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- Is Your Sale Contract Subject to Buyer Cancellation Under the UCIB Rule?

and more ...

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Message from the Chair

Thomas J. Hall

As many of you know, at the NYSBA Annual Meeting, the Real Property Law Section conducted numerous successful and well-attended CLE programs and committee meetings. The General Session provided informative and timely presentations by expert practitioners on a wide variety of topics. My thanks go out to all of our speakers who selflessly gave their time and expertise and made the program such a great success, namely: Brian Lustbader and Gavin Lankford (*2017 AIA Document Revisions*); Richard Fries (*Real Estate Loan Workouts and Strategies*); Daniel Zinman (*Treatment of Leases in Bankruptcy*); Anthony Harwood (The Duty to Protect Client Confidentiality in Electronic Documents); and Linda Shaw (*Strategies for Tenants to Avoid Environmental Issues Lurking Under Leased Property*).

After the General Session, at the Section luncheon, the RPLS awarded Scholarships to two outstanding law school students: Nicholaus Mills, from Cornell Law School, received the Lorraine Power Tharp Scholarship, and Adebare Ogunleye, a student at Albany Law School, received the Melvyn Mitzner Scholarship. We wish them the best in the upcoming legal careers. The Scholarship presentations were followed by the presentation of the Section's prestigious Professionalism Award. This year's recipient, Frank Carroll was honored not only for his long and distinguished career, but also for his high ethical standards, his significant contributions to the Bar Association, his tireless mentoring of younger attorneys and his significant pro bono efforts. Congratulations, Frank!

In addition to the General Session and the presentation of awards, numerous committee meetings were held. The Condominiums & Cooperatives Committee meeting provided attendees with additional CLE credits. The meeting had speakers from the Real Estate Finance Bureau of the New York Attorney General's Office who provided practical and timely insight on various procedures and internal guidance. In addition, other practitioners presented on topics such as "Special Risks in Offering Plans", "First Amendment and Religious Freedom Issues", the "Stop Sexual Harassment in NYC Act" and "Case Law Update." The Title and Transfer Committee held a meeting where the recent Appellate Division decision on the Department of Financial Services Regulations governing licensed Title Insurance Agents was extensively discussed. Finally our Not-for-Profit Entities and Concerns Committee meeting had presentations on "Medicaid Reimbursement Issues", "Affordable Housing Tax Credits", "Good Governance Practices and Avoiding Conflicts of Interest." I want to thank all of the presenters and Committee Chairs (who are too numerous to mention here) for their outstanding work.

Putting together such wonderful programs requires tremendous effort from the speakers, participants and committee members. I want to thank each and every one of them for their contribution to such a successful Annual Meeting. Last but not least, a special thank you goes out to this year's Program Chair, Gerard Antetomaso, who did a great job putting the program together.

If you took advantage of the wonderful programs at the Annual Meeting, I am sure you are now motivated to attend our Summer Meeting which will be held at the ***Equinox Resort & Spa in Manchester, Vermont, July 11-14, 2019***. If you were unable to attend the Annual Meeting, why don't you make it a point to attend our Summer Meeting? We will once again be offering substantial discounts for first-time attendees. I look forward to seeing you there!

Thomas J. Hall

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Is Your Otherwise Firm Sale Contract Subject to Buyer Cancellation Under the "UCIB Rule"?

By Joel E. Miller

Here's the situation. Larry Lawyer's new client—Sam Seller—has just told him the following story. Some months ago, he (Sam) agreed to sell a New York City parcel ("Blackacre") to Bobby Buyer for $1,000,000. Their lawyers had rather quickly agreed upon a normal contract, including a $100,000 down payment. The only sticking point had been whether, or to what extent, Bobby's obligations under the contract should be subject to his actually receiving a described loan that he said he needed in order to pay the purchase price. Bobby was worried about possibly losing his down payment, and wanted not to be bound unless and until such a loan actually closed.

Sam, on the other hand, wanted to have a contract that was not contingent on Bobby's getting financing (such a contract being referred to herein as being "firm"). The contract as signed reflected (in a provision titled "financing contingency" and referred to by Bobby as "the 45-day provision") the following two-part compromise: (i) Bobby would promptly apply to a "lending institution" (a defined term) for a "satisfactory commitment" (also a defined term, which definition incorporated the essential terms of a loan that Bobby deemed sufficient) and diligently prosecute such application; and (ii) if he did not receive a "satisfactory commitment" within 45 days, Bobby could, by giving notice thereof to Sam within three business days thereafter, cancel the contract (and, of course, receive a refund of his down payment).

Months had gone by, without any notice from Bobby, so that, as Sam saw it, the contract had become firm, just as if the 45-day provision had not been included. Accordingly, he was quite surprised when just before the scheduled title closing he received from Bobby a notice that, because his potential lender had withdrawn a "satisfactory commitment" that it had issued, he (Bobby) was electing to cancel the contract and asking for a return of the $100,000. When questioned, Bobby had said that his lawyer had told him that he had that right under a rule of law under which a buyer in his situation was entitled to cancel an otherwise firm contract.

"Do I have to give the money back," Sam asks, "or can I enforce the contract? Blackacre has been off the market for many months," he points out, "during which time I incurred significant carrying charges, all of which will have to be duplicated on any future sale. Even worse, the property's value has nosedived, as I had thought that it might (which is precisely why I wanted to sell). And I am sure that Bobby would not be wanting to cancel if Blackacre's value had gone in the opposite direction. I thought that the 45-day provision had limited my value-drop risk to something like 50 days at the outside, with Bobby taking the risk that something (other than improper action on my part, of course) might prevent the actual closing under the commitment. I wanted not to be involved in that process or dependent on its outcome. At this point in time, I do not even know what conditions were included in the commitment (if there was one) or why it was withdrawn (if it was). For all I know, it is possible that there was a commitment that was withdrawn for no reason other than Blackacre's decrease in value, exactly the risk I wanted to avoid and thought I had avoided. I was willing to take the risk that my crystal ball was too gloomy—that is, that Blackacre's value might to up rather than down, so that I would lose out on the upside—but I did not expect to be whipsawed. It should not be that 'heads Bobby wins, tails Sam loses.'"

"Unfortunately for you," Larry says, "such a rule—which I refer to as the 'UCIB rule,' the letters standing for 'unclosed commitment, innocent buyer'—does exist, at least in the First and Second Departments, an area that includes all of New York City. In brief, the UCIB rule, which was made up by certain judges out of whole cloth, allows the buyer in a contract to purchase real property, if his anticipated financing has fallen through due to the non-closure of a loan commitment, to cancel that contract and get his down payment back, notwithstanding that nothing in the contract itself gives him such a right, provided, of course, that the buyer (i) has done all that the contract required him to do[1] and (ii) has not himself improperly caused the failure of the anticipated financing.[2] For convenience, I refer to such a buyer as 'innocent.'"

A cancellation right can be of great financial significance for a real estate buyer, Larry points out, inasmuch as the seller is normally entitled, upon the buyer's default, to keep the down payment without any showing of actual damages, either because of a liquidated damages

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provision or because the contract is silent on the point, in which situation the law is that, absent a contrary provision, the seller in a real estate contract is entitled to retain a normal down payment if he tenders a proper performance or is excused from such tender by reason of an anticipatory breach on the part of the buyer.[3]

"Do not misunderstand me," Larry continues, "Much as one might feel bad for an innocent commitment-withdrawn buyer, the UCIB rule is in my opinion unjust. As I see it, it improperly overrides the risk-sharing compromise that the parties arrived at as reflected in a contract that includes a provision like your 45-day provision. I may add that I am not entirely alone—at least one appellate judge is of the same view[4] but he was outvoted—and, for the time being at least, the UCIB rule exists. And it may well turn out that you are stuck by it."

"How could such a rule some into being?" Sam asks. "What about the poor seller? And are you saying that the rule might not apply in my case?"

"I will tell you," Larry replies, "but, before I do that, I want to make it clear that I am not saying that I believe that it is always unjust to allow an innocent buyer to cancel a purchase contract because his anticipated financing has fallen through. First of all, whatever the contract says or does not say, a buyer always has a right to cancel if the seller has improperly prevented the buyer's borrowing from being consummated.[5] Also, it is quite usual—and perfectly proper, as I see it—for a contract itself to give an innocent buyer a bargained-for cancellation right, based on either or both of two contingencies: (i) the contract might allow such a buyer to cancel if a described "*commitment*"[6] is not timely[7] obtained[8] or (ii) less commonly, the contract might allow such a buyer to cancel if a described *loan* does not actually *close*."[9]

Larry proceeds to describe for Sam the eight cases in which, as he sees it, the UCIB rule developed. First, though, he points out, by way of preview, that all eight of the cases had something in common, namely that in each of them the buyer was held to have, or might have, a cancellation right. He emphasizes that, on the other hand, the cases differed widely as to what the court said was the source of that right. In four of the cases—*Patterson, Lane, Cone and Creighton*—the source found by the court clearly was the contract itself, and not anything resembling the UCIB rule. On the other hand, in one case—*Kapur*—the court expressly excluded the contract as the source and plainly did rely on the UCIB rule (although it did not give it a name). In the other three cases—*Bobrowsky, Byrne and Lunning*—the court was unfortunately not entirely clear as to the source of the buyer's cancellation right that it found to exist.

Larry first discusses *Patterson*, a case that was decided some 60 years ago, wherein the contract included the following:

> The performance of the terms and conditions to be performed on the part of the purchaser are conditioned upon the purchaser securing a G.I. Mortgage in the sum of $12,700.[10]

"It seems to me likely," Larry says, "that the 'secure a mortgage' phrase was intended to refer to obtaining a *commitment* for a mortgage loan[11]—as opposed to actually *closing* on such a loan—especially if one considers the very next sentence, which read as follows:

> If the purchaser shall be unable to receive a mortgage commitment for this amount within a period of six weeks then at his option this contract may be declared null and void ... .

"As it happened in the *Patterson* case," Larry continues, "the buyer did timely obtain a commitment for the described loan, but, due to no fault of his, the loan did not close. However, the non-closing was not known for some time, so that, inasmuch as the six-week cancellation period was long over, it was clear that the buyer could not utilize the first sentence if it were to be read as creating an obtain-a-commitment contingency (as opposed to a close-a-loan contingency). Rightly or wrongly, the Supreme Court helped the buyer by ruling that the first sentence created a non-*closing* contingency (the no-commitment contingency sentence being simply irrelevant). As that court saw it:

> [T]he contract is conditional upon [the buyer's] securing a G.I. mortgage of $ 12,700 [i.e., getting the money]. Obviously, without such mortgage proceeds, [the buyer] was not financially able to purchase the house and [the seller] was well aware of this fact.' *** The entire factual situation in this case is most unfortunate, but the court cannot now make a new agreement for the parties, nor will it by judicial determination place a strained construction upon the unambiguous provisions thereof, particularly in the absence of any factual showing that [buyer] acted in bad faith and upon an unjustifiable view on his part. The contract specifically stated that "*performance* * * * on the part of the purchaser (plaintiff) are [sic] conditioned upon the purchaser securing a G.I. Mortgage in the sum of $ 12,700.00 * * * " (emphasis supplied). Here, the condition precedent was not fulfilled through no fault on the part of the [the buyer] and, under the circumstances, [the buyer] was excused from performance (cf. *Meyer v. Custom Manor Homes,* 4 A D 2d 488).[12]

"The Second Department said pretty much the same thing: 'The clause in question was inserted in the contract for [the buyer's] protection, apparently with the understanding that unless he procured the mortgage loan [as opposed to merely obtaining a commitment] it would be impossible for him to perform the contract on his part.'[13] Thus, notwithstanding that *Patterson* is sometimes cited as support for the UCIB rule—and the case did involve the classic commitment-withdrawn situation in which that rule can operate—the *Patterson* decision was actually based on the contract's provision (as interpreted by the court) and not on the UCIB rule."

