Commercial and Residential Foreclosure Alternatives (MD)

A Practical Guidance® Practice Note by Mary McCliggott, Leonard & McCliggott Law Group, LLC

Mary McCliggott
Leonard & McCliggott Law Group, LLC

This practice note discusses foreclosure alternatives that are available in Maryland, when and why you would use those alternatives, and legal guidance for each alternative. The note explains both retention and liquidation options and includes tips and guidance for counsel to both creditors and borrowers as they approach a possible foreclosure in Maryland.

For general guidance on commercial real estate financing in Maryland, see Commercial Real Estate Financing (MD). For Maryland-specific clauses for inclusion in a commercial deed of trust, see Deed of Trust Clauses (Commercial) (MD).

Overview and Initial Considerations

There are many reasons a creditor might decide to look to an alternative rather than proceeding with the foreclosure process in Maryland. Maybe they are not in a senior lien position. Maybe we are in the midst of a pandemic and there is a government mandated foreclosure moratorium! Maybe they want to work with the borrower(s) for any number of reasons.

Before proceeding with a foreclosure in Maryland, a creditor should analyze all of the available options taking into consideration cost, time, value of the collateral, lien position, equity, liability factors, and even public relations. Generally, when working with a creditor client such as a bank, the client will know in advance whether they want to proceed with a retention or liquidation strategy. It is your job as their attorney to explain all of the options within each strategy and direct the client to the best one given their particular set of facts, circumstances, and goals. Some clients are more knowledgeable than others on these topics and know exactly how they want you to proceed. Some clients need more counseling and explanation. Also, your strategy may change as the case develops, more facts are discovered, or the borrower(s) become involved.

The first step in the foreclosure analysis process is to order a title search on the collateral property from a reputable title company. When the title report comes back, there are many things to look for. Who owns the property? Usually it is the grantor. What lien position is the creditor in? What other (amount, type) liens are on the property? What is the tax-assessed value of the property? What is the status of the payment of taxes on the property? Below are some scenarios to give you examples of how these factors may change your strategy:

- **Scenario #1.** If the owner of the property is not your grantor (for whatever reason), they may be willing to pay off your lien or negotiate a settlement in exchange for a lien release.
- **Scenario #2.** If the creditor is in a first lien position and the value of the property is high, foreclosure may be the best option. However, if the value is low, the creditor may not want to proceed taking into consideration that foreclosures are very costly. The value of the property may not warrant those expenditures. Similarly, if the creditor is in a junior

lien position, but there is a lot of equity in the property, the creditor may still want to proceed with foreclosure. Keep in mind that the amount of equity has to justify the cost of the foreclosure and the creditor will have to pay off or sell the collateral property subject to the senior lien(s). Selling a property at a foreclosure sale subject to a senior lien will likely quell the bidding. (Note that when considering the property's value, the tax-assessed value is not always accurate. Your client may want to consider obtaining a professional appraisal to gain a more accurate picture of value.)

- **Scenario #3.** The lien search reveals that the property is in a tax sale. The creditor will have to redeem the property by paying all taxes and fees/costs if they want to protect their lien. The creditor should take the cost of redeeming the property added to the cost to foreclose into account when deciding whether a foreclosure makes sense.

Once the title search is analyzed, you will then be able to discuss the available options with your client given the particular set of facts presented. You may also need to suggest that the client order an appraisal as discussed above. Keep in mind that if your client is a bank, many banks have an internal requirement/procedure that an environmental analysis be conducted on the property because environmental concerns and factors may prohibit a foreclosure per internal bank policy. Banks are much more conservative when it comes to foreclosing than most other creditors and if there is any type of environmental liability on the property, they may not want to proceed because a foreclosure always presents the possibility that they will have to buy in the property at the sale and deal with any existing issues. Also remember that taxes on the property will still need to be paid/kept current no matter what option a creditor chooses to proceed with.

