

LAND CONTRACTS AND OTHER SELLER “FINANCING VEHICLES”

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I. BACKGROUND

The depressed housing and mortgage market in N.E. Ohio and elsewhere, around the country, and the over-all slump in the economy, has resulted in extensive job-loss and a glut of foreclosed property. Many properties which are currently listed for sale by the Seller are not selling, in part because Buyers cannot obtain financing. This climate has overstressed Sellers and Buyers alike; in both residential and commercial areas of real estate. The credit crunch and lack of conventional financing sources, has resulted in unsold property. In conjunction with the lack of financing sources, the over-all value of property has lost between 30-40% of market value in N.E. Ohio, in the last year. Many loans have been underwritten with an adjustable interest rate and they are re-adjusting or increasing the monthly payment for borrowers. This has rendered property to be “under-water” or “over-mortgaged.” The depreciated value is compounded because on bank appraisal; comparables (which are more frequently becoming foreclosed neighboring properties sold on REO for 40% less than tax value), are further driving down values. If the Seller is not able to pay off the mortgage existing at the time of payment by the Buyer, the property cannot be sold, either traditionally or by land installment contract (“LIC”) or seller financing vehicles. That is of course, unless the Buyer wants to pay much more for the property than it is currently valued or the Seller’s lender is willing to accept a significant short fall on the debt. Financing for the Buyer, in amount to cover the debt, will not be available unless the Buyer brings substantial cash to the deal.

If the over-mortgaged property doesn’t sell within a reasonable period of time the Seller may contact their lender to request their approval of a “short sale,” or short pay-off. Whether the sale is on traditional sale, LIC or other “short sale” Seller financing arrangement, the lender must be contacted because of the standard form “due on sale provision,” which is in the Sellers mortgage. This provision is in the majority of mortgages and requires that the borrower obtain lender’s consent prior to transferring any fee, beneficial, or other interest in the property. It is my opinion that this would include the transfer of interest under a LIC. The lender may approve the “short sale” LIC or LIC sale because the lender desires to obtain regular installment payments and the Buyer will refinance or assume the current mortgages, after a set period of time. **This step must not be overlooked in importance. It is the authors opinion that this could be malpractice, if the Seller is not made aware of the “due on sale” provision or proper pay-off required on an existing mortgage or other liens, prior to the entering of a LIC.**

Traditional lenders are requiring Buyers to make a higher down payment in order to qualify for loan financing. Buyers are required to carry a higher credit score, and certainly an established credit score. In the pool of potential Buyers many have a poor credit score because they are emerging from foreclosure or bankruptcy protection. Many potential first time Buyers do not

have an established credit score, because they are young professionals beginning their careers or emerging from college or graduate school with excessive student loans. Buyers overloaded with debt are not qualifying. Also in times past, Sellers may have paid all closing costs, and this enabled the Buyer to obtain financing. However, the financing and home purchase transaction is under much more scrutiny, to weed out the fraudulent transaction and “flip” or other scheme which defrauds the lender, or innocent, unknowing purchaser. This scrutiny is occurring at the local governmental level and at the underwriting level, and as a result Buyers are paying closing costs more frequently. This “scrutiny” has further shut the door to the traditional “sale and purchase agreement,” loan financing.

Despite these factors, there are potential Buyers, who have verifiable wages and income and have the financial ability to support a monthly payment towards a purchase price. They do not want to lease. They desire home ownership. They may be willing to pay a higher purchase price (in order to clear the existing Seller mortgages) for property they like, perhaps in a good school district; and their poor credit will be overlooked. The Seller may be desperate to sell or not in need to immediate cash, and may conclude that they are willing to take on the risk of the LIC or Seller financing arrangement to sell the property. Also the Buyer may find the Seller financing terms being offered in the LIC to be more favorable than financing being offered by an institutional lender. It is in this context that the LIC and Seller financing arrangement is most applicable and will become more common in the real estate transaction, than in times past.

