

A builder sold a new house to a buyer for use as the buyer's residence. The buyer paid 10% of the purchase price and financed the rest by executing a promissory note and purchase-money mortgage to the builder.

A year later, the buyer missed several mortgage payments to the builder and became unable to make payments. During that year, property values in the neighborhood declined substantially. The builder suggested that the buyer deed the house back to the builder to settle all claims and avoid the costs and other disadvantages of foreclosure. The buyer deeded the house back to the builder.

Does the builder now own fee simple title to the house?

- A. No, because the deed back to the builder constitutes a disguised mortgage.
- B. No, because the owner of a personal residence cannot waive the right to foreclosure.
- C. Yes, because of the doctrine of equitable redemption.
- D. Yes, because the transaction was reasonable and fair under the circumstances.

Explanation:

Ways to avoid foreclosure

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| Equitable redemption* | Mortgagor pays full amount of outstanding debt (as increased by acceleration clause) plus any accrued interest |
| Deed in lieu of foreclosure | Mortgagor conveys all interest in mortgaged property to mortgagee |
| Renegotiating debt | Parties renegotiate terms of promissory note & mortgage |

*Many states also recognize a statutory right of redemption that permits a mortgagor to reclaim the property *after* a foreclosure sale.

In lieu of foreclosure, the mortgagor may convey title to the mortgaged property to the mortgagee ("**deed in lieu of foreclosure**"). This allows the **grantee-mortgagee** to take **immediate possession of the property** without the formalities of a foreclosure sale. Deed-in-lieu transactions are generally valid so long as they are fair to the grantor-mortgagor. However, they run the risk of being labeled as an **equitable or "disguised" mortgage** (as opposed to a title conveyance) if it appears that the **deed was intended only as security** for the original mortgage.

Here, the buyer deeded the house back to the builder to avoid foreclosure. That transaction was reasonable and fair under the circumstances—particularly since property values had declined so much that any foreclosure sale might have resulted in a deficiency that the buyer would have been obligated to pay out of personal assets. And since there is no indication that the deed was intended only as security for the original mortgage (eg, had the buyer remained indebted to the builder or retained possession of the house), the builder owns the house in fee simple (**Choice A**).

(Choice B) The right to foreclose is held by the mortgagee (eg, builder)—not the mortgagor (eg, buyer)—and the mortgagee can waive this right by accepting a deed in lieu of foreclosure.

(Choice C) The doctrine of equitable redemption allows a mortgagor to prevent foreclosure by paying the full amount of the outstanding debt (as increased by an acceleration clause) plus interest. Had this doctrine been invoked, however, the buyer (not the builder) would own the home.

Educational objective:

A mortgagor can avoid foreclosure by conveying title to the mortgaged property to the mortgagee ("deed in lieu of foreclosure"). Deed-in-lieu transactions are generally valid so

long as they are fair to the grantor-mortgagor and not simply a means of continuing the original mortgage (ie, equitable or "disguised" mortgage).

References

Restatement (Third) of Property: Mortgages & 8.5 cmt. b (Am. Law Inst. 1997) (discussing deeds in lieu of foreclosure).

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