Why Caution Is Warranted When Transferring Title of Mortgaged Real Property: Garn–St. Germain, Due-on-Sale Clauses, and Transfers . . . Oh My!

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Transferring title of real property to an inter vivos trust is an extremely common practice for most estate planners. Many practitioners also engage in transfers of real property to ownership vehicles such as limited liability companies (LLCs). Practitioners must exercise caution when making these transfers if the property is subject to an existing mortgage, however, because such transfers can trigger the due-on-sale clause that is typically included in the mortgage contract.[1]

Due-on-sale clauses. The ubiquitous due-on-sale clause requires a mortgage loan to be repaid in full upon the sale of or conveyance of an interest in the property that secures the mortgage.[2] Transferring title of real property *is* a "conveyance of an interest in" that property and, therefore, risks triggering a due-on-sale clause.

The Garn–St. Germain Act. Fortunately, the Garn–St. Germain Depository Institutions Act of 1982 (Garn–St. Germain Act) exempts certain transfers, including transfers to an inter vivos trust, from triggering a due-on-sale clause *provided certain other requirements are satisfied*.[3] The Garn–St. Germain Act does *not* protect transfers of mortgaged real property into an LLC or other ownership vehicle, however—thus, these types of transfers may trigger a due-on-sale clause and caution is urged.

Requirements for protection for inter vivos trust transfers. The Garn–St. Germain Act protects real estate transfers from triggering a due-on-sale clause only under certain circumstances. Exactly what those circumstances are is somewhat unclear because the statutory text of the Garn–St. Germain Act (found in the United States Code)[4] conflicts with the implementing regulations (found in the Code of Federal Regulations).[5]

On its face, the statutory text of the Garn–St. Germain Act limits protection to "residential" dwellings of five units or less and does not require occupancy, provided the rights of occupancy are not affected.[6]

The implementing regulations, in contrast, make no mention of the size of the dwelling but apply only to a "home," appear to add an occupancy requirement, and introduce the concept of a condition precedent that could exclude a transfer from protection.[7] There was a legislative opportunity to resolve this conflict in late 2018—however, the opportunity went unclaimed and the conflict persists.[8]

Unpublished case law interpreting the conflict between the statutory text and implementing regulations finds the implementing regulation occupancy requirement to be ultra vires, but underscores that there is no protection for LLC transfers. In *Baldin v. Wells Fargo Bank, N.A.*,[9] Wells Fargo argued that a transfer by a borrower, Baldin, of an income property to an LLC (which in turn was funded to Baldin's trust) triggered the due-on-sale clause because (1) Baldin did not occupy the property and (2) LLC transfers are not protected by statute. With regard to occupancy, the court found the imposition of an occupancy requirement within the implementing regulations to be contrary to Congress's clear intent and, therefore, ultra vires; with regard to the LLC transfer, the court found that, on

its face, Garn–St. Germain provided no protection. Thus, it is likely that a court faced with interpreting the conflicting statutory text and implementing regulations will rely more heavily on the statutory text—but it is good to be aware of the conflict nonetheless and comply to the extent feasible with the requirements of both the statute and the implementing regulations to ensure protection.

Compliance may be easily achieved in many cases, but caution is warranted where no protection exists–especially as mortgage interest rates rise. For many trust-based estate plans, compliance with the requirements of both the statutory text and the implementing regulations will not be difficult because many clients own only a single family home that they intend to continue to occupy after the transfer to an inter vivos trust established for their own benefit.

But where the property contains five or more units (such as an apartment building) or when title to the mortgaged property is transferred to an LLC or other ownership vehicle, no protections are afforded by the Garn–St. Germain Act. One solution is to obtain lender approval in writing before executing a transfer that is not explicitly covered by the exemptions in the Garn–St. Germain Act. Of course, as a practical matter, lenders probably do not actively patrol land records for transfers that might trigger a due-on-sale clause.[10] However, given the historically low mortgage interest rate environment,[11] lenders may become more aggressive in tracking such transfers should mortgage interest rates rise significantly in the future. By doing so, lenders stand to call in low interest rate loans, which will likely necessitate refinancing or obtaining new loans at much higher interest rates, benefiting the lenders. Therefore, while caution is always warranted when transferring title of mortgaged real property, significant caution is warranted where Garn–St. Germain protections are not obviously applicable and the current mortgage has a particularly low rate.

