

Why Homeowner Assistance Fund Programs Should be Accessible to Homeowners in Bankruptcy

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The American Rescue Plan Act of 2021 includes \$9.9 billion for creation of a Homeowner Assistance Fund (HAF) to be administered by the Treasury Department. The HAF was established to mitigate financial hardships connected with the coronavirus pandemic and prevent foreclosures among homeowners who have experienced a hardship related to the pandemic. Treasury has released initial [guidance](#) regarding how states should utilize the HAF funds pursuant to an approved plan. States have until July 31, 2021 to submit their proposed HAF plans for approval or provide information regarding when they will submit their proposed HAF plans.

State plans should not exclude borrowers in active bankruptcy from eligibility for the HAF assistance. As explained below, homeowners might need to file bankruptcy for a number of reasons, including preventing a foreclosure sale from occurring while they wait for HAF programs to open for applications and then go through the application process. These borrowers will still need HAF assistance, and helping this population of borrowers to avoid foreclosure would fulfill both the letter and the spirit of the American Rescue Plan.

Many Homeowners Recovering from Economic Impacts of the Pandemic Will Need to File Bankruptcy.

Many homeowners who have experienced a financial hardship related to the COVID-19 pandemic may need to file bankruptcy. This could be necessitated by medical expenses not covered by insurance, credit card debt accumulated during a period of unemployment, car payments that fell into arrears, or other bills that have mounted during the past year. In addition, many homeowners will file bankruptcy in order to prevent a foreclosure sale from occurring while they are attempting to apply for HAF assistance. For example, one-third of the mortgage market is comprised of non-federally backed mortgages that have not been subject to any moratorium on foreclosure sales. These borrowers are among those most likely to need HAF assistance, because their servicers offer few other viable options to save their homes. There is likely to be a surge in foreclosure filings for these homes between now and August 31, 2021, as servicers rush to begin foreclosure before a CFPB rule providing additional foreclosure protections goes into effect. For many of these borrowers, the only way to save their homes will be to file bankruptcy while awaiting HAF assistance.

These homeowners should still be able to obtain HAF assistance despite their active bankruptcy case. Many of them will not be able to afford the necessary bankruptcy payments unless their mortgage arrears are covered by HAF funds. They will need to devote their available income to paying up car arrears or other required amounts in the bankruptcy plan.

States are required to spend at least 60% of the HAF funds on eligible purposes related to homeowners who are up to 100% of area median income or U.S. median income, whichever is greater. These below-median income homeowners are more likely to be financially struggling on multiple fronts, and may need bankruptcy protection for a variety of reasons. They should not be blocked from accessing the HAF program based on having an active bankruptcy case. As described below, bankruptcy law does not pose a barrier to receiving the assistance.

Clearing up Common Misconceptions About Bankruptcy:

- **Mortgage servicers can communicate with borrowers who are in an active bankruptcy case.** Mortgage servicers can, and are required to, send mortgage statements to borrowers in active bankruptcy. They can review such borrowers for loss mitigation, and they frequently offer loss mitigation options to borrowers in bankruptcy. Some bankruptcy courts even have programs to facilitate this process. Servicers can also communicate with HAF administrators regarding matters like mortgage account reinstatement as part of the process of facilitating the use of HAF assistance to cure mortgage delinquencies. These actions do not violate the bankruptcy “automatic stay.”
- **Servicers cannot refuse to take a full mortgage reinstatement simply because a borrower is in bankruptcy.** If the borrower provides sufficient funds to bring the loan current, the servicer must apply it properly to the loan and must not send the money back. If servicers improperly send the money back, the borrower’s bankruptcy attorney can and should intervene to correct the problem. Chapter 13 Trustees can also be helpful in making sure that mortgage servicers correctly apply HAF funds.

A Number of States Had Success Providing Hardest Hit Funds Relief to Borrowers in Bankruptcy.

A number of states successfully provided [Hardest Hit Fund](#) (HHF) assistance to homeowners in an active bankruptcy case. Given the similarities between the HHF and HAF programs, the experiences of program administrators in these states demonstrate that borrowers in bankruptcy can receive funds under this kind of program without legal barriers. The states that allowed homeowners to receive HHF funds while in an active bankruptcy case include at least the following: Arizona, Illinois, Indiana, Michigan, North Carolina, and Rhode Island.

Homeowners in a Chapter 7 Bankruptcy Should Not Be Excluded from HAF Assistance.

Chapter 7 bankruptcy is a relatively short process. Typically, a chapter 7 case will last for about 6 months from the bankruptcy filing to the entry of the bankruptcy discharge. In chapter 7 bankruptcy, debtors must disclose to the court all of their assets, debts, income, and expenses. Any assets the debtor owns that exceed the allowed exemptions are sold for the benefit of the creditors. Chapter 7 bankruptcy is most helpful for dealing with unsecured debts like medical and credit card debt. If a borrower is in default on a secured loan like a mortgage or car loan, the creditor’s lien will survive the bankruptcy, so the borrower must cure the default in order to avoid repossession of the car or foreclosure on the home.

The bankruptcy court and chapter 7 Trustee oversee the case to ensure that creditors are treated equitably (and that no creditor is being unfairly given preference) and that the debtor is not hiding assets that could be paid over to creditors. Since secured creditors must be paid if the debtor wishes to retain the property, there is no problem with the HAF program administrator making direct payment to the mortgage creditor to cure the mortgage arrears. If the HAF assistance is awarded after the bankruptcy filing date, this money should not be treated as an asset of the borrower, because it arose post-petition. Moreover, because funds will typically be paid directly to the mortgage servicer (and the

borrower will never exercise control over the funds), there is an additional argument that this is not an asset of the bankruptcy estate.