The LIC and Seller financing arrangements require creativity in drafting the real estate contracts and advising the client. I am hopeful that my material will assist to explain the basic fundamentals of the LIC and Seller financing arrangements and highlight areas which I believe are most susceptible to error and malpractice; in negotiating, drafting and litigating. Using the LIC and Seller financing arrangements requires understanding and fully comprehending pitfalls of your “standard form” contract, which you may have generated and used for years (or was generated in a form set)---but which was likely not drafted to anticipate a sudden downturn or upturn in the real estate market. When the real estate market is in a state of flux, which it is today, drafting becomes essential. It is also essential to understand receivership and bankruptcy fundamentals. This is becoming evermore important because the economy, if it continues to worsen, will drive Sellers and Buyers into filing for bankruptcy protection.

Practice Pointer- The LIC is not going to assist the Seller who is seriously “under water” or “over mortgaged” or has fallen behind on monthly mortgage payments, with arrears, and foreclosure is imminent. The LIC can assist the Seller who has negotiated a purchase price with the Buyer which is equal to or greater than the mortgage balances owed. The Buyer's installment payment must be at an amount that covers the existing mortgage and after the Seller's lender has consented to the LIC. Could the Seller enter into a LIC with a Buyer and attempt to modify the mortgage loan under the *Making Home Affordable Plan* introduced by the Obama Administration? It doesn't appear that the modification program would apply to the transaction unless it was owner occupied as the Seller primary residences. If the Buyer/Vendee took possession it would not be Seller occupied.

Practice Pointer-Seller must record the LIC (consumer transaction). This is a statutory requirement under ORC 5313.02. If the Seller does not want to contact the lender regarding the due on sale provision and to obtain proper consent to sell on LIC, the lender may discover the LIC upon filing. The lender will also be alerted to the change in possession and ownership because the insurance policy will likely reflect this change.

II. LAND INSTALLMENT CONTRACTS & SELLER FINANCING ARRANGEMENTS

If the Seller desires to facilitate the sale of property he/she may offer to finance in whole or part, the purchase price for the Buyer. The “financing vehicle” can be through LIC, mortgage, note and personal guarantee or other vehicles (rent to own, lease purchase, Seller equity transaction). The Seller or the Buyer can be an individual, entity or trust. The property can be residential, commercial, vacant, or any other zoned classification. The Seller takes on a dual role of both Seller and Lender.

Practice Pointer: The Seller should engage in the same practices of due diligence in requesting financial reporting from the Buyer prior to entering the LIC, and during the payment period. At the very least the Buyer should provide adequate assurances that they are able to make the payments and if their circumstances change they must notify the Seller within a reasonable period of time.

The Seller must consider which percentage interest he/she will charge on the amount financed. It is imperative that the Seller charge the federal applicable rate on any amount financed. The IRS will regard the LIC as a “vehicle of financing” and impute interest on the amount financed.

If the Buyer is an entity, the Seller may require that the Buyer execute personal guaranty.

The properly executed LIC and mortgage are both “vehicles of financing” and act as the security to the Seller for the payment of the purchase price. So long as proper, and in compliance with the statute, the Seller/Vendor and Lender would hold “secured” party status, in Bankruptcy Court. The Seller who short-cuts to avoid foreclosure, on Buyer default, and requests that the Buyer provide an executed deed back to the Seller, to be held in escrow in the event of default, runs the risk of not obtaining “secured party” status without a proper LIC or mortgage.

A. Land Installment Contracts

Two categories of LIC’s exist. The first type of LIC is related to a consumer transaction, where the property contains a “dwelling.” This type of LIC falls within 5313 of the Ohio Revised Code and affords many consumer protections to Buyers. The second type of LIC is related to all other transactions, where the property does not contain a dwelling (i.e. commercial, vacant, mixed).

