

CAN BANKERS TRUST TRUSTS?
Or
A BRISK WALK THRU "NEVER-NEVER (REVOCABLE TRUST) LAND"

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BACKGROUND

In order for a conveyance or a mortgage of real property to be enforceable between the parties, the agreement must be put into writing (this avoids running afoul of the "statute of frauds"). [15 O.S. Section 136] Because lenders like to be first in line when it is time to sell collateral at a sheriff's sale and collect the proceeds, their mortgages are placed in the public land records. [42 O.S. Sections 6-7] This recording process makes the existence of the document known to third parties (e.g., subsequent buyers and lenders) by taking advantage of a statutory process called constructive notice, whereby all third parties (i.e., everyone other than the two parties to the subject transaction) are assumed to have knowledge of all documents filed in the local county land records. [16 O.S. Sections 15-16]

Also, to have an enforceable mortgage, the lenders must take steps to ensure that the mortgagor on the mortgage is a recognized legal entity. In the absence of a legal entity which is capable of receiving and then granting an interest in real property (e.g., a mortgage lien), the conveyance is void and unenforceable. [Jones v. Alpine Investments, Inc., 764 P.2d 513 (Okla. 1987)] When the mortgagor is a natural person (e.g., you and me), rather than an artificial creature of statute, such as a corporation, it is fairly easy to request the mortgagor to establish her identity, disclose her marital status and have both her and her spouse sign the mortgage. [16 O.S. Section 4]

However, the state legislature has found a variety of reasons to recognize artificial persons as legal entities, such as limiting the business owners' individual liability, lengthening the expected life of a business beyond one person's lifetime and raising capital through the new-found ability to attract multiple investors. These newly recognized entities initially included corporations and partnerships, and, more recently, limited liability companies, joint ventures, trusts, estates and unincorporated associations, among others.

[16 O.S. Section 1]

There is a problem inherent in trying to ensure that the proper person signs a conveyance or mortgage when the grantor/mortgagor is a legal entity other than a natural person. When a person is asked to sign in her representative capacity, such as a partner of a fictitious name partnership (i.e., a partnership where the names of the partners are not included in the name of the partnership itself), an extra effort is required to identify the proper representative. The fictitious name partnership must file a Certificate of fictitious name partnership in the local land records where the partnership owns real property. [54 O.S. Sections 81, 83] This Certificate lists the names of the partners and is available to be found by subsequent purchasers and encumbrancers.

TYPES OF TRUSTS

There are times when people desire for the title to their real property to be held at arms length by some other person who is granted the power to manage such property. This is usually done for estate planning purposes or in anticipation of incompetency. When real property is conveyed to a third party to be held for the benefit of a particular person (i.e., a beneficiary), it is said that the real property is being held "in trust". [60 O.S. Sections 171, 175.2, 175.6] When someone speaks of real property being held "in trust" they mean that, while the trustee holds legal title, there were express limitations on the trustee's ability to convey or to encumber title to the real property. Such limitations are set forth in the trust agreement established by the settlor, who is also known as the trustor. [60 O.S. Section 175.24]

There are four kinds of trusts: (1) common law trusts which in Oklahoma are limited to business trusts, (2) public trusts where the title is held for the benefit of the State, (3) express private trusts, and (4) implied trusts usually created by court order. [Herein, we will focus on general trust principles with an emphasis on express private trusts.]

The settlor (who is also called the trustor) is the person who sets up the trust and will often be the grantor who conveys the subject property into the trustee or trustees, or into the trust itself to be held by the trustee or trustees. The trustee is in a special relationship to the beneficiary of the trust and is considered to be in a fiduciary relationship. [60 O.S. Section 174]

All trust agreements have been declared by the legislature to be private documents which are not expected to be placed in the public record. [60 O.S. Section 175.45(c)]

If the grant is made to "Susie Smith, Trustee" without any further description of the trust, then the real property is subject to the claims of the trustee's spouse, creditors and heirs. [60 O.S. Sections 156(A), 157] For the ownership to be free from such third parties' claims, the conveyance must include a further detailed description of the trust, such as "Susie Smith, Trustee of the *Susie Smith Revocable Trust Under Trust Document dated January 1, 1998*". Not only does this label "trigger" a separation between Susie Smith's personal assets from those assets being held by her as a fiduciary, but if Susie Smith is the trustee for several trusts, then this label helps identify which trust is involved, with its different beneficiaries and its different instructions to the trustee.

