AVOIDING THE DUE ON SALE CLAUSE

By Bill J. Gatten

DUE-ON-SALE CLAUSE: The clause (Para. #17) in virtually all mortgage loans, which permits a secured mortgage lender (federal, state or private) to call the entire unpaid loan balance Due and Payable immediately should the property securing the loan be sold, transferred, traded, gifted or otherwise disposed of without the lender's prior written consent (and without giving them the opportunity to charge more money or say "No" to the transfer).

Despite the due-on-sale clause and its implications in the creative real estate financing business, it is quite possible for one to take over the payments on a non-assumable mortgage loan without needing to fear, or even to be concerned with, a DOS Violation…without violating it.

In order to effect such a take-over without an unauthorized transfer, one simply assures that the property is, in-fact, NOT being sold, traded, hypothecated or transferred in any 'unauthorized' manner. In other words, since placement of real estate into the borrower's revocable living trust for asset protection purposes is fully allowable under the law (12USC 1701-j-3; and since appointment of a co-beneficiary is a prudent thing to do anyway: a would-be seller need only place its property into such a trust, and then deal with the interest in the trust, rather than dealing with the property itself. At this point, the buyer (of beneficiary interest: not *real estate*) gains virtually 100% of the same incidents and benefits of Fee Simple Real Estate ownership that he or she might have under a traditional transfer of the property's title.

The only caveat here is that the living trust that is utilized for this purpose must be an Illinois-type, title-holding Land Trust. Such a trust is fully revocable and it is an inter-vivos trust; however, land trusts by nature are directed by their beneficiaries, not the trustee: and all "legal" title, as well as all "equitable" title, is vested with the trustee. Beneficiaries of land trusts own no real estate, only personal property…and even though they retain all the benefits of an owner, the property has not been sold, transferred or hypothecated.

The trust term of the agreement is decided upon by beneficiaries and stipulated in the contract. Such terms generally run for from 1 to 20 years, with the understanding that, at the end of that time, the trust will be terminated and the seller's interest (as little as 10%) will be forfeited to the co-beneficiary (buyer). Such forfeiture merely needs to be in consideration of some future act by the buyer (e.g., prompt payments; strict adherence to contract terms; a share in appreciation or overall profit; etc.). Often times, however, beneficiaries might mutually agree to share profits at termination in proportion to their respective beneficiary interests (50:50, 90:10; 75:25, etc.).

It is most important to understand here that the verbiage of a lender's Due-on-Sale clause doesn't always convey exactly what we or our attorneys THINK it does, or what the lender expects us to believe it does (a little trickery here)…irrespective of whether a lender's exercising its rights under a DOS clause are "real," "false" or indifferent. What the DOS does infer is: "UNLESS PROHIBITED BY APPLICABLE LAW…" the lender has a right to foreclose, if the title to its security is transferred into a trust, and if a beneficiary interest in that trust is sold or transferred." Well...make no mistakes about it! Such action 'IS' indeed prohibited by "applicable law." The Law (The Federal Depository Institutions Act of 1982) strictly prohibits ANY lender from taking exception to a borrower's placing its property into its own inter-vivos (living) trust (such as a Title-Holding Land Trust) and appointing a 2nd party to function as a co-beneficiary or remainder agent. Further, there is nothing to prevent those same co-beneficiaries from leasing the property out to any one they may choose…say, to the 2nd co-beneficiary, for example.

Overall, the process described here creates what is tantamount to a legally constructed, and very safe and well-shielded 'Wrap-Around Seller-Carry' device. Since the original owner of the property has named the second party as a beneficiary in the trust and leased to the property to him or her under a triple-net lease (i.e., net, net, net lease, wherein the tenant pays mortgage interest, property tax and handles all maintenance), the resident beneficiary (or investor co-beneficiary) has obtained all the benefits of a sale… without there actually having been one.

When proposing that a seller remain on the existing loan for you: if you really want to be assured of 'getting the deal,' its important that you make it sound so good for the seller that he can't refuse. To do that, you'd suggest that for his own safety and peace of mind, you'll pay to put the property into a neutral trust (if he prefers), and that he needn't ever transfer the property's title to you at all…until you've proven yourself, by eventually refinancing or selling the property and paying off his loan. Explain that you'll consent to merely becoming a co-beneficiary in HIS trust until his loan is retired in, say, 6 months (or 3, 4, 5 or 20 years…or more).

Note that this arrangement (i.e., a "NARS PAC Trust™") gives you, as the buyer, 100% of the tax write-off (See IRC § 163(h)4(D)); 100% of the use, occupancy, possession; 100% of the equity build-up (from principal reduction); full rights to all rents; and other profits upon the sale or other disposition of the property. As well, you also have any and all of the other rights ordinarily only available under the so-called "Bundle of Rights" in any form of Fee-Simple Real Estate ownership.

In a NARS PACTrust™, the seller needn't ever take any chances with you; and you don't have to take any chances with the seller either. By virtue of the structure of the NARS PACTrust™, the trust property is protected from liens, suits judgments, divorce actions or claims, bankruptcies or anything else you can think of…on both sides…including state and/or IRS tax liens. Moreover, the due-on-sale clause becomes pretty much a non-issue in that the property has not been sold; the title has not been transferred (other than to the borrower's authorized trust); and there is no consideration for a 'purchase of real estate' per se. Furthermore, the commodity being transferred (beneficiary interest in a trust) is characterized as Personalty (personal property), and not Realty (real estate), and is therefore not subject to the same creditor rights as would be real estate. And…the transaction has not infringed upon the lender's foreclosure rights, or compromised its security interest).

In closing, do note that for maximum safety, it recommended that at least 10% of the trust's Beneficiary Interest and 50% of the beneficiary's Power of Direction should be retained by the seller, with an agreement to forfeit that interest to you upon disposition of the property at the trust's termination. However, also note that the Settlor Beneficiary's fifty percent Power of Direction can be given to you by means of either an Assignment of Power of Direction, or by a Revocable, Limited, Power of Attorney. The reason for the seller's retaining a percentage of beneficiary interest is to satisfy the requirement that if the seller places his property into a revocable trust, he must be and remain a beneficiary of that trust. The reason for keeping the 50% Power of Direction intact, is that most county jurisdictions will not re-assess the property for property taxes, or require transfer fees, when transferring the property to a living trust, so long as no more than 50% of the "voting rights" are conveyed.