A LIC defined is an agreement and “financing vehicle” where the Seller/Vendor (“Seller” and “Vendor” are used interchangeably) promises to convey title to a parcel of land at

some point in the future in exchange for a Buyer/Vendee (“Buyer” and “Vendee” are used interchangeably) promising to make monthly payments of principle and interest, amortized, during the contract period. The Seller typically turns over possession, maintenance, taxes, insurance, and other burdens of land ownership to the Buyer of either improved, vacant land, commercial or residential and the Buyer begins making installment payments of principle and interest to the Seller. The Seller maintains the legal title as security for the Buyer’s payment of the purchase price. The Buyer receives equitable title together with possession. Although the contract has not been executed by the Seller for the deed, equity considers the property of the Buyer to consist of real estate, and the property of the Seller to consist of personal property. *Baraby v. Swords*, 166 Ohio App 3d 527, 851 NE 2d 559 (3d Dist. Allen County) 2006 and *Homer C McDowell*, *Land Contracts*, *Title Topics*, July 1943.

A competent and experienced real-estate attorney should prepare the LIC. A form set for LIC would be a dangerous practice. If there is a real-estate broker involved in the transaction, and a form purchase agreement is used, it should make reference to the fact that the sale and purchase is to be financed through LIC, (possibly in addition to cash or note through down payment or earnest money). It should state that the LIC is to be prepared by an attorney and approved by the parties.

It is advisable to conduct two “closings,” which should be handled through an experienced escrow agent. The Seller typically obtains a title examination and title commitment at the time of negotiating the LIC and to determine many important issues (discussed below) but most importantly to determine property description, parties, and any existing encumbrances on the property. The Seller and Buyer must know if the Seller can convey marketable title when the Buyer pays the purchase price in full. This should be obtained from a reputable title agency. The Seller needs to determine the pay-off of any existing mortgages and should obtain the lender’s consent to transfer on LIC, to avoid triggering the “due on sale” provision, which could result in the lender accelerating the date of payment in full. The Seller needs to provide the residential disclosure form and lead-based paint disclosure form, if applicable to the Buyer. The Buyer typically obtains physical inspections, (don’t overlook whether the municipality has a point or sale inspection or notice requirement upon change in possession), approvals for use, environmental inspection, a proper survey and should purchase an Owner’s Policy of Title Insurance, since the Buyer will immediately begin making payments towards the purchase price. The Owner’s Policy of Title Insurance insures the validity and enforceability of the LIC. This would be completed at the time of the first “closing,” and through the designated title agent/escrow agent. At the first “closing” the taxes and utilities are pro-rated, based on the last available tax duplicate, and generally taxes are final. In the event of any increase or decrease in taxes the Buyer would pay the liability. The Buyer delivers the executed and acknowledged LIC to the Seller for recording. The parties must determine which party is responsible for insurance and maintenance and a copy of the declaration page of the insurance policy; showing proper coverage and the additional named/ covered insured, should be delivered into escrow or to the Seller or

Buyer directly. **None of these steps should be overlooked—to avoid malpractice.** When in doubt, conduct more due diligence and you will resolve issues early and avoid later mistakes and possibly unnecessary litigation.

The Seller usually delivers into escrow an executed warranty deed at the second “closing”, when the Buyer makes the last payment due under the LIC. Title is passed according to the dictates of the LIC (i.e. subject to easements, home owners declaration and restrictions, other “permitted exceptions” which should be carefully defined, usually according to the Schedule B of the title commitment). The Buyer-Seller relationship is very similar to the Borrower/Lender, traditional Note and Mortgage financing (discussed below). It is advisable that the Seller/Vendor build protections into the LIC, which do not violate public policy (i.e. attorney fees, liquidated damages, excessive late charges on consumer LIC) which are similar to the protections afforded the lender in the mortgage.

