Chapter 39

The Security Deed and the Promissory Note

SECURITY DEEDS

A ***security deed*** (also known as a deed to secure debt, loan deed, or warranty deed to secure debt) is the most common form of securing a financing instrument for real estate loans in Georgia. Lenders prefer security deeds over mortgages in Georgia because a mortgage creates only a lien on the property, whereas the security deed is an outright transfer of title to the property to the lender to secure the debt. The conveyance by the borrower splits the title to the property into two components: the legal title held by the lender to secure payment of the debt, and the equitable title held by the owner. The owner also retains a right of redemption; that is, the right to pay off the debt and reacquire the legal title. The owner/borrower retains the right of possession of the property and all rights of ownership except those that interfere with the lender's legal title and any rights given up in the security deed. This concept is called hypothecation: the owner/borrower hypothecates, seeming to “own” the property, but limited by the lender’s rights.

ORIGINS OF THE SECURITY DEED

Since a mortgage creates only a lien on the property, the property remains subject to future judgment liens and other legal claims. Therefore, in the 1800's lenders adopted the practice of getting an absolute conveyance from the borrower in the form of a warranty deed, and giving back to the borrower a "bond for title" agreeing to reconvey the property to the borrower when he or she pays off the debt. Later, the warranty deed and bond for title became one instrument. Georgia lenders favor the Security Deed, as it minimizes their risks in the event of non-performance by the Borrower, allows for non-judicial foreclosure, and speeds up recovery of the real estate collateral for their loans. The current Georgia Code section (O.C.G.A. § 44-14-60) provides that the security deed is an absolute conveyance of title, but that the borrower has the right to have the property reconveyed upon repayment of the debt. The current act does not require a reconveyance. When the debt is satisfied, the lender marks the original security deed as paid and the borrower can have the security deed marked satisfied on the public records. If the original security deed is lost, the lender reconveys the property to the borrower by quitclaim deed.

DEFINITION OF A SECURITY DEED

A security deed is an absolute conveyance of title to land from borrower to lender that includes the following provisions:

	(a)	a statement that the deed secures an indebtedness;
	(b)	a power of attorney from the borrower to the lender authorizing the lender to foreclose the property upon the borrower's default;
	(c)	a statement that when the debt is paid, the lender will cancel the security deed or otherwise reconvey the property to the borrower; and
	(d)	other provisions defining the rights and obligations of the parties such

		as a provision that the borrower must maintain casualty insurance in favor of the lender.

PARTIES TO THE SECURITY DEED

The borrower(s) and the lender(s) are the two parties to the security deed. The borrower is the grantor of the security deed, since the borrower is the one conveying the property to secure the debt. The lender is the grantee, since the lender receives the absolute conveyance of the title to secure the debt. The grantor (borrower) retains the equitable title to the property and has the right of possession until default as well as the right of redemption once he or she repays the debt. The grantor remains liable for property taxes, lawsuits for personal injuries (such as an injury to a third party while that person is on the property), and all the other usual obligations of ownership. The grantee (lender) has the legal title, which means ownership without the right of possession or the obligations of ownership retained by the grantor (such as payment of taxes and liability for personal injuries). Although technically incorrect terms as applied to Security Deeds, since many people are used to mortgage instruments they may have used in other states, ***mortgagor*** refers to the borrower and ***mortgagee*** to the lender.

FORMAL REQUIREMENTS OF A SECURITY DEED

A valid and recordable security deed contains the following provisions:

	(a)	an identification of the grantor and the grantee;
	(b)	sufficient language conveying the property from the grantor to the grantee;
	(c)	a valid legal description of the property;
	(d)	proper execution (signed by the owner of the property or another person under a valid power of attorney);
	(e)	proper attestation (witnessing by an unofficial witness and an official witness such as a notary public) which allows the deed to be recorded, although lack of proper attestation will not affect the validity of the deed between the grantor and grantee); and
	(f)	an effective delivery; that is, the grantor (borrower) must put the deed into the possession of the grantee or the grantee's agent with the intention that it shall pass title to the grantee. This requirement is usually fulfilled at closing when the attorney for the lender takes possession of the deed.

COMMON CLAUSES IN THE SECURITY DEED

There is no such thing as a "standard" security deed in Georgia, although the FHA, VA and FNMA/FHLMC have their own standardized versions. Security deeds for commercial properties are often custom drafted and can run fifty pages or more. Some simple security deeds in use in rural communities are only one page. Nevertheless, while there is no one standard form, the following clauses appear in most security deeds:

