"DOING THE DEED" –
DRAFTING TIPS FOR REAL ESTATE DOCUMENTS

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DOING THE DEED – DRAFTING TIPS FOR REAL ESTATE DOCUMENTS

I. INTRODUCTION

This article deals with real estate issues that are likely to crop up in estate planning and estate administration. Estate Planning lawyers are called upon frequently to handle conveyances between related parties. Typical examples include gifts, contributions to trusts, LLCs, partnerships or other entities, partitions between spouses, or between estates and surviving spouses or others, and distributions from trusts or estates. In most of these situations attorneys seem to use special warranty deeds or, in some cases, deeds without warranty or quitclaims. However, this may not be advisable in all situations. Title insurance is rarely purchased in these non-arm's length conveyances and clients generally are not aware that in many of these conveyances, the title insurance policy will not inure to the benefit of the transferee. Thus, in many cases the grantee will not have the benefit of title insurance in the event of a title defect. If a special warranty deed (or a quitclaim or deed without warranty) is used, the grantee would have no claim, or a very limited claim, against the grantor under the deed. Of course, this is the very idea or purpose of using deeds with limited or no warranties.

The author is aware of a professional liability claim against an attorney (in another jurisdiction) who used a quitclaim to distribute real property from a corporation to its shareholder. When a title exception was later discovered, the shareholder made a claim under the company's owner policy of title insurance. The claim was denied because the shareholder was not an insured under the policy and the company no longer had an insurable interest in the property. This resulted in the claim against the attorney.

In addition to conveyancing issues, estate planning attorneys also may be faced with issues involved in listing and selling real property, particularly out of estates, dealing with second homes or other properties located in other jurisdictions, and issues involving gifts and/or loans to descendants or other relatives.

This paper will discuss some of the more common issues presented in these situations and provide some drafting suggestions, as well as practical solutions in these areas.

II. GENERAL CONSIDERATIONS

A. Identifying Record Title.

Before preparing a deed (for any purpose) it is important to gather some basic information. First and foremost, you need to determine who is in title as to the property in question. In the author's experience, the client is frequently wrong as to the status of record title; and thus information provided by the client cannot always be relied upon in preparation of a deed. Examples of situations where client information is incorrect include:

- Name change due to marriage or divorce.
- Failure of a deed to be executed and recorded incident to a divorce (very common)
- Intestacies in chain of title.
- Unfunded bequests under wills (as this audience is aware, wills often leave assets to multiple trusts and the exact funding of particular properties is left to the executor).
- Title in entities that have been administratively terminated (very common).

This all presents lawyers with quite a dilemma. On one hand, we, as lawyers, have a duty to try to properly prepare legal documents. On the other hand, clients balk at paying a large fee for the preparation of a deed, which clients believe is a routine, mundane document that should not cost much. If you have to research title, clear defects in the chain of title, reinstate forfeited entities, and the like, the cost of a deed can be significant.

B. Cover All Parties in Interest.

As mentioned above, it is common for a will to leave the decedent's estate to multiple trusts. Thus, the will itself does not necessarily show which trust is entitled to a particular property or interest in the property. Accordingly, a deed from an executor may need to include the joinder of trustees or individual beneficiaries to "close the loop" on all potential parties in interest.

C. Legal Description of Property.

A sufficient description of the property being conveyed is essential to a valid conveyance of real property. Clients often have difficulty providing the lawyer with a good legal description. The best source of a valid legal description is usually the vesting deed under which the client obtained title. Tax records and addresses can be, but frequently are not, sufficient descriptions for conveyancing. Accordingly, it often is necessary to do some work to obtain a valid legal description, such as obtaining a copy of the last deed in the chain of title. Again, as mentioned above, this often presents problems with clients in terms of what the client is willing to pay for.

III. CHOICE OF DEED

The types of deeds used to convey real estate have developed through the common law and custom, practice and usage. In most jurisdictions, no particular form of deed is required, other than a writing sufficient to satisfy the statute of frauds. In essence, a deed is

merely another form of contract, customarily used for the particular purpose of conveying estates or interests in real property. There are four basic types of deeds customarily used to convey real estate:

A. General Warranty Deed.

A general warranty deed (GWD) is the "highest" or "strongest" type of deed customarily used; and is, in most jurisdictions, the most common form of instrument of conveyance. A GWD warrants title back to the sovereign and operates to make the grantor and his heirs liable for any breach of the title warranties contained in the deed. A GWD is typically held to warrant:

- that the grantor has not previously conveyed the estate or any interest therein to anyone except the grantee; and
- the estate is free of encumbrances (other than those specifically excepted to).

B. Special Warranty Deed.

A special warranty deed (SWD) limits the grantor's warranty of title to defects arising "by, through or under" the grantor. It does not warrant title back to the sovereign. SWDs are often used for conveyances by lenders, trustees, executors, and in other situations where valid reasons exist for limiting the warranties of the grantor.

C. Deed Without Warranty.

A deed without warranty (DWOW) simply disclaims all warranties of title. In most states, a covenant of warranty is not required in a deed. A typical disclaimer of warranties found in a DWOW would read something like the following:

> **"This conveyance is made and accepted without warranty of title, whether statutory, express or implied, and all such warranties are hereby excluded."**

Although all warranties are excluded, a DWOW still purports to convey the property to the grantee.

