

Estate Planning and the Due-On-Sale Clause: Navigating Trust Transfers, LLCs, and the Garn-St. Germain Act

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This article provides an in-depth examination of due-on-sale clauses, the scope and limitations of the Garn-St. Germain Act, and practical guidance for estate planners working with trusts, LLCs, and mortgaged real estate.

INTRODUCTION

For many Americans, the family home or real estate portfolio constitutes the bulk of their net worth. Accordingly, ensuring these properties pass seamlessly to heirs is a core objective of estate planning. Common techniques—such as transferring real estate into a revocable living trust or LLC—are widely used to facilitate probate avoidance, centralize management, and protect against personal liability.

full repayment of the outstanding loan balance if the property securing the loan is sold or transferred without the lender's consent.

Originally designed to protect lenders from unknown or less creditworthy property transferees, the due-on-sale clause can have unintended consequences for borrowers engaging in legitimate estate planning activities. Transferring a mortgaged property—even without changing its

- **§ (d)(3):** Transfers by devise, descent, or operation of law upon the death of a joint tenant or tenant by the entirety.
- **§ (d)(5):** Transfers to a relative resulting from the death of the borrower.
- **§ (d)(6):** Transfers in which a spouse or child of the borrower becomes the owner.
- **§ (d)(8):** Transfers into an inter vivos trust where the borrower is and remains a beneficiary and retains occupancy rights.

These carve-outs provide broad protections for revocable living trusts and death-related transfers to family members, ensuring that commonly used estate planning tools do not inadvertently trigger acceleration of the loan. However, these protections apply primarily to owner-occupied residential real estate and revocable trusts.

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However, when a property is subject to an outstanding mortgage, these transfers can raise a serious issue: the due-on-sale clause. This provision allows a lender to demand full repayment of the loan if the borrower transfers any interest in the property without the lender's prior written consent. In an estate planning context, this can create conflict between a client's long-term objectives and the mortgage lender's contractual rights.

Understanding the nuances of federal law and lender policies is critical to ensure estate plans do not unintentionally jeopardize a client's financial position.

THE DUE-ON-SALE CLAUSE: A HIDDEN RISK

A due-on-sale clause, often termed an *acceleration clause*, is a standard provision in residential mortgage contracts. It grants the lender the right to demand

occupancy—can inadvertently activate the clause unless protected under federal law or lender guidelines.

STATUTORY RELIEF: THE GARN-ST. GERMAIN DEPOSITORY INSTITUTIONS ACT OF 1982

Recognizing the potentially harsh consequences of due-on-sale enforcement in the context of estate planning, Congress enacted the Garn-St. Germain Depository Institutions Act of 1982.¹ The Act prohibits lenders from enforcing due-on-sale clauses in specific, narrowly defined circumstances.

Key exemptions for estate planning

Under § 1701j-3(d), several important exemptions apply:

STRICT COMPLIANCE – SUBSEQUENT TRANSFERS NOT PROTECTED

The Garn-St. Germain Act lists nine exceptions protected from due-on-sale clauses. As practitioners, attorneys can become familiar with the general concept, and may rely on their existing knowledge to the detriment of clients – a common mistake among attorneys and clients is to assume that any intra-family transfer is automatically exempt. In reality, only transfers made by the borrower are protected; a transfer by a subsequent owner of property is typically not protected under the act.

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For example, if a person received the property due to the death of a borrower, that transfer is protected under § (d)(5). If that person subsequently transfers the property to their child, the transfer is not protected under § (d)(6) as the transferor is not the borrower.²

If structured correctly—where the borrower retains occupancy and beneficial interest—some irrevocable trusts may still avoid triggering the due-on-sale clause. However, this area remains legally ambiguous and often requires a case-by-case analysis.

companies (LLCs) for asset protection and estate planning—especially with rental or investment properties. However, LLC transfers are not exempt under the Garn-St. Germain Act. An LLC is a separate legal entity, and even a transfer to a wholly owned single-member LLC is generally deemed a "sale" for purposes of the due-on-sale clause.

Fannie Mae and Freddie Mac guidelines

Despite the lack of federal protection, many lenders follow servicing guidelines from major mortgage entities that allow some flexibility:

Fannie Mae (D1-4.1-02): Permits transfer to an LLC if:

1. The mortgage was purchased or securitized on/after June 1, 2016,
2. The LLC is majority-owned or controlled by the original borrower, and
3. No violation occurs regarding property use.

Freddie Mac (§ 8406.4(b)): Permits transfer if:

1. The original borrower is the managing member,
2. All borrowers are LLC members, and
3. The use of the property complies with the mortgage terms.