Larry continues: "The next case that I found that might be deemed relevant—*Lane*—involved a contract that contained a rather unusual provision to the effect that the contract would *automatically terminate* '[i]n the event the lending institution ... shall refuse to approve the application aforesaid for the amount set forth and upon the terms and conditions above described.'[14] Significantly, it was not stated that anyone had to do anything, and, of even more importance, no time limit for invocation of the automatic-termination provision was set forth. A bank did issue a commitment that met the stated requirements. However, some seven months later the bank withdrew the commitment after it had been informed that the husband purchaser (a bandleader) had lost his principal source of income. The buyers then asserted that the contract had under its own terms automatically terminated. The seller resisted on two separate grounds.

"First, the seller said, the contract had *not* terminated under the automatic-termination provision, inasmuch the potential lender *had in fact approved the application* (notwithstanding that that approval had later been withdrawn). Second, the seller said, the buyers should not be permitted to rely on the withdrawal, inasmuch as they themselves had improperly brought about that withdrawal in order to get out of the contract. The seller's first contention was rejected out of hand, without even a mention and without the citation of any authority (presumably based on the notion that the withdrawal had retroactively nullified the bank's approval as if it had never been given, so that the contract did terminate under the automatic-termination provision[15]).

"As to the seller's second contention, the vote in the Second Department was three to two, with the judges in the majority saying that they were 'of the opinion that the issue of good faith on the part of [the buyers] is key to the decision at bar [and the] trial court found that [the buyers] had acted in good faith in informing the lending institution of their change of circumstances.'[16] The dissenters, aside from questioning the buyers' good faith, '[did] not think that the contract provision can be reasonably construed as requiring a continuing approval between the time [of] the execution of the contract and the closing of title.'[17] The case then went to the Court of Appeals, which affirmed without opinion. In any event, it is clear that, although the buyers were permitted to cancel, their right to do so came out of the contractual provision. No rule like the UCIB rule was involved."

"The next case to look at," Larry continues, "although frequently cited as support for the UCIB rule, was actually decided on a vitally different basis. In *Cone*, [18] the contract contained two contingencies, one of which had been satisfied. 'The other contingency, which is the primary issue on this appeal,' said the Third Department, 'is contained in paragraph 4 of the contract and conditions its effect on [the buyers] obtaining a mortgage *loan* of $19,200, with defendants being required to use diligent efforts to obtain such *loan*.'[19] The buyers did make such efforts and did obtain a mortgage *commitment*. But one of the commitment's conditions could not be fulfilled, and the potential lender withdrew it. It followed, said the court, that the buyers were entitled to a refund of the down payment. 'As long as the purchasers exert a genuine effort to secure the mortgage financing [i.e., get the money] and act in good faith,' the court said, 'they are entitled to *rely on the contract* and may recover their down payment if the mortgage is not, in fact, approved [i.e., if the loan does not actually close].'[20] Thus, the *Cone* court plainly did not rely on any outside-the-contract rule."

Larry next refers to *Bobrowsky*, a case that involved a commitment that was withdrawn, according to the court, due to "a substantial change in [the buyers'] financial circumstances."[21] "But the basis of the decision is unclear," Larry says. "Even though the court stated that 'the material facts in *Lane* are indistinguishable from those at bar,'[22] we are not told what the *Bobrowsky* contract said, and, as I said, the *Lane* contract was unusual. My guess would be that, unlike the *Lane* contract, the *Bobrowsky* contract contained only the typical contingent-on-commitment provision. If that is so, the cases are not even remotely alike. And if that is so, the *Bobrowsky* court was creating a cancellation right not provided for in the document. Thus, it might be that the *Bobrowsky* court may well have, by misreading *Lane*, given birth to the UCIB rule."

Larry goes on: "*Byrne* was still another case that involved a commitment that had been withdrawn, which had there happened, according to the court, 'due to the insufficient income' when one of the buyers lost his job.[23] The court did not point to any source—in the contract or otherwise—for what it found to be a right to cancel. All that the court did was to recite certain facts and conclude therefrom that 'there was no willful breach of the contract of sale by the [buyers].'[24] Both *Lane* and *Bobrowsky* were cited in support. Perhaps the *Byrne* court was *sub silentio* applying the UCIB rule."

Larry next turns to the *Lunning* case,[25] which, he says, appears to be the first one in which the UCIB rule was to any degree actually enunciated. The court's entire discussion of the facts was as follows:

> [The buyers] contracted to purchase shares allocated to an apartment at premises located at 10 Bleecker Street, New York County. After

> obtaining a loan commitment, which was contingent upon no material change in [the buyers'] financial condition at the time of closing, [one of the buyers] became unemployed as a result of an illness which caused his death soon thereafter.[26]

"Presumably," Larry says, "the potential lender then withdrew its commitment. In any event, the surviving buyer and the estate of the deceased buyer sought the return of the down payment, with the seller resisting, according to the court, on the ground that the claimants 'had failed to terminate the subscription agreement in accordance with its terms.'[27] That would seem to indicate that the contingency period had expired. Nevertheless, the court ruled in the claimants' favor, saying only this:

> When a condition of a mortgage loan commitment is not fulfilled through no fault of the purchasers, their performance [of their purchase contract] is excused, so long as they acted in good faith. (Cone v Daus, 120 AD2d 788, 789-790.) [28]

"Three things about *Lunning* should be noted," Larry adds. "First, it deserves emphasis that, so far as we can tell, the claimants' victory was not based on any cancellation right provided for in the contract. Indeed, the First Department did not set forth—or even describe—what the parties' contract said, seemingly deeming those terms to be irrelevant. It is thus likely that the court based its ruling on a perceived—or, I might say, created—rule of law *dehors* the parties' agreement. Second, the only authority that the First Department cited was the *Cone* case, in which the cancellation right was provided for in the contract. Thus, if the *Lunning* court was, as it seems, relying on some non-contractual right, its citation of *Cone* was beside the mark. Third, the Court of Appeals only denied leave to appeal; it did not affirm on the opinion below. Thus, the Court of Appeals was not adopting the UCIB rule, and, as of yet, it still has not done so. Nor has it done the opposite, of course. So, for now at least, the rule exists.

"In one case—*Creighton*—the contract contained what the court described as a 'mortgage contingency clause' that, according to the court, 'provide[d] that if the purchaser is unable to obtain a *commitment* before the specified date, 'then purchaser shall immediately notify Seller and, unless the parties agree in writing to extend such date or Purchaser delivers to Seller a written waiver of this condition, this Contract shall be deemed cancelled and * * * the downpayment shall be promptly refunded to the Purchaser.'[29] As quoted by the court, the provision went on as follows: 'In the event Purchaser shall fail to give such notice to Seller on or before the third business day following the above-specified date, this Contract* * * shall remain in full force and effect.'[30]

"It is especially to be noted," Larry says, "that, unless that result was averted by action of one or both of the parties, the contract was to terminate *automatically* if the buyer could not obtain a commitment within the stated time period. Contrary to the usual provision, no action by the buyer was required in order to cancel the contract.

"A mortgage contingency clause protects a contract vendee from being obligated to consummate the transaction in the event mortgage financing [i.e., the closing of a loan as opposed to the obtaining of a commitment] cannot be obtained in the exercise of good faith and through no fault of the purchaser."

"As it happened, the buyer did timely receive what everyone treated as a commitment within the meaning of the quoted language—notwithstanding that the commitment was conditional—and the seller was timely advised that a commitment had been obtained. Thus, the entire contingency provision, literally read, became irrelevant (because it was not the fact that the buyer had been unable to obtain a commitment within the prescribed period).[31] Some time later, though, the buyer lost her job and so informed the potential lender, which thereupon revoked its commitment. The buyer then refused to close under the contract and claimed, in the words of the First Department, 'relief *pursuant to the mortgage contingency clause of the contract of sale* based upon her failure to obtain the necessary financing.'[32] A seller motion for summary judgment was denied by the lower court, and that ruling was affirmed in an opinion that included the following:

> In the absence of waiver of its [*i.e.*, the below-described 'general rule's'] protection by the buyer, any claim that that [the seller] is entitled to retain the down payment must be based upon the general rule that a party [in this case, the buyer] may not frustrate the performance by bringing about the failure of a condition precedent (*Lindenbaum v. Royco. Prop. Corp.*, 165 AD2d 254, 260).[33]

"Maybe I am wrong," Larry goes on, "but that strikes me as utter nonsense. What about the fact that the buyer defaulted when she refused to close? Also, I do not know what condition the buyer was supposed to have caused not to be satisfied. The only condition in the contract was obtaining a commitment, and all agreed that a commitment had been obtained.

"That the court had slipped from an obtaining-a-commitment contingency to a closing-the-loan contingency is made apparent by the following passage from a later portion of its opinion:

> A mortgage contingency clause protects a contract vendee from being obligated to consummate the transaction in the event mortgage *financing* [i.e., the closing of a loan as opposed to the obtaining of a commitment] cannot be obtained in the exercise of good faith and through no fault of the purchaser [citing *Lunning* and *Cone*].[34]

"According to the First Department, the seller and the escrow agents were properly denied summary judgment because they 'failed to establish, by documentary evidence or otherwise, that [the buyer] was denied mortgage financing because she did not pursue her mortgage application in good faith.' That the buyer had defaulted under the contract was not enough, the court ruled (although it never said that in so many words); the seller could win only by additionally showing that it was the buyer's 'bad faith' that had kept her from closing on the applied-for-and-committed loan.