In addition, be sure that any payment your client receives from a borrower under any scenario discussed herein is vetted and complies with money laundering regulations, especially if you represent a bank. Most banks have their own procedures and regulations in place to comply with such laws and regulations. Make sure that you have language in any agreement that you draft that addresses this issue as well.

Retention Options

Modification and Amendment

A modification and amendment is used to extend a loan. Typically, we see amendments where the loan has matured and the creditor wants to extend the maturity date for whatever reason. For example, maybe the borrower needs more time to refinance or liquidate collateral.

An amendment should include a detailed recitation of all of the loan documents for the loan(s) at issue. The reader should be able to pick up the amendment alone and know exactly what documents evidence the loan(s); what collateral secures the loan(s); and all of the details of the loan(s) (date, amount, etc.). The agreement should then include the terms of the loan that are being changed. Some common changes to terms include maturity date, interest rate, and payments.

Many creditors also take the opportunity when extending a loan to add additional collateral. Consider that most creditors charge costs, expenses, and attorney's fees to the borrower(s) in connection with the amendment. Modification fees are also commonplace. If the loan has a guarantor or guarantors, a separate "consent of guarantor" attachment should be included with the amendment. Please remember to have the amendment and consent of guarantor(s), if applicable, executed under seal. Md. Code Ann., Cts. & Jud. Proc. § 5-102(a)(1). Finally, a corporate borrower should execute resolutions alongside the amendment specifying who is authorized to act/sign on behalf of the business.

Repayment Plan

A repayment plan is a structured repayment of a loan or loans over a period of time. A repayment plan may include the entire outstanding balance or just the past due sums. Ideally, a repayment plan should be in writing.

Refinance

Refinancing a loan or loans basically means that the borrower or borrowers trade in their old loan(s) for a new one. A refinance occurs when the existing or a new bank or lender/creditor pays off an old loan or loans with the new one. Keep in mind that some borrowers may not qualify for a refinance for a number of reasons. For example, you are likely dealing with a distressed obligation that a new creditor may not want to take on. If available, a refinance is a good option if a borrower or borrowers want to consolidate debt, reduce their interest rate, and/or work with a new creditor. It is always a good idea to suggest to borrower(s) that they explore refinancing if the creditor wants to pursue an exit strategy.

Reinstatement

Reinstatement is when a borrower or borrowers pay the overdue amount on a loan or loans, plus fees and costs, to bring the loan/loans current to stop or prevent a foreclosure from occurring. Maryland law allows reinstatement of a loan at any time up to one business day before the foreclosure sale occurs on residential properties. Md. Code Ann., Real Prop. § 7-105.1(p)(1). Keep in mind that in other types of foreclosures (e.g., commercial), reversing a

default and allowing the loan/loans to be brought current may be at the creditor's discretion.

Forbearance

A forbearance agreement is a tool that is used when a loan or loans are in default or when a creditor has taken some action, such as accelerating the loan(s), obtaining a judgment, and/or filing suit, and has agreed to forbear from further legal action in exchange for something (typically, payments). Forbearance agreements are usually used to allow short-term extensions giving the borrower(s) the opportunity to resolve the obligation on their own terms such as selling the collateral property or obtaining a refinance.

When drafting a forbearance agreement, the first section should include a detailed background setting forth, describing, and incorporating each loan document. Think of it as a puzzle. You are piecing together the puzzle so that any reader can pick up your document and know exactly what happened in the transaction. You should then describe and specify the event(s) of default and the action(s) that was/were taken in response. If a lawsuit was filed, specify the details of the lawsuit including date, court, and case number. After that, you will want to acknowledge the agreement to forbear. Sample language of that is as follows:

> The parties have agreed, subject to the terms and conditions of this Agreement, that [creditor] is agreeing to forbear from taking any actions in connection with the Existing Events of Default or otherwise to exercise its remedies as a result of the Existing Events of Default to the extent provided by, and pursuant to the terms and conditions of this Agreement.

