How do I start a real estate company? How do I transfer and buy real estate with an LLC?

In a previous article we established that an LLC is the entity of choice when it comes to holding rental properties, now let's discuss how to own real property in an LLC.

We have talked to many people who just buy a rental property, form an LLC, and then draft and record a deed to transfer the property from their name to the LLC. However, this is not the preferred method if you are financing the property you plan to purchase. Property owners attempt to do this for the primary reason of obtaining more favorable financing options when they purchase the property. However, this is not how you should do this.

The main issue with the transfer described above is that the owner usually has not reviewed the mortgage terms applicable to the property and have not attempted to consult with the loan servicer on whether this type of transfer is permitted. The issue with this is that most mortgages have a due on transfer provision, so that when you transfer the ownership of the property, the remaining balance of the mortgage becomes immediately due.

Just like when you sell your home (assuming your home is subject to a mortgage), you cannot just take the sales proceeds, pocket them, and continue to pay off the mortgage over time. The mortgage loan must be satisfied at the closing so that the mortgage can be released in order for the buyer to take clean title to the property.

When someone transfers a property subject to a mortgage to his or her own LLC, there is usually no exchange of money involved, but it is still a transfer that will likely trigger the due on sale provision under the mortgage.

It is possible that the lender doesn't care about the transfer because the mortgage follows the property and the owner remains primarily liable under the mortgage loan. But you are rolling the dice on this. You may also unwittingly be creating some issues that might arise down the road with respect to the title of the property when you try to refinance or sell the property.

If you have a property that you own that is subject to a mortgage, and you want to transfer such property to an LLC, you should review your mortgage documents and, if applicable, seek consent from your lender or loan servicer. Alternatively and often preferably, you can form the LLC, purchase the property in the name of the LLC, and finance the

property through the LLC. When the transaction is complete, the LLC will own the property and no subsequent transfers will be necessary. Many lenders cooperate with this plan because the loan will still be guaranteed by the individual LLC owner and a mortgage against the property will still be granted to the lender, preserving the lender's security for the loan.

The reason that some people do not do this is because they believe (often wrongly) that the transaction will be harder to finance. That is often not the case, but interest rates may not be as favorable when it comes to financing rental properties in which you will not be residing.

Also, note that if you purchase the property in the name of your LLC, you aren't going to be able to use certain loan products, like an FHA loan. An FHA loan would allow you to purchase the property for 3.5% down if you are personally buying a multi-unit property that you intend to live in. As you can see, there is a substantial difference in the amount needed up front to purchase the property through the LLC. This is why it might make sense to start the company with a friend who might be able to help finance the acquisition. Being an owner of a multi-member LLC brings in a long list of considerations, many of which are covered in a subsequent article about multi-member operating agreements for real estate companies.

As always, each situation is unique, so reach out to an attorney at CPM to discuss your circumstances and the course of action that makes the most sense for you and the real estate you own or plan to own.