One solution is to obtain lender approval in writing before executing a transfer that is not explicitly covered by the exemptions in the Garn–St. Germain Act. While such transparency is generally the best policy, some clients and practitioners are wary of such contact. After all, one might be left without an appropriate solution if the lender refuses to grant permission or fails to respond, especially given that the matter has now affirmatively been brought to the attention of the lender. Your own risk tolerance and the informed risk calculus of your clients must dictate how you proceed.

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[1] Practitioners should also consider (and advise clients regarding) the potential impact of such transfers on title insurance and homeowner's liability insurance. In general, it is wise to contact insurance providers to ensure continuity of coverage. Practitioners should also counsel their clients regarding the impact of the transfer on homestead exemptions and property taxes, if any. *See* Phoebe Stone, *Transferring Title of Real Property: Have You Protected Your Clients . . . and Yourself?*, WealthCounsel Quarterly (Winter 2020).

[2] *See* 12 U.S.C. § 1701j-3(a)(1): Preemption of due-on-sale prohibitions, defining *due-on-sale* to include the sale or transfer of an interest.

[3] 12 U.S.C. § 1701j-3(d) details exempt transfers, which include transfers by devise, descent, or operation of law upon the death of a joint tenant; transfers to relatives resulting from the death of a borrower; and transfers to spouse or children.

[4] 12 U.S.C. § 1701j-3.

[5] Congress provided in 12 U.S.C. § 1701j-3(e)(1) that the implementing rules and regulations for the Garn–St. Germain Act would be made by the Federal Home Loan Bank Board in consultation with the Comptroller of the Currency and the National Credit Union Administration Board. These implementing rules used to appear at 12 C.F.R. § 591. However, the implementing regulations now appear at 12 C.F.R. § 191.

[6] 12 U.S.C. § 1701j-3(d)(8). The statutory text provides: "With respect to a real property loan secured by a lien on *residential real property* containing *less than five dwelling units* . . . a lender may not exercise its option pursuant to a due-on-sale clause upon . . . a transfer into an inter vivos trust in which the *borrower is and remains a beneficiary* and *which does not relate to a transfer of rights of occupancy in the property*. . . ." (emphasis added).

[7] 12 C.F.R. § 591.5(b)(1)(vi) (codified at 12 C.F.R. § 191.5(b)(1)(vi)). The implementing regulations provide: "With respect to any loan on the security of a *home occupied or to be occupied by the borrower*, a lender shall not . . . exercise its option pursuant to a due-on-sale clause upon . . . a transfer, in which the *transferee is a person who occupies or will occupy the property*, which is . . .a transfer into an inter vivos trust in which the *borrower is and remains the beneficiary and occupant of the property*, unless, as a *condition precedent* to such transfer, the borrower refuses to provide the lender with reasonable means acceptable to the lender by which the lender will be assured of timely notice of any subsequent transfer of the beneficial interest or change in occupancy." (emphasis added). Note this condition precedent clause is by itself extremely unwieldy and confusing. Its purpose appears to be the protection of lenders, but it does not actually require lender permission (although it seems to lean in that direction).

[8] 82 Fed. Reg. 47083 (*See* https://www.federalregister.gov/documents/2017/10/11/2017-21904/removal-of-office-of-thrift-supervision-regulations#footnote-2-p47083.) The implementing regulations were originally in Chapter 5 of Title 12 of the Code of Federal Regulations, which set out regulations for the Office of Thrift Supervision (OTS), a bureau of the Department of the Treasury. Congress abolished the OTS in 2011. Because much of Chapter 5 related to the now-defunct OTS, the entirety of Chapter 5 of Title 12 was to be removed and any still-enforceable regulations were to be republished elsewhere, effective Oct 2018. However, the conflicting regulations were re-codified verbatim in a new section: 12 C.F.R. § 191 *et seq*.

[9] No. 3:12-CV-648-AC, 2013 WL 794086 (D. Or. Feb. 12, 2013) (not reported in F. Supp. 2d). Note that the precedential value of an unpublished decision is unclear because some courts permit citation to unpublished decisions or consider them persuasive, if not controlling; other courts do not even permit citation to

unpublished decisions.

[10] Indeed, it is likely that Wells Fargo learned about Baldin's transfer after Baldin made a payment on delinquent property taxes, triggering notification of Wells Fargo as the mortgage holder and further scrutiny of the matter.

[11] The annual average mortgage interest rate for a thirty-year fixed rate mortgage in 2020 was 3.11 percent; in 2010 it was 4.69 percent; in 2000 it was 8.05 percent; and in 1990 it was 10.13 percent. *See* Freddie Mac, *30-Year Fixed Rate Mortgages Since 1971*, *available at* http://www.freddiemac.com/pmms/pmms30.html.