The agreement should go on to acknowledge the outstanding loan balance(s) and then specify the terms of the forbearance. Terms specific to the actual forbearance include the expiration date and payments. Consider also incorporating a requirement to reimburse the creditor's expenses such as attorney's fees and costs.

Make sure that you add standard contractual provisions to your agreement such as consent to have the document signed in counterparts, acceptance of electronic signatures and documents, waiver of trial by jury, choice of law/venue, events of default, etc. Always include a general release of liability claims against the creditor and indemnification language as well. All borrowers and guarantors should consent to and sign the forbearance agreement and it should be under seal, which in Maryland, extends the statute of limitations significantly. Md. Code Ann., Cts. & Jud. Proc. § 5-102(a)(1).

For a form of forbearance agreement for use with a commercial loan, see Forbearance Agreement (Commercial Real Estate Loan). For guidance on drafting and negotiating commercial forbearance agreements, see Commercial Forbearance Agreements.

Release and Settlement Agreement

A release and settlement agreement is used when a creditor agrees to accept less than what is owed on the loan(s), waive the deficiency balance, and release the borrower(s)/guarantor(s). A basic settlement agreement should include all of the following, in detail:

- References to all loan documents
- A confirmation of the payoff(s)
- A description of the settlement amount and date that it is due –and–
- A statement that upon satisfaction of the terms in the agreement, the loan documents shall be deemed paid and satisfied and any debt remaining outstanding shall be forgiven

The agreement should also include creditor indemnification language. Standard contractual provisions should be included as well as discussed in other sections of this practice note.

A settlement and release agreement should also specify that the transaction may have tax implications, that the creditor has made no representations regarding same, and that the borrower(s) has/have had opportunity to consult with a lawyer and/or tax professional. This type of agreement should be executed under seal as well. Md. Code Ann., Cts. & Jud. Proc. § 5-102(a)(1). Most importantly, a release and settlement agreement should include a release of the creditor or a mutual release. A sample mutual release is as follows:

> KNOW ALL MEN BY THESE PRESENTS that XXX (the "Lender"), XXX (the "Borrower"), and XXX (the "Guarantor") (together with the Borrower, the "Obligors") for the sum of $X.XX paid to Lender, which shall constitute good and valuable consideration and intending to be legally bound hereby, do hereby remise, release and forever discharge each other, their present and former officers, directors, employees, agents and servants and each of them, and their respective successors and assigns of and from any and all manner of actions, causes of action, suits, debts, dues, accounts, covenants, contracts, agreements, judgments, liens, demands and claims whatsoever in law or in equity, arising out of [the Loan Documents] from Lender to Borrower for which Obligors are indebted, directly or indirectly to Lender, which each

of Lender and Obligors ever had, now have or which each of Lender and Obligors or their respective successors and assigns hereafter can, shall or may have, for, or by reason of any cause, matter or thing.

Make sure that your client has all information necessary to determine if a release and settlement is in their best interests. It is recommended that the borrower(s) and guarantor(s) (if applicable) provide detailed financials before a decision is made to accept less than the full balance of a debt. You do not want your client to walk away having accepted less than what the balance is when the borrower(s)/guarantor(s) have misrepresented what they are capable of paying without verification. Tax returns, bank statements, W-2s, pay stubs, and mortgage statements are some examples of typical financial documents that are requested by creditors in these situations.

Liquidation Options

Sale or Short Sale

A short sale occurs when the collateral property is sold for less than the loan balance and the creditor agrees to accept less than the payoff in exchange for the release of their lien. Typically, the borrower(s) will find a buyer for the collateral property, execute a contract, and present the contract to the creditor for approval. Often, in a short sale transaction, more than one lien release must be negotiated and it can get complicated if many creditors are involved and/or have liens on the collateral property. Borrowers may request a short sale for a variety of reasons. Maybe they cannot afford the property anymore and the property has lost value since purchase. Maybe they are seeking to reduce or eliminate debt.

