

Deeds In Lieu Of Foreclosure



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The difficult part is understanding deeds in lieu from both sides of the fence.

IF YOU WERE to research the topic of deeds in lieu of foreclosure, you would find it tends to be discussed from two different perspectives — the lender's perspective and the borrower's perspective. In most legal writings, deeds in lieu of foreclosure are generally discussed from the lender's point of view. The concerns focus, for example, on whether the lender can obtain good and marketable title upon the conveyance, whether it can preserve the priority of its mortgage lien against junior lienholders and inchoate mechanics' liens, or whether the deed in lieu of foreclosure process may be preferable to the costs and delays often associated with the foreclosure process. *See* John C. Murray, *Deeds in Lieu of Foreclosure — Current Developments*, http://www.firstam.com/ekcms/uploadedFiles/firstam_com/References/Reference_Articles/John_C_Murray_Reference/Foeclosures/deedsliu.pdf (2001); *see also* *CIT Group/Consumer Finance, Inc. v. U.S.*, No. 1:06-CV-72 SEB-JMS 2007 WL 2325843, at * 1 (S.D. Ind., March 14, 2007); *see also generally* James R. Stillman, *Taking a Deed from the Borrower: Structure and Form*, *Modern Real Est. Trans.* (vol. 3, July 2004). For a thorough discussion of lender's concerns and excellent procedural review of the deed in lieu of foreclosure process generally, *see also* W. Wade Berryhill, *Deed in Lieu of Foreclosure, Structuring Commercial Real Estate Workouts: Alternates To Bankruptcy*

(2nd ed. 1999); *see also generally*, Deborah Paris & Steven Williams, *What Lender's Counsel Should Know About Deeds in Lieu of Foreclosure*, 6 Prac. Real Est. Law. 57 (Sept. 1990).

In those articles that discuss the borrower's concerns, however, the pith of the story always is that the deed in lieu of foreclosure process is preferable to a foreclosure because it allows the borrower to avoid the public embarrassment of a foreclosure proceeding. The goal of this article is to explain, in plain terms, some of the significant elements of the deed in lieu of foreclosure process so that you, the reader, can get a sense of the issues from both perspectives.

WHAT EXACTLY IS A DEED IN LIEU OF FORECLOSURE?

• A deed in lieu of foreclosure is actually a process. The process commences when the borrower is no longer able to continue making payments to his lender. Having defaulted under the loan, the borrower (who in writings is also called the mortgagor) might approach his lender with an offer to surrender his property in exchange for the lender not foreclosing on the property, but rather accepting it as consideration for and in discharge of the borrower's debt. *See In re Anderson*, No. 95-15419-SSM 1997 WL 1102027, at *6 (Bankr. E.D. Va. August 29, 1997) ("a deed in lieu of foreclosure is a voluntary deed conveying mortgaged property to the secured party as an alternative to the proceedings that would otherwise be required under applicable state law to foreclose the owner's equity of redemption. Usually, although not necessarily, the consideration for the conveyance is the full or partial satisfaction of the secured debt.").

Once the offer is made, the lender will respond whether it will accept the borrower's offer and, if so, under what terms. At that point, the parties will negotiate the terms of the surrender, which will be memorialized in a settlement agreement at closing. Before closing, the lender will engage in a traditional due diligence process, such as reviewing the

status of leases and contracts affecting the property, seeking title insurance from its title company, etc. If all goes well, the parties will proceed with closing, at which time the transfer of the deed from the borrower to the lender will be made and the lender will arguably hold absolute title (versus only a security interest in) the property.

DRAFTING THE SETTLEMENT AGREEMENT

• As suggested above, the deed in lieu of foreclosure process should begin with the borrower making a written offer to deed the property to the lender. This is an important step, because it will evidence that the transaction is voluntary on the part of the borrower. *See* John C. Murray, *Deeds in Lieu of Foreclosure: Practical and Legal Considerations*, 26 Real Prop. Prob. & Tr. J. 459 (1991). This journal article by John Murray, which is incredibly comprehensive and oft cited both herein and in many court opinions, suggests that:

"[u]nless the offer of conveyance by the borrower is voluntary, there is a significant risk that the borrower may later contest the transaction. Factors that taint a transaction include undue pressure, fraud (actual or constructive), unconscionable advantage, duress, undue influence, or grossly inadequate consideration. For example, if the borrower successfully argues duress or undue influence, the entire transaction may be set aside. In the alternative, the borrower may choose to recover the value of the property, the equity of redemption, or the profits realized on resale. Additionally, if the lender's conduct is flagrant or outrageous, courts may assess punitive damages against the lender."