1. Residential Land Contracts

Land Installment Contracts that fall within Ohio Revised Code 5313, are LIC where special protections are afforded to the Buyer and involves a consumer transaction only. **This codification of law ONLY applies the LIC covering residential property or which contains a “dwelling”, and which is entered into after its effective date, 11-25-1969.** The term “residential” is generally defined as containing a “dwelling”. But “residential” and “dwelling” have been interpreted differently by the Courts, for example a multi-unit apartment building or a hybrid, retail, apartment property may extend the statutory protections of the statute. The LIC vehicle on commercial property, or mixed property, or vacant land (which does not include a “dwelling”) does not extend the protections of the statute. It is stated that ORC 5313, has no applicability to purely commercial properties. *Johnson v. Maxwell, 51 Ohio App. 3d 137, 554 NE2d 1370 (1988)*. It is imperative to remember that the forfeiture (or eviction) rights afforded to the Seller under a LIC do not apply to commercial property, and typically the Seller remedy upon default is to bring a foreclosure against the Buyer/Vendee.

Practice Pointer: In addition to the above, LIC statutes do not apply to (1.) “option contracts” (2.) contracts requiring final payment within (1) year of date of the agreement for purchase (3.) contracts pertaining to real property outside of the State of Ohio.

Practice Pointer: A “lease purchase” is usually deemed to be a disguised LIC, if any of the lessee’s “rent” payments are to be applied to the purchase price, or if the lessee is required to make a down payment or deposit, before the lessor is to convey title. Two recent Court of Appeals decisions reached opposite results and attention should be taken to the jurisdiction of the property. *Fadelsak v. Hagley, 2003 WL 21489613 (Ohio Ct. App. 4th Dist. Lawrence County) 2003* (finding the “lease purchase” to be a LIC) and *Windsor v. Riback, 2008 WL 1849617 (Ohio*

Ct. App. 11th Dist. Geauga County) 2008 (finding the “lease purchase” did not extend benefits of LIC to Buyer).

(a) **Elements of the LIC, Statutory Minimum Contents**

ORC Section 5313.02, to determine the minimum contents for a LIC, is shown below, in paraphrase.

- (i) the full names and current mailing addresses of the parties;
- (ii) the legal description of the property;
- (iii) the purchase price;
- (iv) the amount of the down payment;
- (v) the amount of the installment payments;
- (vi) and, the interest rate charged (must be equal or greater than federal applicable rate).

Other requirements, although less obvious from a read of the statute, are as follows:

- (i) list of the encumbrances against the property;
- (ii) express statement that the Seller will cause a copy to be recorded (within 20 days of execution);
- (iii) **the Seller will provide evidence of title in accordance with the prevailing custom in the area where the property is located (imperative to order a title commitment)**
- (iv) Every Seller shall provide at least once per year, or upon demand, (but no more than twice per year) a statement to the Buyer indicating that amount of the Buyer’s payments credited to principle and interest, and the remaining balance due.
- (v) Executed in recordable form, with same formalities of a deed, proper acknowledgment is required.

Practice Pointer: It is recommended to attach to the LIC at the time of execution a full and complete legal description, amortization schedule of payments, proposed deed and list of encumbrances which show on the record and which have been determined to exist on the title commitment.

(b) **Recommended clauses for the Seller/Vendor**

- (i) acceleration clause upon the failure of the Buyer to comply with terms of contract;
- (ii) additional or alternate remedies available to the Seller;
- (iii) clear provision regarding payment of taxes, insurance & maintenance. It is advantageous to have the Buyer carry the proper coverage and furnish monthly evidence of payment to the Seller and have the Seller designated as a covered insured;
- (iv) mandate that the Buyer must make payment directly to the Seller (not to the Seller's mortgage holder);
- (v) prohibition against assignment or leasing the property, without the express written consent of the Seller;
- (vi) **if the Seller's mortgage contains a "due on sale" provision, the Seller has the right to accelerate the Buyer's obligation to complete the payment of the purchase price in the event of foreclosure;**
- (vii) **default rate of interest (i.e. 12%) which will be applied against the accelerated debt owed at the time of default.**

Practice Pointer: It must not be overlooked to warn the Seller of the "due on sale" provision in most mortgages. This entitles the lender to accelerate the date for payment in full of the balance due thereunder, if the borrower transfers the property without the consent of the lender. I put this warning in writing to the client.

