shown in the graph: Chapter 7: 2003-2004, Chapter 7: 2006-2007, Chapter 13: 2003-2004, and Chapter 13: 2006-2007. The number of filers in each range of time is shown, and separated by year and chapter filed.

B. Results

There were a total of 100 filers. Of the 100, 51 filed between 2003-2004, and 49 filed between 2006-2007.

Of the 51 that filed between 2003-2004, 30 filed Chapter 7 and 21 filed Chapter 13. Of the 30 that filed Chapter 7 between 2003-2004, 12 owned property. Of the 21 that filed Chapter 13 between 2003-2004, 7 owned property.

Of the 49 that filed between 2006-2007, 24 filed Chapter 7 and 25 filed Chapter 13. Of the 24 that filed Chapter 7 between 2006-2007, 14 owned property. Of the 25 that filed Chapter 13 between 2006-2007, 16 owned property.

A different perspective would show that of the 51 who filed between 2003-2004, 19 owned property; while, of those 49 who filed in 2006-2007, 30 owned property.

In addition to the ownership rates, foreclosure rates were also analyzed. In each category, it was determined whether the owner who filed for bankruptcy kept the property after the bankruptcy, or sold the property (as of December 2008). In 2003-2004, four of those who owned homes and filed Chapter 7 bankruptcy sold the home after the bankruptcy. Of those four, one was a foreclosure sale. In 2006-2007, four of those who owned homes and filed Chapter 7 bankruptcy sold the home after the bankruptcy. Of those four, all four were foreclosure sales. In 2003-2004, three of those who owned

homes and filed Chapter 13 bankruptcy sold the home after bankruptcy. Of those three, one was a foreclosure sale. In 2006-2007, six of those who sold homes and filed for Chapter 13 bankruptcy sold the home after bankruptcy. Of those six, all six were foreclosure sales.

Exhibit 3 shows the time between the purchase of a home and the filing of bankruptcy for both chapter and year. The data in these charts consists of the bankruptcy filers studied who owned a home. Each horizontal line represents two filers.

In Exhibit 5, the time between filing for bankruptcy and the foreclosure sale is shown. The data in this chart consists of the 12 filers who underwent foreclosure. Each horizontal line represents one filer.

C. Analysis

In 2003-2004, 58.82% of bankruptcy filings were Chapter 7 filings, with only 41.18% being Chapter 13 filings. In 2006-2007, the numbers evened out with 48.98% being attributable to Chapter 7 filings and 51.02% to Chapter 13 filings. This basically shows that prior to the Bankruptcy Abuse Prevention and Consumer Protection Act, if a person were to file bankruptcy he or she would be more likely to file for Chapter 7 rather than Chapter 13.

The main issue of this study is to determine the likelihood that part of the foreclosure problem is that individuals are choosing foreclosure as an alternative to bankruptcy, so it is important that the homeownership rate among bankruptcy filers is established. In 2003-2004 40% of Chapter 7 filers owned property, but 58.33% of Chapter 7 filers owned property in 2006-2007. In 2003-2004 33.33% of Chapter 13 filers owned property, but 64% of Chapter 13 filers owned property in 2006-2007. In general,

37.25% of filers owned homes in 2003-2004, with 61.22% of filers owning home in 2006-2007. There was a large increase in the percentage of filers who owned homes after the Bankruptcy Abuse Prevention and Consumer Protection Act passed. This increase indicates that more homeowners were in financial distress after the Act's passing.

At first glance, this appears as though that bankruptcy was actually helping more after the Act passed; however, the data in Exhibit 2 shows why this is not the case. Of the total that filed for bankruptcy and owned a home between 2003-2004, 63.16% filed for Chapter 7 while only 36.84% filed for Chapter 13. In 2006-2007, however, only 46.67% filed for Chapter 7 while 53.33% filed for Chapter 13. Chapter 7 allows a liquidation of non-exempt assets to pay creditors, and a home is not a non-exempt asset in Florida. Chapter 13, however, requires the filer to repay some of their debts from post-bankruptcy income. This makes Chapter 7 easier because it allows the debtor to be free of future obligations, whereas Chapter 13 requires future obligations on the part of the debtor.