"The next development was a split decision of the First Department—*Kapur*—with the majority unmistakably basing its ruling on the UCIB rule.[35] The majority first correctly pointed out that the contract itself had not given the buyer, who had obtained a commitment that had been withdrawn after he lost his job, any right to cancel. The majority's language on this point is worth looking at:

> Inasmuch as [the buyer's] mortgage commitment letter was revoked by the lender after the contingency period, the provision in the contract of sale conditioning [the buyer's] right to the return of his escrowed down payment upon his cancellation of the contract within seven business days after the date specified for obtaining the commitment letter was inapplicable. Nor, under the circumstances at bar, involving a commitment revocation as opposed to the failure to obtain a commitment in the first instance, was [the buyer's] cancellation of the contract otherwise governed by specific provisions of the parties' contract.[36]

"The majority having said that," Larry continues, "one would have expected an affirmance of the lower court's ruling in favor of the sellers. But that is not what happened. Instead, the Appellate Division majority—without ever saying so—simply assumed the existence of the UCIB rule. The only question, according to those judges, was whether the buyer had or had not improperly brought about the withdrawal of the commitment:

> This being the case [i.e., the buyer having no cancellation right under the parties' contract], plaintiff purchaser's right to the return of his escrowed down payment turns instead upon whether the commitment revocation and consequent failure of the transaction was attributable to bad faith on plaintiff's part (*Creighton*; *Lunning*; *Lane*).[37]

"There was a vigorous and thoughtful—and, I believe, wholly correct—dissent that included the following:

> It is a fundamental tenet of contract law that the parties are free to allocate the risks that might affect performance. It is expected that the contracting parties will negotiate the terms necessary to take those risks into account. Indeed, the standard form contract in use here actually allocates the risk of the purchaser not receiving the contemplated mortgage financing during the period between the contract signing and the closing. Initially, the seller bears the risk; the contract of sale grants to the buyer the right to cancel the contract if he is unable to obtain a mortgage commitment, if he has cooperated with the application process, and as long as he exercises this right in a timely manner. But, once the purchaser receives a mortgage commitment, the provisions of this standard residential cooperative contract of sale allocate to the buyer the risk of his financing falling through prior to the closing. Between the time the letter of commitment—even a conditional one—is issued and the scheduled closing, the purchaser no longer has a right to cancel.
>
> Nor can this change in the purchaser's circumstances be said to constitute the type of impossibility that under common-law contract principles would excuse the purchaser's performance under the contract. A sudden downturn in the finances of a contract vendee does not eliminate his obligation to make the contracted-for purchase, and the failure to do so entitles the contract vendor to all available remedies for breach of contract: "Generally, once a party to a contract has made a promise, that party must perform or respond in damages for its failure, even when unforeseen circumstances make performance burdensome …. Impossibility excuses a party's performance only when the destruction of the subject matter of the contract or the means of performance makes performance objectively impossible." Moreover, the impossibility

must be produced by an unanticipated event that could not have been foreseen or guarded against in the contract.

The intervening events that occurred here, the purchaser's loss of employment and the resulting loss of the mortgage commitment, were clearly a possibility that could have been anticipated and provided for in the contract of sale. Indeed, the contract explicitly recognized the possibility that the commitment obtained by the purchaser might contain conditions, and logically, whenever a condition is imposed, there is a possibility that the purchaser might not be able to satisfy it. The very terms of the contract therefore implicitly recognize the possibility of the events that occurred here: the bank's imposition of a condition that the purchaser could not satisfy, viz., that his financial circumstances remain unchanged.

An examination of the terms of the parties' contract demonstrates that the purchaser-plaintiff has no contractual right to cancel the contract and be repaid his down payment. Consequently, his prospective inability to close on the cooperative contract of sale constitutes a default, entitling the sellers to retain the down payment as liquidated damages—which provision, by definition, is included in the contract to protect the seller in the event of a default by the buyer.

Neither the terms of the parties' contract nor any principle of contract law excuse [the buyer's] performance under the contract. Nevertheless, as [the buyer] correctly points out, a number of cases, including the cases relied upon by the majority here, have held that a purchaser's inability to perform a condition imposed by a lender, resulting in revocation of a previously-issued mortgage commitment, may excuse the purchaser from performance of a contract of sale and entitle him to the return of his down payment.

Because rote application of this rule appears to run counter to longstanding contract law, I suggest that the underpinnings of these cases be examined before they are applied. Some of these case holdings are supported by the terms of the contracts themselves, or other established doctrines of contract law. In others, the result appears to be simply an attempt to arrive at an equitable result in an unfortunate situation.

In *Lunning*, this Court enunciated a broad rule that "When a condition of a mortgage loan commitment is not fulfilled through no fault of the purchasers, then performance is excused, so long as they acted in good faith" (citing *Cone*). *** However, the decision contains no indication as to the exact financing contingency provisions contained in those parties' contract of sale. To the extent that the provisions were similar to those in the present case, I believe that the Lunning case was wrongly decided and should not be followed.

Nor does it appear that *Cone*, upon which the *Lunning* Court relied, supports the broad ruling enunciated in *Lunning*. *** It is noteworthy that the financing contingency provision contained in the contract at issue in *Cone* referred to obtaining, not a "commitment," but a "conventional mortgage loan." While the contingency of obtaining a commitment letter is clearly satisfied by a bank's issuance of such a letter, the contingency of obtaining a loan is not necessarily satisfied unless and until the lender actually advances the funds. Because they were unable to satisfy the lender's condition, the purchasers in *Cone* could not obtain the contemplated loan, and thus, unlike the case now before us, their contract's financing contingency was never satisfied. The situation in that case is therefore distinguishable from cases such as this, where the financing contingency refers only to the purchaser's obtaining a mortgage commitment, and where such a commitment was initially obtained (albeit subsequently revoked).

And, in *Patterson*, cited in *Cone*, the contract provided that the contract was conditioned upon the purchaser securing a G.I. mortgage; it went on to provide that if the purchaser was unable to obtain a mortgage commitment within six weeks, then at his option the contract could be declared null and void and the down payment repaid. *** As in *Cone*, the contract language in *Patterson* conditioned the agreement upon securing a "mortgage" rather than a "mortgage commitment" —although it then went on to provide for a procedure if a commitment could not be obtained.

***

Yet, instead of considering the terms of the contracts of sale in considering whether the negotiated terms covered the presented situations, cases where mortgage commitments have been revoked have turned their analysis solely to whether the purchaser acted in good faith.[38]

> These cases recite and apply the rule that 'a party may not frustrate the performance of an agreement by bringing about the failure of a condition precedent.'[39] In doing so, they blur the line between the terms of the parties' contract of sale and the terms of the mortgage application. They incorrectly treat conditions contained in mortgage commitments as conditions precedent contained in the related, but separate, contract of sale.
>
> Despite the irrelevance of the recited rule to the situation presented, these cases have essentially reasoned that a purchaser's failure to comply with a condition to a mortgage commitment is the same as a failure to satisfy a condition precedent contained in the contract of sale. They therefore conclude that where a mortgage commitment is revoked, the seller will be entitled to retain the down payment only upon proof that the purchaser actually brought about the failure of compliance with the condition imposed by the lender.[40] In other words, as long as the purchaser did not act in bad faith, his inability to perform the condition to the mortgage commitment is enough to excuse his performance under the contract.
>
> To the extent that this rule is applied without reference to the terms of the parties' own agreement, it represents a complete departure from the law of contracts and conditions, the only body of law truly applicable, in favor of an equity-laden analysis founded in nothing more than sympathy for the unfortunate buyer.[41]

"Oddly enough," Larry notes, "the majority in effect agreed with Judge Saxe's sympathy point. Its opinion included the following:

> Under the dissent's interpretation, the last-minute revocation of a mortgage loan commitment by a lender, even a wholly arbitrary one, would put the purchaser in the unenviable position of either having to proceed to closing notwithstanding that its diligent and good faith efforts to secure alternative financing were unsuccessful, or to risk forfeiture of the down payment. This is not the law, nor should it be.[42]

"In any event," Larry continues, "the UCIB rule, still unnamed in the reported decisions, is, for now at least, the law in New York City.[43] We have to accept that and deal with it."

"Okay, I get that," Sam says, "but you said that the rule might not apply to me. What is that about?"

"First of all, Larry responds, "we will have to see whether Bobby is actually covered by the rule. There may be real questions about its scope.[44] For one thing, it may be that the rule covers only buyers who, because a qualifying commitment was in fact obtained within the prescribed period, could not escape via the no-commitment-received route. Also, the courts may decide that the rule does not cover a buyer who could have canceled under a 45-day-like provision but for whatever reason did not. [45] Such a failure could occur for many reasons. Maybe the buyer had already arranged other financing. Maybe the buyer was confident that he could obtain other financing. Maybe the buyer thought the deal so good that he was willing to take his chances. Maybe the buyer mistakenly believed that what he had received did satisfy the contingency. Maybe he had just though carelessness missed an opportunity to cancel. It would not be unreasonable for the courts to decline to give a second cancellation right to a buyer who had squandered a previous cancellation right. And, at this point in time, we simply do not know why Bobby did not cancel under the 45-day provision; all we know is that he did not.

"If it turns out that Bobby really did obtain a qualifying commitment, we will next look into whether it was actually withdrawn. Maybe Bobby is just saying that. Maybe he, for whatever reason (perhaps the decline in Blackacre's value), asked that the commitment be terminated. Alternatively, we might be able to show that Bobby—by action and/or inaction—induced the potential lender to back out.

"Also, we do not know when the withdrawal is supposed to have taken place. If it was some time ago, we would argue that any cancellation right that Bobby might have had under the UCIB rule had only a limited life, so that it was waived when he did not exercise it within a reasonable—presumably, very short—period of time.[46] A buyer in that position has all the operative facts and should not be permitted to have a free option to either stay in the deal or get out of it, depending on how things develop. If it turns out that Bobby held off during a period in which he thought that he had a good deal but then tried to back out after Blackacre's precipitous drop in value, I believe that we will have a winner.

"Finally," Larry concludes, "maybe someone will take the case to the Court of Appeals and convince that court that the UCIB rule is unjust and should be abrogated. As to this point, we can only hope."

Endnotes

1. There may be issues as to whether the buyer made a proper application and pursued it in good faith. *See, e.g.*, *Companion v. Touchstone*, 88 N.Y.2d 1043, 651 N.Y.S.2d 399, 674 N.E.2d 329 (1996) (4-3), *aff'g* 222 A.D.2d 1087, 635 N.Y.S. 842, 843 (1995), wherein the buyer had obligated himself to keep trying for the described loan until and unless he could demonstrate that it could not be obtained. The majorities in both appellate courts affirmed the lower's court's ruling that the buyer had made such

a demonstration and was therefore entitled to get his money back, whereas the dissenters thought that a jury should resolve the issue. *See also Delsack v. Cumella*, 189 A.D.2d 640, 593 N.Y.S.2d 2, 3 (1st Dep't 1993) (buyers applied through broker rather than to "institutional lender" as required by contract); *Slamow v. Delcol*, 79 N.Y.2d 1016, 584 N.Y.S.2d 424, 594 N.E.2d 918 (1992) (5-1-1), *aff'g* 174A.D.2d 725, 571 N.Y.S.2d 335, 335 (2d Dep't 1991) (application for $241,650 loan proper where requirement was to apply for a loan "of not less than $201,375"); *Safanovskaya v. Ostrow*, 32 Misc.3d 136(A), 936 N.Y.S.2d 61, 61 (Sup. Ct. App. Term 2d Dep't 2010) (if required by contract, buyer must apply to more than one potential lender).

2. Clearly, a buyer who has wrongfully brought about the non-occurrence of an anticipated loan is not entitled to cancel as a result of that non-occurrence. *See, e.g.*, *Garber v. Giordano*, 16 A.D.3d 454, 791 N.Y.S.2d 175 (2d Dep't 2005); *Lindenbaum v. Royco Prop. Corp.*, 165 A.D.2d 254, 567 N.Y.S.2d 218 (1st Dep't 1991); *Heath Knolls Invs., Inc. v. Westlake Residential Ptnrs., LLC*, No. 2:07-cv-049, 2008 U.S. Dist. LEXIS 34284, at *1 (D.Vt. Apr. 24, 2008); *Price v. Bartkowiak*, 715 F. Supp. 76 (S.D.N.Y. 1989).