(c) **Recommended clauses for the Buyer/Vendee**

- (i) clear provision regarding the payment of taxes, insurance & maintenance;
- (ii) provision which allows the Buyer to make payment directly to the Seller's mortgage lender or senior lien holder or monthly evidence from the Seller that mortgage has been paid;
- (iii) provision which bars the Seller for further encumbering the property, without the express written consent of the Buyer;
- (iv) clear covenant by the Seller to convey clear and marketable title to the Buyer only subject to those permitted exceptions, as defined in the LIC.

(d) **Forfeiture / Foreclosure.** The Seller/Vendor's main remedies, upon Buyer/Vendee default are for either forfeiture or foreclosure. **It is the Seller's forfeiture right (consumer transaction only) that makes the LIC appealing over the standard mortgage financing arrangement whereby foreclosure is required.** This is obviously appealing to the

Seller because foreclosures can be slow and costly. Forfeiture, which on its face, is quicker and cheaper, may result in a windfall to the Seller if the value of the property, upon repossession exceeds the Seller's damages resulting from the default. The Seller has the ability to cause the Buyer to forfeit his/her interest under the LIC without the Seller's bringing a foreclosure action, if the below circumstances are met. The forfeiture is the loss of the Buyer's down payment and any principal payments made. The Seller is entitled to claim the fair rental value for the period since execution of the LIC, plus any deterioration or destruction of the property occasioned by the Buyers use. Such amounts should be deducted from the sums paid by the Buyer toward the purchase price. If the payments exceed the fair rental value, plus deterioration, then the Seller is not entitled to judgment for any additional amount. The Buyer likewise should not be awarded a judgment for any return of the excess of his payments on the purchase price. *Butler v. Michel, 14 Ohio App 3d 116, 470 NE 2d 217 (Summit County) 1984*. The forfeiture can be brought in a forcible entry and detainer eviction action under Chapter 1923 of the Revised Code, and is an exclusive remedy, barring any further action on the LIC.

The forfeiture option is only available if all of the following apply:

- (i) The Seller has given written notice to the Buyer of his/her default and the Buyer has not cured that default within thirty days after receipt of the notice. ORC 5313.05. If the default is cured within the thirty day period, then the forfeiture option is not available;
- (ii) After expiration of the thirty day notice period without a cure, the Seller serves written notice to the Buyer that identifies the LIC and describes the property covered by it, specifies the terms and conditions of the LIC that were breached, and notifies the Buyer that the LIC will be forfeited unless the Buyer fully performs within ten (10) days of the completed service of notice. ORC 5313.06.
- (iii) The LIC has been in effect for less than five (5) years;
- (iv) The Buyer has paid less than twenty percent (20%) of the total purchase price ("purchase price" is not statutorily defined, but has been found in *Smith v. Blackburn, 31 Ohio App. 3d 251, 511 NE 2d 132 (Scioto County) 1987*, to be the face amount of the contract, excluding insurance premiums, real estate taxes, or interest on unpaid principle), and;

- (v) The Seller dispossess the Buyer of possession of the property pursuant to a forcible entry and detainer action pursuant to Chapter 1923 of the Revised Code.

Absent compliance with the above, then the Seller's only remedy is to institute a foreclosure action to recover possession of the property just as it would under a typical foreclosure of a mortgage. ORC 5313.07. As between the Seller and Buyer the Seller is entitled to proceeds of the sale up to the unpaid balance due upon the contract.

Other remedies are available to the Seller and Buyer, (unless forfeiture was previously elected by Seller) which ORC 5313 does not preclude, i.e. action to quiet title to establish the validity of claim to the property; suing for unpaid installments; mutually cancelling the interest of the Seller and Buyer in accordance with 5301.331.

