



## **Deeds in Lieu of Foreclosure: The Basics**

By Alison Hohengarten, Of Counsel, Hurley Re PC

One of the alternatives to foreclosure when a borrower has defaulted on a property loan is offering a deed in lieu of foreclosure. This process transfers the current interest in the property of the borrower to the lender, usually in exchange for the lender's waiver of one or more rights it would have if it pursued foreclosure.

Typically, the first step in the process is the borrower making an offer to deed the property to the lender. If the offer is accepted, either at face value or through one or more negotiations on terms, a settlement agreement is drafted. The settlement agreement is an important part of the process in part because it sets forth the consideration for the Deed in Lieu. It usually states that the borrower has entered into the transaction on a voluntary basis, and it specifies exactly what will be released. It should also clearly state the agreement and the intent of the parties to maintain the mortgage lien, so that it remains in place in cases where there are junior lenders on record and the lender wants to avoid problems associated with merger. Merger problems may occur where the same party (i.e. lender) holds both the mortgage lien and the title to the property (i.e. received through a deed in lieu of foreclosure), so the mortgage debt "merges" into the fee title and is therefore extinguished. That merge leaves lender without a way to foreclose against other creditors, including junior lenders. By stating in the settlement agreement that the mortgage is not extinguished or cancelled, nor is the borrower released from the debt (and sometimes that lender covenants not to bring any action against the borrower for any deficiency), a lender may avoid the problems presented by the doctrine of merger.

All that said, the lender will not usually accept an offer for a deed in lieu unless there are no other junior encumbrances on the property, partly because of merger and partly because they are taking back an encumbered property, thus making it difficult to sell. In some cases where there are junior lenders, the lender may require that the borrower make some additional contribution to the amount owing.

Once settlement is reached, the closing is much like any other property sale transaction, wherein the lender will want a title insurance policy and has to perform due diligence prior to closing in order to understand the condition of title. The Deed in Lieu closing will also include the executed settlement agreement, some sort of affidavit from the borrower that it is a voluntary process, the title insurance policy and in some cases, a separate instrument from lender setting forth its covenant not to sue. The Deed in Lieu can be beneficial for borrowers facing foreclosure in that it may not hurt their credit as much as a foreclosure and it offers some finality often faster than a foreclosure. It can be beneficial for lenders similarly in terms of speed, and is potentially cheaper than the ultimate cost of a foreclosure process.

For more information regarding Deeds in Lieu of Foreclosure and other property transfer or loan default issues, please contact Alison Hohengarten at 541-317-5505.