Chapter 7 would allow a debtor to use future income to make mortgage payments by discharging other debt. While Chapter 13 does include a mortgage in a repayment plan, it includes other debts to repay as well. By including the other debts, it may not be possible for the debtor to make the mortgage payments as well as the other required debts that he or she owes. Therefore, the increase in homeowners filing is an increase in Chapter 13 homeowners filing, not Chapter 7 homeowners filing. This implies that in order to use bankruptcy to save a home, the filer must be capable of entering into a repayment plan, which requires the debtor to pay other debts in addition to the mortgage.

One of the more obvious trends is that of the time between the filer's purchase of his or her property and the filing of bankruptcy. In both Chapter 7 and Chapter 13 during 2003-2004, the number of years between the purchase of the property and the filing of bankruptcy is very sporadic, as can be seen in Exhibit 3. However, there is a clear difference in 2006-2007. In both Chapter 7 and Chapter 13, the trend is similar. The majority of filers filed for bankruptcy within three years after the purchase of his or her home. The trend shows that those filing between 2006-2007 owned their homes for a much shorter period of time than those filing between 2003-2004. These filers would be of the group who bought during the supposed "housing boom," when borrowing is considered to have been more accessible, and lenders were lending with no-doc loans and the like. This implies that these are people who really should not have been in these houses because they simply could not afford them.

There appears to be more Chapter 7 filers in 2006-2007 who filed within three years after purchasing the property than there are Chapter 13 filers. In 2006-2007, there are more Chapter 13 filers—than Chapter 7 filers—who had owned the home for more than three years. The restriction on Chapter 7 filers that mandates that they not make more than the state's median income can be seen in this trend. It is likely that those who filed Chapter 7 bankruptcy in 2006-2007 had a lower income relative to those who file Chapter 13. Those with an income above the median level would not be allowed to file for Chapter 7, and would be forced to file Chapter 13, if at all. Logically, it can be assumed that those who filed Chapter 7 were less able to make mortgage payments on a mortgage that he or she could not afford, so these individuals were unable to hold onto the house for as long as those who filed Chapter 13. Those who filed Chapter 13 could

potentially have a higher income, and make mortgage payments for a longer period because of the larger income.

Another significant finding of the data is the foreclosure rate among bankruptcy filers—after the bankruptcy was filed. As discussed above, of the four Chapter 7 homeowners that sold his or her house, and filed between 2003-2004, one was a foreclosure sale. Of the three Chapter 13 homeowners that sold his or her house, and filed between 2003-2004, one was a foreclosure sale. Because there are so few homeowners who sold his or her home to analyze, it is difficult to draw a conclusion for 2003-2004.

There is a significant foreclosure trend among the filers in 2006-2007 (refer to Exhibit 4). Of those who homeowners filed for Chapter 7 in this time period, all of the individuals who sold his or her property did so through a foreclosure sale. This is also the case for those who filed Chapter 13 in this time period. Although it is only four individuals for Chapter 7 filings and six individuals for Chapter 13 filings, all of those who sold their homes sold through foreclosure sales. This implies that those filing for bankruptcy in 2006-2007 were doing so to keep his or her home because the only ones who did not keep his or her home lost his or her home through foreclosure. Those filing in 2006-2007 were most likely part of the contributors to the real estate crisis.

Related to the foreclosure data is the time between filing for bankruptcy, and the actual foreclosure sale. There is a significant amount of time between filing and a foreclosure sale, as can be seen in Exhibit 5. Filing for Chapter 13 bankruptcy stops a lender from foreclosing on a home, so at the time of filing a filer could stop making payments, but remain in the home. This would essentially be free rent for filers, and the

amount of time is significant. The 2006-2007 filers whose homes were foreclosed on in the end were able to obtain between four and sixty months, with a median of about 13 months, of free rent. Combining bankruptcy with foreclosure had the potential to allow a filer to discharge debts in addition to receiving free rent.