2. Non-Consumer or Non-Residential Land Contracts

ORC Chapter 5313 does not apply. The forfeiture remedy would not be available for the Seller upon a defaulting Buyer. Typically the Seller institutes a foreclosure on the LIC. The LIC terms for the non-residential transaction should be carefully drafted. In particular, the remedies provisions must be very clear. It is recommended that the Seller request that the Buyer provide a cognovit promissory note (discussed below) evidencing the Buyers obligation to pay the full amount of the purchase price pursuant to the payment terms of the LIC, in addition to preserving the right to foreclose and sell the property at a foreclosure sale in order to apply the proceeds received at such sale to the unpaid balance due under the LIC or note. The Buyer may want the protections afforded to him/her in ORC 5313 to be carried forward in the non-residential transaction. If the parties do not intend for ORC 5313 to be applied, it should be stated as such. **It may be advantageous to use the traditional note and mortgage financing vehicle over the LIC, because it is more familiar to the Courts.** One advantage for the LIC may be that the Seller can sell on LIC and so long as the LIC does not prevent it, grant a later mortgage to a lender with the expectation that it will be paid off, at the time of transfer of clear and marketable title to the Buyer. It also may be that the Buyer could assume the existing mortgage put on by the Seller if the loan terms are favorable.

3. Additional Topics to Consider with Land Contracts

- (a) Voluntary Release or Satisfaction of Land Contracts. If the LIC has been recorded of record in the county which the real estate is

situated it should be released of record to “clear title.” If the Seller under a LIC conveys the property to the Buyer, or the Buyer conveys their equitable interest back to the Seller (best through quit-claim deed), a merger of title is presumed to occur, which would not require the filing of the release. Most counties require that a separate release be filed with the recorder which release would always reference the Instrument No/volume and page of the recorded land contract. Some counties will permit a marginal release, where there is a handwritten note of the release on the margin of the original land contract. When examining the records you must take notice of marginal entries. The Buyer or Seller or any person with an interest in the land could also put on the record an Affidavit of Facts Relating to Title under ORC 5301.252. The Affidavit of Facts Relating to Title will be filed with the county recorder and put facts on the record which will attempt to “clear title,” and assist the title examiner and title company to insure further transfer of the property clear of the old LIC.

(b) Liens & Actions Involving Land Installment Contracts

- (i) The Seller/Vendor under the LIC retains legal title and any liens which normally attach to real estate will attach to a vendor’s interest. As a general rule, creditors of the vendor can only reach the subject property to the extent of the Seller/Vendor remaining equity. Vendor has a lien for so much of the purchase money as remains unpaid. ORC 5301.26 defines Vendor’s Lien.
- (ii) Divorce or Surviving Spouse Rights of the Buyer/Vendee-Dower does not attach to a Buyer/Vendee interest under a LIC. *Rands v. Kendall, 15Ohio 671 (1946)*;
- (iii) Breach of a LIC, to enforce, or defeat the LIC as between the current Seller/Vendor and Buyer/Vendee;

*Elements: To recover for breach of contract, a party must establish that (1) a binding contract exists; (2) the non-breaching party performed its contractual obligations; (3) the other party failed to fulfill its contractual obligations without legal excuse; and (4) the non-breaching party suffered damages as a result of the breach. (*Garafalo v. Chicago Title Ins Co., 104 Ohio App. 3d 95, 108 (1995)*;

*Statute of Limitations: Fifteen years from when cause accrued. RC§2305.06

*Burden of Proof: Preponderance of the Evidence

*Remedies: Seller/Vendor may bring an action in forfeiture (consumer or residential) or foreclosure. Vendee may bring an action in specific performance seeking title, or breach of contract seeking return of sale proceeds (minus fair rate of rental), plus any property value increase. Reimbursement for capital improvements? See above for more discussion.

