Voluntary Mortgage Foreclosure - An Alternative to Deeds in Lieu of Foreclosure

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It is a familiar question these days: What is a commercial lender to do when faced with a borrower who is in default but willing to cooperate? If a loan workout or forbearance agreement is not feasible, a deed in lieu of foreclosure may be an option. However, distressed properties and borrowers with financial difficulties often come with baggage. Subordinate mortgages, mechanics' liens, judgments and tax liens may deter a lender from accepting a deed in lieu of foreclosure. In these situations, a voluntary mortgage foreclosure, essentially accelerated foreclosure by advertisement, may be the best option. It allows a lender to take title to property free of subordinate debt in less time and with less cost than a traditional mortgage foreclosure.

Voluntary mortgage foreclosure requires that the parties enter into a written agreement to foreclose the mortgage with the mortgagor's redemption period reduced to two months, rather than the usual six, or even 12, month redemption period. Other factors which reduce the time needed to foreclose are a shorter notice period to occupants of the property and a shorter publication period for the notice of mortgage foreclosure. This shortens the total time for the foreclosure process by about four and one-half months (up to ten and one-half months, in the case of an otherwise 12-month redemption period).

The requirements for voluntary mortgage foreclosure, other than a default which has existed for at least one month, include a mortgagor willing to waive its rights to reinstate the mortgage before the sale, to surplus proceeds from the sale, to contest the foreclosure, and to rents and occupancy from the effective date of the voluntary mortgage foreclosure agreement through the end of the redemption period. The mortgagor grants the mortgagee possession of the property as of the date of the agreement, or consents to the appointment of a receiver. This is one of the biggest advantages of voluntary mortgage foreclosure. The lender takes possession of the property and starts collecting rents to pay the expenses of the property much sooner than it could in a traditional foreclosure, and may avoid the relatively costly procedure of petitioning a court for appointment of a receiver.

In return for these agreements from the mortgagor, the mortgagee waives any deficiency judgment or other claim for personal liability against the mortgagor. However, this does not preclude a payment to the mortgagee as a part of negotiation of the voluntary mortgage foreclosure agreement, or collection from any guarantor.

Why would a borrower enter into a voluntary foreclosure agreement? First, it releases the borrower from liability for a deficiency judgment. Second, it may also provide for release or limitation of guarantor liability. Finally, it results in a faster disposition of the mortgaged property, which may allow a borrower to recognize gain or loss on the disposition in a more favorable tax year.

The new, but increasingly popular, voluntary mortgage foreclosure process saves time and money, allows for immediate possession by the lender or a receiver and provides a good alternative to deeds in lieu of foreclosure when there are or may be subordinate liens. Moss & Barnett's Real Estate Group is experienced in negotiating and drafting voluntary foreclosure agreements and can assist you in determining whether a voluntary mortgage foreclosure is the best option for your situation.

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