There were a few influences among the filers in this study. In 2003-2004, there really are no obvious trends. The data in 2003-2004 should be used as a baseline for analyzing the filers of 2006-2007. The filers in 2006-2007 have a connection to two important events: 1) the real estate crisis and 2) the enacting of the Bankruptcy Abuse Prevention and Consumer Protection Act. These filers, both of Chapter 7 and Chapter 13, show a trend of not owning the property for very long before filing for bankruptcy. The implication of this is that these individuals were responsible for mortgage payments that they could not afford because they were granted loans for which they should not have qualified. The second significant trend is that of all the filers who owned property, the only ones who "sold" their properties did so through the foreclosure process. This further supports the implication that these individuals could not afford the loans. Bankruptcy was likely used to prevent foreclosure, yet in the end these individuals lost their homes in foreclosure anyway, which with the possibility of free rent, may or may not have been intentional. A statistic that even further supports the fact that more homeowners were unable to afford their mortgage in 2006-2007 is the percentage of filers who were homeowners. In 2003-2004, about 37.25% of filers were homeowners, while that percentage increased to 61.22% in 2006-2007. In general, more bankruptcy filers were homeowners—who recently purchased his or her home—in 2006-2007, which

implies that more individuals who recently purchased a home in the preceding years were financially distressed in 2006-2007.

More specifically, another trend is the switch from filing Chapter 7 bankruptcy to filing Chapter 13 bankruptcy: while 63.16% of filers who owned a property in 2003-2004 chose to file Chapter 7 over Chapter 13, only about 46.67% chose to file Chapter 7 over Chapter 13 in 2006-2007. This shows that by including the means test—which would keep anyone earning more than the state's median income from filing Chapter 7—some homeowners were likely prevented from filing Chapter 7.

The real estate crisis is clearly exhibited through the choices and actions, as well as the results of those choices and actions of the bankruptcy filers in this study: the choice of homeowners to file for bankruptcy; the foreclosures that may result; and the choice of one chapter of bankruptcy over another, or in combination with foreclosure, whether that choice is by willingness or circumstance.

IV. Conclusion

The analysis of the study has a few limitations. First of all, the exact details of the filings were not used. This makes it difficult to use valuable information such as a filer's income, non-exempt and exempt assets, Chapter 13 cases in which filers failed to make payments as required by the repayment plan, and any outside agreements worked out with mortgage companies to continue mortgage payments. The second issue is with limiting the study to one zip code of Cape Coral. Cape Coral, Florida is a troubled area, but that does not mean one zip code is necessarily representative of the entire city. A third problem is the exclusion of filers in the area because the specific information about their filings could not be obtained. This problem is somewhat related to the first

problem. Obviously, more research would be needed to determine whether or not my conclusions are completely on target; however, given what I have found, it can be shown that the change in bankruptcy law has had an effect on the foreclosure rate.

The major changes in bankruptcy law that have affected the actions of debtors are discussed below. These items have made bankruptcy more difficult, which has made foreclosure a more attractive option for homeowners.

To File for Chapter 7, Earnings Must Be Below Median Income

Now that a restriction has been placed on the amount of income as Chapter 7 filer can earn, it is likely less homeowners will be able to use Chapter 7 as an alternative to foreclosure. In order to obtain a mortgage, a debtor should make enough money to repay that mortgage over a certain amount of time. It is likely that the debtor's income will be more than the state's median income. As can be seen in the data of the study, the percentage of bankruptcy filers that were homeowners who filed Chapter 7 was less in 2006-2007 than it was in 2003-2004. While Chapter 13 filings have increased, it is a less attractive option than Chapter 7 as it requires future obligations, which may interfere with mortgage payments, causing the loss of the home through foreclosure in the end.