If the property is mistakenly conveyed to "Susie Smith, Trustee", as described above, so that it appears to be held by her in her individual and not her fiduciary capacity, then remedial steps are required. A correction deed from the original grantor to "Susie Smith, Trustee of the Susie Smith Revocable Trust Under Trust Document dated January 1, 1998", or other evidence of the existence of a trust condition on the property (such as a Memorandum of Trust, described below) needs to be placed in the record. [60 O.S. Section 156(B) & 16 O.S. Sections 82-84]

It should be noted that unless a review of the trust instrument itself or the recorded Memorandum of Trust (discussed below) discloses the need for all of the trustees to sign the mortgage, it is sufficient under Oklahoma's statutes for a majority (i.e., more than 1/2) of the trustees to sign it. [60 O.S. Section 175.17(A)] The names of the trustees will usually be set forth on the face of the deed placing the property into trust. This will show you how many trustees there are, and, therefore how many must sign the conveyance or mortgage. This means that 1 of 1, 2 of 2, 2 of 3, 3 of 4, 3 of 5, etc., trustees must sign the documents. [60 O.S. Sections 171, 175.17]

It has also been the law in Oklahoma for a long time that, in the absence of a limitation in the trust agreement or the Memorandum of Trust, any trustee (or a majority of trustees, if there are more than one trustee) is presumed to have the authority to hold, encumber and convey real property of the trust. [60 O.S.

Sections 171, 175.24(A), 175.45]

GRANTEE: TRUST v. TRUSTEES

In 1988, and again in 1989, the ability to hold real property "in trust" was modified by state statute so that, as an alternative to having the title shown to be in the trustee or trustees, the title could be conveyed, for the first time, into the name of the trust itself, such as the "Susie Smith Revocable Trust Under Trust Document dated January 1, 1998." [60 O.S. Section 175.6a] The reason this law was enacted was not to reflect a new idea or a better idea, but was to correct numerous mistakes made where conveyances had been made to the trust itself before the state legislature made it legal to do so. While there are not any court cases yet saying it was proper for the legislature to make this trust statute retroactive, the legislature said it was retroactive anyway; if it was not retroactive, it would not "fix" their "broken" titles. [60 Section 175.6b]

However, because a conveyance into the name of the trust itself rather than to the trustee(s) fails to disclose the name of the trustee(s), the state legislature has also required that a Memorandum of Trust be signed by the trustee and placed in the local land records. [60 O.S. Section 175.6a] Even if the trust document itself is reviewed during the conveyance or the loan transaction, the Memorandum of Trust must be placed in the records in order to provide future interested parties with -- at a minimum -- the name of the trust, its date of creation and the name of the trustee(s).

Therefore, there are now two equally acceptable ways for real property to be held in an express private trust condition: by the trustee or by the trust.

IRREVOCABLE v. REVOCABLE

Express private trusts are presumed to be revocable, unless expressly made irrevocable in the terms of the trust agreement. [60 O.S. Section 175.41] If they are irrevocable, then the grant of power by the settlor to the trustee is immediate and cannot be taken back. A revocable trust is similar to a general power of attorney, where the principal can terminate the attorney-in-fact's authority. If a revocable trust is not revoked by the settlor by the time the settlor dies, then the trust becomes irrevocable.

The specific or general powers of the trustee are listed in the trust

document. By statute, a trustee is presumed to have the authority to convey or encumber real property, unless the trust document includes specific limitations. [60 O.S. Section 175.45] If the settlor desires to advise third parties that such limitations exist, then, in order to prevent the trustee from abusing or exceeding her limited authority, either the full trust document or a Memorandum of Trust disclosing any limitations must be placed into the public records. [60 O.S. Sections 175.6a, 175.45] As noted above, it is public policy in Oklahoma for the terms of express private trusts to remain private and it is not expected that they will be filed in the public records. [60 O.S. Section 175.45(c)]

It should be noted that there is at least one Oklahoma Supreme case holding that revocable trusts are illusory because of their revocable nature. [Thomas v. Bank of Oklahoma, N.A., 684 P.2d 553 (Okla. 1984)]

SUCCESSOR TRUSTEE

Whenever a natural person is appointed as a trustee it is reasonable to anticipate that a replacement or successor trustee will need to serve at some time in the future.