3. *See, e.g., Maxton Builders, Inv. v. LoGalbo*, 68 N.Y.2d 373, 378, 502 N.E.2d 184, 186, 509 N.Y.S.2d 507, 509 (1986), *aff'g Lawrence v. Miller*, 86 N.Y. 131 (1881).

4. *See Kapur v. Stiefel*, 264 A.D.2d 602, 603, 695 N.Y.S.2d 330 (1st Dep't 1999) (3-1 decision) (Saxe, J., dissenting) (Judge Saxe's powerful dissenting opinion is quoted at considerable length at 14, below); *but see Sanjana v. King*, No. 153650/2017, 2018 N.Y. Misc. LEXIS 2298 at *10 (Sup. Ct., N.Y. Co. 2018) ("Of course, as a general matter, it makes sense to allow a buyer to get back the downpayment where a lender revokes financing *after* making a commitment" (emphasis in original)), on appeal to First Department.

5. *See, e.g., Spiegelman v. Gordon*, 212 A.D.2d 775, 624 N.Y.S.2d 851 (2d Dep't 1995).

6. There may, of course, be issues as to whether what was received constituted the kind of commitment contemplated by the contract. *See, e.g.*, *Applied Behavior Analysis, Inc. v. Greater N.J. Annual Conference*, 67 A.D.3d 714, 888 N.Y.S.2d 207 (2d Dep't 2009); *Zellner v. Tarnell*, 65 A.D.3d 1335, 885 N.Y.S.2d 745 (2d Dep't 2009); *Eves v. Bureau*, 13 A.D.3d 1004, 788 N.Y.S.2d 211 (3d Dep't 2004); *Lindenbaum v. Royco Property Corp.*, 165 A.D.2d 254, 567 N.Y.S.2d 218 (1st Dep't 1991); *Lieberman v. Pettinato*, 120 A.D.2d 646, 502 N.Y.S.2d 242 (2d Dep't 1986); *Sanjana v. King*, No. 153650/2017, 2018 N.Y. Misc. LEXIS 2298 at *8 (Sup. Ct., N.Y. Co. 2018) ("To view a conditional approval as a commitment would require the Court to ignore the significance of the mortgage contingency provision, which created a deadline to move the sale along") (on appeal to First Department); *Friend v. McGarry*, 141 Misc.2d 479, 533 N.Y.S.2d 357 (Sup. Ct. N.Y. Co. 1988); *Donato v. Baltrusaitis*, 56 Misc.2d 935, 290 N.Y.S.2d 659 (Sup. Ct., Queens Co. 1968). That matter, albeit obviously of crucial importance, is not discussed herein.

7. There may be a question whether the commitment was obtained within the time limit set forth in the contract. *See, e.g.*, *Carpentino v. Balint*, 145 A.D.2d 458, 458, 535 N.Y.S.2d 100 (2d Dep't 1988); *Aurrichio v. Rinaldi*, 56 Misc.2d 663, 289 N.Y.S.2d 808 (Sup. Ct., Suffolk Co. 1968) (extension of time for contingency to be resolved implies extension of time in which to cancel). In view of the usual reason for the time limit set forth in the contingent-on-obtaining-commitment provision, it would seem obvious that a post-period withdrawal ought to be irrelevant in such a case, which one supposes is why most contracts do not address the point. However, some contracts— which obviously do not embody the typical compromise—do deal with a post-commitment-period withdrawal. *See, e.g.*, *Lindenbaum v. Royco Property Corp.*, 165 A.D.2d 261, 567 N.Y.S.2d 218 (1st Dep't 1991); *Helig v. Maron-Ames*, 25 Misc.3d 838, 885 N.Y.S.2d 563 (Civ. Ct., Kings Co. 2009).

8. *See, e.g.*, *Zellner v. Tarnell*, 65 A.D.3d 1335, 1336, 885 N.Y.S.2d 745 (2d Dep't 2009); *Hoft v. Frenkel*, 52 A.D.3d 779, 780, 860 N.Y.S.2d 209 (2d Dep't 2008); *Young v. Leger*, 288 A.D.2d 857, 857, 732 N.Y.S.2d 782 (4th Dep't 2001); *Anderson v. Krupp*, 199 A.D.2d 295, 295, 604 N.Y.S.2d 273 (2d Dep't 1993); *Maldonado v. Moore*, 135 A.D.2d 1138, 1138, 523 N.Y.S.2d 275 (4th Dep't 1987); *Friend v. McGarry*, 141 Misc.2d 479, 480, 533 N.Y.S.2d 357 (Sup. Ct., N.Y. Co. 1988) (contract also included a loan-not-closed contingency). *cf. Stotz v. Cleveland*, 53 A.D.2d 787, 788, 384 N.Y.S.2d 540 (3d Dep't 1976) (contract to terminate automatically if commitment not received by certain date). Sometimes it is provided that either party can cancel if a qualifying commitment is not timely received. *See, e.g.*, *Eves v. Bureau*, 13 A.D.3d 1004, 1005, 788 N.Y.S.2d 211 (3d Dep't 2004); *Young v. Leger*, 288 A.D.2d 857, 732 N.Y.S.2d 782 (4th Dep't 2001); *Anderson v. Krupp*, 199 A.D.2d 295, 295, 604 N.Y.S.2d 273 (2d Dep't 1993); *Lieberman v. Pettinato*, 120 A.D.2d 646, 647, 502 N.Y.S.2d 242 (2d Dep't 1986).

9. *See, e.g.*, *Buonocore v. Dubois*, 16 A.D.3d 359, 791 N.Y.S.2d 436 (1st Dep't 2005), *lv den.*, 5 N.Y.3d 706, 801 N.Y.S.2d 799, 835 N.E.2d 659 (N.Y. 2005); *Long v. Legg*, 264 A.D.2d 718, 718, 695 N.Y.S.2d 367 (2d Dep't 1999); *Sciales v. Foulke*, 217 A.D.2d 693, 693, 630 N.Y.S.2d 325 (2d Dep't 1995); *Friend v. McGarry*, 141 Misc.2d 479, 480, 533 N.Y.S.2d 357 (Sup. Ct., N.Y. Co. 1988) (contract also included a loan-not-closed contingency); *Price v. Bartkowiak*, 715 F.Supp. 76, 80 (S.D.N.Y. 1989) ("[W]hen a contract makes a purchaser's obligations subject to the *closing* of a loan, the risk is shifted to the seller. *** However, the seller is still protected by the good faith requirement") (emphasis added).

10. *Patterson v. Marchese*, 12 Misc.2d 189, 191, 173 N.Y.S.2d 759, 760 (Sup. Ct. Westchester Co. 1958), *aff'd*, 10 A.D.2d 639, 640, 196 N.Y.S.2d 903, 904 (2d Dep't 1960).

11. In the vernacular, "get a mortgage [loan]" usually means "obtain a commitment for a mortgage loan." On the other hand, the speaker might really mean "close on a mortgage loan." And the phrase "obtain financing" presents the same difficulty. Sometimes, the context makes the meaning clear. But often it does not. Obviously, the difference can be critical. It is truly regrettable that so many draftspersons—and even some courts—employ language that is unclear in this respect.

12. *Patterson*, 12 Misc.2d at 191, 173 N.Y.S.2d at 761.

13. *Patterson v. Marchese*, 10 A.D.2d at 640, 196 N.Y.S.2d at 904.

14. *Lane v. Elwood Estates, Inc.*, 31 A.D.2d 949, 950, 298 N.Y.S.2d 751, 753-754 (2d Dep't 1969) (3-2), *aff'd w/o op.*, 28 N.Y.2d 620, 320 N.Y.S.2d 79, 268 N.E.2d 805 (1971).

15. According to the dissenters, the lower court had based its ruling on its mistaken belief that no commitment had ever been obtained. *See* 31 A.D.2d 949, 950, 298 N.Y.S.2d at 751.

16. *Id.* At 950. That change in circumstances was the husband buyer's loss of his principal loss of income. The majority also stated that a significant fact was that the buyers had five children, one of whom had a brain injury.

17. *Id.*

18. *Cone v. Daus*, 120 A.D.2d 788, 789, 501 N.Y.S.2d 523 (3rd Dep't 1986).

19. *Id.* (emphasis added).

20. *Id.* at 790 (citation omitted and emphasis added).

21. *Bobrowsky v. Landes*, 124 A.D.2d 618, 619, 507 N.Y.S.2d 879 (2d Dep't 1986). The only thing that we are told about the "substantial change" is that it was the buyers' "loss of income."

22. *Id.* at 619.

23. *Byrne v. Collins*, 142 A.D.2d 661, 662, 531 N.Y.S.2d 17 (2d Dep't 1988).

24. *Id.*

25. *Lunning v. 10 Bleecker St. Owners Corp.*, 160 A.D.2d 178, 553 N.Y.S.2d 148 (1st Dep't), *lv den.*, 76 N.Y. 710, 563 N.Y.S.2d 61, 584 N.E.2d 671 (1990).

26. *Id.* at 149.

27. *Id.*

28. *Id.*

29. *Creighton v. Milbauer*, 191 A.D.2d 162, 163-4, 594 N.Y.S.2d 185 (1st Dep't 1993).

30. *Id* at 164.

31. *Id.* It was based on this literal irrelevancy of the entire provision that the First Department ruled that the above-quoted remain-in-full-force-and-effect language was inoperative notwithstanding the undoubted fact that the buyer had never waived the automatic-cancellation provision.

32. *Creighton*, 191 A.D.2d 162, 594 N.Y.S.2d at 186 (emphasis added).

33. *Creighton*, 191 A.D.2d at 163, 594 N.Y.S.2d at 187-88. Immediately after the quoted language, the court added that "[t]he burden to establish that a condition was prevented or rendered impossible [by the other party] in order to avoid liability under a contract rests upon the party seeking to enforce it [*i.e.*, the contract]. (*Id.*)."

34. *Id*. at 165 (emphasis added). It may be that the defendants had hurt their chances by, according to the First Department, making the following four (actually irrelevant to their position) assertions that the court found had not been demonstrated: (1) The buyer did not timely advise the seller that a commitment had been obtained. (2) The buyer was in default due to the remain-in-full-force-and-effect language of the contingency provision. (3) The contingency provision had "already lapsed." (4) The potential lender's revocation of its commitment was caused by, in the words of the sellers, the buyer's "knowing and willful failure to submit the documentation and information previously requested" by the potential lender. 191 A.D.2d at 164, 594 N.Y.S.2d at 187.

35. *Kapur v. Stiefel*, 264 A.D.2d 602, 695 N.Y.S.2d 330 (1st Dep't 1999) (3-1).

36. *Id*. at 603.

37. *Id*. (citations wholly or partially omitted). The court then, citing *Creighton*, ruled that the "bad faith" issue "is not an issue properly resolved as a matter of summary adjudication since the record raises questions of fact as to whether the termination of plaintiff's employment leading to the commitment revocation was a circumstance of plaintiff's making intended to bring about the failure of the subject real estate transaction." *Id.*

38. *Lane v. Elwood Estates, Inc.*, 31 A.D.2d 949; *Creighton v. Milbauer*, 191 A.D.2d 162; *Lindenbaum v Royco Prop. Corp.*, 165 A.D.2d 254, 260.