- (iv) Foreclosure of a Seller/Vendor mortgage, tax lien, or other liens & priority;

If a senior lien creditor asserts a priority claim over the Buyer/Vendee interest you must analyze the validity of the lien. Are the statutory elements met in creation of the lien? Is it properly acknowledged? Does it state the signors names? I check routinely if the named notary is registered with the State of Ohio. This is easily found at the Ohio Secretary of State website <http://www.sos.state.oh.us/SOS/Notary/Search.aspx>. Is the Plaintiff entitled to enforce the Note? By assignment? Is the assignment or note their possession? Is the legal description accurate and attached to the mortgage? There is a current trend in the Northern District of Ohio Bankruptcy Court and around the country, attacking mortgages based on alleged defects in execution, and inadequate or missing legal descriptions—*In re Wheeler*, 2006 WL 1645214 (S.D. Ohio 2006) improperly executed mortgage results in mortgage did not covers wife undivided ½ interest; mortgage does not reference wife as borrower and wife not in notary clause, even though she signed. *In re Bunn*, 2008 WL 4449551 (S.D. Ohio 2008) is an example of a reversal of a bankruptcy trustee who tried to void a mortgage based on legal description. Holding: Inquiry must be made as to whether the inclusion of only the street address and PPN is enough to put a bona fide purchaser on notice as to the existence of an encumbrance on the debtor's property.

What should the Buyer/Vendee do to protect the purchase money paid? The LIC should provide for the Buyer/Vendee to make payments directly to the Seller/Vendor mortgage holder. See above discussion regarding recommended clauses for the Buyer/Vendee. If it is discovered that the

LIC is not properly executed, the Buyer should immediately record an Affidavit of Facts Relating to Title regarding his/her “equitable interest.”

- (v) Action to enforce federal tax lien, child support lien, federal anti-terrorism lien, real estate taxes and assessments, environmental liens, mechanic’s liens filed against a vendee. These liens attach to a Buyer/Vendee interest. A very aggressive creditors attorney may attempt to reach the Buyer/Vendee equitable interest by an action of a creditor’s bill under ORC 2333.01.

NO other liens attach to a vendee interest;

- (vi) **Probate Issues-** In probate the application and “inventory” of assets of the decedent submitted to the Court should show the Seller/Vendor LIC interest as personal property and the Buyer/Vendee LIC interest as “equitable interest” in real property. Before the LIC is completed what happens if the Seller/Vendor or Buyer/Vendee dies. The appointed executor or administrator, with the consent of the other party to the LIC (Seller/Vendor or Buyer/Vendee) can apply to the Probate Court for letter of authority and further order to assume and complete the LIC. Proper notice is required to be given to the surviving spouse, heirs, legatees or devisees and hearing (unless waived). The determination by the Probate Court is whether the completion of the LIC would be in the best interests of the estate. The executor or administrator could file a petition to alter or cancel the LIC. The executor or administrator could become authorized to file a forfeiture or foreclosure action to protect the best interests of the estate.

- (vii) **Bankruptcy Issues-** What if the Seller/Vendor or Buyer/Vendee files for bankruptcy protection.

If the Seller/Vendor files for protection, he/she must show the executory contract on Schedule G of the Petition and express whether the LIC will be assumed or rejected. Schedule A should reflect the legal description with nature of interest being noted as a Vendor interest in a LIC. The Schedule B should reflect the asset as personal property and the value stated should be the balance of the purchase price owed under the LIC. The asset could be exempted

under the Homestead Exemption because the Seller/Vendor may use the property as their dwelling.

If the Buyer/Vendee files for protection the same issues apply, except the asset should be shown on Schedule A, as real property and the nature of ownership is “equitable title”. It should be shown on Schedule G, executory contract. The Seller/Vendor should be shown on Schedule D, as a secured creditor. Does the Homestead Exemption apply to the Buyer/Vendee’s “equitable interest” or the purchase money which the Buyer/Vendee has paid to the vendor + any inflation of value of the property which would belong to the Buyer/Vendee, it should. 11 USCA 541(D) defines legal and equitable title as property of the bankruptcy estate.