The Increase in Costs and Required Courses

Intuitively, higher costs and more time that must be invested (in the courses) is likely to play some role in deterring individuals from filing bankruptcy. Although, there has not been a decrease in the number of filings, there has not been an increase either. There has been an increase in the percentage of homeownership among filers. This is a reflection of the overall increase of homeowners in distress. The lack of increase in filings, despite an increase in financially distressed individuals, shows that those

individuals are not filing for bankruptcy, therefore, choosing an alternative. The increase in costs and required courses may have been a factor in the rejection of the bankruptcy option.

Obstacles to the Conversion of Assets

White (2007) lists some of the provisions included in the Bankruptcy Abuse Prevention and Consumer Protection Act that has hindered the conversion of non-exempt assets into exempt assets. This affects both Chapter 7 filers and Chapter 13 filers. Chapter 7 filers are affected because prior to the Act, they may have been able to have less of their assets liquidated. Chapter 13 filers are affected because—as they must repay at least the value of their non-exempt assets—the total amount that they would have to repay may have been lower. The following list specifies some of these provisions:

- Unless the filer has lived in a state for at least two years, he or she must use the old state's exemptions.
- A homestead exemption will be not be for more than $125,000—in any state—unless the property was purchased at least 2 1/2 years prior to filing.
- Paying down a mortgage must be completed at least 3 1/3 years prior to filing, or the equity added to the home will not be considered exempt.
- Home renovations must be completed at least 10 years prior to filing for the equity added to the home to be exempt.

While it may have once been possible to plan ahead, in terms of bankruptcy, and to convert non-exempt assets into exempt assets, the new provisions require any type of planning to be very far in advance. The amount of time that a filer would have to know that he or she would be filing in the future is almost impossible. It is unlikely that a filer

would be able to plan that far in advance. These provisions basically cause filers to be more liable for a greater amount of repayment to creditors—either through liquidation of non-exempt assets, or repayment equal to the value of non-exempt assets.

The new difficulties of bankruptcy has played a role in increasing the foreclosure rate, simply by making foreclosure a more attractive option.

The Mortgage Forgiveness Debt Relief Act of 2007

The Mortgage Forgiveness Debt Relief Act of 2007 did not truly apply to the filers in this study. It may have applied to those filing in 2007 because there is the possibility that they were aware of the discussion on passing the Act, which may have persuaded some individuals to allow foreclosure rather than file for bankruptcy. There would be no way to quantify this number, other than asking individuals who went through the foreclosure process if this was the case.

In general, this new Act will most likely persuade even more individuals to choose foreclosure, either instead of or in conjunction with bankruptcy. "Debts discharged through bankruptcy are not considered taxable debt," which is a benefit that was once offered through bankruptcy, but not foreclosure ("Home Foreclosure and Debt Cancellation"). This act has allowed an individual who is going through the foreclosure process to receive a forgiveness of debt—the home sells at a foreclosure sale for less than the mortgage, and the lender does not hold the borrower liable for that difference—which gives that individual a break on taxes. Under previous circumstances, that difference forgiven would have been considered taxable income, which would have required an individual who had just gone through foreclosure and lost his or her home to pay taxes

even though there was no monetary gain. This act serves to make foreclosure an even more attractive option.

What the Results Mean

In the analysis of the results, I am able to show that there was a decrease in the percentage of homeowners who filed Chapter 7 bankruptcy from 2003-2004 to 2006-2007, which would be concurrent with the Bankruptcy Abuse Prevention and Consumer Protection Act preventing homeowners in distress from filing Chapter 7 bankruptcy to avoid foreclosure. While Chapter 7 would allow a debtor to liquidate non-exempt assets to repay creditors, and use all future income to repay a mortgage, Chapter 13 would not allow this. Chapter 13 would require that a debtor repay not only the mortgage lender in the repayment plan, but other creditors as well.

