



## Deeds in Lieu of Foreclosure

find the article at: "<http://www.car.org/legal/foreclosure-short-sale-folder/deed-in-lieu-foreclosure/>"

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Aug. 5, 2008 (revised)

The difficult financial times have dramatically increased the number of foreclosures which property owners are facing. An alternative to a short sale or foreclosure to be considered by property owners is the possibility of deeding the encumbered property back to the lender--giving the lender a "deed in lieu of foreclosure." REALTORS® need a basic understanding of this process to effectively assist their clients in these circumstances.

### **Q 1. What is a deed in lieu of foreclosure?**

**A** A deed in lieu of foreclosure is a deed given by the trustor (the borrower) to the beneficiary (the lender) to stop the foreclosure process or as a way to completely avoid the start of the foreclosure process. (Cal. Civ. Code § 2889; *Bradbury v. Davenport*, 120 Cal. 152 (1898).)

### **Q 2. What are the advantages and disadvantages to the lender of taking a deed in lieu of foreclosure?**

**A** By accepting a deed in lieu of foreclosure, the lender avoids the costs and delays of foreclosing. However, (1) any junior liens are not extinguished (a foreclosure wipes out junior liens), (2) the borrower may later try to set the conveyance aside, and/or (3) the borrower's other creditors may argue that the conveyance was a "fraudulent conveyance" which jeopardizes their ability to satisfy their claims against the borrower.

Lenders can protect themselves against hidden junior liens by obtaining an endorsement to the beneficiary's title insurance policy that places title in the beneficiary free and clear of any junior liens.

### **Q 3. What are the advantages and disadvantages to the borrower of giving a deed in lieu of foreclosure?**

**A** By giving a deed in lieu of foreclosure and thus stopping the foreclosure, the borrower avoids any further injury to his/her credit and insulates himself/herself from any possible exposure to a deficiency judgment. If the deed in lieu is given to the lender early on, the borrower avoids having a notice of default recorded against his or her name. However, the borrower will be denied any opportunity to retain the excess proceeds, if there are any, following a trustee's sale.

Courts do not necessarily invalidate a transfer by deed in lieu of foreclosure even if the value of the property greatly exceeds the balance on the loan. (See *Bastajian v. Brown*, 57 Cal. App. 2d 910 (1943).)

**Q 4. Does giving a deed in lieu of foreclosure to a lender automatically cancel the note and deed of trust?**

**A** Not necessarily. There should be a clear written agreement between the borrower and the lender regarding this issue of whether the debt is cancelled or whether the borrower still owes the lender any additional sums of money.

**Q 5. 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?**

**A** No. A deed in lieu of foreclosure given at the time of making the loan or required to be given in the loan documents effectively cuts off the borrower's redemption rights (with a judicial foreclosure only) following default and is thus prohibited by law. (*Bradbury v. Davenport*, 120 Cal. 152 (1898).)

**Q 6. Can a borrower complete a deed in lieu of foreclosure and record it without the lender's permission?**

**A** No. A borrower shouldn't do that for two reasons. First, transfer of title doesn't automatically extinguish the note and deed of trust. Second, recording the deed raises a rebuttable presumption of the delivery and acceptance of the deed by the lender. A deed does not effectively transfer title if it is not accepted by the lender (*Perry v. Wallner*, 206 Cal. App. 2d 218 (1962)). In fact, Civil Code Section 1058.5 provides a lender with a way to reject this attempted transfer of title. The lender can record a Notice of Nonacceptance.

**Q 7. Where can I obtain additional information about this and related subjects?**

**A** This legal article is just one of the many legal publications and services offered by C.A.R. to its members. For a complete listing of C.A.R.'s legal products and services, please visit [car.org](http://car.org).

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