	(a)	ESCROW FOR TAXES AND INSURANCE - The normal rule for priority of liens is that the first creditor to file without knowledge of prior liens has priority. Thus, if a lender filed a security deed in the proper county courthouse without knowing of any other liens on the property (including recorded liens, which the lender could have discovered), then the lender's security deed has priority. If, a year after recording the security deed a creditor obtains a judgment against the borrower and records it, the security deed still has priority as a charge against the property because it was recorded first. This normal rule does not apply to property taxes. Thus, if a lender files a security deed in 2011 and the borrower does not pay her 2012 county property taxes, the property taxes have priority over the security deed. For this reason, many lenders require borrowers to maintain ***escrow accounts***. In addition to the principal and interest payment, the borrower pays one-twelfth of the property taxes every month to the lender. When the property taxes are due, the lender pays them. This process helps insure the lender against priority liens for property taxes. The lender may also require the borrower to pay one-twelfth of the annual hazard insurance premium. Most of the value of improved property is the building and improvements; and if the building is destroyed and uninsured, the lender will be able to foreclose on the land only which will not satisfy the debt on foreclosure. Therefore, the lender will require that the debtor maintain insurance against hazards and that the hazard policy proceeds be payable to the lender so that the lander has security for payment of the debt in case of casualty. When the borrower has a high equity in the property, the lender may not require an escrow account. If the borrower makes at least a twenty percent down-payment, the lender is often confident that the borrower's investment in the property is sufficient incentive to the payment of the taxes and insurance without an escrow account.
	(b)	DUE-ON-SALE CLAUSE - Often lenders will restrict the right of the borrower to sell or transfer an interest in the property without obtaining the lender's permission. This clause protects the lender if interest rates go up. Since most borrowers have a right to prepay, when rates go down, borrowers will often refinance the property and prepay the loan. The lender does not have a similar option to force borrowers to prepay if rates go up. The ***due-on-sale clause*** prevents the borrower from selling the property after rates have gone up and passing on the low interest rate loan to a purchaser, who assumes the loan.
	(c)	WAIVER OF HOMESTEAD - The borrower waives the right to claim the benefit of any homestead laws that would affect the rights of the lender to collect the debt.
	(d)	NONRECOURSE PROVISIONS - This clause does not typically appear in most security deeds and must be negotiated between lender and borrower. Under this clause, the lender agrees that if the borrower defaults on the loan, the lender's remedies are limited to foreclosing on the property. The lender cannot sue the borrower on the promissory note to collect a deficiency judgment if the property does sell at foreclosure sale for the amount of the debt.
	(e)	RELEASE PROVISIONS - If the security deed secures unimproved

		acreage, the borrower and lender may negotiate for the lender to release certain tracts of acreage as the loan is paid down. This situation occurs frequently where a developer grants a security deed to a lender (or owner) financing the purchase of raw land. As the developer subdivides and develops tracts for homes, stores, warehouses, or other uses, buyers purchase the smaller acreage tracts; and the developer uses the cash from the sales to pay down the loan and get those tracts released from the blanket security deed.
	(f)	DEFAULT - The law has no precise definition of a ***default*** in real estate loan instruments. The borrower and lender are free to negotiate what acts will constitute a default. Residential real estate loan instruments for VA, FHA and FNMA/FHLMC loans are standard and the borrower cannot negotiate the provisions. The failure of the borrower to do anything that he or she promised to do in the real estate loan instruments will be a default. Thus, a default can include the failure make payments on time, the failure to pay property taxes and insurance premiums when due, or failure to keep the property in good repair.

THE PROMISSORY NOTE

A security deed requires an underlying debt for the deed to be valid. Usually the debt takes the form of money advanced by the lender to the borrower, although no money changes hands in a purchase money security deed in which the seller finances all or part of the purchase price of the property and simply defers the collection of the purchase price in return for payments of principal and interest. The evidence of a debt is usually a ***promissory note***, a written instrument in which a borrower promises to pay a lender a sum of money under certain terms and conditions. Both the security deed and the promissory note are forms of contracts.

PROVISIONS OF THE PROMISSORY NOTE

The promissory note contains provisions that spell out the promise, the amount of the debt, the identity of the parties, the costs to the borrower, the terms of repayment, and the penalties for failure to fulfill those payment terms.

	(a)	PROMISE TO PAY - The note includes a promise by the borrower to repay the debt to the lender.
	(b)	AMOUNT - The lender must give some consideration to the borrower. Usually that consideration is the principal amount of the loan. The promissory note must state this amount in US dollars or legal tender.
	(c)	PAYEE - The note designates the person or entity who will be receiving the payments. The original designated payee in the note can assign the right to collect the debt to a different party. It is this characteristic that makes the note a negotiable instrument.
	(d)	PAYOR - The note also designates the person(s) or entity liable for the repayment of the debt.
	(e)	INTEREST AND PAYMENT - The note spells out the annual rate of interest, the date when interest begins to accrue, and the amount and

		due dates of payments.
	(f)	DEFAULT, LATE FEES AND ACCELERATION - The common definition of a default is the failure to make the payments when due. The security deed will usually have a similar definition of default. Most notes provide that if the payor does not make the payments on time, the lender may charge late fees. Most notes also include an acceleration clause, which makes the entire amount of the note due if the borrower defaults. Without the acceleration clause, the lender would have a right to sue only for the payments that the borrower had already missed.
	(g)	OTHER AGREEMENTS - The borrower and lender may agree to other provisions in the note, such as attorney's fees if the lender is forced to sue to collect the debt.
	(h)	RECOURSE PROVISIONS - Based upon lenders' rights, there are two kinds of promissory notes: recourse notes and nonrecourse notes. In a recourse note, the lender may look to either the promissory note or the security deed to satisfy the debt. That is, the lender may elect to sue the borrower on the note, which is a personal promise to repay the debt, or the lender may elect to foreclose on the security deed. In a nonrecourse note, the lender's remedy is limited to foreclosing on the property under the security deed. Thus, if the foreclosure sale does not produce the total amount of the debt, the borrower in a nonrecourse loan would not be liable for any deficiency resulting from the foreclosure.
	(i)	PREPAYMENT - The borrower does not have a right of prepayment unless the loan documents provide for one. The lender and borrower are contracting for payments over a long time, such as 30 years; and the lender has a right to expect payments over the full contract term. However, most residential loans allow the borrower to prepay the loan. Lenders and borrowers negotiate the prepayment rights in commercial loans, and the lender frequently charges a prepayment penalty.