If the short sale is approved, the creditor must decide whether or not to pursue the deficiency balance. If the creditor does not waive the deficiency balance, the creditor should send a letter or enter into an agreement with the borrower(s) indicating that in exchange for the payment of an agreed upon amount, the creditor will release the security instrument attached to the property. To avoid legal issues, you should be very specific with the following items when drafting the letter/agreement:

- Date of the release
- Creditor's name
- Grantor's name
- Trustee's name
- County
- Address
- Tax ID number –and–
- Amount the creditor is accepting

The creditor should reserve the right to review and approve the final HUD-1 or other similar closing statement to make sure that all proceeds of sale are going to them.

Below is sample language from a short sale agreement in which the lien instrument covers more than one property and only one property is being released. In this situation, the loan balance is not being released:

> The Deed of Trust also encumbers other parcels, and this Agreement neither provides for the release of the other parcels from the lien of the Deed of Trust, nor does it release or settle the remaining balance due on the Loan. This Agreement does not preclude me from collecting the remaining balance due on the Loan or enforcing any other rights I have under the documents associated with the Loan.

If the creditor agrees to a short sale in which they are releasing the deficiency balance, they should have a release and settlement agreement executed specifying the short sale terms. Please refer to the section in this practice note on release and settlement agreements.

Deed in Lieu of Foreclosure

A deed in lieu of foreclosure is used when a borrower or borrowers in default agree to deed the collateral property over to the creditor. This type of arrangement benefits a creditor because it allows them to obtain ownership of the collateral real estate without incurring the fees and costs associated with a foreclosure. It is also a much quicker process than a foreclosure. The creditor can then turn around and market and sell the real estate and apply the proceeds of the sale to the loan balance. That being said, title to the real estate needs to be closely examined if a deed in lieu is being considered. A deed in lieu transfer is not recommended if there are any other significant liens on the property because unlike a foreclosure, junior liens will not be released / wiped out upon transfer of the property.

Therefore, a creditor should examine a title search, analyze value, and obtain lien payoff information before deciding to proceed with a deed in lieu transaction. Sometimes, junior lien balances are small enough to still warrant a deed in lieu transaction. The creditor should also be sure to obtain a title insurance policy as they would if they were taking the property in at a foreclosure sale.

Benefits to the Borrower

Why would a borrower or borrowers want to deed their property over to a creditor? First of all, many times, creditors will waive any deficiency balance if a borrower agrees to a deed in lieu transaction. Borrowers may also not want to go through the foreclosure process or have run out of other options. Or perhaps there are other liens on the property that the creditor is willing to repay in order to sell the real estate that the borrower does not want to deal with.

Documentation

A deed in lieu transaction should be documented by a deed in lieu of foreclosure agreement. The agreement should detail all of the loan documents and the event(s) of default and state that the borrower(s) has/have agreed to convey the collateral property to the creditor. The agreement should state the outstanding loan balance(s) and represent as follows:

> (i) the amount of the Indebtedness substantially exceeds the fair market value of the Premises; (ii) the Premises is unable to generate sufficient income to repay the Indebtedness in accordance with the terms of the Loan Documents [if applicable]; and (iii) the consideration to be received by the Borrower pursuant to the terms of this Agreement represents the payment by the Creditor of full, fair and adequate consideration for the Premises.

A closing date should be specified in the agreement as well as the necessary closing documents such as the deed, bill of sale, etc. The creditor should make sure that there is a release of liability provision, indemnification language, and all other standard contractual provisions, many of which have been referenced and discussed herein. The agreement should contain the legal description of the property as an exhibit, as well as the deed and bill of sale as additional exhibits, and should be executed under seal. Md. Code Ann., Cts. & Jud. Proc. § 5-102(a)(1).

