How Deeds of Trust Work

BY PHIL AURBACH, ESQ.

Deeds of trust are common, complex, and have had a checkered history. This article explains how they are created, what happens if the borrower pays, the foreclosure and sale procedure if the borrower defaults, anti-deficiency protection, and a brief description of the one-action rule. This article does not discuss mortgages.[1]

The Transaction Giving Rise to a Deed of Trust

Assume a borrower needs $10,000 and assume a lender has $10,000 to loan. Lenders don't want just a promissory note that is basically an IOU. A lawsuit must be filed to enforce it, which means discovery, trial, judgment, then finding assets, sending the sheriff to seize the assets, and selling them to pay the judgment partially or fully. Lenders usually want land as security, which allows a lender to foreclose on the land if the borrower defaults. If the borrower has land, (or uses the money to buy land), then many lenders request a deed of trust as a condition of giving the borrower the money.

Security—More than an IOU

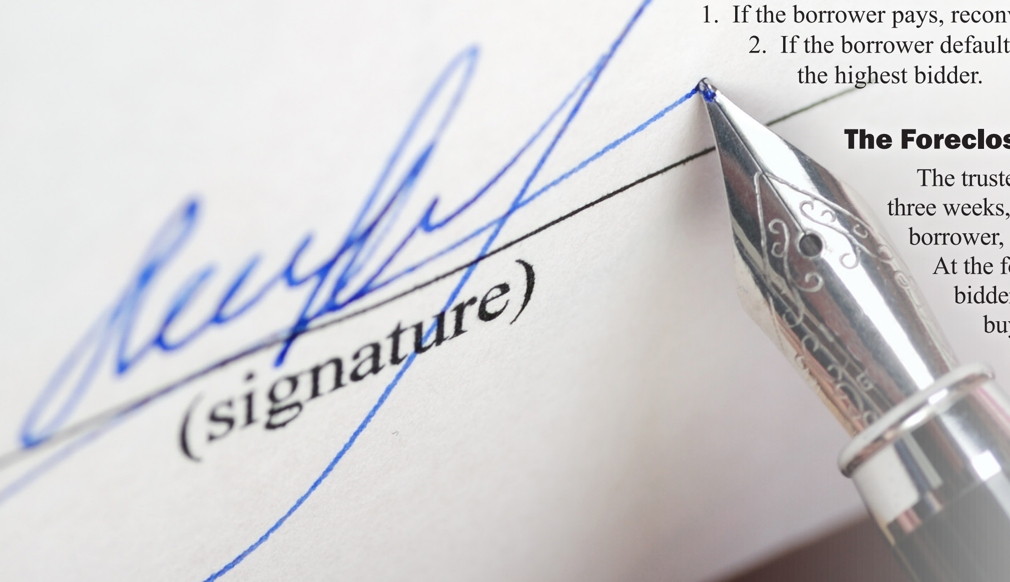
In Nevada, lenders like a deed of trust (or "trust deed") to give them security in case the borrower defaults. Some states use a mortgage for security, which is a two-party transaction involving both the lender and the borrower. A mortgage usually needs a lawsuit for oversight of the sale. Additionally, there is a one-year redemption period, during which the borrower can take the land away from the person or entity who purchased the land at the foreclosure sale by paying the foreclosure bid price plus additional fees. Deeds of trust are favored because the lender can foreclose on the land, i.e., take it away from the borrower without going to court, and there is no redemption period, i.e., the foreclosure sale is "final."

How a Deed of Trust is Created

A borrower signs a deed of trust to convey title to the borrower's land to a trustee[2] with a power to sell[3] the land to the highest bidder if the borrower doesn't pay. The deed of trust transfers title to the land to the trustee, *but* the transfer is subject to certain conditions.

The conditions are:

1. If the borrower pays, reconvey title back to the borrower.
2. If the borrower defaults, advertise and sell the land to the highest bidder.



The Foreclosure and Sale Procedure

The trustee must advertise the sale once a week for three weeks, post notice of the sale, and mail notice to the borrower, other lenders, and people that ask for notice. At the foreclosure sale, the land is sold to the highest bidder and the trustee issues a trustee's deed. This buyer could be someone who comes to the foreclosure sale (a third party), or it could be the lender making a "credit" bid with some or all of the money that is owed to the lender. The lender then owns the land.

