UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In re

CYNTHIA MOONEY Case No. 03-14955 K

Debtor

Ordinarily, a mortgage payoff figure can be stated with certainty without any regard whatsoever to the market value of the mortgaged premises. But some "subsidized" mortgages involve "recapture" provisions that are pegged to the actual or appraised value of the property at the time the mortgage is satisfied. Such a mortgage poses a question here.

In the Second Circuit, a Chapter 13 debtor may treat a junior mortgage on her residence as unsecured under 11 U.S.C. § 506(a) and 11 U.S.C. § 1325(b)(2) in accordance with the 2nd Circuit decision in *In re Pond*, 252 F.3d 122 (2001) if that junior mortgage is not supported by at least a dollar of value. It may be stripped down to a "zero" secured claim, despite *In re Nobelman*, 508 U.S. 324 (1993). The residence here was appraised for the Debtor at $45,000[1] and the Debtor has obtained a payoff statement from the U.S. Department of Agriculture (USDA), the first mortgage holder, in the amount of $54,137.99. There is a second mortgage in excess of $22,000 held by Attica-Wyoming Correctional Employees Federal Credit Union (Credit Union) that would be treated, under the *Pond* Decision, as unsecured if the Debtor's balance on the first mortgage is in fact greater than the value of the residence.

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[1] This value is disputed by the credit union.

The question here is whether the Debtor may include in the USDA payoff balance the amount of $16,446.35 described as the "maximum amount of subsidy subject to recapture." The mortgage with the USDA is subject to a Subsidy Repayment Agreement (See Appendix A attached) which outlines when and to what extent the borrower may be responsible for any portion of the recapture amount. The Credit Union argues that the amount of recapture ($16,446.35) is not properly included in the payoff amount because the Debtor might never be required to pay any portion of the recapture amount, such as if the Debtor paid the loan off and deferred the recapture until her death, or if the property were to lack sufficient value to "trigger" a "recapture." And it also argues that the structure of the USDA subsidy is such as to assure that there is value supporting the Credit Union loan, in that a certain amount of equity that is otherwise liened by the USDA is released by the USDA loan documents in a way as to give value to the junior mortgage.

Part l

Taking the latter argument first, it can be seen that the Subsidy Repayment Agreement contemplates that any equity in the home that existed at the time of the subsidized borrowing (by virtue of a down payment on a new purchase, or, in borrowing against a home already owned, by virtue of borrowing less than the value of the home) is set aside to the borrower, [see ¶ 6(f)], so long as the home is worth more than the balance due on the loan.

Here, using the Debtor's own valuation of $45,000 we find that there is a payoff balance due (excluding recapture) of $37,671.53, leaving equity "subject to recapture" of $7308.47. But $1300 of that would be allowed to the Debtor in a hypothetical sale of the

property for $45,000.

And so the Credit Union argues that $1300 is value supporting its junior mortgage, and *Pond* cannot apply.

That argument is rejected. So long as the amount claimed by the senior mortgage does not exceed the amount liened (here the Mortgage Instrument had a face amount of $40,700, but stated that "[T]his instrument also secures the recapture of any interest credit or subsidy which may be granted to the Borrower by the Government pursuant to 42 U.S.C. § 1490a") the junior lienor cannot avail itself of any agreement solely between the borrower and the senior lienor by which the senior lienor might be viewed as having given up value in favor of the borrower. Were this not true, then every episode of some form of grace or forbearance (such a waiver of a late fee) that works in favor of a borrower must be viewed as giving value to the junior lienholder. Here, the recorded mortgage gave notice to the Credit Union that there might be interest subsidy and that the mortgage secured all recapture; the fact that the USDA sets aside some recapture to the borrower is not a waiver of the mortgage in favor of a junior lienor.

More difficult is the closely-related question of whether the Debtor here could herself be viewed as having, in essence, encumbered, in favor of the Credit Union, any right to such a set-aside, thereby giving value to the junior lien. That will be discussed in Part 3 of this Decision.