D. Quitclaim.

A quitclaim (QC) purports to convey only that interest, if any, which the grantor owns in the property. This can be contrasted to a "true deed," which purports to convey the land itself. A QC does not generally impart the implied covenants contained in the words "grant" and "convey." A "true deed" passes any after-acquired title, while a QC passes only the grantor's present interest. Also, a grantee under a quitclaim cannot be a bona fide or "innocent" purchaser for value. The use of QCs and DWOWs is common in many states, but less so in Texas where such forms of conveyance are typically limited to special circumstances where title is doubtful and the grantee seeks merely to remove a cloud.

IV. TITLE INSURANCE CONSIDERATIONS

A critical factor in connection with the choice and form of deed is the existence or non-existence of title insurance, and the issue of who is benefited by any existing title policy.

A. Who is "Insured" by an Owner Policy?

The Texas T-1 form of owner policy defines the "Insured" as follows:

> the "Insured" named in Schedule A to the Policy, and, also includes:
>
> successors to the title of the Insured by operation of law as distinguished from purchase, including heirs, devisees, survivors, personal representatives or next of kin:
>
> successors to an Insured by dissolution, merger, consolidation, distribution or reorganization;
>
> successors to an Insured by its conversion to another kind of entity;
>
> a grantee of an Insured under a deed delivered without payment of actual valuable consideration conveying the title;

(1) If the stock, shares, memberships, or other equity interests of the grantee are wholly-owned by the named Insured,
(2) If the grantee wholly owns the named Insured,
(3) If the grantee is wholly-owned by an affiliated entity of the named Insured, provided the affiliated entity and the named Insured are both wholly-owned by the same person or entity, or
(4) If the grantee is a trustee or beneficiary of a trust created by a written instrument established by the Insured named in Schedule A for estate planning purposes.

Thus, in many family situations title insurance will automatically inure to the benefit of a grantee. However, these automatic successor provisions are generally limited to "distributions" and include "contributions" only if the Insured is the sole owner (directly or indirectly) of the grantee. For example, if property is contributed to an entity or corporation, the

title insurance will follow the property only if the Insured is the sole owner of the entity.

An owner policy can be endorsed to add a related party grantee as a named insured. The endorsement is known as a "T-26" endorsement and is authorized by Procedural Rule P-57. The cost is 10% of the basic premium. This means, for example, if the premium for the full owner's policy is $10,000, the endorsement would cost $1,000. To be eligible for an additional insured endorsement, the additional insured party must be as follows:

a. Living Trust, Acquisition of Interest under Existing Agreement, Family Partnership or Family Corporation:

(1) the trustee or successor trustee of a living trust to whom the insured transfers the title after policy date, and/or the beneficiaries of the living trust, or
(2) any partner, member or stockholder that acquires the interests of the other owners of the insured in accordance with the terms and provisions of a written agreement in effect at date of policy, or
(3) a family partnership or family corporation solely composed of or owned by members of the insured's family and the insured.

b. Limited Liability Company

(1) there will be a transfer(s) of all or any part of the limited liability company members' interests in the insured to any transferee(s), or
(2) the withdrawal(s) of one or more of the members from the limited liability company, or
(3) the addition(s) of one or more persons or entities as members of the limited liability company.

V. ALTERNATIVES

If the title policy will not automatically benefit to the grantee, and the client is not eligible for, or does not want to purchase an additional insured endorsement or a new owner policy, then, the grantee will not have any rights under the grantor's title policy. On the other hand, the grantor will have coverage under the policy as long as the grantor has an insurable interest in the property. An insurable interest includes the liability of the grantor under covenants of warranty in a deed.

A. Use of General Warranty Deed (GWD).

The continuing warrantor coverage under an existing title policy for the grantor under a GWD could indirectly make the grantor's title insurance available to the grantee, if the grantee paid valuable consideration for the property. If a title defect is later discovered, the grantee could make a claim on the title warranty in the deed, and, in turn, the grantor could make a claim under his owner policy of title insurance.

Caution: In these situations, the deed should not be made subject to all matters of record because such an exception could destroy any possible claim on the grantor's warranty. Rather, consider limiting the exceptions to warranty to (1) exceptions created by the Grantor, and (2) the exceptions set forth in the Grantor's owner policy. The goal is to limit the grantee's claim on the warranty to only those encumbrances covered by the grantor's title policy.

There are two primary problems with using a GWD. First, the grantor is exposed to potential claims by future remote grantees in the chain of title after a conveyance by the initial grantee. Of course, the original grantor would still have title insurance coverage to fall back on. However, consider the possibility of limiting the general warranty to the named grantee and disclaiming warranties to remote grantees.

Finally, the effectiveness of using the GWD will be limited if the transfer is a gift or otherwise without consideration because the title insurer will be able to argue that since the grantee paid nothing, it has suffered no compensable loss and therefor has no valid claim against the grantor. In these cases, endorsements, if available, or new title policies should be considered.