The results also showed that homeowners that filed bankruptcy in 2006-2007 were more likely to have recently purchased (within the past three years) the home, which implies that these homeowners should not have received mortgage loans in the first place, especially those filing Chapter 7 bankruptcy between 2006-2007, as they were required to be below the state's median income by law. It is not to say that those with lower than the state's median income should not own homes. It simply means that an individual with lower income should receive a lower loan amount. If a person makes $20,000 a year, then he or she should not receive a loan for $300,000. It is simple mathematics; the income should be able to repay the loan over a certain period of time.

As Joint Center for Housing Studies of Harvard University states, "the markets most exposed to cutbacks in loans with interest-only and payment-option features are the country's most expensive" (The State of the Nation's Housing 2008, 19). The problem is

by no means limited to low-income homeowners. This is part of the reason that the foreclosure problem has been escalated by the change in bankruptcy law. Debtors with an income above the state's median income level have been prohibited from filing Chapter 7 bankruptcy. This has left many distressed homeowners with a choice between Chapter 13 bankruptcy and foreclosure, or some combination of the two. Bankruptcy requires more costs (to attorneys, to the court, for the required financial courses) and more time (court dates, meetings with attorneys, sitting in the actual courses). Combining Chapter 13 bankruptcy and foreclosure may be intentional or unintentional on the part of the debtor, but it has the same result: preventing the lender from foreclosing, reorganizing debts into a repayment plan (which includes the mortgage and possibly other debts), and eventually not making the required plan's payment. Filing for Chapter 13 will at the very least delay foreclosure, and if the cost of rent for the amount of time foreclosure is delayed is greater than the cost of filing for bankruptcy, then the filer may be able to obtain free rent. The results of this study show that there are substantial amounts of free rent to be gained from the combination of bankruptcy and foreclosure.

When a homeowner is in distress, it comes down to what option will provide the most benefit, or the least burden. Bankruptcy was made more expensive, complicated, and difficult, and overall less attractive. The findings show that the percentage of bankruptcy filers owning homes has increased from 37.25% in 2003-2004 to 61.22% in 2006-2007. There has not, however, been a corresponding increase in the actual number of bankruptcy filings. With more homeowners being in distress, and bankruptcy being a less attractive option, homeowners likely found foreclosure to be a more attractive alternative.

The Bankruptcy Abuse Prevention and Consumer Protection Act has played a role in the increase of foreclosures. Filing for bankruptcy is an alternative to foreclosure, and in making that alternative more difficult to use, foreclosure becomes a more attractive option.

Exhibit 1: Filers by Tme Frame and Chapter

		Chapter 7		Chapter 13	
Total Filers	100	54	54.00%	46	46.00%
Filed in 2003-2004	51	30	58.82%	21	41.18%
Filed in 2006-2007	49	24	48.98%	25	51.02%

Exhibit 2: Ownership Rates Among Filers by Time Frame and Chapter

	Total Filers	Owned Property		Did Not Own Property	
2003-2004	51	19	37.25%	32	62.75%
2006-2007	49	30	61.22%	19	38.78%
	Total Property Owners	Owners Who Filed Ch. 7		Owners Who Filed Ch. 13	
2003-2004	19	12	63.16%	7	36.84%
2006-2007	30	14	46.67%	16	53.33%
		Owned Property		Did Not Own Property	
Total Chapter 7 Filers	54				
2003-2004	30	12	40.00%	18	60.00%
2006-2007	24	14	58.33%	10	41.67%
Total Chapter 13 Filers	46	Owned Property		Did Not Own Property	
2003-2004	21	7	33.33%	14	66.67%
2006-2007	25	16	64.00%	9	36.00%