39. *Creighton* 191 A.D. 162 at 165, citing *Lindenbaum* 165 A.D. 2d at 260.

40. *Creighton* 191 A.D.2d 162; *Lindenbaum*, 165 A.D.2d 254; *Lane*, 31 A.D.2d 949.

41. *Kapur*, 264 A.D.2d at 605-610 (Saxe, J., dissenting) (some citations wholly or partially omitted).

42. *Kapur*, 264 A.D.2d at 603.

43. It was applied in the following recent cases: *Chahalis v. Roberta Ebert Irrevocable Trust*, 163 A.D.3d 623, 623-24, 81 N.Y.S.3d 159 (2d Dep't 2018) (citing *Blair* and *Kapur*); *Blair v. O'Donnell*, 85 A.D.3d 954, 925 N.Y.Y.2d 639 (2d Dep't 2011) (citing *Cone*, *Creighton*, *Lunning* and *Kapur*); *Carmona v. McKiernan*, 66 A.D.3d 729, 886 N.Y.S.2d 350 (2d Dep't 2009) (citing *Byrne*, *Bobrowsky* and *Lane*). It is interesting that a federal district court applying Vermont law expressly declined to adopt the UCIB rule, holding that any cancelation right must derive from the contract itself, which the buyer had not shown: "[T]he express terms of the limitation provision are silent on the legal consequences of a revocation of the original financing commitment after the expiration of the rescission deadline. Therefore, questions of fact exist regarding whether the 24-day rescission period applies under the circumstances of this case." *Heath Knolls Invs., Inc. v. Westlake Residential Ptnrs.*, LLC, 2008 US Dist. LEXIS 34284 (D.Vt. 2008).

44. Although the issue does not arise in Sam's case, it may be that the UCIB rule does not apply where the contract does not contain any obtain-a-commitment contingency. Maybe the courts would deem it unfair to stick a seller in such an instance. Or should it depend on whether the seller did or did not know, or have reason to know, that the buyer needed a loan in order to close? If, as appears to be the case, a seller can, by having certain language included in the contract, preclude application of the UCIB rule (*see Helig v. Maron-Ames*, 25 Misc.3d 838, 885 N.Y.S.2d 563 (Civ. Ct. Kings Co. 2009)), is it enough for the contract to say—as some forms do—that the buyer is not seeking financing?

45. At least one court has already held to that effect. *Sanjana v. King*, 2018 N.Y. Misc. LEXIS 2298 (Sup. Ct. N.Y. Co. June 8, 2018) (on appeal to First Department).

46. *But cf. Maldonado v. Moore*, 135 A.D.2d 1138, 523 N.Y.S.2d 275 (4th Dep't 1987), wherein it seemed to make no difference that the buyers waited more than two months before canceling. It must be noted, however, that the sellers could have helped themselves, in that the contract provided that either party could cancel if the buyers could not obtain a commitment by a specified date. As a separate point, it may be noted that the court ruled that a commitment issued after that date was not to be taken into account.

TRUST ME: The Dirt on Trust Ownership of Real Estate

By Mindy H. Stern

INTRODUCTION

So, a client walks into a bar (association) expressing an interest in transferring real property into a trust. How should you respond? When is a trust appropriate, or when is an LLC the better approach? This article will help you ask that client the right questions, provide an overview of several types of trusts and the various purposes they serve, and identify issues you should address with your clients to help them achieve their goals.

OVERVIEW—PURPOSE AND TYPES OF TRUSTS

Revocable Trusts

A revocable trust, also often referred to as a living trust, is a contract between the creator of the trust (the grantor) and the named trustee. It typically is created to avoid the expense and possible delay of probating a will, to make it easier and less expensive to create and administer additional family trusts to be created after death, and to provide an orderly way to manage the grantor's financial affairs if the grantor becomes disabled or incapacitated. It is a useful tool to avoid the ancillary probate of real property located in jurisdictions other than the one where the grantor is domiciled. It also can avoid probate in the state of domicile if it contains the grantor's plan for the ultimate disposition of his or her assets, although it does not cut off a surviving spouse's right of election under New York Estates, Powers and Trust Law (EPTL) Section 5-1.1-A (b)(1)(F) with respect to the property. Real property (and cooperative apartments, if the cooperative corporation permits it) can be transferred to a revocable trust or purchased and sold by a trustee after the grantor transfers the property to the trust.

However, because the trust is revocable and amendable, for tax purposes there is no completed gift. So, despite common client misconceptions to the contrary, *revocable trusts do not save estate or income taxes*. And transferring real property from a joint tenancy or a tenancy by the entirety may create a gift tax issue.

Irrevocable Trusts

Unlike revocable trusts, transfers of property to an irrevocable trust are deemed completed when the transfer is made. Tax savings and other benefits can be achieved through different types of irrevocable trusts.

Qualified Personal Residence Trust (QPRT)

Qualified personal residence trusts (QPRTS) are trusts authorized by Internal Revenue Code (IRC) Section 2701. A personal residence (either the principal residence, or one other residence) is transferred into an irrevocable QPRT.[1] To qualify as a personal residence, the property cannot be occupied by anyone other than the creator of the QPRT or the grantor's spouse or dependent.[2]

The creator of the QPRT has a right to use the residence for a fixed term. When the term ends, the residence passes to designated beneficiaries, or continues to be held in further trust for their eventual benefit. During this initial term, the grantor's payment of interest on any loan secured by the real estate, or any rent payable in connection with it (including monthly maintenance payable to a cooperative corporation, or common charges payable to a condominium association), is not considered a gift, and the trust creator can continue to take those payments as deductions on his or her personal income tax returns; but the payment by the trust creator of mortgage *principal* constitutes a gift. [3]

The transfer of a residence into a QPRT is a gift of a future interest, because the beneficiaries won't receive it until the trust term ends. The value of the gift is, therefore, less than it would be if the property was transferred to the beneficiaries today. The value is determined actuarially according to IRC § 7520, taking into account: (1) the present value of the property; (2) the length of the trust term (the longer the term, the lower the value of the taxable gift); (3) the age of the trust creator; and (4) the interest rate then used by the IRS in its actuarial tables.

A QPRT works well for property likely to appreciate in value during the grantor's remaining life, because it removes that future appreciation from the grantor's estate. But there are two important caveats.

First, the trust creator must survive the term to take advantage of the tax benefits.[4] Otherwise, the value of

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the residence at the grantor's death is included in the grantor's estate as though the trust was never created. If this is a concern, the trust creator can (if insurable at acceptable rates) purchase a term life insurance policy in the face amount of the estate tax payable if the trust creator does not survive the term. If the insurance is purchased by, and placed in, an irrevocable insurance trust, the proceeds can be eliminated from the estate. To reduce costs, the insurance can be purchased during the last year or two of the term.

Second, if the grantor wishes to remain in the residence after the term expires, the trust cannot require the beneficiaries to consent, and must explicitly prohibit a sale of the residence back to the trust creator.[5] In addition, the grantor must pay fair market rent to the then owner of the property (the beneficiaries if they acquired title outright, or the trustee of the trust if the property remains in further trust for the grantor's lifetime). But this rental stream can (and should) be viewed as another way of transferring wealth to the ultimate property recipients. It is common practice for the trust creator to continue to use and enjoy the residence pursuant to a written occupancy agreement until the grantor's death.

Medicaid Asset Protection Trusts

Medicaid asset protection trusts (MAPTs) are increasingly popular for families with modest means. They protect the equity in a family residence from being depleted to pay for nursing home care for the elderly relative residing in it. The Medicaid program in New York currently has a five-year lookback period for asset transfers made by the trust grantor prior to the grantor's application for nursing home care. Different look-back rules apply for in-home care. MAPTs often are recommended by elder care attorneys, for several reasons. They protect the residence not only for purposes of qualifying for Medicaid without exposing the home equity from claw back, but also from other creditors and relatives with self-interested ulterior motives. The grantor can continue to live in the home after the transfer. If the trust permits, the trustee can sell the existing home without any documents having to be signed by an often mentally incapacitated grantor, and either purchase another residence for the grantor, or if the grantor relocates to a nursing home, preserve the net proceeds in trust to supplement, rather than supplant, the government benefits then being received by the grantor. Because the grantor's gift of the property to the trust is considered an incomplete gift for estate and gift tax purposes, the lifetime capital gains tax exclusion for a homeowner's principal residence usually is preserved, keeping in mind, as is generally the case, that if some portion of the property is used for other purposes, this could affect the exclusion amount, and if the transferred property remains in the trust at the time of the grantor's death, for income and estate tax purposes the trust beneficiaries receive it with a stepped-up income tax basis.

If the senior was receiving STAR, veteran or other property tax exemptions, these continue after the transfer to a MAPT. These and other exemptions are discussed in more detail below.

Even though the trust is irrevocable, which typically triggers a need for the trust to become a separate taxpaying entity with rates identical to individuals but which ratchet up to the highest brackets more quickly, if the MAPT is drafted as a "grantor trust," income generated by trust assets is taxed at the individual grantor's income tax rates on the same rate schedule for individuals, rather than trust rates.

Testamentary Trusts (created post-death, either in a Will or a Living Trust)—A testamentary trust is one created in the will of the property owner, which takes effect upon his or her death. The typical purpose of a testamentary trust created to hold real estate is to permit one family member to use or occupy it, or, if it is income-producing property, to receive the financial benefits of the property, during his or her life, or for some other specified term. When the term ends, the property typically is transferred to other family members, friends or charity. This is a common second marriage scenario, where the grantor wants a surviving spouse to be able to occupy a residence or vacation home for life, or until he or she no longer wants or is able to do so, and to then transfer the property to the children of a first marriage. It can (and often is) also used for commercial property where the owner wishes to control who among multiple generations receives the economic benefit of the real estate. Transfers of real property to a testamentary trust may or may not save estate taxes, depending upon the testator's overall estate plan.

Credit Shelter Trust—Married couples often establish trusts described as "credit shelter" or "by-pass" trusts. The purpose of this trust is to enable the surviving spouse (and sometimes other family members too) to use and enjoy the property in the trust during the spouse's lifetime without losing the benefit of the lifetime estate tax exemption amount available to the first spouse to die under federal or state law, depending on how the trust is drafted (hereafter referred to in these materials as the "Applicable Exclusion Amount"). The credit shelter trust can only be funded with property individually owned by the first spouse to die (with no designated beneficiary transferring the property, post death, to one or more third parties outside the deceased spouse's will), or with that spouse's interest in property owned as a tenant in common with others.

Qualified Terminable Interest Property (QTIP) Trusts—Married couples also often use the QTIP trust to achieve estate tax benefits while protecting property against the claims of possible creditors and second spouses. The QTIP allows assets (in a common estate plan, assets in excess of the Applicable Exclusion Amount being held in a credit shelter trust) to be held by a trustee for the benefit of the surviving spouse during his or her lifetime, free of estate and gift tax, with the remainder passing to named beneficiaries after the surviving spouse's death. Although a QTIP can save estate taxes, at the death of the surviving spouse the remainder is subject to estate tax, the net effect of which may be a deferral rather than an elimination of estate tax on the combined assets of the couple.

As is the case with all estate planning techniques, whether a credit shelter trust and/or QTIP trust is appropriate for a married couple will depend upon the circumstances of each situation.

