

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WISCONSIN

UNITED STATES
BANKRUPTCY COURT
FILED

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In re

LINDA L. MIDDAUGH,

Debtor.

C.L. AUSTIN, CLERK
MILWAUKEE, WISCONSIN

Case No. 02-32054

Chapter 13

MEMORANDUM DECISION ON DEBTOR'S OBJECTION TO
CLAIM OF USDA (#3) AND DEBTOR'S OBJECTION TO
USDA'S MOTION FOR RELIEF AND ABANDONMENT

INTRODUCTION

The debtor, Linda L. Middaugh, filed this chapter 13 case on September 19, 2002. The United States of America, acting through the Rural Housing Service, Rural Development, filed a proof of claim on November 6, 2002, in the amount of \$40,421.16 (Proof of Claim No. 3).¹ The proof of claim also stated that the arrearage on current loan payments at the time of filing was \$1,072.96.

The debtor filed an objection to the claim, asserting she could not determine how the Rural Housing Service arrived at the \$40,421.16 figure, the amount of the total indebtedness was no more than \$6,296.81, the subsidy amount subject to recapture was less than \$40,421.16, and the date her debt was incurred was May 30, 1980, not March 29, 1984, as shown on the proof of claim (Document No. 35).

¹The agency acknowledged at trial and in its brief that this figure should be \$38,199.01 due to a recalculation of the interest subsidy for 1980-84.

On May 1, 2003, the Rural Housing Service filed a motion for relief from the automatic stay and abandonment on the grounds the debtor had not made a payment since the bankruptcy was commenced. The motion further stated that the debtor, as of April 29, 2003, had incurred a postpetition arrearage in the amount of \$2,145.92, the balance owed on the debt was \$40,804.22, and the property had an assessed value of only \$43,470 (Document No. 48).

The court held combined evidentiary hearings on the debtor's objections to the claim and to the motion for relief on December 17, 2003 and February 4, 2004. The court heard testimony from Rand Bersch and Julie Giese from the Rural Housing Service, the debtor, Linda Middaugh, and the debtor's accountant, Ronald Langenfeld. Both parties submitted post-trial briefs on their respective positions.

LEGAL AND FACTUAL BACKGROUND

On May 30, 1980, the debtor obtained two loans from the Farmers Home Administration, now known as the Rural Housing Service, Rural Development. One loan was in the amount of \$24,100, with an interest rate of 10%, and the second was in the amount of \$4,400, with an interest rate of 11%. The debtor qualified for a payment subsidy, explained below, which reduced the amount of her installment payments, but is subject to recapture upon the occurrence of certain events. According to the debtor, she obtained the loans as part of a divorce settlement to pay off some indebtedness on her home, as well as to remodel the property. The loans, and any subsidy recapture or other amounts due the agency, were secured by a real estate mortgage on a home located at 1919 Park Avenue, New Holstein, Wisconsin (Exhibit B). Based upon the real estate tax bill for

2003, which updates the value stated in the motion, this property has an estimated fair market value of \$45,690 (Exhibit K).

The debtor decided not to remodel, and after the closing, \$8,798.77 remained undistributed from the loan proceeds. This was to be applied to both loans. On March 26, 1981, the smaller loan was paid in full from the proceeds. The agency, however, made an error in applying the remaining balance to the larger loan. In 1983, the error was corrected and the funds were properly applied to the larger loan, with retroactive credit to the date the funds should have been applied. In 1989, the agency also failed to apply a \$124 payment, but that error was also corrected. Although there was considerable testimony from the debtor concerning these errors, it appears to the court all payments have now been properly credited.

After the loan was made, the debtor was placed on a twelve-month payment moratorium, ending March 29, 1984, at which time the \$24,100 loan was reamortized, curing the debtor's delinquency. The principal balance at the time of the reamortization was \$18,495.69 and the accrued interest was \$1,643.49, for a new principal amount of \$20,139.18 (Exhibit C). The reamortization agreement signed by the debtor provided the debtor would then make a monthly payment of principal and interest in the amount of \$178. Any subsidy granted during the term of the loan would reduce this monthly amount. The debtor's actual payment history proved to be rather sporadic.