These guidelines offer a potential pathway for compliant transfers, particularly for investment properties already being used as rentals. Nevertheless, borrower vigilance and documentation are essential, as lender policies and enforcement practices can vary.

Data and market context

These guidelines are important because approximately 70% of mortgages are backed by Fannie Mae or Freddie Mac, while LLCs and LLPs own approximately half of rental homes with five or more units, and approximately 15% of single-family rental homes.

POTENTIAL WORKAROUND

In high-value estates or risk-prone scenarios, the best approach may be to request written lender consent to the planned transfer. This is often overlooked but may offer definitive protection against future disputes.

[F]or rental or investment properties, transfers into trusts—even revocable ones—are not clearly protected. Landlords seeking to transfer such properties into trusts or entities for liability shielding or estate planning should proceed with caution.

A scenario commonly encountered in estate planning involves a surviving spouse whose recently deceased partner was the sole borrower on the mortgage. In such cases, the surviving spouse is not protected under the Act and may face enforcement of the due-on-sale clause.

This distinction underscores the need for precise planning. Once a property has passed from the borrower to another party—even a spouse or child—further transfers may trigger acceleration.

REVOCABLE VS. IRREVOCABLE TRUSTS

Revocable living trusts

Transfers into revocable living trusts generally qualify for protection under Garn-St. Germain. So long as the borrower remains a beneficiary and there is no transfer of occupancy rights, the lender may not enforce the due-on-sale clause. This exemption aligns with the intent of many estate plans, which involve the settlor maintaining control and occupancy during their lifetime.

Irrevocable trusts

The situation becomes more complex with irrevocable trusts. Although not explicitly excluded, these transfers may fall outside the safe harbor if:

- The borrower is no longer a beneficiary, or
- There is a transfer of occupancy rights to another party.

Sample trust provision

Here's a clause designed to avoid triggering due-on-sale, and aligns with § (d)(8):

The Settlor shall retain a beneficial interest in, and the exclusive right to occupy, the property at [address] during the Settlor's life.

However, such language will cause the property to be included in the Settlor's estate under IRC Section 2036, so estate tax implications must also be considered.

RENTAL PROPERTIES AND THE OWNER-OCCUPANCY REQUIREMENT

The Garn-St. Germain Act and accompanying regulations draw a critical distinction between owner-occupied and non-owner-occupied properties. Specifically, 12 C.F.R. §191.5(b)(1)(vi) limits the revocable trust exemption to situations in which the borrower is both a beneficiary and an occupant.

Thus, for rental or investment properties, transfers into trusts—even revocable ones—are not clearly protected. Landlords seeking to transfer such properties into trusts or entities for liability shielding or estate planning should proceed with caution. Absent lender approval, these transfers may expose the owner to immediate loan acceleration.

TRANSFERS TO LLCs: LEGAL ENTITY, LEGAL RISK

Not covered by Garn-St. Germain

A common alternative to trust-based planning is the use of limited liability

If that is not a viable option, one possible workaround for rental property is a two-step approach.

1. Transfer the property to an LLC, as permitted by the lender.
2. Subsequently transfer the LLC interests in a manner that more closely adheres to the client's estate plan.

There are risks associated with this strategy, particularly if the lender takes the position that these two steps are actually one transaction, thereby triggering the due-on-sale clause. But if care is taken to ensure that the transfer to the LLC is permitted and diligently enacted, a lender is unlikely to enforce the due-on-sale clause upon the subsequent transfer of the LLC interests.

PROFESSIONAL ETHICS AND RISK MANAGEMENT

Estate planners and attorneys have ethical duties to:

- Review the property's current use and mortgage type before recommending a transfer.
- Identify due-on-sale risks and how it could impact a client's estate plan.
- Warn clients about the possibility of loan acceleration.
- Avoid giving assurances without written confirmation from lenders.
- Use engagement letters and disclosures that outline these risks and to clarify that the attorney is not responsible for lender enforcement actions beyond their control.

Failure to properly advise clients may result in professional liability.

CONCLUSION: NAVIGATING THE LEGAL LANDSCAPE

Estate planning is an act of foresight—but without attention to due-on-sale

clauses, it may become a liability. Practitioners must weigh the benefits of probate avoidance and asset protection against the risks posed by mortgage enforcement. With a working knowledge of the Garn-St. Germain Act, awareness of lender-specific guidelines, and practical planning tools, estate planners can mitigate risks and achieve their clients' goals.

In all cases, the key is proactive legal guidance, thorough documentation, and close attention to lender requirements. The result: a secure, efficient estate plan that avoids probate—and avoids surprises.

End Notes

¹ 12 U.S.C. § 1701j-3.

² *In re Pugh*, 2019 WL 4180281 (Bankr. E.D. Wis. 2019).