

## SELLER-CARRIED TRUST DEEDS AND LAND SALE CONTRACTS WHICH TO USE AND WHEN?

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Today we are seeing more seller carry-back real estate transactions. These are the transactions in which, for various reasons [*usually having to do with the buyer's lack of access to bank financing*], a seller agrees to carry back a security interest for some of the purchase price.

*Example: Buyer, emerging from an earlier short sale or other distressed housing event, finds a property he would like to purchase today. The seller owns the property free and clear of any bank loans. Even though his consumer credit record is stellar, our buyer has one black mark on his credit report – the distressed housing event. As a result, he is unable to secure bank financing at today's rates, and is unwilling to obtain a "hard money" loan [i.e. a private loan at an astronomic interest rate and on draconian terms, including a harsh prepayment penalty]. He proposes to pay the seller 20% down in cash, and asks that the seller carry back a security interest on the property for the next five years, as he rebuilds his credit score so that he can qualify for a prime rate loan.*

In such cases, the seller, and to a lesser extent the buyer,<sup>1</sup> may wonder what the best security arrangement is for their situation. In Oregon, the choice is typically between (a) a note and trust deed, or (b) a land sale contract.

Before discussing the perceived benefits of each, let's look at the basic differences between the two.

**Note and Trust Deed.** Oregon trust deeds are a statutorily recognized process for obtaining an interest in real property to secure an obligation for repayment of a loan – usually, but not always - a "purchase money loan," i.e. a loan used to purchase the subject property. [See, ORS 86.705 – 86-795](#). Here is a quick summary of the features of the transaction:

- Buyer signs a note and trust deed for the remaining 80% of the purchase price that the seller has agreed to carry back.
  - The note promises to pay the money, and
  - The trust deed describes the seller's remedies if the buyer defaults under the promissory note.
- At time of closing the transaction, the buyer executes a note and trust deed to the seller, and seller conveys title to the buyer. This means that: (a) The buyer now owns the property subject to the lien of the trust deed, and (b) The seller retains a recorded security interest in the property.
- Once the promissory note is paid in full, the lien of the trust deed is released by the recording of a "Deed of Reconveyance" which is the functional equivalent of a

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<sup>1</sup> I say "lesser extent" since typically, it is the seller who will dictate the terms of this carry-back arrangement, not the buyer.

satisfaction of mortgage. The property is now free and clear of the lien of seller's trust deed.

**Land Sale Contract.** With the exception of certain remedies on default, land sale contracts are not a creature of statute. The rights and duties of the parties are governed by the Common Law, i.e. appellate case law that has developed as "precedent" over the years. If the parties agreed to use a land sale contract rather than a note and trust deed,<sup>2</sup> here is how the transaction would look:

- Seller and buyer would sign a contract setting forth the buyer's repayment obligations and the seller's remedies in the event of default;
- Significantly, no deed is conveyed from seller to buyer. This means that the seller retains legal title, while the buyer has "equitable title." The latter designation really means that the buyer has virtually all of the rights of an owner, but cannot convey legal title during the life of the contract.
- Once the contract is paid off, the seller [*or escrow company if the seller pre-signed the deed*] will convey legal title to the buyer. Thereupon, the property is free and clear of the lien of the seller's contract.

**Pros and Cons.** The primary differences between using a trust deed versus a land sale contract relate to the remedies available on default.

- Note and Trust Deed. The seller's primary remedy upon a buyer's default is a statutory, non-judicial foreclosure. That is, the process does not include the filing of a lawsuit in court; it is conducted non-judicially by following the statutorily described process of mailing a notice to the buyer, and publication of the foreclosure sale date.<sup>3</sup>
  - Seller Advantage: It is relatively fast, i.e. 130 – 150 days;
  - Seller Advantage: There is no right of redemption to the buyer, i.e. there is no statutory period after the sale for the buyer to "repurchase" the property – the seller gets possession of the property almost immediately after the sale;
  - Buyer Advantage: There is no risk to the buyer of a "deficiency judgment" where he/she could be held liable if the seller's net sale proceeds were less than the debt due;
  - Buyer Advantage: Up to five days before the date of the foreclosure sale, the buyer may "cure" the default, by paying the amount of the arrears, plus statutory costs and attorney fees. This reinstates the note and trust deed and the buyer resumes the repayment regime described in the promissory note.
- Land Sale Contract. Generally, the seller has a wide range of remedies which are enumerated in the contract. Most are not addressed in the Oregon statutes. The judicial remedies range from "strict foreclosure" where the seller forecloses and gets the property back, judicial foreclosure, where the seller forecloses and a public sale is held, to specific performance, where the seller could actually sue to "force" the buyer to