B. Special Warranty Deed with Assignment of Prior Warranties.

As noted above, a gift to a child, grandchild (or third party) or a trust for such a donee, will not carry the title insurance with it. Thus, a general warranty deed would not be advisable for a gift conveyance. If there is no title insurance (or minimal) in place, or the grantor is unwilling or unable to issue a GWD (such as in a gift deed), the alternative would be a SWD coupled with an express assignment of prior warranties in the chain of title. An example of such an assignment clause is as follows:

> **"Notwithstanding the foregoing, this deed is made with full substitution and subrogation of Grantee in and to all covenants and warranties by others heretofore given or made in respect of the property hereby conveyed or any part thereof."**

This type of language may allow the grantee to pursue a prior grantor in the chain of title (who may or may not have title insurance). Again, the issue of consideration and compensable loss is present. In other words, the grantee under a gift deed may have no

compensable loss, since no consideration was paid for the conveyance.

C. Deeds from Trustees and Executors: Exculpation Clauses.

If you are representing an executor or trustee who is making a distribution out of an estate or trust, the typical format would be a SWD, perhaps with the subrogation clause set forth above. One reason for this in Texas is that it has been held that executors and administrators (and possibly other fiduciaries) do not have authority to make a general warranty of title. See Burleson v. Whaley, 299 S.W. 718 (Tex. Civ. App. - Austin 1927, no writ). Even when a special warranty deed is used, however, an executor or trustee will want to be sure that its liability is limited to his or her acting in a representative capacity. One way to make this clear is to include an exculpatory clause in the deed. An example of such a clause is as follows:

> **"The foregoing covenants and agreements made by Grantor are made solely in its fiduciary capacity as _____________ and in no other capacity whatsoever, and the liability of Grantor under such covenants and agreements is limited to Grantor acting in such fiduciary capacity and is limited to the assets of held by Grantor at the time any such liability may be conclusively established."**

Remember that the definition of the "Insured" under an owner policy includes beneficiaries of trusts, heirs and devisees. Therefore, in many instances involving deeds from executors and trustees, the grantee will receive the benefit of an existing title insurance policy.

VI. OTHER CONVEYANCING ISSUES AND CONSIDERATIONS

A. Gift Deeds.

A gift deed will typically be by special warranty deed. In the consideration clause, in lieu of the traditional "$10.00 and other good and valuable consideration" recital, the deed should reflect that it is a gift and without consideration other than love and affection, or words to that effect. In other words, make it clear a gift is intended. Since there is no consideration, the grantee will not have a title warranty claim, so there is no reason to use a general warranty deed. Title insurance is not typically purchased in gift transfers; however, a grantee under a gift deed could purchase title insurance. The premium would be based on the fair market value of the property, which may necessitate an appraisal. Since an appraisal may be needed for the gift tax return in any event, the grantee could utilize that appraisal to buy a title insurance policy on the gifted tract. The only situations the author has seen where this is actually done, are when the grantee intends to use the gifted property as collateral for a construction loan to build on the land. In that case, the lender is requiring a loan policy of title insurance anyway, so the grantee can buy an owner's policy at the full premium rate and add-on the mortgagee policy at virtually no cost (there is a simultaneous issue discount that makes the loan policy cost nominal in such situations).

B. Distribution Deeds.

Distribution deeds also are typically special warranty deeds. As noted above, a title insurance policy will inure to the benefit of "successors to the title of the Insured by operation of law as distinguished from purchase, including heirs, devisees, survivors, personal representatives or next of kin." Accordingly, to make it clear the deed is a distribution from an estate, the author finds it helpful to include recitals in distribution deeds that explain the context of the deed. For example, a distribution deed from an estate might contain recitals such as the following:

> **"John Decedent died on _________. The Last Will and Testament of John Decedent dated __________ and First Codicil thereto dated ________ (together called the "Will") was admitted to probate in Cause No. _____ in Harris County Probate Court No. __. Letters Testamentary were granted to Joe Smith and Mary Jones, as Independent Co-Executors and they continue to serve in that capacity. In satisfaction of the devise under the Will, the Grantor desires to distribute the Property to the Grantee."**

Also, in the consideration clause in a distribution deed, it is recommended that the deed recite that the consideration for the conveyance is "A distribution from the Estate of John Decedent," rather than "$10.00 and other good and valuable consideration," to make it clear the deed is an estate distribution.

C. Other Rights and Appurtenances.

Conveyances of real property typically convey other rights and appurtenances associated with ownership of real property. Examples are rights in adjacent streets, alleys or other rights of way, easements benefitting the land, riparian rights, and so on. These typically pass by operation of law, even if not specifically referenced in a deed. However, in trust and estate distributions and other intra-family conveyances, a lawyer is forced to work from some fairly vague title information and questionable legal descriptions. The family often does not want to pay for current surveys. Accordingly, it often is helpful to

include in such a conveyance, a "catch-all" type clause that picks up miscellaneous property rights, and perhaps other properties owned by the trust or estate in the area. An example of such a provision is as follows:

