

Deed in Lieu of Foreclosure



As a homeowner facing foreclosure, you may have another option. An alternative to a short sale or foreclosure is deeding the encumbered property back to the lender—giving the lender a “deed in lieu of foreclosure.”

What is a “Deed in Lieu of Foreclosure”?

A Deed in lieu of foreclosure is a deed instrument in which a mortgagor (borrower) conveys all interest in a real property to the mortgagee (lender) to satisfy a loan that is in default and to avoid foreclosure proceedings.

Are there advantages or disadvantages for the lender with a Deed in Lieu of Foreclosure?

The deed in lieu of foreclosure offers several advantages to the lender. The lender is able to assume ownership of the property, creating a more efficient process by limiting court costs and waiting periods involved in standard foreclosure processes. Standard foreclosure procedures can take years to process in court and are further complicated by personal bankruptcy declarations, which are relatively common in such cases. Lenders also benefit in terms of improved settlement efficiency, which greatly reduces the time, cost and potential complications that would otherwise be involved in a repossession procedure. The disadvantages are junior liens are still in place (foreclosure clears junior liens), the borrower may later try to set the conveyance aside and/or other creditors may argue that the conveyance was a “fraudulent conveyance” that jeopardizes their ability to satisfy their claims against the borrower.

Are there advantages or disadvantages for the borrower with a Deed in Lieu of Foreclosure?

For a borrower facing foreclosure, the deed agreement can relinquish him or her from underlying debt, thus removing the foreclosure record from a credit record and reducing the need for a declaration of personal bankruptcy. The deed agreement will also insulate the borrower from any possible exposure to a deficiency judgment. If the deed in lieu is given to the lender early, the borrower may also avoid having a notice of default recorded against them.

Does the Deed in Lieu of Foreclosure automatically cancel the note and deed of trust?

Not necessarily so there should be a clear written agreement between borrower and lender stating whether the debt is cancelled or whether the borrower still owes the lender any additional sums of money.

Can a lender have a deed in lieu of foreclosure held by escrow at the time of making the loan to be transferred to the lender in the event of the borrower’s default?

No. The intent is for the seller/lender to circumvent the time periods for foreclosure and go right to record with the default documents. Pre-signed documents for forfeiture or foreclosure are invalid. They must be executed at the time of the default. If the default occurs and the borrower THEN wants to execute a deed in lieu of foreclosure to the lender, then that document would be valid – but not a pre-signed document.

At the time of default the lender must give the borrower the proper notices according to the applicable statutes based on the property location. The lender and borrower cannot simply ignore or circumvent the statutes with regard to foreclosure proceedings. Even if the borrower willingly and with full knowledge executes these pre-foreclosure documents, they would be held invalid because the borrower cannot waive their statutory rights for proper proceedings in the event of a foreclosure.

Can a borrower complete a deed in lieu of foreclosure and record it without the lender’s permission?

No. Both sides must enter into the transaction voluntarily and in good faith. The transfer of title doesn’t automatically cancel the note and deed of trust and a deed does not effectively transfer title if it is not accepted by the lender. The lender is protected by the ability to record a Notice of Non-Acceptance.



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