B. Seller Financing Traditional Note, Mortgage, Guarantee, Assignment of Rents

The purchase money mortgage financing vehicle usually requires the Buyer to make a small initial payment on the purchase price, and the Seller delivers a deed to the Buyer. The Buyer delivers a promissory note or cognovit note (non-consumer transaction), secured by a mortgage, back to the Seller for the remainder of the purchase price. The Buyer and Seller serve a dual role as borrower and secured lender. If the Buyer defaults in payment, the Seller may either sue on the note or foreclose the mortgage. The Seller may seek deficiency judgment if filed within the statute of limitations.

1. Promissory Note vs. Cognovit Note

The cognovit note feature contains a warrant of attorney to confess the judgment, against the debtor immediately, upon default, and without filing a separate legal action to seek judgment and the amount of the debt owed, if the formalities of the statute are followed. It requires strict compliance with ORC 2323.13 which defines the transaction and requirements of the cognovit note and the process of obtaining judgment. **It cannot be used on a “consumer transaction,” or “consumer loans.” It must contain the exact warning language in ORC 2323.13(D) in CONSPICUOUS size font, on the face of the note, and executed by the borrower/maker.** The cognovit note should contain all the same basic provisions of a promissory note, most importantly being right to accelerate the debt upon default, a default interest rate, and right to reimbursement for reasonable attorney fees and court costs.

2. Basic provisions of the Note

- (a) Payments; commence date and balloon payment date; on demand;
- (b) Interest and default interest rate ****Critical because consumer transactions generally do not permit late charges or attorney fees to be paid upon default;
- (c) Due of sale provision;
- (d) Negotiable – so that it can be sold;
- (e) Assignment;
- (f) Default Clause –right to accelerate;
- (g) Prepayment;
- (h) Events of default;
- (i) Remedies;
- (j) Standard misc. provisions for all contracts;
- (k) **Schedule of payments or amortization schedule.**

3. **Statutory Mortgage vs. Traditional Mortgage (long form)**

A statutory form mortgage is codified in ORC 5302.12. It is very short because it contains two defined terms which are defined elsewhere in the ORC. “Mortgage Covenants” defined in ORC 5302.13. “Statutory Condition” defined in ORC 5302.14. It is recommended to broaden this short form to include more protections for the lender/mortgagee. The mortgage must be executed with same formalities as a deed which requires ONLY acknowledgement ORC 5301.01. It must clearly and accurately describe the underlying debt which it secures and the real property which is being granted to the lender under the mortgage. Close attention must be paid to the legal description attached and referenced in the mortgage. Lender should obtain a survey, and obtain a Loan Policy of Title Insurance for the amount of the loan. The mortgage must be recorded to preserve priority over competing liens. ORC 5301.23. The mortgage of record expires under statute within 21 years after the date of the mortgage or 21 years after the stated maturity date of the principal sum, if a stated date appears on the mortgage, whichever is later ORC 5301.30. It is important to read the statute as there are further limitations to this expiration of interest.

Practice Pointer Must state in the mortgage how payments are to be applied— and apply them per the mortgage. *First Federal Bank v. Angelini, 2007 Ohio 6153 (3rd District Court of App., Crawford Cty)Nov 19, 2007.*

4. **Personal Guaranty**

5. **Assignment of Rents, Security Agreement & UCC's**

C. Lease Purchase and Rent to Own

1. Lease Agreement w/ Purchase Agreement attached as exhibit

- (a) Distinguish from land installment contract. Could be interpreted as LIC and fall within the LIC statute. May require foreclosure remedy.
- (b) Lease Agreement w/ option to purchase or right of first refusal
- (c) Buyer should put on record a memorandum of lease, which contains right of first refusal.
- (d) Eviction vs. Foreclosure
- (e) May not require the consent of the lender upon execution if “due on sale” provision is not triggered or if the mortgage does not contain a “family rider”.
- (f) Many clients find this more easy to understand. But, Courts may be concerned with allowing forfeiture or eviction to be used by the Seller if any amount of “rent” is being applied against the purchase price.