> **"For the same consideration stated above, Grantor does hereby grant and convey to Grantee (1) all interest of Grantor in any other real property located in ___________ County, Texas, (2) all interest of Grantor in any strips and gores between the Property and abutting properties, whether owned or claimed by deed, limitations, or other-wise; (3) any land owned or claimed by Grantor that is adjacent, contiguous to, or a part of the land described herein, whether those lands are owned or claimed by deed, limitations, or otherwise, and whether or not they are located inside or outside the description given herein, or whether or not they are held under fence by Grantor, or whether or not they are located in the survey referred to herein; (4) all of Grantor's rights to any land situated in any adjacent street or other right-of-way or lying under the bed of any creek, stream or waterway adjoining or traversing the land; (5) all of Grantor's rights under any existing lease or leases for oil and gas, or oil, gas and other minerals, so that Grantee shall be entitled to receive the royalties and other benefits that are associated with the interest and payable under any such lease or leases, together with all of Grantor's remainder or reversionary rights, or similar interest; (6) all rights of Grantor in and to any claim or cause of action for damages or other relief, and any defenses associated with such claims (excluding, however, Grantor's rights of contribution or indemnity) against any third party who may have caused damage to the land or improvements prior to the date hereof; and (7) all other rights, privileges and appurtenances owned by Grantor and in any way related to the Property (all such rights being referred to herein as the "Additional Interests"); provided however, that the conveyance of the Additional Interests by Grantor is made without warranty of title of any nature whatsoever and Grantor hereby expressly excludes and disclaims any warranty of title as to the Additional Interests."**

CAVEAT: the foregoing language has to be used carefully, as it may not fit all circumstances. For example, you may NOT want to convey adjacent parcels to a particular grantee, as another grantee is to receive that land. If appropriate, the language regarding oil and gas leases also can be modified to include surface leases as well; or if no mineral leases are involved, that language can be deleted or replaced with a reference to surface leases, if any.

D. Minerals and Mineral Leases.

A deed (GWD, SWD or DWOW) or a QC will pass whatever mineral title the grantor may own, unless expressly reserved by the Grantor. Accordingly, the same considerations as discussed above generally apply to mineral conveyances as well, where the minerals and surface are owned together. However, in Texas minerals are frequently owned separately from the surface and may be separately conveyed. The typical method for such a conveyance would be a SWD since title insurance considerations would generally not be applicable. Mineral Leases are typically filed of record, so an assignment of a mineral lease also should be recorded.

If the minerals are producing, the operator will need to be notified and new division orders obtained so that the royalty payments can be made to the proper recipients. Operator requirements in this area vary, so you will have to see what the requirements are in a particular case. However, with respect to estates, to get the payments made to the executor, operators usually require fairly recent letters testamentary, a copy of the will and order admitting the will to probate (preferably recorded in the county or counties where the property is located), and the FEIN for the estate. Then, when it is time to fund the distributions from the estate to the trusts or individual devisees, updated letters testamentary and a copy of the recorded distribution deeds, plus SSNs or FEINs for the transferees (as the case may be) will likely be required.

E. Real Estate Leases.

Leasehold rights in real property are considered real property interests. The lessor's interest in a lease typically follows the land and would pass with a deed, unless reserved, although it is customary in real estate transactions to have a separate assignment of leases that accompanies a deed. The lessee's interest under a lease would typically be transferred by an assignment of lease. Most real estate leases are not recorded, but if there is a recorded real estate lease, the assignment also should be recorded. To be recordable, the assignment must be notarized and must contain a legally sufficient property description.

Normally, a property owner will not want a lease, especially a relatively short term lease, to be recorded, because proving the termination of the lease in a future

transaction could be a problem. Thus, if the estate, trust or family have interests in both sides of a lease (such as a lease from a family partnership to a family business entity), the author would generally not put such a lease (or assignment of such a lease) of record – or even specifically mention it in a deed or other recorded instrument. If for some reason a recorded lease is desirable (this would typically be from the lessee's perspective), the author recommends recording only a short memorandum of lease showing the termination date, and not recording the entire lease.

F. Partition Deeds.

Partition deeds are deeds between co-owners of property whereby the property is either divided into separate parcels of land owned separately by the former co-owners of undivided interests, or marital property is converted from community property to separate property (or vice versa, although the latter is not really a true partition). Partition deeds often are in furtherance of partition agreements. It is possible to combine the deed and the agreement in some situations. However, the author usually prefers to have a separate agreement and deed, and record only the deed, without referring to the agreement in the deed. Partition deeds among co-owners, for example heirs who inherit undivided interests in land may wish to divide the land so that each heir owns a separate and distinct tract, are usually special warranty deeds that contain recitals explaining the facts and circumstances. A common form of partition deed is where the surviving spouse desires to partition the homestead all to herself individually, and place other compensating assets into a trust created under the Will, so the homestead is not subject to undivided ownership between the estate, a trust and the surviving spouse personally. There are a number of valid and practical reasons to do this, including ad valorem tax considerations (see section VIII.C below), issues regarding accounting to remainder beneficiaries, and others. An example of recitals from such a partition deed is as follows:

"The following facts form the basis for this Deed:

1. **John Smith and Sally Smith, as husband and wife, formerly owned the Property as community property.**
2. **John Smith ("Decedent") died on July 4, 2010 in Harris County, Texas.**
3. **The Last Will and Testament of Decedent dated September 7, 2007 (the "Will") was admitted to probate in Cause No. XXXXX in Probate Court No. X of Harris County, Texas, and on August 15, 2010 Letters Testamentary were issued to Sally Smith as Independent Executrix of the Decedent's Estate (the "Estate"), and she continues to serve in such capacity.**
4. **As allowed by law, Sally Smith as the surviving spouse of Decedent, and as Independent Executrix of the Estate, and joined pro forma by Sally Smith as Trustee of the trusts created under the Last Will and Testament of John Smith, has partitioned and exchanged certain community property to the result that Sally Smith partitioned and set over to the Estate, all of her right, title and interest in the property described herein as Tract A, and partitioned and set over to Sally Smith, individually, all of the Estate's right, title and interest in and to the property described herein as Tract B.**
5. **Subject to the exceptions set forth below, Grantor desires to convey and partition the properties described and conveyed herein as set forth below."**

A deed in furtherance of an agreement to convert community property to separate property, or vice versa, would contain similar recitals, but conformed to the facts of the situation. For example:

"1. Grantors formerly owned the real property (and all improvements thereon) more particularly described in Exhibit A attached hereto as community property.

