

Memo 1995-20A Other Real Estate and Contracts for Sale -Replaced Memo 1995-4

TO: Judi Stork, Deputy Commissioner
FROM: Sonya Allen, Staff Attorney
DATE: July 5, 1995

RE: Other Real Estate and Contracts for Sale

ISSUE: If a bank sells Other Real Estate (ORE) on contract, must the length of the contract be less than 10 years to maintain compliance with K.S.A. 9-1102?

ANSWER: Once a contract for sale of real estate has been entered into by the parties and the deed is transferred to an escrow account, a bank will not be considered to be the owner of the property, and therefore will not be subject to the time limitation imposed by K.S.A. 9-1102 if, at a minimum, the following factors are present:

1. The parties intend the transaction to be a bona fide sale of the property by way of a contract for deed.
2. The buyer has the right to full possession and use of the property.
3. The buyer has the duty to pay taxes and insurance premiums on the property.
4. The buyer has the right to assign his rights under the contract.
5. The contract provides for a reasonable amortization period. A reasonable amortization period would be one in which the buyer is contractually required to pay each year on the total debt for the purchase price an amount at least equal to the amount that would be necessary to amortize the debt within:
 - A) 20 years for farm ground or unimproved land; or
 - B) the normal first mortgage amortization period an independent institution would use for other types of real estate.

DISCUSSION:

K.S.A. 1994 Supp. 9-1102 (b) states that "Any bank or trust company may acquire real estate in satisfaction of any debts due it and may purchase real estate at judicial sales, but no bank or trust company shall bid at any judicial sale a larger amount than is necessary to protect its debts and costs. **No real estate or interest in oil and gas leasehold acquired in the satisfaction of debts or upon judicial sale shall be carried as a book asset of the bank or trust company for more than 10 years. At the termination of the 10 years such real estate shall be charged off...**"

The answer to the question of whether the time frame of a contract for deed transaction must be for less than 10 years even if the property is held in escrow really centers around whether the act of transferring the deed to be held in escrow sufficiently transfers the property out of the bank's control to consider this a sale for the purposes of 9-1102(b). If the bank is no longer considered to be the "owner" of the property once the contract is entered into and the deed is put into an escrow account, then the bank would not be subject to the 10 year limitation of 9-1102.

It is clear that the act of delivering a deed into escrow does not in and of itself determine who is the owner of the property. Moore v. Moore, 93 Kan. 697, 150 Pac. 230 (1915). In Roberts v. Osburn, 3 Kan. App. 2d 90, 589 P.2d 985 (1979), the Kansas Court of Appeals stated that when a deed is

placed in escrow, certain conditions are imposed which must be met before delivery of a deed may be made, and legal title to the property in question does not pass until all of the conditions are performed and the deed is released from escrow. 3 Kan. App. 2d at 94, citing 29 Am. Jur. 2d, Escrow §5 (emphasis added). The bank, in the contract for deed situation, would continue to hold the legal title while the deed was in escrow. However, this does not solve the question of who will be considered to be the "owner" of the property. Property rights can be "split" into legal and equitable titles. By placing the deed into escrow, in the contract for deed context, the seller displays his intentions to convey substantial beneficial interests to the buyer, while maintaining legal title to the property as security for payment of the buyer's obligation. The buyer is said to have equitable title to the property and may, in effect be the "owner" by virtue of the doctrine of equitable conversion. Both the Appeals Courts in Roberts and the Supreme Court in Moore indicated that the determining factor in such a situation is the intent of the parties to the transaction. Other factors which helped the Appeals Court to ascertain that the transaction was intended to transfer the rights of beneficial ownership, and therefore the equitable title, to the buyer included the buyer's right to possession and use, the right of the buyer to assign his interest in the property, and his duty to pay taxes and insurance premiums on the property. 3 Kan. App. 2d at 94-95.

The doctrine of equitable conversion, as it applies to a contract for deed transaction, has been explained as follows:

"Under the doctrine of equitable conversion upon the execution of a valid, enforceable contract for the sale of realty, the purchaser becomes the equitable owner of the realty holding the purchase money as trustee for the seller. The seller becomes trustee of the legal title for the purchaser with a lien on the land as security for the purchase money." Roberts at 97, citing Hartman v. Hartman, 11 Ill. App. 3d 524, 297 N.E. 2d 199 (1973).