<sup>2</sup> Don't be confused by the word "contract" here. Almost all agreements, including promissory notes and trust deeds, are "contracts" if they contain the necessary legal elements. But the term "land sale contract" is used specifically to designate a contract between a seller and buyer that secures a repayment obligation for the purchase price.

<sup>3</sup> Note: In certain cases, the seller could go to court to judicially foreclose the trust deed.

buy the property, and pay the proceeds due under the contract. There is one statutory remedy, “forfeiture” which permits the seller to non-judicially foreclose by following certain mailing procedures and recording an affidavit of forfeiture at the conclusion of the process. It is not totally dissimilar to the non-judicial foreclosure process for trust deeds in that is relatively quick and does not entail any deficiency liability to the buyer. See, [ORS 93.505 – 93.945](#).

- Seller Advantage: Seller’s range of remedies is broader – i.e. he/she can decide at the time of default, what remedy to pursue. For example, if the property had markedly increased in value, statutory forfeiture might be appropriate; if it had dropped in value, judicial foreclosure with a deficiency judgment might be appropriate.
- Seller Advantage: It is generally perceived that the more highly leveraged the transaction is, i.e. the lower the buyer’s down payment, the more appropriate it is to use land sale contract. This is because the seller can act more swiftly, possibly with a larger “hammer” and not have to contend with a buyer who defaults, then cures, then defaults again. Upon default, the seller can accelerate the unpaid balance due under the contract, and immediately pursue foreclosure. If the buyer has no defense to the default, the seller can file in court and seek summary judgment and possibly recover the property back in a matter of months.
- Buyer Advantage: The only real “advantage” that a buyer can and should try to secure if a land sale contract is used, is to soften the default provisions so they may not be triggered in a harsh and unexpected manner. The main protection is to require that before a default in payment may be declared, there be a fair period, e.g. ten days, which would only commence following the seller’s issuance of a written notice to the buyer. Note, however, that even when a seller agrees to this, he or she may reserve the right to eliminate the written notice if the buyer goes into default more than once in any one 12-month period.

**Miscellaneous.** Listed below are some general observations about trust deeds and land sale contracts:

- Note that the above discussion about seller carry-backs assumes the property is lien free, i.e. there is no bank loan in a first position, already on the property. If there is, and it is not going to be paid off, if the parties agree, they would have to do a “wrap” transaction, whereby the first lien would not be disturbed, and the seller’s carry back, either by contract or trust deed, would be subordinate to the bank’s first position lien. These transactions can be risky for reasons beyond the scope of this article. Suffice it to say, there are two important issues that must be addressed: (a) The seller and buyer must have an “allocation of risk” provision in the security instrument, identifying whether seller or buyer will assume the risk if the underlying lender accelerates the loan balance on account of the transaction; and (b) The buyer should insist upon some means of verification that the seller is paying all installments on time. This is sometimes accomplished through the use of a collection escrow, although that can slow down the seller’s payment of the balance of funds to the seller.

- Land sale contracts pose potential issues if there is no fulfillment deed in escrow and the seller should pass away.
- The utility of seller carry-back transactions has been clouded by the Consumer Finance Protection Bureau's new rules going in place in January 2014. [See, post here](#). A discussion of those rules is well beyond the scope of this article, and parties considering a carry-back transaction should first consult legal counsel familiar with the regulatory issues.

My personal preference in most cases is to use a promissory note and trust deed in those transactions in which the seller is comfortable with the buyer's financial information and credit history and the down payment is not something he/she could easily walk away from – e.g. 15% or more. The reason generally is the speed of the trust deed foreclosure process, the definitive statutory guidelines, and the fact that most trust deed foreclosures are not commenced until it is quite clear that the buyer is incapable of curing. If the transaction is a “wrap” – i.e. there is a pre-existing loan on the property that will not be removed - a land sale contract might be preferable, since the seller can act quicker to accelerate the balance, and take the property back.

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