A newly married couple, anxious to start a life together, decided to build a new home. They financed the home by executing a 15-year promissory note and purchase-money mortgage to the bank. The mortgage, which contained a power-of-sale clause, was promptly recorded.

Seven years later, the couple legally separated. Neither could afford the mortgage payments on their individual salary, so they abandoned the home and stopped making mortgage payments. After the couple missed two payments, the bank decided to initiate a foreclosure proceeding.

The jurisdiction follows the title theory of mortgages and allows for nonjudicial foreclosures.

Which of the following actions poses the most financial risk to the bank?

A. Accepting a deed in lieu of foreclosure.

B. Entering the property to make repairs prior to foreclosure.

C. Foreclosing on the mortgage through a privately conducted public sale.

D. Leasing the home to a tenant.

Explanation:

This jurisdiction follows the title theory of mortgages, so a **lender** is considered the **owner** of the mortgaged property **until** the **mortgage debt is fully satisfied**. This gives the lender the right to take possession of the property at any time (unless the mortgage states otherwise). If the lender takes possession, then it assumes the **duty to take reasonable care** of the property **until foreclosure proceedings end**.

The duty of reasonable care includes the **duty not to commit waste** that would impair the value of the property. As a result, the lender is **liable to the borrower** if the **value of the property is reduced** because of the lender's actions during foreclosure proceedings.

Here, if the bank chooses to lease the home, it runs the risk that the tenant will damage the property. Damage to the property reduces any equity that the borrower (here, the couple) may have in the home. Such damage would amount to waste, for which the bank would have to account to the couple during the foreclosure proceedings. Therefore, leasing the home to a tenant poses the most financial risk to the bank.

(Choice A) A borrower may deed all interest in the property to the lender in lieu of foreclosure. This poses minimal financial risk to the lender because it allows the lender to take immediate possession of the property without any further legal formalities and to generally reserve the right to pursue a deficiency against the debtor.

(Choice B) The bank may enter the property to make repairs prior to foreclosure because this would likely *increase* the value of the property—not impair it.

(Choice C) In jurisdictions that permit nonjudicial foreclosure, a lender may foreclose on a mortgage through a privately conducted public sale when the mortgage contains a power-of-sale clause (as seen here). This allows the bank to foreclose without court intervention.

Educational objective:

A lender has the right to take possession of mortgaged property but is liable to the borrower for any waste that the lender commits during foreclosure proceedings.