The last regular monthly payment made by the debtor was in December 2001 (Exhibit F). The last payment made on the loan was made by tax intercept in 2002, in the amount of \$848.42. The debtor has not made any payments since her petition was filed because she feels the installment payments due under the mortgage have been paid in full. In other words, she no longer is required to make monthly payments, and the mortgage secures only the subsidy recapture. If principal and

interest payments are still due, plus the monthly escrow amount, the debtor's monthly payment should be \$268.24. While the debtor objected to making escrow payments, these are now an agency requirement when there is a default, such as occurred when the agency had to pay a portion of the 1998 real estate taxes not paid by the debtor (Transcript p.57). Furthermore, the reamortization agreement provides that escrow payments may be required at any time (Exhibit B). The agency has from time to time paid additional real estate taxes, plus certain insurance premiums (Exhibit K). Because the debtor has not been making her monthly payments, there is a negative balance in the escrow account of \$1,160.08 (Exhibit H).

As part of the agency's interest subsidy program, 7 C.F.R. Part 3550, the debtor was allowed to make smaller monthly mortgage payments, based on a formula which took into account various aspects of the debtor's financial situation.² The mortgage states that it is subject to present (1980) FHA regulations and to future regulations not inconsistent with the terms of the mortgage. Thus, from time to time over the course of this loan, the way the subsidy is determined has changed, such as whether an income tax homestead credit is applied to reduce real estate taxes used to calculate the subsidy. The agency's accounting system has changed, and it changed from local record keeping to its Centralized Servicing Center. This made the 24 years of the debtor's financial relationship with the creditor difficult to understand and to reconstruct.

²The subsidy was calculated each year, later changed to every other year, based upon financial information provided by the borrower, such as number of dependents, living expenses, real estate taxes and insurance. The debtor is currently not receiving the interest credit subsidy because, as of 1997, the credit is not available to borrowers such as the debtor who fail to make a full payment (Transcript of 12/17/03 Hearing, p. 64).

Based upon the agency's subsidy audit, the debtor has received the following in interest subsidies (See Exhibits AA, BB, F):

<u>Time Period</u>	<u>Subsidy Received</u>	<u>Totals</u>
June 1980 - September 1981	\$ 122.00 per month	\$ 1,952.00
February 1983 - March 1984	\$ 137.00 per month	\$ 1,918.00
April 1984 - March 1985	\$ 111.00 per month	\$ 1,332.00
April 1985 - March 1986	\$ 109.00 per month	\$ 1,308.00
April 1986 - March 1990	\$ 111.00 per month	\$ 5,328.00
April 1990 - March 1991	\$ 77.00 per month	\$ 924.00
April 1991 - March 1992	\$ 81.00 per month	\$ 972.00
April 1992 - March 1993	\$ 100.00 per month	\$ 1,200.00
April 1993 - March 1994	\$ 95.00 per month	\$ 1,140.00
April 1994 - March 1995	\$ 73.00 per month	\$ 876.00
April 1995 - March 1996	\$ 85.00 per month	\$ 1,020.00
April 1996 - March 1997	\$ 69.00 per month	\$ 828.00
June 1997	\$ 69.00	\$ 69.00
July 1997	\$ 197.48	\$ 197.48
September 1997 - January 1998	\$ 98.74 per month	\$ 493.70
February 1998	\$ 98.74	\$ 98.74
April 1998 - June 1998	\$ 98.74 per month	\$ 296.22
July 1998	\$ 210.04	\$ 210.04
August 1998	\$ 222.60	\$ 222.60
March 1999 - June 1999	\$ 111.30 per month	\$ 445.20
September 1999 - February 2000	\$ 111.30 per month	\$ 667.80
March 2000	\$ 222.60	\$ 222.60
December 2000	\$ 111.30	\$ 111.30
January 2001	\$2,000.90	\$ 2,000.90
February 2001 - November 2001	\$ 111.05 per month	\$ 1,110.50
April 2002	\$ 444.20	\$ 444.20
		<u>\$25,388.28</u>