Some of the reasons a successor trustee might take the place of the original trustee include: (1) death of the trustee, (2) disability of the trustee, (3) resignation of the trustee, and (4) passage of a specified period of time as set forth in the trust instrument. [60 O.S. Section 173]

Unfortunately, other than through the issuance of a court decree declaring that the operative facts have arisen (e.g., the trustee's death), there are no documents specifically authorized by the legislature to be relied upon -- after being filed of record -- to answer the question as to whether it is time for the successor to step in. The closest that the statutes have come to recognizing a document suitable to support the of a successor trustee is the fairly recently enacted statute authorizing the filing of an affidavit -- with attached supporting papers such as a certified death certificate or a doctor's certification of incompetency for the initial trustee -- signed by a person who has personal knowledge of the facts being stated, where such facts are relevant to the title. [16 O.S. Sections 82-84; 60 O.S. Section 175.37]

Therefore, in many instances, a title examiner or a title insurance company will accept an affidavit from a knowledgeable person, preferably the settlor or

beneficiary, or other person with personal knowledge of the facts concerning the successor trustee. The affidavit needs to be reviewed and then, if acceptable, placed in the public land records for the benefit of subsequent persons needing to know who is the successor trustee.

FEDERAL AGENCY GUIDELINES

The terms of the "Fannie Mae - Servicing Guide V, 202.06: Intervivos Revocable Trusts (6/29/93)" allow a revocable grantor trust to be an eligible borrower only if (1) the trust is established by a natural person by a written document with the trust to be effective during the settlor's lifetime, (2) the settlor reserved to herself the right to revoke the trust during her lifetime, (3) the primary beneficiary of the trust was the settlor of the trust, (4) the income of at least one of the settlors was used to qualify for the mortgage, (5) the settlor whose income was used to qualify for the mortgage will occupy the security property, (6) the settlor whose income was used to qualify for the loan will sign the mortgage instruments, (7) the trustee who holds title to the property must include one of the settlors or be an institutional trustee, (8) the trustee must have the power to mortgage the security, (9) the security property is a one-family principal residence, and (10) full title must be vested in the trustee. Each trustee and each settlor (whose income was used to qualify for the mortgage) must execute the security instrument (i.e., the mortgage). In addition, any settlor must "acknowledge" the terms of the security instrument (i.e., the mortgage).

The Fannie Mae promissory note must be executed by the trustee solely as trustee if the individual who was the trustee was not a credit applicant. The note must be executed by the trustee both as trustee and in her individual capacity, if the individual was also a credit applicant. The mortgage must be executed by each trustee, and its terms must be acknowledged by any settlor who was a credit applicant. The form of these signature blocks is shown on Exhibit "A" attached hereto.

The terms of the "Freddie Mac - Single Family Seller/Servicer Guide Volume 1, 22.10: Living Trusts (09/27/96)" allow a revocable grantor trust to be a home mortgage borrower only if (1) the settlor is the trustee (or one of the trustees), (2) the settlor occupies the property as a primary residence or as a second home, and (3) the loan applicants are (a) the settlors in the settlors' individual capacity and (b) the trustee on behalf of the trust. The promissory note must be executed by both the settlor individually and the trustee on behalf

of the trust. The mortgage must be executed by the trustee on behalf of the trust and acknowledged by the settlor.

The terms of the "FHA - 4155.1 Rev - 4, Chg-1: Mortgage Credit Analysis for Mortgage Insurance on One-to-Four Family Properties -2-2: Mortgage Eligibility (Borrowers) (09/01/95)" allow the insurance of a mortgage to a revocable grantor trust if (1) the individual borrower is the trust beneficiary, and (2) the individual borrower occupies the property. The promissory note must be executed by both the owner-occupant (i.e, the individual borrower), and by the trustee. The mortgage must be executed by the trustee, and by the individual borrower, if such individual's signature is required by state law.

The terms of "VA - 38CFR36: Dept. Of Veteran Affairs - 36.4402: Eligibility (07/01/97)" allow a veteran to be eligible for mortgage assistance in acquiring a housing unit which is held by a grantor revocable trust so long as the interest being acquired by the veteran is at least a beneficial interest in a grantor revocable trust that ensures that the veteran, or the veteran and spouse, have an eligible life estate.