Exhibit 3: The Number of Years between Purchasing and Filing

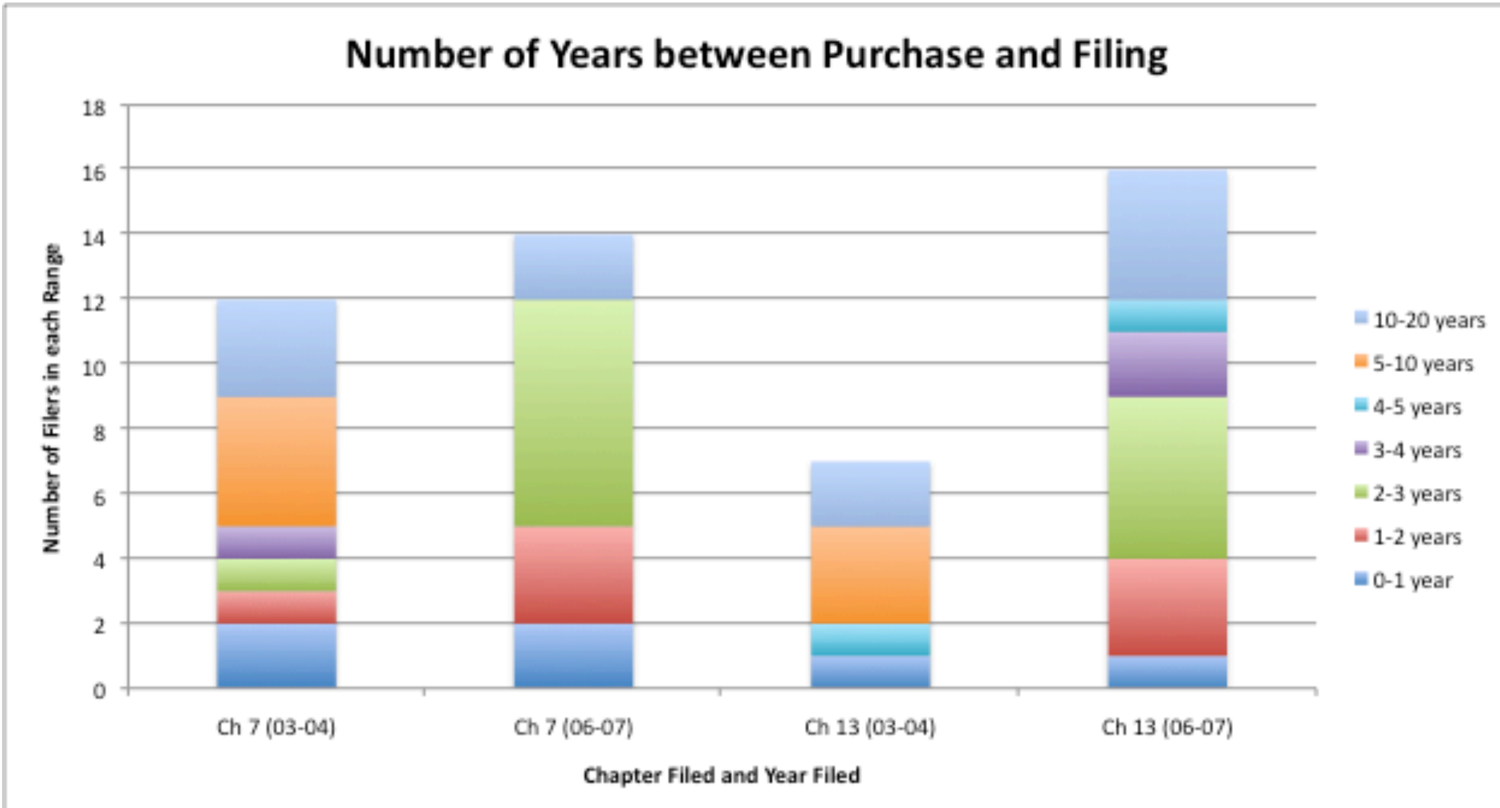


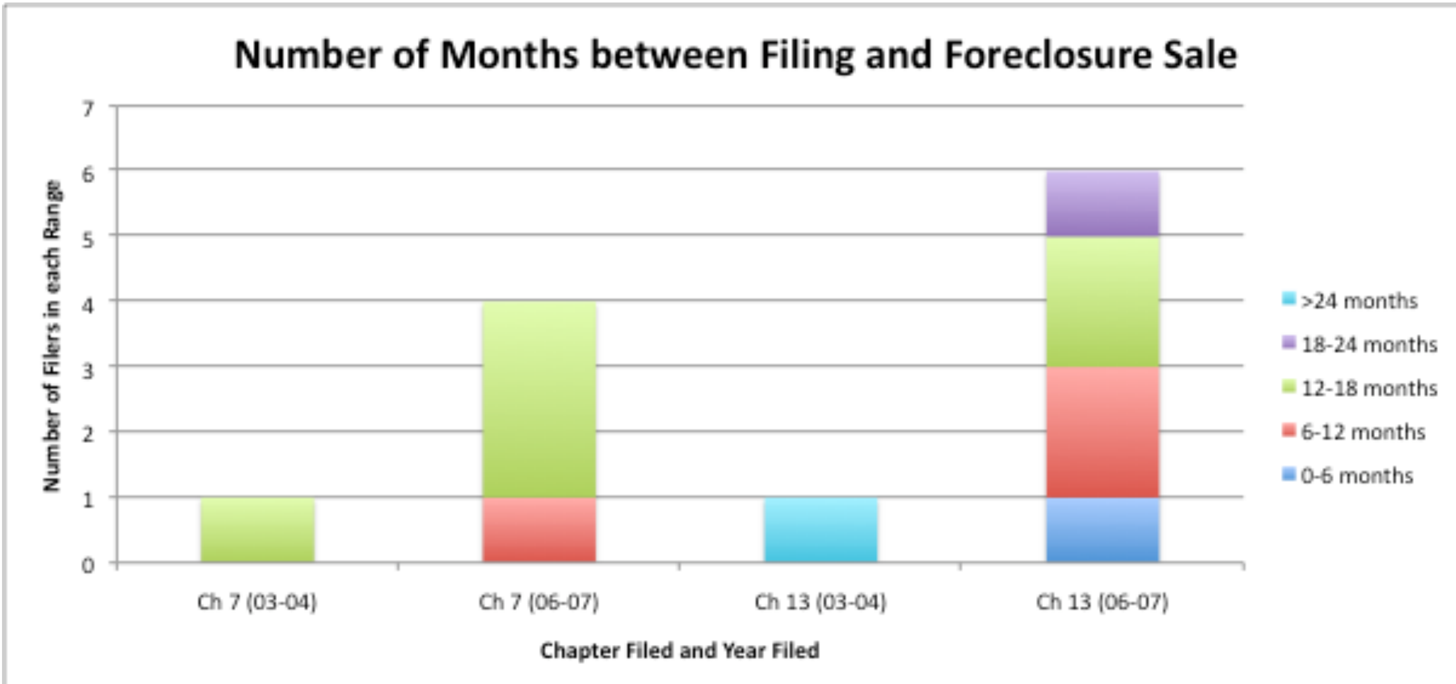
Exhibit 4: Foreclosure Rates Among Filers Who Owned Homes By Time Frame and Chapter

	Total Filers	Owned Property	Sold Property		Foreclosure Sales	
2003-2004	51	19	7	36.84%	2	28.57%
2006-2007	49	30	10	33.33%	10	100.00%

Chapter 7	Total Chapter 7 Filers	Owned Property	Sold Property		Foreclosure Sales	
2003-2004	30	12	4	33.33%	1	25.00%
2006-2007	24	14	4	28.57%	4	100.00%

Chapter 13	Total Chapter 13 Filers	Owned Property	Sold Property		Foreclosure Sales	
2003-2004	21	7	3	42.86%	1	33.33%
2006-2007	25	16	6	37.50%	6	100.00%

Exhibit 5: The Number of Months between Filing and Foreclosure Sale



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