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Kagie's Korner - Due on Sale

Due on Sale Clause - What Are Your Duties?

Due to high interest rates, there has been a significant increase in seller financing transactions. As a licensed professional, you should be aware of your duties and obligations to the parties in a transaction regarding a due-on-sale clause.

R162-2f-401a. Affirmative Duties Required of Licensed Individuals. An individual licensee shall:

(6) before the execution of a binding purchase or lease agreement, disclose in writing to clients, agents for other parties, and unrepresented parties:

(d)(i) the existence or possible existence of a due-on-sale clause in an underlying encumbrance on real property; and

(ii) the potential consequences of selling or purchasing a property without obtaining the authorization of the holder of an underlying encumbrance.

A due-on-sale clause, also known as an “acceleration or alienation clause” is a provision commonly attached to a mortgage. This allows the lender to call the loan due, in full, if the securing property is sold or transferred to a new owner.

Lenders include the due-on-sale clause provision to protect their financial interests. A change of ownership may make substantial modifications to the risk profile of the loan. Lenders can find out about a change of ownership in any number of ways: receiving the tax notice that is not in the borrower’s name, a change of property insurance providers, checking the property abstract with the county recorder’s office, when a seller changes the contact individual or the address where the monthly mortgage invoices are to be mailed, to name a few.

In today's market, lenders have a huge incentive to call the mortgage due upon a sale, and are indeed calling notes due, something the mortgage industry has not seen for decades. Interest rates have more than doubled in the past few years, and a lender now has a great incentive to invoke a due-on-sale clause to close out a low-interest rate loan.

Imagine the following scenario: a seller needs to sell and they enter into a seller financing purchase agreement because they have an interest rate of 2.8% that allows the buyer to “afford” the property. The buyer puts money down, takes possession and updates the insurance provider with the lender. The lender is notified of the change in insurance and realizes that the property has been sold. The lender calls the loan due. The buyer can’t qualify for the purchase at current rates. The seller has already invested the down payment received from the buyer into a new property. Who will be harmed when the lender calls the loan due? Both buyer and seller may be harmed. Buyer most likely used their available funds for the down payment and does not have cash available to pay off seller’s existing mortgage. Buyer may not qualify to obtain a new loan because current mortgage rates put the property out of buyer’s price range. Seller probably does not have funds available to pay off the note that is now due and faces foreclosure. Facing foreclosure, seller may feel pressured to foreclose against buyer. As the agent involved, did you adequately inform (notify) the parties of this possibility? How did you clearly and unambiguously document your notification with your client? What now is your liability?

Most buyers and sellers are unaware of the due-on-sale clause and its ramifications. Ensure that you are protecting your clients and yourself by diligently informing them with adequate documentation of the probable risks associated with their financing decision and encourage the parties to research the due-on-sale issue thoroughly before entering into these types of transactions so they can make a well-informed decision.