

What Is The Difference Between a Title Theory and a Lien Theory State?

Often a buyer wonders if he is buying property in a state which is considered a "title theory state" or a "lien theory" state. Why would you need to know which custom is practiced in your state?

When financing is involved in a real estate purchase, it is important to understand if you will be subject to the title or lien theory of mortgages. The way in which a state will interpret how mortgage law is followed will be determined by which type of theory is practiced in your state.

Each type of theory has special considerations on who will hold title and how foreclosure proceedings would take place if they were to become necessary. In title theory states, the borrower does not actually keep title to the property during the loan term. The seller gives the buyer/borrower a deed to the property but when the borrower signs the mortgage for the loan the borrower gives the title back to the mortgage holder. The lender then holds title to the property, as security only, until all loan payments have been made. During that time the borrower has the right to possession of the property, and the lender delivers the deed back to the borrower only after the loan obligation has been satisfied.

In a lien theory state, the buyer holds the deed to the property during the mortgage term. The buyer promises to make all payments to the lender and the mortgage becomes a lien on the property, but title remains with the buyer. The lender's lien is removed once the payment of all loan payments have been completed. Foreclosure proceedings in a lien theory state may be more difficult for the lender than in a title theory state, due to the fact that the buyer is holding title to the land and not the lender.

There is another type of mortgage custom which is referred to as the Deed of Trust theory. Under a Deed of Trust, the seller gives title to the buyer, and the buyer then signs a Deed of Trust which makes the lender the beneficiary in the Deed of Trust. A third-party trustee typically holds the title to the property in trust, with the power to foreclose on the buyer if there is a default. The buyer owns the property and has all rights of ownership and possession, subject only to the conditions in the deed of trust. When the loan has been paid off, the lender will give clear the title by way of recording a Deed of Reconveyance. The Deed of Reconveyance removes the lender's interest in the property.

Some states have modified the title and lien theories, and these states are referred to as "intermediary theory" states. In these states, the title remains with the borrower, but the lender may take back title to the property if the borrower defaults on the loan. Be sure to check with your title officer at the time of your purchase or sale to verify the current practice in your state.