

## Stripping Off Second Mortgages in Bankruptcy

### Q: What is a second mortgage strip off?

A: A second mortgage strip off is when a homeowner who has filed a Chapter 13 bankruptcy is allowed to “strip off” (no longer be liable) for a totally underwater second mortgage. Typically, the limitations in the Bankruptcy Code prevent a mortgage on a principal residence from being modified in a Chapter 13 case. Various courts have held that when the amount of the first mortgage is more than the value of the property, the second and third mortgages are no longer secured and the limitation on modification no longer applies. For this reason, courts have held that these underwater second and third mortgages can be treated as unsecured claims and stripped off by a Chapter 13 plan.

### Q: Are second mortgage strip offs recognized in Minnesota?

A: **Yes.** In a recent Minnesota Bankruptcy Court decision, *Fisette v. Keller*, for the first time in Minnesota the Court allowed a debtor to explore a plan to strip off a second and third mortgage because the first mortgage was for over \$175,000 when the appraised value of the property was only \$145,000. Therefore, no equity existed in the property to secure the second or third mortgages and they were treated the same as unsecured debt.

### NOTE

**This FAQ provides general information and is not meant to be legal advice. Consult a competent legal professional for advice specific to your situation.**

### Q: What if a mortgage is only partially secured?

A: Under existing Bankruptcy law as interpreted by the Supreme Court in *Nobleman v. Am. Sav. Bank*, 508 US 324 (1993), if a mortgage is even partially secured, meaning that any portion of the property value is higher than the amount owed on the first mortgage, that mortgage **cannot** be modified (i.e. reduced to the value of the house) as it is not unsecured according to the Bankruptcy Code. In this situation the mortgage remains on the property, and cannot be stripped off in a Chapter 13 bankruptcy.

### Q: When does the strip off of a wholly unsecured mortgage go into effect?

A: According to the court in *Fisette*, the strip off of a wholly unsecured mortgage is effective as soon as the debtor has fulfilled his or her obligations under the bankruptcy plan. Fulfillment of a Chapter 13 bankruptcy plan includes completion of monthly trustee payments over an average period of three to five years as established in the plan.

**Q: How has this changed?**

A: Before *Fisette*, Minnesota courts had refused to allow for strip offs of unsecured mortgages in bankruptcy plans. After this case however, a new tool is available. In line with most other courts, Minnesota now formally recognizes the ability to strip off second mortgages of underwater homeowners in Chapter 13 bankruptcy proceedings. Second mortgage strip offs do not apply in Chapter 7 bankruptcies.

**Q: Who can I talk to about bankruptcy?**

Only an attorney can give you advice about whether to file bankruptcy. Nonprofit Homeownership Advisors can give you general information about bankruptcy but cannot give you advice about whether bankruptcy is a good option for you. A Homeownership Advisor can help you develop a budget to assess whether a Ch. 13 repayment plan may be affordable, and discuss other options if you're struggling with your mortgage payments.

*This information is provided as a service of the Minnesota Homeownership Center and is not legal advice. Consult a competent legal professional for advice specific to your situation.*

For additional information about foreclosure contact a Homeownership Advisor in your area by contacting the Minnesota Homeownership Center today: 651-659-9336 or 866-462-6466 or [www.hocmn.org](http://www.hocmn.org).