Although the agency shows the balance on the loan is \$6,296.81, the agency's lien on the house would be far greater due to the subsidy lien. Because the debtor is currently living in the house, the subsidy is not due. Even if the loan were paid off, the subsidy granted during the term of the loan would not have to be paid as long as the debtor lives in the house, as she plans to do for the foreseeable future. However, if the property were sold, the subsidy agreement provides a formula

for how the sale proceeds would be distributed (Exhibit N). First, the subsidy is recaptured. This includes the interest subsidy, plus the amount of principal paid down more quickly because of the interest subsidy (Exhibit DD). The amount of principal reduction attributable to subsidy received by the debtor is \$4,309.47³ (Exhibits GG, FF). Then, if the debtor has equity in the property, it permits the debtor to receive a portion of the “value appreciation.” If the property is voluntarily conveyed to the government or liquidated by foreclosure, the debtor will not receive any portion of the value appreciation. Pursuant to the mortgage note, if the debtor pays off the principal and interest on the loan, the subsidy recapture remains a lien on the property until due (Exhibit B).

The amount due on the loan in the event of foreclosure is thus calculated as follows:

Principal	\$ 6,296.81
Interest	1,040.27
Escrow	1,160.08
Interest Subsidy	25,388.28
Principal Reduction	
Attributable to Subsidy	4,309.47
Total	<u>\$38,194.01</u>

The debtor’s expert, Ronald Langenfeld, CPA, testified that based upon his review of the debtor’s records, the loan would have been paid off as of September 2001. This included a recalculation of the amount due under the reamortization agreement in 1984. Because Mr. Langenfeld’s opinion was based only upon information provided to him by the debtor, his calculations did not take into account the facts that the debtor did not make all of her payments timely, she was not entitled to the subsidy when she did not occupy the premises, and the agency advanced funds for real estate taxes and insurance.

³Principal reduction attributed to subsidy for the period prior to the amortization, 1980 to March 1984, is \$780.40. Principal reduction attributed to subsidy for the period after the amortization to the present is \$3,529.07.

ARGUMENTS

The agency contends its proof of claim is accurate, with an adjustment of the interest subsidy figure for the 1980 to 1984 period. Because the fair market value of the property is \$45,690 and the total mortgage and subsidy recapture balance is \$38,194.01, the agency asserts there is only a minimal equity cushion. In the event of a foreclosure judgment, the agency would be required to afford the debtor either a six-month period of redemption if no deficiency is sought, or a one-year period of redemption if a deficiency judgment is sought. Therefore, interest will continue to accrue, along with real estate taxes and hazard insurance costs. According to the agency, there is no "cushion" in this case and the automatic stay should be terminated and the property abandoned by the trustee.

The debtor contends the proof of claim filed by the agency includes loan balance and subsidy recapture amounts which are unreliable. Even if the agency's figures for subsidy recapture and principal reduction attributable to subsidy are taken as correct, this would leave the agency with a claim in the amount of \$29,697.75 on a property assessed at \$45,690. The debtor asserts she should not be penalized for reasonably believing the mortgage had been paid in full. The agency has failed to establish that its claim is correct or that its interest in the property is not adequately protected.

DECISION

Proof of Claim.

Pursuant to 11 U.S.C. § 502 and Fed. R. Bankr. P. 3001(f), a proof of claim is prima facie evidence of the validity and amount of the claim. The burden of going forward then shifts to the

objecting party, who must present evidence equal in probative force; only then does the burden revert back to the claimant to prove the validity of the claim by a preponderance of the evidence.

The debtor asserts that the amounts claimed due by the agency are unreliable, inconsistent, and manipulated. Without question, the documentation in this case has been a mixed bag. However, the court is not persuaded the agents responsible for unsnarling this mess have any nefarious scheme to defraud the debtor, and in fact they have made a good faith effort to claim only what is due. Furthermore, given that regulations and accounting procedures have changed over the years, there was no showing by Ms. Middaugh that the agency violated its own rules in getting a subsidy in any particular year; on the contrary, it appears that sometimes Ms. Middaugh received a subsidy when she was not entitled.

An example of the agency's alleged manipulation of evidence is set forth in the debtor's post-trial brief. The debtor had sent for accountings of loan activity, and one delivered in November of 2001 showed she had received a subsidy of \$2,074 for the period during which she did not occupy the house. A follow up accounting received the next month removed this subsidy because she was not entitled to it during the period from September 1981 through January 1983. Yet, the brief observes, both spreadsheets show the debtor behind in payments on December 6, 2000, by \$3,310.87. Without the subsidy, she should have been farther behind. So how can this be? Easy. In March of 1984, the loan was reamortized, and both accounts show a zero balance. Subsequent activity was identical in both accountings, resulting in the same default amount sixteen years later.