Id. at 463. *See also* *Levenson v. Feuer*, 803 N.E. 2d 341, 349 (Mass. App. Ct. 2004); *Shawmut Bank Connecticut, N.A. v. Rensyn Assocs.*, No. CV-94-0071169 1995 WL 230983 (Conn. Super. Ct. April 12, 1995).

If the transaction is not voluntary, but rather the result of undue pressure from or influence by the lender, for example, a court may, upon review of the transaction, set it aside. *See* Murray, *supra*, at 463. Upon receipt of the borrower's offer, the lender should acknowledge the offer in writing, making clear in its response the exact terms upon which it would accept a deed in lieu of foreclosure from the borrower. *Id.* at 465.

Consideration

If the borrower accepts the terms of the lender's response, the parties have the basis for their deed in lieu of foreclosure agreement, which is commonly referred to as a settlement agreement. The first term the parties will want to memorialize in the settlement agreement is the consideration that will be given in exchange for the deed. *Id.* at 468. In most, but not all cases, the consideration for the deed in lieu of foreclosure is the forgiveness of the underlying debt. *Stewart Title Guar. Co. v. Fallgatter*, No. F045349 2006 WL 562202, at * 3 (Cal. Ct. App. March 9, 2006). The consideration, however, must be adequate. *See, e.g., In re Asousa Partnership*, No. 01-12295DWS 2006 WL 1997426 (Bankr. E.D. Pa. June 15, 2006); *Nash Finch Co. v. Corey Development, Ltd.*, 231 F.Supp.2d 882, 891 (N.D. Iowa, 2002). While the determination of adequacy can be based upon a fair market appraisal ordered by the lender, which in all cases should indicate the property in question is worth the same as or less than the borrower's debt, it should not be based solely on the property's assessed value. If the property securing the debt is worth more than the debt itself, the lender might prefer to liquidate the property instead of agreeing to a deed in lieu of foreclosure. *See* Murray, *supra*, at 468. Note, too, if the deed in lieu of foreclosure is regarding a non-recourse debt, "the consideration would never be more than the fair market value of the property 'since with non-recourse debt the mortgagor never was personally liable for any portion of the debt.'"

ZIRP-IC, LLC v. Hennepin County, Nos. 31282, 04-02759 2005 WL 937432, at *3 (Minn. Tax Ct. Regular Div. April 21, 2005). *See also Farm Credit Bank of Spokane v. Tucker*, 813 P.2d 619, 625 (Wash. Ct. App.1991) ("It is settled that assessed value is not to be considered in determining fair market value" (internal citation omitted)).

When reflecting upon the consideration in the settlement agreement, the parties may state that the consideration "consists of forgiving the personal indebtedness of the borrower, waiving the right to immediately foreclose against the property and exercise of all other rights, and releasing the lien of the mortgage, except when merger is not intended." *See* Murray, *supra*, at 469. Note, however, that Murray goes on to suggest that: "[i]n lieu of a [Settlement Statement] releasing the borrower from personal liability, the lender should execute a separate covenant not to sue. A release might be construed as forgiving the underlying indebtedness and thus the mortgage, even though the lender does not intend to release the mortgage lien. Executing a separate covenant not to sue can help avoid a misinterpretation of a release." *Id.* The concept of merger is discussed below.

What Is To Be Released?

The parties' concepts of what should be released should be clear, however for they will likely not be the same. While the lender will endeavor for the release to be one of personal liability only (as opposed to the covenants and warranties which may be asserted under the settlement agreement, such as environmental indemnifications), the borrower will seek to be fully released from any liability for the deficiency, which is to say the difference between the borrower's debt and the price for which the property is later sold by the lender. *Id.* at 515-19. Note that deficiency judgments are expressly permitted, albeit with certain restrictions or requirements, under Maryland's consumer loan credit regulations (*see* Md. Code Ann., Comm. Law Art.