CONTINUED ON PAGE 12

CONTINUED FROM PAGE 11

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Anti-Deficiency Legislation[4]

Because some lenders would bid a very small part of the amount they were owed, the lender would get the property and still be owed most of the money that was borrowed. The borrower is now protected by NRS 40.459: anti-deficiency legislation. An action on the note is a contract claim for relief. A deficiency action is statutory.[5]

Here is how NRS 40.459 works to protect borrowers and guarantors by decreasing the amount owed by the fair market value of the land or the amount the land sold for, if greater than the fair market value. If the lender forecloses and is still owed money, the lender can apply to a court for "deficiency judgment" under NRS 40.459 for the lesser of these two calculations:

(A)	(B)
the amount owed $100 minus the	the amount owed $100 minus the
fair market value -$200 of the property	Sale price at the -$60 the foreclosure sale
($0)	$40

The One-Action Rule: NRS 40.430

Before 1987, the one-action rule was very harsh. If a lender filed a lawsuit, even a counterclaim, the deed of trust was void. *Component Systems Corp. v. District Court*, 101 Nev. 76, 692 P.2d 1296 (1985). After the *Shields* case gave guarantors the same anti-deficiency protections as borrowers, lenders were back in front of the Legislature in 1987 and 1989 attempting to change the *Shields* ruling. Democracy in action. During the 1987 legislative hearings on various statutes that would reverse *Shields*, Justice E.M. "Al" Gunderson heard about the legislative hearings and came across the street[6] to testify against the legislation that would overrule *Shields*. Justice Gunderson and Jon Joseph, the head of the Nevada Bankers Association and the president of Valley Bank, met in the hallway of the legislature and hammered out some modifications to the one-action rule to keep Justice Gunderson's ruling in place. Those negotiations are now part of NRS 40.430(6), describing exceptions to an action that would void a deed of trust. In 1989, NRS 40.435 was added to make it clear that filing a lawsuit would not void a deed of trust unless the lawsuit went to final judgment.

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ENDNOTES:

1. A mortgage is a two-party transaction where the borrower gives a nominal conveyance to the lender which is held in abeyance as a security for the payment of a certain debt.'" *Topaz Mutual Co. v. Marsh*, 839 P. 2d 606, 108 Nev. 845 (1992) (quoting *Nee v. L.C. Smith, Inc.,* 97 Nev. 42, 624 P.2d 4 (1981). Mortgages must be foreclosed by judicial foreclosure since March 1, 1967. NRS 106.020.
2. *Summa Corp. v. Greenspun*, 96 Nev. 247, 607 P. 2d 569 (1980) (a trust deed conveys the trustor's title or interest in land to the trustee).
3. NRS 107.080(1) (all deeds of trust after March 29,1927 automatically include a power of sale).
4. In 1986, the Nevada Supreme Court decided *First Interstate Bank v. Shields,* 102 Nev. 616, 730 P. 2d 429 (1986). This unanimous decision held that guarantors WERE protected by Nevada's anti-deficiency protections and overruled *Manufacturers & Traders Trust v. Dist. Ct.*, 94 Nev. 551, 583 P.2d 444 (1978) and *Thomas v. Valley Bank of Nevada*, 97 Nev. 320, 629 P.2d 1205 (1981)). Justice Gunderson had dissented in *Manufacturers and Traders* (1978) and *Thomas* (1981), but with new members on the court and his reasoning in the dissenting opinions prevailed and became the law in Nevada. The legislature codified it in NRS 40.459.
5. Although a deficiency action seems to be a contract action, the elements of proof for the deficiency are 1) amount owed, 2) fair market value, and 3) sales price at the foreclosure sale. Also, the statute of limitations on a contract is 6 years on a "contract, obligation or liability founded upon an instrument in writing: NRS 11.190(1)(b). However, the statute of limitations on a mortgage or deed of trust is 10 years. NRS 106.240. *Facklam v. HSBC Bank USA for Deutsche ALT-A Sec. Mortg. Loan Trust*, 133 Nev. 497, 401 P.3d 1068, 1070-71 (2017) (holding, under "long-standing" Nevada precedent, lender may foreclose on mortgaged property that is security for payment of a promissory note even if "the statute of limitations for contractual remedies on the note has passed"); *Henry v. Confidence Gold & Silver Mining Co.*, 1 Nev. 619, 622 (1865) (recognizing "modern" rule that a "statute of limitation [does] not destroy the debt but only [takes] away the remedy"). Thus, the remedy for breach of contract/promissory note is damages as calculated by the amount owed. The remedy for a deed of trust deficiency action is the statutory calculation described above.
6. The Supreme Court building was across the street from the Legislature in 1987.