2. Grantors have this day agreed to partition such property into two separate tracts, referred to herein as Tract "B" and Tract "C," each described respectively on Exhibits "B" and "C" attached hereto.

3. Subject to the exceptions set forth below, Grantors desire to convey and partition among themselves such real property described in Exhibit A as set forth below.

Subject to the exceptions to conveyance and warranty as to both Tracts "B" and "C," the parties hereto have PARTITIONED, GRANTED, CONVEYED and SET OVER, and by these presents do hereby PARTITION, GRANT, CONVEY and SET OVER, the Property referred to herein as Tract "B" and Tract "C," and all fixtures and improvements located thereon (herein called the "Property") unto each Grantee as the sole and separate estate and property of each Grantee, and each Grantee shall have, hold, possess and enjoy such Property interest partitioned,

granted and set aside to such Grantee, free of and from claims by the other party hereto, as follows:

1. **To RICHARD SMITH, as his sole and separate estate and property, the Property referred to as Tract "B" and described in Exhibit B; and**
2. **To MARY SMITH, as her sole and separate estate and property the Property referred to as Tract "C" and described in Exhibit C."**

Alternatively, the conversion agreement itself could be recorded instead of a deed.

Partition deeds are typically special warranty deeds, but in some cases a general warranty of title may be called for in the event both parties are named insured under fairly recent title insurance policies covering the properties to be conveyed.

G. Affidavits of Heirship.

An affidavit of heirship is typically not a substitute of a formal instrument of conveyance, such as a deed. However, affidavits of heirship may provide a way of "curing" an apparent break in a chain of title caused by an intestacy. Texas Title Examination Standard 11.50 addresses conveyances by heirs. The standard calls for the title examiner to "identify the heirs of the decedent, along with the devisees in any unprobated will, and require that all of them join in a conveyance of the property of the decedent." Standard 11.70 expressly deals with affidavits of heirship, and provides that, in the absence of information to the contrary, the "examiner may rely upon an affidavit of heirship with respect to the family history and the identity of heirs of the decedent." The Texas Estates Code Section 203.001 provides that, subject to rebuttal, a proper affidavit of heirship may be received as prima facie evidence in any proceeding to declare heirship. Section 203.002 of the Texas Estates Code sets forth a suggested form of affidavit of heirship. The State Bar of Texas Real Estate Forms Manual also provides the same form as its Form 81-1, *Affidavit of Facts Concerning Identity of Heirs*. Title examiners typically require an affidavit from someone who is related to the decedent but will not inherit from the decedent. If none is available, an affidavit from someone with close personal knowledge of the decedent's family history, supported by at least one supporting affidavit from someone with no interest in the estate may suffice. Title examiners are not required by law to accept such affidavits, but in the author's experience, they will often be accepted, especially if the missing piece is a small interest and all other aspects of the transaction appear to be in order.

VII. CONTRACTUAL ISSUES

A. Listing Agreements.

An estate or trust may need to list real property for sale during estate administration. The form listing agreements that will be presented by brokers are going to have some issues to be dealt with. There are two levels of issues – one level deals with business issues presented by any listing agreement; the other are issues unique to sales by executors or trustees.

1. Business Issues.

The main "business" issues presented by a listing agreement (not unique to sales by executors or trustees) are:

a. The terms under which a commission is payable. Most listing agreements prepared by brokers are what is known as "an exclusive right to sell." This means if the property is sold during the term of the agreement, the broker earns its commission, even if it didn't procure the buyer. Thus, for example, if the property ends up being sold to a family member, or exchanged in a partition transaction with a family member for an interest in another estate asset, the broker will be entitled to a commission. Accordingly, if those are possibilities, sales to family members need to be excluded.

b. Another related issue is that most listing agreements also provide that a commission is earned if the broker procures a ready, willing and able buyer during the term of the agreement, who offers to purchase the property on the price and terms of the listing. Most contracts have a number of contingencies; most listing agreements don't spell out all the terms; what is a conforming offer? When is a buyer truly "ready, willing and able" For these and other reasons, the author likes to alter these types of provisions to provide that, notwithstanding the other terms of the agreement, the commission is earned and payable, if (and only if) a sale closes and funds, and not otherwise.

c. Finally, most listing agreement have a broker protection period clause that provides that if the property is sold within some period of time after the expiration of the term of the listing to a buyer to whom the broker made the property known, the broker still gets paid. Some of these forms will have an exception IF the property is listed with another licensed broker who is a MLS member in the locality. Some do not have this exception. These provisions can be traps. Brokers send out mass mailings. They claim almost anyone was made aware of the property by their efforts. The author likes to tighten these up to provide: (i) a short term – no more than 90

days; (ii) the broker must promptly present a list, and the list is limited to the broker's top 5 – 10 prospects with whom the broker must have had substantive contact; and (iii) if the property is re-listed with another licensed broker, the first broker gets no commission.