Qualified Domestic Trusts for Non-Citizen Spouses—Spouses who are not U.S. citizens do not have an unlimited marital deduction.[6] Effective January 1, 2019, IRC § 2523(i)(2) permits an annual exclusion of $155,000 for transfers to non-citizen spouses—the same limit for post-death transfers to non-citizen spouses qualifying for the marital deduction. This amount—hereafter referred to as the "Non-Citizen Spouse Annual Exclusion Amount"—is indexed annually for inflation. To transfer more than $155,000 in 2019 to a non-citizen spouse, a citizen spouse must create a "qualified domestic trust" (QDOT) in the citizen spouse's will or a trust intended to serve as a will after death. The trust must comply with the provisions of IRC § 2056A which requires, among other things, that the trustee of the QDOT be a U.S. citizen.

So, if a citizen spouse and a non-citizen spouse jointly purchase real estate, and the non-citizen spouse does not contribute equally to the purchase price, the gift tax implications must be considered. For example, if the couple purchases property for $1 million, and the citizen spouse contributes $800,000, and the non-citizen spouse contributes $200,000, the citizen spouse will be deemed to have made a gift to the non-citizen spouse of $300,000 (the difference between $200,000 and $500,000, half the value of the property). Applying the Non-Citizen Spouse Annual Exclusion Amount for a gift to a non-citizen spouse, only $155,000 of the $300,000 gift would be tax exempt. So, the citizen spouse would be required to file a gift tax return and the citizen spouse would be using up $145,000 of his or her Applicable Exclusion Amount (the difference between the $300,000 gift and the $155,000 Non-Citizen Annual Exclusion Amount).

LIMITED LIABILITY COMPANIES

Limited liability companies are creatures of statute. New York's Limited Liability Company Law ("LLC Law") was enacted in 1994. Since then LLCs have become a common way to own real estate, especially what are typically referred to as a "single purpose entity"—an LLC formed solely to own a single piece of real estate. Section 609 of the LLC Law limits the personal liability of its members, managers and agents without their express written consent (such as personal guarantees and other contractual agreements) except as expressly set forth in the LLC's articles of organization, or for the member's fraudulent or other wrongful conduct under circumstances in which a court would permit the corporate veil to be pierced, or if a member/manager breaches his or her fiduciary duty to fellow members/managers. Single-asset LLCs also limit the liability of the entity itself to matters arising from or related only to that property, instead of multiple assets. As the New York State Supreme Court noted in *Spota v. White*, an LLC is "the hallmark of an investment in real estate and is used to limit personal liability." [7]

One of the key advantages to entity ownership for real estate in estate planning is the ease with which transfers can be made. Rather than needing to prepare, sign and file deeds each time the original owner (or any subsequent owner) wishes to transfer an interest in the property, a simple unrecorded gift letter or assignment of interest, coupled with updating the entity's membership interest records, can be executed. Depending upon the jurisdiction and the interest being conveyed, city or state real property transfer tax returns may need to be filed, and transfer tax may need to be paid, at the time of the conveyance.

Another key advantage is the convenience by which management planning and restrictions on transfer can be achieved. It is customary for management responsibilities to lie within the control of a single member or manager, and for transfers (either at the death of a member, or at the member's election) to be restricted to family members. So, LLCs provide a convenient way, for example, to retain and manage a valuable vacation home or family investment property for the benefit of subsequent generations.

TRUSTS VS. LLCS AS AN ESTATE PLANNING TOOL

Personal Liability

We already discussed LLCs. What about trusts? EPTL Section 11 describes the powers, duties and limitations of trustees. For example: they can be surcharged and removed as trustees if they co-mingle trust funds with their own assets.[8] It is against public policy under Section 11-1.7 if trustees fail to exercise reasonable care, diligence and prudence in carrying out their duties. A trustee who fails to comply with the Prudent Investor Act (Section 11-2.3) also risks surcharge and removal.[9] And if a trustee abuses his or her discretion in a dishonest, arbitrary or capricious manner, a court might require the trustee to pay from personal assets what is needed to rectify the abuse.[10] That said, trusts typically contain provisions exonerating trustees from personal liability if

Continued on page 18

Annual Meeting Program

Left: Brian Lustbader and Gavin Lankford explored AIA document revisions.

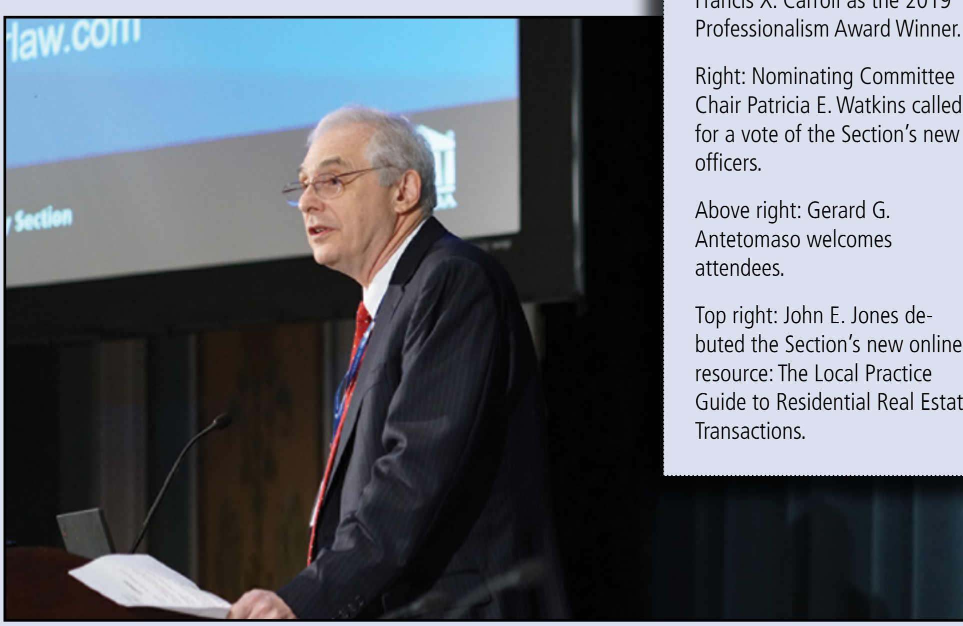
Bottom left: Ira Goldenberg invites members to attend the Section Summer Meeting in Manchester, Vermont July 11-14.

Bottom right: Award Committee Chair Peter V. Coffey announced Francis X. Carroll as the 2019 Professionalism Award Winner.

Right: Nominating Committee Chair Patricia E. Watkins called for a vote of the Section's new officers.

Above right: Gerard G. Antetomaso welcomes attendees.

Top right: John E. Jones debuted the Section's new online resource: The Local Practice Guide to Residential Real Estate Transactions.



Luncheon attendees applaud the 2019 Real Property Law Section Professionalism Award recipient.

Annual Meeting Awards Lunch

New York City

Section Chair Thomas J. Hall awards the Section's Outstanding Online Community Contributor Award to Linda Maryanov and Francisco Augspach.

First Vice Chair Gerard G. Antetomaso looks on as Scholarship Committee Co-Chair Joel H. Sachs presents Albany Law School student Adebare Ogunleye with the Melvyn Mitzner Scholarship.

Scholarship Committee Co-Chair Mindy H. Stern presents Cornell Law School student Nicholaus Mills with the Lorraine Power Tharp Scholarship, while Section Chair Thomas J. Hall looks on.

Keynote speaker Joe Scalio of KPMG discussed qualified opportunity zones.

Francis X. Carroll (center) receives the 2019 Real Property Law Section Professionalism Award from Awards Committee Chair Peter V. Coffey (right) and First Vice Chair Gerard G. Antetomaso.

Trust Ownership

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trust assets depreciate or shrink in value absent a showing by affirmative evidence that the trustee failed to act within the scope of the trustee's authority, failed to exercise reasonable care, diligence and prudence, or failed to be impartial as to all interested parties.

Creditor Protection

As previously discussed, an LLC affords broad creditor protection with limited exceptions. A revocable trust does not, because the assets transferred to it are treated for these purposes as available to creditors. An irrevocable trust created with a debtor's assets is subject to being set aside as a fraudulent conveyance. But an irrevocable trust created with the assets of a third party is not available to the creditors of a trust beneficiary who has no discretion or control over the assets.

Avoiding Probate/Estate Administration

If someone domiciled in New York dies owning real estate located in another jurisdiction with no co-owner as joint tenants with rights of survivorship or as tenants by the entirety, an ancillary proceeding typically is required in the other jurisdiction in order for the New York Surrogate's Court-appointed estate executor (if there is a will) or administrator (if there isn't) to have the power to transfer the property, either to the recipients entitled to it under the will or by intestacy, or to a third party if it is being sold. Some jurisdictions vest immediate ownership in the heirs at law, and sometimes a title company is willing to insure a transfer without an executor or administrator being appointed if provided with sufficient proof that there are no heirs at law other than those requesting the transfer (this is a non-starter if the will contains different specific legatees or devisees different from the heirs at law), no creditors, and no estate or income tax liabilities. But even when that is the case, or if there is no title insurer involved, there may be other third parties (such as a lender or a cooperative corporation) who demand ancillary probate or administration.

Ancillary proceedings can be avoided by holding title to the real estate in the following ways: (1) with one or more joint tenants with rights of survivorship or by a married couple as tenants by the entirety; (2) in an LLC or other corporate entity; or (3) in a trust. But there are other estate planning and income, estate, and gift tax consequences to each of these decisions, discussed elsewhere in this article, which need to be considered before selecting which method of avoiding an ancillary probate or administration proceeding best serves the needs and goals of each client.

Insurance

Insurers of commercial property usually are comfortable with entity or trust ownership. They are more concerned about the nature of the building and improvements located on, and types of activities being conducted on, the premises, and assess insurable risks accordingly. Residential property is different. Some insurers will not underwrite residential property owned by an entity or trust, because they don't consider it "owner occupied" as they do when the property is individually owned, even when you explain that the transfer is for estate planning or other purposes and does not impact how the property is used. So be proactive and confer with the client's insurance company before final decisions are made. If the client needs to find a more receptive insurance company, the sooner this is addressed the better, as it might affect the timing and cost of the transaction.

Property Tax Issues (STAR and Other Exemptions)

Clients who own residential property often benefit from certain real property tax exemptions or abatements. New York has a veritable alphabet soup of possibilities available in various jurisdictions. Following are some examples, not intended to be an exhaustive list: STAR, Enhanced STAR, Veterans Exemptions, Senior Citizen Homeowners Exemptions, Disabled Homeowners Exemptions, Clergy Exemptions, Disabled Crime Victim/Good Samaritan Exemptions, SCRIE, and in New York City, the Cooperative and Condominium Property Tax Abatement Credit. Before transferring property benefiting from one or more of these abatements or exemptions, you need to confirm that the client will not lose them. A client might decide to proceed with the transfer anyway, but I believe in the "no surprises" rule when it comes to client relations, and you should too.