In an earlier Kansas case, the Kansas Supreme Court was asked to decide whether, in a contract for deed transaction, the buyers should be considered the "owners" of the property for the purpose of passing risk of loss to the buyers. The Court decided that the buyers were indeed the owners, and based the decision in part on this passage from Williston on Contracts:

"The intention of the parties is the factor in any proper decision. Parties do not frequently make express provisions as to risk, but they do indicate whether they intend a present transfer of the rights of ownership or a future transfer, and there should be no doubt that they expect all the incidents of ownership to pass from the seller to the buyer at that time. That time frequently will not be when the legal title is transferred. If, as frequently happens, a purchaser is given immediate possession under his contract, with the right to use the property as his own to the same extent as is customary with a mortgagor, the title is retained merely as security for payment of the price. It is a short way and in many states a common way of accomplishing the same end that would be achieved by conveying to the purchaser and taking back a mortgage. *When by the contract the beneficial incidents of ownership are to pass is the time which the parties must regard as the moment of transfer. This is the time when the purchaser is held to become the 'owner,'* under alienation clauses in insurance policies, and no little authority supports the conclusion that then, and not before, the risk passes to the vendee."

Toluenke v. Abernathy, 174 Kan. 668 at 671, 258 P. 2d 282 (1953), emphasis supplied.

In reaffirming its position regarding the importance of the intention of the parties to the transaction, the Court in Garnett State Savings Bank v. Tush found that in a contract for deed transaction, where the bank retained the legal title as security for the purchase price, and all of the beneficial incidents of ownership passed to the buyer, what the bank actually retained was an equitable mortgage, and the buyer was the owner of the property from the moment the beneficial interest passed to him. In order to create a mortgage contract, the Court notes, no particular form of instrument is necessary. If the evidence discloses an intent to charge real property as security for an obligation, a lien is created. 232 Kan. 447, Syl. 3,5, 657 P. 2d 508 (1983).

The Supreme Court of the United States had the opportunity to evaluate a contract for sale transaction concerning the sale of land owned by the United States to an individual. The purchaser had full rights of possession and use of the property under an executory contract for sale which provided for a cash payment followed by annual installments. The contract further contained conditions, which if not met, could result in the United States retaking possession of the land. Upon completion of all the contract provisions, the United States was required to execute and deliver a quitclaim deed to the realty. In determining that the purchaser (vendee) was the "owner" of the realty, the Court noted "[w]here beneficial interest has passed to a vendee, the retention of legal title does not give a significant difference from the situation of a deed with a lien retained or a mortgage back to secure the purchase money." S.R.A., Inc. v. Minnesota, 327 U.S. 558 at 569, 90 L.Ed. 851, 66 S.Ct. 749 (1946).

CONCLUSION:

It is clear from the above analysis that contract for deed transactions have the capability of transferring ownership to the buyer before all of the conditions of the contract, including full payment of the purchase price have been fulfilled. The purpose behind K.S.A. 9-1102's limitations on ownership of real property is to protect the bank from the risk of loss associated with owning real estate. It is the department's position that once a contract for sale of real estate has been entered into by the parties and the deed is placed in an escrow account, if the contract effectively transfers the beneficial interest and risk of loss associated with the property to the buyer, a bank will not be considered the owner of the property for regulatory purposes. Therefore, a bank which enters into a contract for sale of real estate transaction will not be subject to the time limitation imposed by K.S.A. 9-1102 if the following factors are present:

1. The parties intend the transaction to be a bona fide sale of the property by way of a contract for deed whereby all of the incidents of ownership are transferred to the buyer and the legal title is retained by the bank as security for payment of the contract price.
2. The buyer has the right to full possession and use of the property.
3. The buyer has the duty to pay taxes and insurance premiums on the property.
4. The buyer has the right to assign his rights under the contract.
5. The contract provides for a reasonable amortization period. A reasonable amortization period would be one in which the buyer is contractually required

to pay each year on the total debt for the purchase price an amount at least equal to the amount that would be necessary to amortize the debt within:

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