2. Issues Related to Listings by Executors and Trustees.

In addition to the foregoing, there are a few issues with listing agreements that are unique to sales by executors and trustees.

a. If applicable, the executor or trustee will want to make it clear they are acting in a representative capacity only. See suggested language following Section IV.C above. It is often the case that a seller is acting both as a personal representative and individually in the same transaction – the most common example being a surviving spouse who also is the executor. In such a situation, the surviving spouse has an individual interest in the property and would not be acting solely in a representative capacity, so the exculpatory language would not apply.
b. A listing agreement where at least one of the sellers is a personal representative should make it clear that the seller will deliver only a special warranty deed at closing.
c. The seller's disclosure requirements of Section 5.008 of the Property Code do not apply to sales by fiduciaries, such as executors or trustees. Brokers tend to overlook this and routinely require executors and trustees to fill out the 5.008 disclosure forms. However, Section 5.008(e)(5) expressly exempts executors and trustees from this requirement. Accordingly, if all the sellers are executors or trustees, the listing agreement should specify that the seller is exempt and will not be providing this disclosure. However, if one or more of the sellers are individuals, such as a surviving spouse, the exemption will not apply and those sellers will have to provide the disclosure form.
d. Most broker listing forms contain indemnification clauses whereby the owner indemnifies the agent for certain claims. Such indemnities are probably not appropriate for fiduciary sellers, and thus should be deleted or modified to be releases only.

B. Contracts of Sale.

The issues for sellers who are fiduciaries in a Contract of Sale are similar to the issues in a listing agreement.

1. Capacity of Seller(s).

An executor or trustee who is selling real property from an estate or trust will want to make it clear they are acting in a representative capacity only. See suggested language following Section IV.C above. It is often the case that a seller is acting both as a personal representative and individually in the same transaction – the most common example being a surviving spouse who also is the executor. In such a situation, the surviving spouse has an individual interest in the property and would not be acting solely in a representative capacity, so the exculpatory language would not apply.

2. Seller's Disclosures.

As discussed above with regard to listing agreements, fiduciary sellers, such as executors and trustees, are exempt from the requirements of Section 5.008 of the Texas Property Code to provide the seller's disclosure form otherwise called for by Section 5.008. The theory for this is that, as fiduciaries, those parties are not in a position to have sufficient knowledge of the property to make the disclosures. Of course, the same cannot be said for a surviving spouse. Accordingly, if the executor also is the surviving spouse and is a seller in his or her individual capacity as to a community interest, the disclosure will have to be given. If all sellers are fiduciaries, however, the box at Section 7.B(3) of the TREC One to Four Family Residential Contract form should be checked.

3. Special Warranty Deed.

The TREC contract form, Section 9.B(1) provides for a general warranty deed. If the sellers are fiduciaries, it is customary to deliver a special warranty deed, rather than a general warranty deed. Accordingly, in these situations, this section should be changed, or overridden by language added to Section 11 (Special Provisions).

4. Other Issues for Fiduciary Sellers.

In addition to the issues mentioned above, most fiduciary sellers will want to: (1) sell the property AS IS, and thus should check box 7.D(1) [calling for an AS IS sale], and (2) delete the duty to restore the property in the event of a fire or other casualty. Regarding the AS IS language, in addition to checking the box in 7.D(1), the author recommends adding a more extensive AS IS clause to the contract.

VIII. OTHER REAL ESTATE RELATED ISSUES.

A. Intra-Family Mortgage Loans.

The low interest rate environment of the last 5 years has created an opportunity for the senior generation, especially those who have little or no gift exemption available beyond annual exclusion, to make low interest rate mortgage loans to their children or grandchildren to finance or refinance homes or other properties. The Applicable Federal Rate for mid-term obligations (3 – 9 years) has been at or under 2% for some time, while money market rates on deposits have been around 1%, and third party mortgage rates have been in the range of 3.5 – 4%. Thus parents or grandparents can provide a benefit to their children or grandchildren by making below-market rate loans, while at the same time doubling the interest earned on the funds. A true "win-win" situation. For the most part, these transactions are relatively straight forward loans, documented by a real estate lien note secured by a deed of trust. However, there are a few potential pitfalls or issues to be aware of, including the following:

1. <u>Separate vs. Community Property Issues</u>.

If the property is the marital homestead of the borrowers, both the husband and wife must sign the deed of trust to grant the lien, even if the property is the separate property of one of the spouses. If it is desired that the property not become part separate and part community, and the loan not be a community obligation, great pains will have to be taken to prevent this. In the author's experience, it is almost impossible to successfully pull this off, but in the event one wants to attempt it, the steps would be as follows:

- Stipulate in the deed of trust that the property is the separate property of the designated spouse, and the other spouse is joining pro forma for homestead purposes only.
- Have only the spouse whose separate property is involved sign the real estate lien note, and provide in the note that the property itself is the sole recourse in the event of a default – i.e., make the loan a limited recourse loan such that foreclosure against the property is the only remedy and no deficiency judgment can be taken against the obligor. Alternatively, recourse could be limited to any and all separate property of the obligor, but not otherwise. An example of such a clause is as follows:

  "Lender acknowledges the proceeds of the loan evidenced by this Note are and shall be the sole and separate property and estate of [name of spouse]; and Lender hereby agrees that this indebtedness shall be paid only out of [his/her] separate funds and that only [his/her] separate property (including the property purchased with the proceeds of this loan) shall be liable for the payment of this indebtedness."