The most common is the STAR (School Tax Relief Program) created by § 425 of the New York Real Property Tax Law (RPTL).[11] New Yorkers who own and reside in one, two or three family homes, condominium units or cooperative apartments as their primary residence are eligible for these partial abatements on their property taxes. Transfers of the property to a revocable trust still qualify for the STAR abatement if the property is the primary residence of the trustee or trust beneficiary. This also is true for the NYC Cooperative and Condominium Property Tax Abatement Credit under § 467a of the RPTL. But transfers to an LLC or other corporate entity are ineligible for the STAR abatement, even if the homeowner is the sole member of the entity and occupies the property as his or her primary residence, unless the property is a qualifying farm.

Enhanced STAR is available under § 425 of the RPTL to seniors (65 and older) who own and live in their primary residence and meet certain income requirements.

The same eligibility requirements regarding trusts and LLCs as they relate to the STAR program apply here.

There are several types of veterans' exemptions available under §§ 458-a and 458-b of the RPTL for residential property owners who rendered military service to the U.S.[12] The eligibility requirements vary, as do the ways the exemption amount is computed. These exemptions are available to shareholders and unit owners of coops and condos who otherwise meet the eligibility requirements. Transfers to trusts qualify for the abatement provided the owner eligible prior to the transfer is the trustee or beneficiary of the trust. Although we were advised by a representative of the NYS Department of Taxation and Finance (NYSDTF) in a telephone call that transfers to LLCs are treated the same as trusts, the statute and the Department's application forms and instructions are silent as to the eligibility of LLCs or other entities for these exemptions, so it would be prudent not to rely upon that advice and assume that there is no available abatement, even if the homeowner/veteran is the sole member of the LLC or sole shareholder or partner of other corporate entities and occupies the property as his or her primary residence.

Disabled homeowners are eligible for additional property tax abatements if they meet certain requirements. The property must (1) be used solely for residential purposes (otherwise the exemption is available only for the portion used for residential purposes), (2) be the "legal residence" of the disabled person, and (3) be occupied by that person unless he or she is receiving medical treatment at a facility. A trust can own the property if all the beneficiaries qualify for the exemption. Transfers to an LLC are ineligible for the disabled homeowners' abatement, even if the homeowner is the sole member of the LLC and occupies the property as his or her primary residence.

There is a Disabled Crime Victim/Good Samaritan Exemption under § 459 of the RPTL available for one, two or three family homeowners who become physically disabled because of a crime.[13] The home must have been improved to make it handicap accessible, and the improvements must enhance the property's value. The increase in the value attributable to the improvement is exempt from property tax. The statute and NYSDTF application documents are silent as to the eligibility of trusts and LLCs for this exemption, so it is prudent to assume they are not.

In addition to property tax exemptions granted to eligible not-for-profit entities under § 420a of the RPTL, there also is an exemption under § 462 of the RPTL for property owned by a religious organization and used as a residence for its clergy, provided various eligibility requirements are met. In addition, § 436 of the RPTL exempts from property tax residential property held in trust by and occupied as a residence by clergy for the benefit of congregation members if the clergy is actively engaged in the work of the denomination and the property otherwise meets the eligibility requirements under 420a; and § 460 of the RPTL grants a property tax abatement of up to $1,500 to clergy who occupy a residence while actively engaged in the work assigned by the congregation or who are unable to do so either because the clergy is over 70, or suffering from impaired health. The un-remarried spouse of otherwise eligible clergy can continue to receive this abatement. The exemptions under §§ 436 and 460 are not available for transfers to LLCs or other corporate entities owned by otherwise eligible clergy.[14]

Financing

It is standard operating procedure for commercial property, often income producing, and sometimes the site of business operations (industrial, office, retail, mixed use) to be purchased by "SPEs" (single purpose entities), which typically (but not always) are LLCs. Commercial lenders are both accustomed to and comfortable with such arrangements, usually requiring guarantees from principals and other collateral they deem sufficient to secure the loan repayment.

Conversely, financing the purchase of residential property in an entity or a trust has its challenges. Fannie Mae doesn't allow either. That leaves jumbo loans made by portfolio lenders, credit unions and others who don't sell their loans on the secondary market as the only lenders. As to those, each lender is likely to have its own underlying guidelines which should be ascertained as soon as your client tells you that he or she is considering buying, financing or mortgaging property owned individually through a trust or similar entity. Mortgages typically have due-on-sale clauses that are drafted broadly enough to include "mere change of identity" transfers of title. Although the federal Garn-St. Germain Depository Institutions Act of 1982 (12 U.S.C. § 226) prohibits lenders from denying consent to a transfer from an individual to that individual's intervivos revocable trust, the current mortgagee holding a mortgage with a due-on-sale clause will most likely treat all other transfers as being subject to its consent, triggering an application process that essentially is a full refinance.[15]

In my experience (which isn't necessarily dispositive), lenders willing to entertain entity ownership of residential property don't favor LLCs over trusts, or vice versa. The key consideration for a trust is whether it is revocable (typically acceptable) or irrevocable (typically not, because of concerns about the trust assets being unavailable to creditors). Other considerations also come into play. In the case of an LLC, that might include, for example, how many members are in the LLC, who they are, and their connection to the real estate. For a trust, often the bank will require the grantor and at least one of the trustees to be the borrower. So, if the proposed title holder is an LLC or a trust, the key take-away here is to address the financing issue right away with the client's mortgage broker or prospective lender, to determine what approvals are required, and what choices are available.

Income Tax

Unless you are a CPA or tax attorney who regularly deals with income tax issues relating to real estate, my first (and probably most important) advice is to bring your client's tax advisor into the planning process early on. Every client has their own income tax issues and deciding whether to form an entity or create a trust to hold title to real estate cannot be done in a vacuum. Each has tax consequences and making the wrong decision could cost your client time, money and aggravation.

That said, there are a few basic considerations to be aware of. First, if there is only one member of an LLC, it is treated for income tax purposes as a "disregarded entity" and there is no double taxation—meaning, no tax at the entity level. If there are multiple members, the LLC will be treated for income tax purposes as a partnership, unless the members elect otherwise.

Second, sometimes the right entity choice is an S-corporation rather than an LLC, because depending upon where the property is located, and where the entity is conducting business, and whether the entity is holding title passively to non-income producing property, or actively managing property generating significant income, there could be self-employment tax for an LLC, but not for an S-corp. Again, the client's tax advisor should help you evaluate this.

If the trust is a revocable trust, it is treated for income tax purposes as a "disregarded entity" (same as a single member LLC) and there is no double taxation—meaning, no tax at the trust level.

If the trust is an irrevocable trust, it must obtain its own EIN and is treated as a separate entity for income tax purposes. Unless the trust provides otherwise, income generated by trust assets is taxable to the trust, subject to some complicated rules regarding trust distributions that are beyond the scope of this discussion. As mentioned in the discussion about MAPTs, trust income tax rates currently are identical to personal income tax rates, but accelerate to the higher brackets faster, and sometimes the trust is intentionally drafted to attribute all trust income to the grantor—the trust creator—as a way of making additional lifetime gifts to the ultimate beneficiaries.

It is essential to evaluate how best to achieve each client's goals regarding their real estate in the context of their overall estate, gift and income tax planning.

Amendments to Governing Documents

Single-member LLC documents and revocable trust documents can both be amended easily.

Multi-member LLC documents can also be amended easily provided the requisite number of members as provided for in the original governing documents agree or if there is no applicable provision in the governing documents, provided the requirements in the governing limited liability company law are met.

Under EPTL 7-1.9, irrevocable trusts cannot be revoked or amended without the written, signed and acknowledged consent of the grantor and all the beneficiaries. Court approval is required when some of them are minors.[16] If the trust by its terms also requires the consent of the trustee, that too is required unless a court determines otherwise. *See* for example *Elser v. Meyer*, 29 A.D.3d 580, 814 N.Y.S.2d 684 (2d Dep't 2006) where the appellate court returned the case to the supreme court to determine if the trustee unreasonably withheld his consent.[17]

Because of these constraints, well-drafted trusts provide discretion to the grantor and/or trustees in certain scenarios, and if federal and governing state law is complied with, their decisions are likely to be upheld. For example, sometimes the trust will allow the grantor to remove and replace trustees or allow trustees to appoint successors (although this still requires court approval if the trust is a testamentary trust), or allow trustees to use the governing law's "decanting" statute (if there is one) to transfer the trust assets into a new trust containing different administrative provisions intended to fix problems or address omissions in the existing trust. The "decanting" statutes are different, so you would need to research the applicable law to evaluate what discretion trustees have to extend the trust term, change beneficiaries or their respective interests, or make other key changes. New York's "decanting" statute is in 10-6.6 of the EPTL.[18]

Administrative Costs and Burdens

LLCs are relatively easy to form. In New York, pick an available name, file articles of organization with the New York Secretary of State's Office pursuant to § 203 of the LLC Law, select the method by which the entity elects to be taxed, and off you go, with one significant caveat. Section 206 of the LLC Law requires an LLC to publish, within 120 days of its formation, notice of the formation in two general circulation newspapers designated by the county clerk in the county where the LLC was formed for six consecutive weeks. If you think you can get around the publication requirement by selecting a less expensive newspaper in another county, forget it. That's illegal. Another often tried, equally ineffective approach is forming the entity in another jurisdiction (Delaware or one of the Dakotas often are selected because they are perceived as more hospitable to entities and creditors prefer the bankruptcy-related protections in the Delaware LLC statute) and then not qualifying to do business in the state where the property is located. Part of the qualification process in New York is fulfilling those publication requirements. There are no publication requirements for corporations in New York.

Once formed, New York LLCs as well as foreign entities qualified to do business here have reporting and biennial registration fee requirements. This is, of course, in addition to any income tax reporting requirements. Maintaining a separate bank account and not co-mingling corporate and personal assets and expenses are prudent ways to confirm that members are preserving the corporate formalities needed to withstand efforts to pierce the corporate veil. So, there is an ongoing cost associated with forming and maintaining an entity in New York.

On the other hand, trusts do not have such formation requirements. The due execution of the trust indenture is sufficient to create it. If it is irrevocable, obtain a separate tax ID number for it, and comply with the tax reporting requirements.

But before you abandon LLCs because of these costs, consider this: the sole member of an LLC is not answerable to anyone else for actions taken on behalf of the entity. Members of a multi-member LLC (or the managers, if it is manager-managed) are answerable to each other, but not to outsiders unless they contractually agree to be (lenders being the prime example). On the other hand, trusts come with special statutory obligations to account to trust beneficiaries. If the trust is revocable, and the grantor is the sole trustee, those obligations are minimal because the grantor can revoke or amend the trust whenever he or she likes. If there is a co-trustee, the revocable trust can (and often does) permit the grantor to continue to control how the trust funds are invested and distributed unless and until the grantor becomes incapacitated. But once that happens, or if the grantor dies, or if the trust was irrevocable when formed, the trustees have a fiduciary duty to the beneficiaries. The trust indenture can permit the trustees to decide not to provide annual accountings or judicial accountings, and limit trustee liability to "bad boy" acts, but none of those clauses completely absolve trustees of all liability, as previously discussed.

So, when helping a client select which type of entity or trust works best, the administrative costs and burdens of each should be discussed, so that the client makes an informed decision. Again, the key is avoiding post-decision surprises.

