

What You Should Know About Bond for Deed

from the desk of David M. Touchstone

In recent years, the device of Bond for Deed has become more popular in the State of Louisiana. For reasons explained below, Bond for Deed presents risks to both buyer and seller which are not inherent in other modes of financing the transfer of real estate.

The recent popularity of Bond for Deed arises primarily from two contexts. The principle driving force in the growth of Bond for Deed has been the “due on sale” clause in residential mortgages. In 1989, FHA mortgage forms were revised to limit assumptions. Prior to 1989, FHA mortgages could be assumed on a non-qualifying basis, i.e., any buyer (no matter how poor a risk) could assume an FHA mortgage, and there was nothing the mortgage holder could do about it. With the 1989 revision, the mortgage holder had a right to “call” the note (demand full payment) if the owner transferred the property without payoff and without the mortgage holder’s permission. VA mortgage forms and conventional mortgage forms soon followed suit in including “due on sale” clauses. However, these mortgage revisions failed to address the effect of a Bond for Deed contract. Recently, the Louisiana Court of Appeals has ruled that the 1989 mortgages, as written, did not contemplate that a Bond for Deed contract constituted grounds to exercise the “due on sale” clause and demand full payment. This was, however, small consolation to Bond for Deed proponents in that most of the standard mortgage forms (including FHA, VA, and conforming conventional) were redrafted in the late ‘90’s to state that Bond for Deed



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triggers the “due on sale” clause. Bottom line: If your client has recently mortgaged his home, in all likelihood, Bond for Deed will not be available.

The second common context for use of Bond for Deed is the owner financed sale. Many sellers, being frustrated by the time delays and expense involved in traditional foreclosure, have turned to Bond for Deed as an alternative. With respect to the issue of time, their confidence in Bond for Deed is misplaced. It is rare that a Bond for Deed seller can receive his property in less than 60 days in cases of default. This is approximately the time delay involved in traditional real estate foreclosures in Northwest Louisiana. While it is true that most Bond for Deed property recoveries are effected with less expense than traditional foreclosure, Bond for Deed presents substantial risks to Bond for Deed sellers which should give pause before this device is used. First and foremost, the Courts of this state have

ruled that termination of a Bond for Deed is to be considered as “rescission” of the contract and, as such, the parties, to the extent possible, are to be returned to the position they were in prior to the Bond for Deed. If a Bond for Deed purchaser made a significant down payment at closing, he may be entitled to a return of all or a portion of the down payment. Should the Bond for Deed purchaser make such a demand, the Bond for Deed seller is faced with substantial delay in recovering his property (while the matter wends through the courts), substantial attorney fees to litigate the matter, and the possibility of having to return some or all of the down payment. If you represented the Bond for Deed seller and this happens, how happy will your client be with you?

Another risk from the seller’s perspective is the possibility that Bond for Deed fails to pass muster as to the US Constitution with respect to the property recovery procedure. The Bond for Deed statute provides that a Bond for Deed seller (or in some cases, the Bond for Deed servicing agent) is to advise the Bond for Deed purchaser by certified or registered mail of a default. The Bond for Deed purchaser has 45 days from the date of mailing to cure the default. If the Bond for Deed purchaser fails to timely cure the default, the Bond for Deed seller files a document in the parish land records that the Bond for Deed is terminated. Note that this process does not involve filing suit, nor does a judge monitor any of the procedures. In a long line of cases, the US Supreme Court has ruled that the 14th Amendment to the US Constitution prohibits making laws that allow creditors to self help without “due process of law.” This writer believes that when Bond for Deed is put to the Constitutional test in some future case, it will be found wanting. After that, recovery of any property sold by Bond for Deed will be highly problematic.

From the buyer’s perspective, Bond for Deed presents some pretty grave risks. To ful-

ly comprehend the risks, it is necessary to understand that a Bond for Deed does not transfer ownership. It is a contract that states that ownership will be transferred in the future (usually after the buyer has made all payments due under the Bond for Deed). Meanwhile, the Bond for Deed seller continues to own the property. But what if the Bond for Deed seller should die before title transfers? Although the seller’s heirs or succession representative would be obligated to perform, actual implementation could be messy and expensive. Or what would happen if the Bond for Deed seller got into financial trouble and tax liens or judgments should be recorded in the parish mortgage records? The courts of this state have not addressed the latter scenario, and the lack of case law puts a Bond for Deed buyer in this situation in a very difficult position as far as obtaining clear title. Or what if the Bond for Deed seller should file Chapter 13 bankruptcy? Here again, the Bond for Deed purchaser would be confronted with an unforeseen situation causing him delay and extra expense.

Finally, Bond for Deed purchasers receive a different treatment under the law as far as homestead exemption. While purchasers under non Bond for Deed contracts are only required to file homestead exemption the first year, Bond for Deed purchasers must refile **every** year. Furthermore, there is a substantial possibility that the statute which allows Bond for Deed purchasers to file homestead exemption violates the Louisiana State Constitution. Hence, it is highly possible that in the future homestead exemption will be denied to Bond for Deed purchasers.

Conclusion: Bond for Deed can be a valuable financing alternative, but it should only be used for highly motivated sellers and buyers and **only as a last resort** when no superior form of financing is available. Furthermore, clients should be thoroughly advised as to the risks involved to avoid future embarrassment.