- Finally, only the separate property of the obligor spouse should be used to pay the mortgage. This is difficult to accomplish, and would probably require either (or possibly both) pre or post nuptial agreements making income from separate property also separate property, and then going to great lengths to be sure to pay the mortgage only from those funds and keeping accurate records to that effect.

The author normally does not recommend this approach. It's simply too difficult to administer and often creates marital problems. Having the ability to foreclose in the event of a default is usually sufficient for the parents in these situations.

2. <u>SAFE Act Considerations</u>.

In response to perceived predatory lending practices associated with the so-called subprime mortgage crisis of 2008, President Bush signed the Housing & Economic Recovery Act (Public Law 110-289) into law on July 30, 2008, Title V of which is the Federal Secure and Fair Enforcement for Mortgage Licensing Act of 2008 ("Federal SAFE Act"). The Federal SAFE Act, in part, requires the states to pass certain regulations and licensing laws pertaining to residential mortgage lending. As a result of the federal mandate, the 81st Texas Legislature enacted the Texas Secure and Fair Enforcement for Mortgage Licensing Act of 2009 ("Texas SAFE Act") when H.B. 10 was signed on June 19, 2009. The Texas SAFE Act, which is codified in Chapter 180 of the Texas Finance Code, requires private lenders making loans secured by residential property to be licensed as "Residential Mortgage Loan Originators" under one of Chapters 156, 157, 342, 347, 348 or 351 of the Texas Finance Code, in addition to complying with the requirements of Chapter 180. It does not apply to commercial property loans or loans for investment purposes.

As defined in Section 180.002 of the Texas SAFE Act (in pertinent part):

- "'Residential mortgage loan originator'…means an individual who for compensation or gain or in the expectation of compensation or gain…takes a residential mortgage loan application; or…offers

or negotiates the terms of a residential mortgage loan.

- o It does not apply to an individual who receives the same benefits from a financed transaction as the individual would receive if the transaction were a cash transaction.

- 'Residential mortgage loan' means a loan primarily for personal, family, or household use that is secured by a mortgage, deed of trust, or other equivalent consensual security interest on a dwelling or on residential real estate."

Although many family loan transactions are exempt from the Texas SAFE Act requirements, not all will be exempt, as the exemptions are narrowly defined.

Section 180.003 provides that the following are exemptions from the Act (in pertinent part):

- "an individual (meaning a natural person) who offers or negotiates terms of a residential mortgage loan with or on behalf of an immediate family member of the individual;

  - o 'Immediate family member' means the spouse, child, sibling, parent, grandparent, or grandchild of an individual. The term includes a stepparent, stepchild, and stepsibling and a relationship established by adoption.

- an individual who offers or negotiates terms of a residential mortgage loan secured by a dwelling that serves as the individual's residence."

Additionally, Section 156.202 of the Texas Finance Code provides a de minimis exemption from licensure for Seller financed transactions, but it limits a property owner to five such mortgage loans within any 12 consecutive-month period.

Loans by or to an entity (and not an individual) are affected by the Texas SAFE Act, as well as loans to non-related or more distantly related individuals. Thus, residential mortgage loans to nieces, nephews, cousins or unrelated friends are not permitted unless the lender is licensed under the Texas Safe Act. Also a loan from a trust that does not fit into an exempt category, would require the trust to be licensed as a Residential Mortgage Loan Originator. The Texas Department of Savings and Mortgage Lending can assist with compliance questions.

There are a range of penalties for a Texas SAFE Act violation that may be imposed by a regulatory official (as applicable - the banking commissioner, savings and mortgage lending commissioner, consumer credit commissioner, credit union commissioner) that include, but are not limited to: orders to cease and desist from conducting business; restitution, non-renewal, revocation or suspension of a license; and an administrative penalty up to $25,000.

B. Out-of-State Real Estate.

Clients often own real property in other jurisdictions. Common examples are second homes in places such as Colorado, New Mexico, Florida, or interests in family legacy properties, such as farms or ranches located in other states. For estate planning and probate purposes, such properties present some interesting challenges, including (but not limited to) the following:

- Avoidance of ancillary probate in other states;
- Avoidance (by the lawyer) of practicing law in a jurisdiction in which you are not licensed;
- Liability protection (especially for properties that are rented);
- State and local tax considerations – these may include state income tax issues on rental income or sales proceeds, local property tax issues (including the effect of entity ownership on tax rates), transfer taxes that may be triggered by a contribution to a family entity, and residency issues (depending on how much time the clients spend in that jurisdiction)(see more complete discussion below); and
- Financing considerations related to the eligibility of the property for mortgage loans, and possible defaults under existing financing that may be triggered by a change in ownership.

1. Title Holding Considerations.

An in-depth analysis of these issues is beyond the scope of this presentation, but suffice it to say that in many (if not most) situations, local counsel will be a necessity. That being said, the author would suggest the following as possible "solutions" for the ownership of out-of-state property:

- Joint tenancy with right of survivorship. The advantage of this is simplicity and cost – it costs virtually nothing to create and at least avoids probate on the first spousal death. However, on the second to die, ancillary probate would be required. In many jurisdictions, ancillary probate is a streamlined procedure and is not a significant cost. Accordingly, this simple approach often can be a workable solution.
- Living trust. A Texas living trust could own the out-of-state property and avoid ancillary probate, assuming the trust transfers the property to a successor trustee or otherwise outside the estate of the decedent. That is, the trust should not pour back to the estate. This approach is probably less

costly than the LLC approach described below, but more expensive than a JTWROS. It also has an advantage if the property is subject to a mortgage, as describe in part 2 below.