SPECIAL CONSIDERATIONS FOR COOPS

Transfers of cooperative apartments to entities have become increasingly more common since the laws previously creating adverse tax consequences were changed, and as shareholders have become more sophisticated about estate planning and pressure Boards of Directors to be more flexible. Boards have two primary concerns—who is occupying the apartment, and who is financially responsible for paying shareholder obligations. These typically are addressed in occupancy agreements and personal guarantees prepared by counsel to the cooperative corporation and signed by the shareholder requesting the transfer to the trust. The corporation also usually requires any further transfers from the trust to the ultimate beneficiaries to be subject to further Board approval when the event triggering the trust termination (often the death of the trust grantor/original shareholder) occurs.

TITLE ISSUES FOR TRUSTS

When underwriting title for a transfer to a trust, title companies typically ask for a complete copy of the instrument creating it, for several reasons.

1. If the trust was created during the grantor's life, the title company needs to confirm it was properly executed by all necessary parties in accordance with EPTL 7-1.17.[19]
2. If the trust is a testamentary trust created in the grantor's will after death, the title company needs proof that (1) the will was admitted to probate by a court of applicable jurisdiction (in New York, the Surrogate's Court located in the county where the decedent was domiciled); and (2) a trustee was appointed by the court, any successor trustees now serving were court-appointed, and the current trustee's appointment was not revoked.
3. Whether lifetime or testamentary, the title company also needs to confirm that the instrument creating the trust gives the trustee the power to acquire and convey real estate without restriction, or, if it is silent as to that power, that the law governing its formation does not require this power to be contained in the trust instrument. The title company will need a complete copy of the trust, including all amendments.
4. If there are judgments and liens against the grantor of a revocable trust, they attach to assets in the trust, so they must be cleared for the trustee to convey title to real estate owned by the trust.
5. The title company probably will want an affidavit from the trustee confirming (1) that the trust was in full force and effect when the property was transferred to it, (2) that it remains in full force and effect at the time the trustees are conveying it from the trust, and (3) that the trustee has the authority under the trust instrument to convey and acquire property.
6. If there is more than one trustee, the trust must be reviewed to confirm whether all trustees must sign, or if the signatures of a single trustee or a majority are sufficient.

If there are trusts in a chain of title, the title company may need to confirm that each of those trusts were in full force and effect when the property was transferred from them, unless the deeds were recorded six or more years ago.

There may be other provisions in the trust instrument which require further inquiries and underwriting, such as a limited power of appointment given to the grantor to select beneficiaries, or a life estate granted to the grantor or others, and, depending upon the type of trust and the grantor's retention of certain powers or beneficial interests, if the grantor has died, federal and state estate tax lien clearances.

Deeds from trusts must cite full consideration, and the trust must have a tax ID number – either the grantor's social if the trust is revocable, or a separate EIN if the trust is irrevocable.

The proper manner for trusts to hold title is in the name of the trustees, not the trust. Example: "John Doe and Jane Doe, or their successors, as trustees of the Doe Family Trust u/a/d July 28, 2018," not "The Doe Family Trust."

Trustees cannot delegate their fiduciary duties, so they must either pre-sign conveyance documents or attend a conveyance closing.

CONCLUSION

When considering whether to recommend to a client that real estate be acquired by or transferred to a trust or an LLC, it is essential to first understand the client's goals and the nature and intended use of the property. It is equally important to bring the client's other professional advisors into the discussion—their insurance consultant, tax advisor, title insurer, estate planning counsel and possibly their personal financial advisor. Entity ownership (including trusts) can limit personal liability, achieve valuation discounts, and control who is entitled to use and enjoy the property, and receive its economic benefits. But as is always the case with proper planning, each client situation must be evaluated on its own merits to determine the most appropriate planning tools. Some clients are more reluctant to give up the control required to achieve substantial tax benefits. Aggressive tax planning must always be weighed against each client's other needs and desires, to achieve a proper balance between preserving wealth for future generations and allowing current owners to enjoy their assets (and the economic benefits of those assets) during their own lifetime.
And all the considerations described in these materials should be discussed before deciding which options best serve the needs of the client and the client's family, now and in the foreseeable future.

Endnotes

1. Treas. Reg. § 25.2702-5(b)(2).
2. Treas. Reg. § 25.2702-5(b).
3. *See* N.Y. Est. Powers & Trusts Law 11-2.1(1)(1)(A) (McKinney); *see also* PLR 9249014, (I.R.S. Sept. 4, 1992).
4. IRC § 2036.
5. Treas. Reg. 25.2702-5(b).
6. IRC § 2056A; IRC § 2523.
7. *Spota v. White*, 997 N.Y.S.2d 101, 101 (Sup. Ct. 2014).
8. EPTL 11-1.6 (McKinney).
9. EPTL 11-1.7, 11-2.3 (McKinney).
10. EPTL 11-2.3-A (McKinney).
11. N.Y. Real Prop. Tax Law § 425 (McKinney).
12. RPTL § 458-1, 458-b (McKinney).
13. RPTL § 459-b (McKinney).
14. RPTL § 436, 460 (McKinney).
15. Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97- 320, 96 Stat. 1469 (codified as amended in scattered sections of 12 U.S.C.), codified in 12 U.S.C.S. § 1701j-3(d)(8).
16. *See, e.g., In re Mainzer*, 151 Misc.2d 203, 206, 573 N.Y.S.2d 129 (Sur. Ct. N.Y. Cty. 1991); *In re Johnson*, N.Y.L.J, June 3, 2011 at 30, col 1 (Sur. Ct. N.Y. Cty. 1986); *In re Silverstein*, N.Y.L.J., May 28, 2009, at 41, col. 5 (Sur. Ct. Kings Cty. 1986).
17. *See, e.g., Elser v. Meyer*, 29 A.D.3d 580, 581, 814 N.Y.S.2d 684 (2006) (where the appellate court returned the case to the supreme court to determine if the trustee unreasonably withheld his consent).
18. EPTL 10-6.6 (McKinney).
19. EPTL 7-1.17(a) (McKinney).

Bergman on Mortgage Foreclosures: A Few Facts on Loans

By Bruce J. Bergman

A Usurious Loan—Really?

I am reminded of a NYSBA CLE program in which I participated a few years ago when a portion of an all-day session assigned to me included a discussion of usury. This happens to be a difficult and arcane topic, although there is a way to present it in understandable fashion. Nonetheless, the post-presentation comments of the attendees indicated a wonderment as to why usury was being offered: "I don't encounter that in my practice" observed a few. While it is true that usurious loans are not an everyday occurrence, case law confirms that it *does* happen and the subject *is* litigated—and a recent case underscores the point.[1]

To be sure, the case is not a mortgage foreclosure matter (it was a suit on a note but the point is the same) and the example is particularly egregious. Concededly too, this will rarely be a concern for institutional lenders but it can be an issue for private lenders and their counsel.

Here, a promissory note was executed to repay principal of $200,000 with interest at the rate of 100 percent, or 50 percent per annum for two years. The obligor was an individual but the note provided that the borrower's corporation would honor full payment of the loan. When default ensued and the plaintiff moved for summary judgment in lieu of complaint, the court addressed a host of very basic usury maxims, which in turn offers a salutary overview of meaningful basics.

First was the recitation that the maximum interest rate before civil usury is invoked is 16 percent—any rate in excess of that is usurious. That noted, it must be observed that the exceptions to this rule are both significant and nuanced and attention should be paid to those. The elemental aspect, though, is that a loan from an individual lender to an individual borrower in an amount under $250,000.00 is subject to the 16 percent rule.

Next, the court noted that criminal usury, the only usury defense available to a corporation, would apply when a person knowingly charges interest on a loan or forbearance at a rate exceeding 25 percent.

There is, however, a presumption against a finding of usury so that one seeking to impose a usury defense bears a heavy burden of proving it by clear and convincing evidence. The borrower bears the burden as well of proving each element of usury by clear and convincing evidence—usury will not be presumed.

However, where a loan agreement is usurious on its face—as was patently so here—usurious intent will be implied and usury will be found as a matter of law.

At a stated interest rate of 50 percent per annum, usury on the face of the note could not have been clearer.

And then comes the consequence of such a loan. The rule is that a usurious contract is void and relieves the borrower of the obligation to repay both principal and interest. (But note there are exceptions for certain institutional lenders.) Critically, where usury has occurred "the borrower can simply keep the borrowed funds and walk away from the agreement."

It is rather startling that both a lender and its counsel (assuming it had legal advice) could charge such an absurd rate of interest. Most cases of usury are far more subtle involving additional fees which, when added to the note interest rate, cross the line from a legal to an unenforceable percentage. In any event, these things are possible and having at least an elemental sense of the basics is worthy.

Endnote

1. *Roopchand* v. *Mohammed*, 154 A.D.3d 986, 62 N.Y.S.3d 514 (2d Dep't 2017).

Bruce J. Bergman, author of the four-volume treatise, *Bergman on New York Mortgage Foreclosures*, LexisNexis Matthew Bender, is a member of Berkman, Henoch, Peterson, Peddy & Fenchel, P.C. in Garden City. He is a fellow of the American College of Mortgage Attorneys and a member of the American College of Real Estate Lawyers and the USFN. His biography appears in *Who's Who in American Law* and he is listed in *Best Lawyers in America* and *New York Super Lawyers*.

Bergman on Mortgage Foreclosures:

Loan Modification Application Does Not Save Statute of Limitations

The statute of limitations has lately proven so deadly to lenders that it elevates the importance of those acts or events which can toll or revive the period of limitations. These include, among others, any part payment of the mortgage or a writing which acknowledges the debt.[1]

This would immediately suggest that a mortgage modification agreement would serve to start the statute of limitations running fresh. That would typically be so because such an agreement is invariably a clear acknowledgement that the debt exists, and a promise to repay it, albeit in a now slightly different fashion.

But what so often precedes a mortgage modification is an *application* for that modification. If a borrower is seeking to modify the mortgage, one would think that inherent in that is an acknowledgment that the debt exists—why else would the borrower seek to modify the obligation?

At the same time, though, the application itself is typically not an unconditional promise to pay—an aspect which is needed to revive the statute of limitations. The application seeks permission to enter into an agreement which might indeed become that acknowledgement, but the application itself does not represent that.

While the principle is not necessarily new (a case citing that goes back to at least 1991) it is only a recent ruling which places the concept in the context of the mortgage modification application which, after all, is far more common today than it was decades ago.[2]

Here, the rule was affirmatively stated that the loan modification application was not an acknowledgment of the debt *and* an unconditional promise to repay the debt sufficient to reset the running of the statute of limitations.

That being so, where a foreclosing lender is in jeopardy that the statute of limitations will extinguish the debt, and that coincides with the possibility of pursuing a mortgage modification, the lender will need to think about obtaining an acknowledgment of the debt and the promise to pay either in the application (not easy to do) or in some accompanying clear writing.

Whether this will be obtainable is, of course, somewhat problematic. But it needs to be understood that the application itself, which may or may not lead to a full modification agreement, is likely to be insufficient to save the day.

Endnotes

1. There really is much to this exigent subject and for those for whom a complete presentation of the law would be helpful, attention is invited to 1 *Bergman On New York Mortgage Foreclosures* §5.11[6], LexisNexis Matthew Bender (rev. 2018).
2. *U.S. Bank National Association v. Kess*, 159 A.D.3d 767, 71 N.Y.S.3d 635 (2d Dep't 2018).

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