Part 2

The Credit Union has argued that if there would be no recapture in a hypothetical sale of the home at the appraised value as of the date of the filing, then no amount of recapture

should be included in the mortgage payoff figure used to determine whether there is any value supporting the junior lien. And the Court is satisfied that the Credit Union is correct that there would be no recapture in a hypothetical sale at the appraised value of $45,000. This is because the Debtor owed in principal, interest and real property taxes, a total of $37,691.53, leaving only $7,308.47 available toward any recapture. But no recapture occurs until after that $7308.47 is reduced (see ¶ 6(c)) by hypothetical costs of sale (for other purposes, we use 10% of fair market value,[2] which equals $4500), and by the amount of principal paid off on the loan calculated at the promissory note interest rate (¶ 6(d)) which was $11,233.85. Only if the $7308.47 were NOT exhausted, would the USDA then be entitled to receive "Any principal reduction attributed to subsidized interest calculations," and (¶ 6(e)) (later on down the priority sequence[3]) a portion of the "value appreciation."

The Court finds that the above approach is fully analogous to the "usual" *Pond* scenario, in which the payoff figure for the senior mortgage, set forth without regard to the value of the property, is fixed on the filing date. That has historically been the relevant date for innumerable purposes under the Bankruptcy Code, and in the usual *Pond* scenario, it is the relevant date for the computation of the payoff figure for the senior lien.[4]

The Court sees no reason why the same date should not control as to mortgages

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[2] See *In re Dixon*, 140 B.R. 945 (Bankr. W.D.N.Y. 1992).

[3] It is in the midst of this part of the sequence that the Debtor's original $1300 equity, as discussed in Part l of this Decision, would be set aside to the Debtor.

[4] This writer has never been asked whether a different date should control, such as, perhaps, the date of the hearing on the motion, or the date of confirmation of the plan, or the date of the Chapter 13 discharge, etc.

such as this, where the payoff figure depends upon the market value of the property. The Debtor's own appraisal, obtained for purposes of this *Pond* determination, is for $45,000. Because of the complexities of the "Recapture" formula, it is not clear to the Court how much higher the value would have to reach in order to hit the precise dollar amount at which recapture would eat up every dollar of value other than the $1300 set-aside. But it seems that that would require a substantially higher value. At some point too there would be at least a dollar of value for the second mortgage. Application of the *Pond* holding in such a case seems enigmatic, at least without having the USDA's computer program for recapture computations as a resource.

Fortunately, however, that is irrelevant because the recapture computations only yields to us the hypothetical payoff amount. Once we have that, we must add back in the value that the USDA would not exact from the Debtor at a $45,000 sale - - the $4500 costs of sale and the $11,233.85 in principal-paid-down-at-the-note rate.

Part 3

The question as to these two items then becomes "Whose value is that, anyway?" It certainly is value to which the first lienor has a right as against the junior lienor. And it certainly is value to which the Debtor has a contract right as against the first lienor.

But now we must address the question left unanswered at the end of Part 1 above. Did the Debtor herself convey that value (as security) to the Credit Union by granting it the mortgage?

The answer lies in a document not presented to the Court - - the second mortgage instrument. Such instruments typically convey a security interest not just in the land, but in any rents, condemnation awards, hazard insurance proceeds, etc. To the best of this writer's knowledge, second mortgages do not generally convey an owner's rights to any credits, etc. that the owner is entitled-to as against the first lienor. But the fact that the senior lien here was a USDA mortgage may have led the credit union to use a different kind of second mortgage instrument.

CONCLUSION

The Court finds that the language of the second mortgage instrument will be determinative of whether this *Pond* motion will be successful or unsuccessful.[5] If this matter is not settled by **November 21, 2003**, then the Credit Union shall provide the Court with a copy of the instrument, for the Court's interpretation.

SO ORDERED.

Dated: Buffalo, New York
October 30, 2003

/s/ Michael J. Kaplan
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U.S.B.J.

[5] As noted in footnote 1 above, the Credit Union also disputes the $45,000 appraisal; today's ruling is without prejudice to returning to that issue if the mortgage instrument is in the Debtor's favor.

APPENDIX A