



## **Deed in lieu of foreclosure: Making the best of a bad situation for homeowners**

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Mortgage foreclosures adversely affect homeowners in many serious ways, not the least of which is the negative effect it has on their credit rating. A foreclosure stays on a credit rating for at least 7-10 years. In fact, in many ways it is easier to re-establish credit from a bankruptcy rather than a foreclosure. If faced with the possibility of a mortgage foreclosure action, alternatives should be considered by the borrower and the lender to make the best of a very bad situation. One such alternative is a deed in lieu of foreclosure transaction.

A deed in lieu of foreclosure is a deed instrument in which a mortgagor (i.e. the borrower) conveys all interest in a real property to the mortgagee (i.e. the lender) to satisfy a loan that is in default and avoid foreclosure proceedings, and it offers several advantages to both the borrower and the lender.

The advantages to the borrower are that it immediately releases him/her from most or all of the personal indebtedness associated with the defaulted loan, and the borrower's credit doesn't suffer as much as it would if it displayed a foreclosure. In addition, the quicker the borrower is released from the mortgage payments each month, the less they owe on the back payments and penalties for late fees.

The lender benefits by avoiding the time and cost inherent in conducting a mortgage foreclosure proceeding, taking possession of the property through an eviction proceeding, and subsequently selling the property to a third party purchaser.

The ordinary effect of the taking of a deed in lieu is to extinguish the lender's mortgage and vest the lender with title subject to all other existing liens and encumbrances. Before accepting the deed, an examination of title should be made to identify other liens previously known or not, as these liens remain after the deed is transferred. This is generally different from a foreclosure in which the liens junior to the foreclosed mortgage can be wiped out in the foreclosure proceeding.

There are a number of conditions for a lender to consider a deed-in-lieu conveyance:

1. The foreclosure is imminent and unavoidable;
2. The borrower is unable to sell the property;
3. There are no other liens or encumbrances attached to the property that the lender's title would be subject to upon conveyance of the deed in lieu;
4. The indebtedness must be secured by the real estate being transferred;
5. Both the borrower and the lender must enter into the transaction voluntarily and in good faith;
6. The settlement agreement must have total consideration that is at least equal to the fair market value of the property being conveyed;
7. The borrower must agree to immediately and voluntarily vacate the property, leaving it in broom clean condition.

Additionally, the lender must determine if the proposed deed in lieu conveyance will be insurable. To protect the lender's interest, and ensure that they have insurable and marketable title that they can subsequently sell to a third party purchaser following the deed in lieu conveyance, the lender should

obtain title insurance insuring their fee ownership interest in the property.

With the recent passage of the "Home Equity Theft Prevention Act" (Act), Chapter 308 of the Laws of 2006, signed into law on July 26, 2006 by then governor Pataki, and effective on February 1, 2007, a number of title agents and title insurance underwriters have declined to insure deed in lieu transactions, leading many lenders to believe that deed in lieu transactions are no longer a viable option to avoid foreclosure.

The purpose of the Act is set forth in the legislation:

"The legislature finds and declares that homeowners who are in default of their mortgages or in foreclosure may be vulnerable to fraud, deception, and unfair dealing by home equity purchasers, during the time period between the default on the mortgage and the scheduled foreclosure sale date, homeowners in financial distress, especially poor, elderly and financially unsophisticated homeowners, are vulnerable to aggressive "equity purchasers" who induce homeowners to sell their homes for a small fraction of their fair market values, or in some cases even sign away their homes, through the use of schemes which often involve oral and written misrepresentations, deceit, intimidation, and other unreasonable commercial practices."

The act contains a provision that a transaction in "material violation" of requirements of RPL Section 265-A is voidable and may be rescinded by the equity seller within two years of the date of the recording of the conveyance to the equity purchaser. Rescission is accomplished by the equity seller giving a notice of rescission to the equity purchaser and his or her successors in interest (if the successor is not a bona fide purchaser or encumbrancer for value), and by recording the notice of rescission in the recording office of the county in which the property is located within two years of the date on which the conveyance to the equity purchaser was recorded.

This right of rescission has given title agents and title insurance underwriters pause, leading some to take the position that these deed in lieu transactions are uninsurable. Further analysis of this Act negates this position.

A "Bona fide purchaser or encumbrancer for value" is, in particular, defined as:

"...anyone acting in good faith who purchases the residential real property from the Equity Purchaser for valuable consideration or provides the Equity Purchaser with a mortgage or provides a subsequent bona fide purchaser with a mortgage, provided that he or she had no notice of the Equity Seller's continuing right in, or equity in, the property prior to the acquisition of title or encumbrance, or of any violation of this section by the Equity Purchaser as related to the subject property". The interest of a bona fide purchaser or encumbrancer acquired before recording of a notice of rescission is not affected.

In addition, the Act applies when a homeowner enters into a Contract of Sale with respect to his/her home, and the property is a) being foreclosed on; b) the homeowner is sixty days past due on his/her mortgage payments; or c) the Contract of Sale contains a "reconveyance agreement."

A "re-conveyance agreement" occurs when a homeowner enters into a Contract of Sale to temporarily convey title to a third party, in exchange for goods or services rendered to the homeowner, and the third party agrees to re-convey title to the homeowner as soon as the debt has been repaid, or the homeowner has paid the third party the agreed value of the services rendered.

Lenders do not enter into these re-conveyance agreements with deed in lieu transactions. Instead, the homeowner executes a deed conveying permanent title to lender, and, in consideration for that conveyance, lender forgives the underlying mortgage indebtedness.

A Deed in Lieu conveyance is permanent, and the homeowner does not have a right or expectation

that he/she can reacquire title to the property. In fact, each customer signs an Estoppel Affidavit which specifically states that they have defaulted on the mortgage indebtedness, that they are executing a deed in exchange for a forgiveness of the debt, that they have vacated the property, and that they understand the property will be immediately listed for sale by lender.

WebTitle Agency, as authorized issuing agent for First American Title Insurance Company of New York and Fidelity National Title Insurance Company, has received authorization to insure the fee ownership interest of the lender in a deed in lieu transaction, upon receipt of an affidavit signed and notarized by and between the parties and their principals, attesting to the following: 1.) That the current value of the property is not in excess of the balance due under the mortgage, and that mortgagor/grantor has negligible equity in subject premises; 2.) That mortgagor/owner is no longer in physical possession of subject premises, and that same has been vacated and surrendered; 3.) Deed is an absolute conveyance given freely and under no duress or coercion; 4.) There are no recorded or unrecorded side agreements, buyback and/or leaseback provisions on the property (i.e. such as an option to repurchase) or any proceeds there from.

With the provisions of the Home Equity Theft Prevention Act deemed inapplicable to these deed in lieu transactions, and the above requirements being met to the satisfaction of the proposed title insurer, allowing for the lender to acquire insurable and marketable title for subsequent resale to a third party purchaser, these deed in lieu transactions remain a viable alternative to a mortgage foreclosure action.

In conclusion, in this turbulent time of declining property values and financial crisis, mortgage foreclosures will certainly continue. If faced with the possibility of a mortgage foreclosure action, borrowers and lenders do have alternatives to mortgage foreclosure in the form of a deed in lieu conveyance, that while unfortunate....does mitigate adverse effects on borrower credit rating, making the best out of a very bad situation.

John Nitsche is the president WebTitle Agency, Rochester, N.Y.

New York Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540