

A carpenter decided to start a business with his friend. In order to fund the business, the carpenter took out a loan from a local bank. The carpenter signed a 30-year promissory note to the bank and secured the note with a mortgage on his cabin, which served as his primary residence. The mortgage included a due-on-sale clause and was promptly recorded by the bank.

After running a successful business together for 10 years, the carpenter wanted to reward his friend for all of his hard work. As a result, the carpenter conveyed the cabin by quitclaim deed as a gift to the friend. When the bank received notice that the cabin had been transferred to the friend, the bank demanded full payment of the remaining mortgage debt. When neither the carpenter nor the friend made the required payment, the bank initiated foreclosure proceedings.

Will the bank likely prevail?

- A. No, because a due-on-sale clause can only be enforced when the mortgaged property is sold to another.
- B. No, because a due-on-sale clause cannot be enforced against a mortgage on a primary residence.
- C. Yes, because the due-on-sale clause made the friend personally liable for the mortgage debt.
- D. Yes, because the transfer of the mortgaged property triggered the due-on-sale clause.

## Explanation:

### Common mortgage provisions

<b>Acceleration clause</b>	Allows creditor to demand entire loan due & payable if debtor defaults
<b>Due-on-sale clause</b>	Allows creditor to demand entire loan due & payable if debtor sells mortgaged property without permission
<b>Due-on-encumbrance clause</b>	Allows creditor to accelerate mortgage obligation if debtor obtains second mortgage or otherwise encumbers property
<b>Defeasance clause</b>	Requires creditor to give debtor legal title to property & release mortgage lien once all payments are made

**Mortgage documents** are used to convey a lender (mortgagee) an interest in real property to secure repayment of a debt. These documents may contain a **due-on-sale clause**, which allows the lender to demand **full payment** of the remaining mortgage debt if the **debtor** (mortgagor) **transfers** the mortgaged property **without the lender's consent** (absent limited **exceptions**). If the debtor is unable to pay, then the lender can initiate foreclosure proceedings to recover any remaining debt.

Here, the carpenter gave the bank a mortgage on his residence, the cabin, to secure a loan. The mortgage contained a due-on-sale clause, which was triggered when the carpenter transferred the cabin to the friend by quitclaim deed and allowed the bank to demand full payment of the remaining loan balance. The fact that the cabin was gifted (not sold) has no impact on the bank's ability to enforce this clause (**Choice A**). And since the carpenter did not make the required payment, the bank will prevail in its foreclosure proceedings.

**(Choice B)** A due-on-sale clause *can* be enforced on a primary residence or any other real property used to secure repayment of a debt.

**(Choice C)** The due-on-sale clause made the *carpenter* (mortgagor) personally liable on the debt if the mortgaged property was conveyed without the bank's consent. The *friend* would be personally liable only if he agreed to **assume** the mortgage debt (not seen here).

### Educational objective:

A due-on-sale clause allows a lender to demand full payment of the remaining mortgage debt if the debtor transfers the mortgaged property without the lender's permission. Although labeled a "due on sale" clause, the clause is triggered by most transfers—including gifts.

### References

55 Am. Jur. 2d Mortgages § 415 (2019) (due-on-sale clauses).

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