HOMESTEAD ISSUES

A nagging question which is causing substantial concern among both attorneys and lenders is how to reconcile the continuing requirement under the State Constitution and State Statutes for both spouses to sign any conveyance or mortgage covering the parties' marital homestead, with the increased use of revocable grantor trusts by married couples (also known as "living trusts" and "inter vivos trusts"). Any conveyance or mortgage signed by either a husband or wife -- but not both -- which covers land which is the parties' marital homestead is void in the absence of the other spouse's signature. [16 O.S. Section 4]

This growing number of revocable grantor trusts are being created in order for husbands and wives to be able to place the title to their homestead into trust - - while continuing to occupy it -- to avoid the cost and delay of probate while also deferring or avoiding estate taxes. [16 O.S. Section 1] However, there are conflicting signals being sent by various governmental authorities as to what happens to the spouse's homestead rights and protections after a revocable grantor trust is created.

In 1988, and again in 1989, the Oklahoma legislature said, for the first time, by inference, that an express private trust was a legal entity capable of holding and conveying title to real property. [60 O.S. Section 175.6a] In addition, in 1995 the legislature more definitely stated that trusts, in general, were legal entities capable of holding title. [16 O.S. Section 1] The IRS treats a trust for many purposes as an entity separate from the grantor and settlor.

However, a 1971 Oklahoma Attorney General Opinion held that when a settlor places her marital homestead into a revocable grantor trust and continues to occupy the property, the settlor retains sufficient interest in the property to continue to have the right to claim a homestead tax exemption against ad valorem taxes. [] And then in 1997 the State legislature enacted statutes declaring that if a husband and wife convey their real property into a revocable trust and continue to occupy the premises as their residence, then the land must be treated by the ad valorem taxing authorities as if it is still owned by the grantors as individuals. [68 O.S. Section 2802.1] This produces a result where the assessed value cannot be increased by the county assessor more than 5% per year, rather than being increased by the full amount of the increase in assessed value.

Therefore, the strong public policy displayed in the Oklahoma Constitution [Art. 12, Section 2] and in the state's statutes [16 O.S. Section 4; 31 O.S. Section 1] protecting the marital homestead from creditors' claims, must be taken seriously when deciding whether to seek a spouse's signature on any mortgage.

Consequently, until there is legislative clarification at the state level on how to handle this homestead issue when dealing with a revocable grantor trust, in addition to following the federal agency guidelines, discussed above, a cautious approach would require you to have the trustee sign the mortgage as trustee and, if the trustee is married, then to have both the trustee and the trustee's spouse sign the mortgage as individuals.

To be fair, the language in the mortgage should not show the persons who are signing as individuals taking on the same degree of liability as the trustee, who is a fiduciary, but should include wording similar to the following: "Sue Smith and Ken Smith, wife and husband, hereby waive and disclaim any interest -- either legal or equitable -- in the subject real property; however, in order to conform to state practice relating to real property, they also hereby subordinate and acknowledge the encumbrance of any interest they might have in the subject real property, including but not limited to any homestead interest, to the lien of

this mortgage."

This cautious step would avoid what would be an unpleasant surprise indeed, if the lender discovered that its mortgage was unenforceable against the homestead because the trustee's spouse failed to sign the mortgage.

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EXHIBIT "A":
FANNIE MAE SIGNATURE AND ACKNOWLEDGMENT BLOCKS

MORTGAGE NOTE: EITHER AN INDIVIDUAL TRUSTEE (WHO IS NOT BOTH A SETTLOR AND A CREDIT APPLICANT) OR AN INSTITUTIONAL TRUSTEE

“ _____ (signature)
_____, Trustee of the _____ Trust under
instrument dated _____, for the benefit of _____ (borrower).”

MORTGAGE NOTE: INDIVIDUAL TRUSTEE WHO IS BOTH A SETTLOR AND A CREDIT APPLICANT

“ _____ (signature)
_____, individually and as Trustee of the _____ Trust
under trust instrument dated _____, for the benefit of
_____ (borrower).”

SECURITY INSTRUMENT (MORTGAGE): ALL TRUSTEES

“ _____ (signature)
_____, Trustee of the _____ Trust under trust instrument
dated _____, for the benefit of
_____ (borrower).”

**SECURITY INSTRUMENT (MORTGAGE): ACKNOWLEDGMENT BY
SETTLOR/CREDIT APPLICANT**

“By signing below, THE UNDERSIGNED, Settlor(s) of the _____
Trust under instrument dated _____, for the benefit of
_____ (borrower) acknowledges all of the terms and covenants
contained in this Security Instrument and any rider(s) thereto to be bound
thereby.

Trust Settlor”

(A:\LENDERS\TRUSTS2.DOC)