

DUE ON SALE CLAUSES

Most real estate Promissory Notes and Deeds of Trust contain a clause commonly called "Due on Sale". This essentially means that if the property is sold or an interest is conveyed to another *without the lender's written permission* then the lender can accelerate the loan by demanding payment in full. If the buyer does not payoff the loan, the lender can then declare a Default and commence foreclosure.

Due on Sale clauses have a long and varied history in United States and California law. For many years they were unenforceable since the sale would not necessarily cause any real damage to the lender (ie: the original promissor was still liable). However, in 1982, Congress passed the Barn-St. Germain Act which validated all due on sale clauses regardless of contrary state law. California adopted this provision in Civil Code §2924.6. Essentially, the law holds that loans represent contracts between borrowers and lenders and that the terms of the contract should govern.... not equitable evaluations of subsequent purchasers. The rationale was that many loans are fixed rate and not allowing enforcement would compel lenders to eventually hold whole portfolios of lower interest non-competitive loans. This was not a risk they agreed to in making the loan originally. Thus, the bottom line is that lenders can and often do enforce the Due on Sale clause.

Buying or selling a home subject to a loan with a due on sale clause is not illegal but is a breach of the loan contract. This gives the lender a right to a remedy (acceleration) which the lender may or may not elect to take. So what do you do:

1. Seek the lender's written permission. This is obviously best. However, it also notifies the lender to be aware of a possible transfer. If the buyer is a poor credit risk and could not reasonably get a loan on his own, don't expect the lender to approve the assumption of the loan.
2. Buyer gets a new loan. This is subject to the buyer's credit-worthiness.
3. Sell subject-to the existing loan and risk a possible acceleration if and when the lender learns of the sale.
4. Don't buy a home.

This sheet is not intended to be a recommendation or legal opinion upon which you should rely when faced with the decision about dealing with a due on sale clause. It is intended to give you some basic information that could affect your transaction. For further information, you are referred to Mortgage and Deed of Trust Practice (California Educ. of the Bar), Real Property Transactions (Rutter Group), or your own independent legal and financial advisors.

Received: _____

BUYER: _____ SELLER: _____