For forms for use with a deed in lieu transaction for commercial property, see:

- Deed in Lieu of Foreclosure Agreement (Commercial) (Pro-Lender)
- Covenant Not to Sue (Deed in Lieu of Foreclosure) (Commercial)
- Release (Deed in Lieu of Foreclosure)
- Owner's Affidavit (Deed in Lieu of Foreclosure) (Commercial)

Friendly Foreclosure

In a friendly foreclosure sale, the borrower(s), creditor, and a buyer sign an agreement under which the creditor will foreclose its lien and transfer the collateral real estate to the buyer with the cooperation of the borrower(s). A friendly foreclosure may be ideal in a situation where a short sale or deed in lieu are not options because there are junior liens on the collateral property that need to be wiped out.

Cash-for-Keys / Property Rent-Back

Cash-for-keys and property rent-backs are not foreclosure alternatives, however, they merit discussion because creditors often use them to help a foreclosure go more smoothly.

Cash-for-Keys

Unfortunately, people who go through the foreclosure process may damage a property before moving out. Also, evicting an occupant from a foreclosed property is often costly and time-consuming. The last thing that a creditor will want to deal with when they are attempting to prepare and liquidate collateral property that they took title to through a foreclosure sale or deed in lieu transaction is an occupant that they have to legally remove from the property.

To incentivize the former homeowner(s) or occupant(s) to move out peacefully and voluntarily and leave the property in satisfactory condition, the creditor should consider offering a lump-sum payment commonly called "cash-for-keys." Offering cash-for-keys is a standard policy for many banks. Typically, the payment amount will be anywhere from a few hundred to a few thousand dollars. The cash-for-keys agreement should be in writing. In exchange for the funds, the homeowner(s) or occupant(s) agree/s to vacate the collateral property by a set deadline. There is typically a requirement that the property be left in "broom swept" condition, which means it's been cleaned up, all personal items are gone, there has been no vandalization, garbage is removed, and fixtures are still in place. The creditor should conduct a final inspection to ensure that all requirements of their cash-for-keys agreement have been met before making the payment.

Rent-Back Agreement

A rent-back agreement gives the homeowner(s) or occupant(s) extra time to live in the collateral property after closing, becoming the new owner's temporary tenants. Duration and amount of rent is decided by the parties. This type of agreement should also be in writing, similar to a lease.

Mary McCliggott, Principal Attorney, Leonard & McCliggott Law Group, LLC

Assisting banking institutions/lenders/creditors for over a decade with management of their distressed loan portfolios, Mary McCliggott handles all aspects of civil litigation and debt collection cases for her clients in Maryland, Virginia, and the District of Columbia. Mary has years of experience with real estate and other collateral issues, foreclosures, tax sale cases, bankruptcy, and transactional work, including but not limited to, negotiating and drafting settlement and forbearance agreements, amendments, mortgages and deeds of trust, security agreements, collateral releases, and payoff and short sale letters.

Mary also assists her clients in maintaining compliance with federal regulations and has a large network of law firms and attorneys throughout the country enabling her to place referrals to and oversee outside counsel if legal services become necessary in another jurisdiction. In addition, Mary provides representation to clients with regard to contract, tort, landlord/tenant, and probate/estate matters.

In her spare time, Mary is a Legal Writing and Advocacy in the Courts Lecturer at Goucher College.

This document from Practical Guidance®, a comprehensive resource providing insight from leading practitioners, is reproduced with the permission of LexisNexis®. Practical Guidance includes coverage of the topics critical to practicing attorneys. For more information or to sign up for a free trial, visit lexisnexis.com/practical-guidance. Reproduction of this material, in any form, is specifically prohibited without written consent from LexisNexis.

LexisNexis.com/Practical-Guidance

LexisNexis®

LexisNexis, Practical Guidance and the Knowledge Burst logo are registered trademarks of RELX Inc.
Other products or services may be trademarks or registered trademarks of their respective companies. © 2021 LexisNexis