

The Risk of Becoming the Biggest Loser: Using Bankruptcy to Save the American Dream

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Consumers often find that attaining an asset, like a house, is a challenge, only to discover that holding on to it can seem impossible. Currently, American households are suffering from the after-effects of the Great Recession. The Great Recession was characterized by high unemployment, record numbers of foreclosures and high levels of bankruptcy filings. Each of the participants of this study sought bankruptcy protection and the timing of this action is important because it comes on the heels of the Great Recession. For all of the participants of the study, bankruptcy was used as a measure of asset protection to save the American dream of homeownership.

Twenty-four consumers filing Chapter 13 completed surveys and consented to be interviewed as they waited for creditor meetings at bankruptcy court. Twelve had mortgages and half of these participants, representing couples, were selected for the study. Interviews were audio recorded and transcribed. Categories, developed from data analysis, were used to inductively evaluate the financial condition of the participants. Data from surveys, interviews, and bankruptcy records were used to identify the status of participants' employment, housing, and financial solvency.

The results pertaining to the status of the participants' households are particularly relevant because the setting of the study was Memphis, TN, located in the 8th District of the Federal Reserve Bank. Memphis is the king of Chapter 13 because it has traditionally led the nation in Chapter 13 bankruptcy filings. In addition, in 2011, Memphis received the unenviable distinction of having the third sickest housing market in America, according to the 24/7 Wall St. housing analysis. To make matters worse, Memphis was also recently declared the poorest metro area in the nation, based on data from the U.S. Census Bureau's American Community Survey.

Results indicated that participants experienced changes in their employment status that affected the level of income, which became a major factor in the consumer's ability to meet their mortgage obligation. Another related factor was age and health that affected the ability of the consumer to work and earn sufficient income. Mortgage financing options used by consumers were varied. Although some participants still held their original mortgages, others had refinanced their mortgage or had home equity loans that affected their ability to pay for their homes. Financial ratio results indicated housing was the largest item affecting the household balance sheet of participants. In addition, findings also indicated that many consumers made attempts to communicate with their mortgage lenders and were denied opportunities for loan modifications. Participants indicated that bankruptcy was used as a last resort to avoid foreclosure after efforts to improve their finances and negotiate better mortgage terms failed.

At the 2008 National Research Symposium on Financial Literacy and Education, researchers concluded that qualitative research on consumer financial behaviors should be encouraged to explore important issues and factors that are not addressed by quantitative research. This study addresses this gap by exploring bankruptcy as a form of asset protection in a qualitative research study, based on interviews that provide personal feedback from the consumer. That feedback was enhanced by objective data like financial records that were part of the participant's bankruptcy file.

The results indicate that many participants have experienced financial difficulty due to events related to the Great Recession that were beyond their control. Although bankruptcy can provide financial relief, its effectiveness was hampered by the passage of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) of 2005. The Act was promoted as a measure of reform but it made the process of filing bankruptcy more difficult. An increase in the foreclosure rate was a potential unintended consequence of this law because consumers no longer had the option of choosing Chapter 7 to eliminate unsecured debt so income could be freed to pay for the household mortgage. Options should be explored to reverse this act or improve it, given the number of people affected by the Great Recession. This is a time when financial relief through bankruptcy should be readily available to American consumers. The bankruptcy option can be further enhanced by empowering the court with the ability to modify mortgage loan terms.

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The infrastructure available to obtain mortgages and buy homes is well established. However, there is no well-defined infrastructure to assist consumers when circumstances beyond their control affect their ability to survive financially. The benefits of homeownership have been researched and received strong support. If attaining the dream of homeownership is important, then efforts to hold on to that dream should be addressed and receive just as much attention.