- LLC formed in the jurisdiction where the property is located. This approach has the advantage of not only avoiding ancillary probate, but also affords the client liability protection. In this regard, for a number of reasons, the author generally does not recommend registering a Texas entity in the other state if possible, and believes the client is better served with a special purpose LLC organized in the state where the property is located. The state-specific LLC could be (i) a stand-alone entity, owned by the clients, (ii) a living trust formed by the clients, or (iii) a subsidiary of a Texas family limited partnership. This is the most costly approach, due not only to the more extensive documentation, but also on-going compliance issues, such as state franchise tax reports and the like. Additionally, care must be taken to be sure entity ownership is permitted under any applicable condo or subdivision restrictions, and that local property taxes will not be materially higher due to entity ownership.

2. Financing Issues.

If the property is subject to a mortgage, the mortgage instrument may contain a "due-on-sale" clause that triggers a default on any change in ownership. However, federal law in the form of 12 USC Sec. 1701j-3 provides relief. Under this provision, federal law pre-empts the exercise of a due-on-sale clause for transfers to living trusts. This exemption, however, would not apply to a transfer to a LLC or family partnership. Another issue involving financing is the practical effect of entity ownership on mortgage lending. Conventional mortgage lenders whose loans are sold in the secondary market will generally lend only to individuals. If the parties desire to finance out-of-state property, ownership through a LLC or limited partnership will complicate the lending transaction. Unless the lender is a relationship lender, such as a friendly bank where the parties regularly do business, it may not be possible to obtain a loan for the LLC or partnership.

3. State Tax Issues.

In the author's experience, many clients are shocked to learn that rental income from a rental property located in another jurisdiction with a state income tax is subject to taxation in that state. Since Texas has no individual income tax, these clients seem to assume no tax issues exist in other states. If the client has not been filing state income tax returns in another state, but has earned rental income in that state, placing title in a LLC may have an immediate and possibly adverse effect. The LLC will be registered with the state. Accordingly, the State tax office will be looking for annual returns to be filed. If they are not filed, the LLC will fall out of good standing, which will cause problems later when the property is sold. If returns are filed, the state may enquire as to why personal returns were not filed previously (in the author's experience, however, this rarely happens and the prior years are simply overlooked). Accordingly, before transferring a property to an entity, the client should be asked about rental activity and whether state income tax returns have been filed. This also could be an issue even if ownership remains personal, because, when the property is sold, the title company will report the sale to both IRS and the state tax authority. The state will then expect a return to be filed as to any gain on sale, which could result in inquires about prior rental income before any estate planning transfers are made. In short, the client should be made aware of potential state income tax issues.

In addition to state income tax considerations, property taxes and transfer taxes also need to be considered. Will a transfer to a LLC cause higher property taxes than individual ownership? Is there a state transfer tax based on the value of the property being conveyed? If so, is there an exemption available for this type of transfer? Typically, exemptions exist for transfers to control entities and for gifts. However, in many states, the grantor must apply for the exemption in advance of filing and then submit the deed along with the exemptions certificate.

Often tax bills are sent to the property address. If the property is transferred to a LLC or other entity, notice to the local property tax office may be required to ensure the client will receive property tax statements in a timely fashion at the client's permanent address.

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4. Conclusion.

Accordingly, when recommending an ownership structure for out-of-state property, one must not only consider probate avoidance and liability issues, but also mortgage financing issues, as well as state and local issues, such as restrictions, property taxes, income taxes and transfer taxes. There are often exemptions for controlled entities and living trusts. In some jurisdictions, before filing, you must apply for and obtain an exemption through a separate procedure. To navigate some of these issues, you may need local counsel.

C. Residential Homestead Qualifying Trust Issues.

If homestead property is to be conveyed to a trust, whether testamentary or inter-vivos, care must be taken to be sure the trust complies with the qualifying trust requirements of the Texas Property Tax Code, Section 11.13(j), which was recently amended. Under this provision, a "qualifying trust" is defined as follows:

"(3) 'Qualifying trust' means a trust:

(A) in which the agreement, will, or court order creating the trust, an instrument transferring property to the trust, or any other agreement that is binding on the trustee provides that the trustor of the trust or a beneficiary of the trust has the right to use and occupy as the trustor's or beneficiary's principal residence residential property rent free and without charge except for taxes and other costs and expenses specified in the instrument or court order:

(i) for life;
(ii) for the lesser of life or a term of years; or
(iii) until the date the trust is revoked or terminated by an instrument or court order that describes the property with sufficient certainty to identify it and is recorded in the real property records of the county in which the property is located; and

(B) that acquires the property in an instrument of title or under a court order that:

(i) describes the property with sufficient certainty to identify it and the interest acquired; and
(ii) is recorded in the real property records of the county in which the property is located."

If the trust is a pre-existing irrevocable trust and does not meet the foregoing conditions, the trust will not benefit from the individual's homestead exemption unless the conveyancing document or other agreement binding on the trustee, contains the required rights of the beneficiary.