Questions have been raised about whether a borrower in a chapter 7 bankruptcy case can receive assistance to repay utility arrears, which is one allowed purpose for HAF funds. If a HAF program is paying utility arrears on behalf of a borrower in bankruptcy, there may need to be some consideration of whether this is a secured or unsecured debt. In some jurisdictions, municipal water service is secured by a lien by operation of law. If the utility debt is secured, there should be no problem with paying the debt in full despite the pending bankruptcy. If the utility debt is unsecured, a voluntary payment by the debtor after the bankruptcy filing still should be acceptable, but another option would be to simply use the HAF funds to pay the deposit for future utility service (usually equal to two times the average monthly bill), and allow the old account balance to be discharged in the bankruptcy.

Borrowers in Chapter 13 Bankruptcy Should Not Be Excluded from HAF Assistance.

Chapter 13 bankruptcy involves a payment plan in which the debtor pays a required amount over a three to five-year period and only then receives a discharge. Because the chapter 13 plan allows for curing the arrears on a secured debt over that three to five-year period, this is the most common kind of bankruptcy filing by homeowners attempting to save their home from foreclosure.

Similar to a chapter 7 bankruptcy, debtors in a chapter 13 case must disclose to the court all of their assets, debts, income, and expenses. However, in a chapter 13 filing, the creditors are typically paid through the chapter 13 plan payments (from the debtor's disposable income), rather than from the sale of assets.

When a chapter 13 case is filed, the debtor proposes the chapter 13 plan, including how much will be paid to various creditors. A confirmation hearing is scheduled for about 2 months after the case is filed, although confirmation is often postponed several times while the debtor works on addressing any objections from the chapter 13 trustee or creditors and possibly modifying the proposed plan. Regardless of whether a chapter 13 plan has been confirmed or has not yet been confirmed, the approval for HAF funds may be a reason for the debtor to modify the chapter 13 plan. If that is necessary, the debtor's bankruptcy attorney can be expected to handle it.

Program administrators should be able to send HAF funds directly to mortgage servicers. When debtors make their usual chapter 13 plan payments to the chapter 13 trustee, this includes an amount for the mortgage arrears, which are then sent by the chapter 13 trustee to the mortgage servicer. Sometimes the monthly plan payment also includes an amount to cover the prospective mortgage payments that come due during the plan – bankruptcy court districts that require this are known as “conduit” jurisdictions. In either case, chapter 13 trustees can agree to allow a direct payment to the mortgage servicer. Many chapter 13 trustees allowed Hardest Hit Funds (HHF) payments to be sent directly to the mortgage servicer rather than being passed through the trustee's account. This kind of direct payment is likely the best way to handle the HAF funds. The bankruptcy attorney can contact the chapter 13 trustee to inform them of the direct payment being sent. Depending upon the terms of the debtor's confirmed plan, if the HAF assistance paid to the servicer will cure the mortgage arrearage, the debtor may wish to modify the plan.

The only other potential issue in an active chapter 13 case is that court approval is required if the debtor will incur a debt while the bankruptcy case is pending. When HHF assistance was structured as a

forgivable loan, this required bankruptcy court approval. Such approval was easily granted with no opposition, because it was in the best interest of all creditors for the mortgage arrears to be cured in this manner. When HAF assistance is structured as a grant rather than a forgivable loan, the bankruptcy court would not need to approve the chapter 13 debtor's participation in HAF.

How to Ensure that State HAF Programs Work Well for Borrowers in Bankruptcy

States should allow borrowers in bankruptcy to receive HAF assistance, and should follow these steps to smooth the way:

1. **Include a question on the application form about whether the borrower is in an active bankruptcy**, and a statement that, if the answer is yes, the borrower should inform their bankruptcy attorney that they are applying for program funds. The borrower's bankruptcy attorney is in the best position to take any necessary steps to ensure that funds are handled properly and to deal with any bankruptcy implications.
2. **Communicate with Chapter 13 Trustees.** If there are questions or common issues arising with respect to HAF funds for borrowers in bankruptcy, program administrators could communicate with the Chapter 13 Trustee(s) in the relevant bankruptcy court district (some states have one federal district court, and others have more than one) to find out if they would like to develop a template or common procedure that will be followed when debtors in Chapter 13 bankruptcy are receiving HAF funds.
3. **If servicers send back the funds, escalate the problem.** Servicers should not be sending back money received from HAF programs. If that does happen in a rare occasion early in the program, the servicer needs to be educated about the fact that they can accept this money and must apply it to the mortgage account. Usually the borrower's bankruptcy attorney is the best situated to communicate this, although a Chapter 13 trustee can also help. Unrepresented or "pro se" bankruptcy filers might be able to get free legal assistance with this discrete issue from a legal services program in the area. NCLC is willing to help put any HAF program administrator in touch with a knowledgeable legal services attorney or Chapter 13 Trustee in order to eliminate any friction in this process.
4. **Make sure funds are applied properly.** Servicers should be required to apply the funds to the account properly to bring it current. Both inside and outside of active bankruptcy cases, it is important for state administrators to oversee this process and follow up on any issues.

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