The debtor has not provided a credible proposal for the amount of the interest or principal reduction subsidies. All she can say is that she is not satisfied with the agency's calculation (Transcript p.125). Her post-trial brief indicates that the interest subsidy should be no more than

\$30,684.76; however, since the agency calculates the interest subsidy at \$25,388.28 and the principal reduction subsidy at \$4,309.47, for a total of \$29,697.75, the court will accept the agency's calculations. This amount constitutes a lien against the debtor's homestead but it is not subject to payment, except under the conditions stated under the loan and mortgage. As these conditions are not contemplated by the debtor's plan, these amounts are owing but not yet due.

As to the loan amount, the debtor contends she must be paid in full by now. She based this on calculations done by her CPA, Mr. Ronald Langenfeld, who based his calculations on a straight 1% rate. He was not aware of the \$2,074 subsidy the debtor had improperly received when she did not reside in the property from 1981 through 1982; thus, his calculation of the reamortization amount was short by at least this much. Coincidentally, Mr. Langenfeld conceded that if the principal amount were increased by about \$2,000, there would be a positive balance due on the loan (Transcript p.169). Also, he did not take into consideration the fact that 1% was a minimum amount, and she might not have been entitled to that amount every year, nor did he consider defaults and agency advances for real estate taxes and insurance. Consequently, his testimony must be disregarded.

The agency figures show principal due of \$6,296.81, plus interest of \$1,040.27, and an escrow shortage of \$1,160.08, all as of the date of filing. These are supported by the evidence and are allowed. The arrearage in payments as of the date of filing is \$1,072.96. The post-petition arrearage was \$4,023.50 as of December 2003 (Exhibit E), and this default continues to accrue at the rate of \$268.24 (\$178 principal and interest, \$90.24 escrow) per month. The court allows the amount of pre- and post-petition arrearages and will allow the filing of a supplemental claim for the amount of the post-petition arrearage through July 2004.

Relief from the Automatic Stay and Abandonment.

The movant bears the initial burden of showing "cause" for relief from the automatic stay, whereupon the burden shifts to the debtor to show that the creditor's interest is adequately protected or there is other cause for the stay to remain in place. 11 U.S.C. § 362(d)(1). Additionally, the party seeking relief or adequate protection payments has the burden to establish that the debtor does not have any equity in the property, and after the party seeking relief establishes a lack of equity, the burden of proof shifts to the debtor to show that the property is necessary for an effective reorganization. 11 U.S.C. § 362(d)(1), (g)(1, 2).

Here, the debtor has not made note payments, and she has a history of not making timely payments of real estate taxes. However, her failure to make payments was because of her strong conviction that none were due. If she makes timely payments, that cause goes away. As the agency's claim has been allowed, she will be required to do so beginning in August 2004. As the debtor's income will not allow for a lump sum payment of the post-petition arrearage, the agency shall file a supplemental claim for payments through July 2004.

The total lien on the debtor's homestead was \$38,194.01 as of the date of filing. The house is worth approximately \$45,690. Therefore, the debtor does have equity in the property. It is doubtful that the debtor could find suitable housing as cheaply as \$268.24 per month; thus, maintaining this home is necessary for an effective reorganization.

With such a small equity cushion, if the debtor does not make timely full payments, the creditor will no longer be adequately protected. Furthermore, failure to make proposed plan payments to the trustee will jeopardize the agency's adequate protection because a significant amount of payments will be coming from the trustee on account of the arrearage claim.

Accordingly, the agency's motion for relief from the automatic stay is denied, subject to the debtor maintaining current payments to the creditor and to the trustee. It will be necessary to have a confirmed plan before distributions can be made by the trustee. If the debtor does not have a confirmed plan by August 31, 2004, or if the debtor defaults at any time on payments to the plan or on the terms of the loan, the agency may renew this motion by letter to the court.

Dated at Milwaukee, Wisconsin, July 23, 2004.

BY THE COURT



Honorable Margaret Dee McGarity
Chief United States Bankruptcy Judge

This is to certify that copies of this document were mailed
this 23 day of July, 2004 to the following:
Atty. Kevin Knefel & King
By: DM