

THE ILLINOIS LAND TRUST

I. BACKGROUND

Generally, Arizona recognizes three methods for securitizing real property; a Mortgage (A.R.S. §33-701 et seq.), Deed of Trust (A.R.S. §33-801 et seq.) and an Agreement for Sale (A.R.S. §33-741 et seq.). A fourth method, a subdivision trust, has been recognized in Arizona for the limited use of facilitating the development and sale of subdivision projects; see the Subdivision Trust – A Useful Device in Real Estate Transactions, 3 Ariz. Law Review 1. While an Illinois Land Trust is a creature of statute in several jurisdictions; Illinois (IRSC 61, 71-73, 77-18B) and Ohio (ORC 5301.03 and 1707.01(B)), there is no similar statutory framework in Arizona.

In an early interview with Larry Dunning, he was questioned as to the use of Illinois Land Trusts as a security device in the transactions involving the Receivership entities. In response to this inquiry, he responded that the idea to use the Illinois Land Trust model arose as a result of having attended a seminar presented by J. Douglas Swob, J.D., MBA, a member of the Ohio State Bar.

II. THE ILLINOIS LAND TRUST MODEL

In general, the land trust is a type of trust in which legal and equitable title to real property is held by the trustee on behalf of a beneficiary or beneficiaries. The duties of the trustee are defined in the trust document.

“Legal title,” as referenced above, to the real property is that title which empowers one to deal in all respects with the property as the “true owner” from all public indications. The trustee in the Land Trust Model is provided with this legal title, which will be held in the name of the trustee. The trustee also acquires “equitable title” to the real property. Equitable title is the right of a party to acquire full legal title or to acquire the incidents of ownership of the subject property even though it may not be named on the deed.

Thus, in a normal land trust situation, the trustee is given both legal and equitable title to the trust property. The significance of the Trustee’s title is that it allows the trustee full power to deal with the real property, such as: selling, buying, optioning, leasing or mortgaging the property, at least as far as third parties are concerned.

In order to facilitate the creation of the trust, a formal trust agreement is created. The trust agreement will define the rights of the trustee, as well as the beneficiaries to that trust. Significantly, in an Illinois Land Trust situation, the trust agreement will define the rights of the various beneficiaries, which are defined as the first and second beneficiaries under the trust agreement.

By example, in a typical Illinois Land Trust transaction, the owner of a piece of property seeks to obtain financing from a third party. In order to obtain the financing, the

owner is required to securitize the loan. Towards this end, the owner of the property agrees the transfer of the property to the trust, with the understanding that both legal and equitable title will vest in the trustee. The trust agreement will then define the rights of the first beneficiary/borrower, which are typically the right to possession and the use and enjoyment of the property. The right to transfer or encumber the property is specifically withheld under the trust agreement; requiring the consent of the lending party prior to transfer. The lending party will be defined in the trust agreement as the second beneficiary. While not holding legal or equitable title, the second beneficiary retains the specific right to direct the trustee in dealing with title. The property cannot be encumbered nor transferred without the consent of the second beneficiary.

The borrower issues a note, which defines the terms of repayment. Upon payment in full of the obligation from the first beneficiary/borrower to the second beneficiary/lender, the second beneficiary/lender is mandated to advise the trustee to execute a deed transferring the property out of the trust, back to the borrower/first beneficiary.

One of the major attributes of this transaction is that the real property interest of the owner of the property, upon transfer of the property to the trust, becomes a personal property interest in the trust.

The lenders interest, as second beneficiary, is securitized by the personal property interest of the borrower/first beneficiary. The interest is represented by the filing of a UCC1 filing with the Secretary of State, and not the recordation of a real estate interest with the County Recorders Office. Accordingly, upon completion of the transaction, the record title to the property should reflect ownership in the trustee, free and clear of any claims of either the first beneficiary and/or second beneficiary.

III. THE ANMP ILLINOIS LAND TRUST MODEL

Under the model to have been used by the Receivership entities, the investors of the Receivership Entities were to have been placed in a Limited Liability Companies (hereinafter the "LLCs") created by Dunning or his representatives. The LLCs were then to compile sufficient funds to make the loans being requested by the borrowers. Had the model been complied with, the LLCs would have made loans directly to the borrowers, prior to the creation of the trusts. The loans would have been secured by a standard deed of trust in favor of the LLCs. Subsequently, the borrower would then have transferred the property to the trust, and become a first beneficiary under the trust agreement. The LLCs would become second beneficiaries under the trust, and title to the property would have been in the name of the trust. The investors would have had recorded security interest in the real property, as well as a security interest in the first beneficiary's personal property trust interest. Unfortunately, the model was not complied with and often times the interests of the LLCs were never recorded. In addition, funds were often times disbursed prior to their being sufficient funds to meet the financial commitments.

IV. THE IMPACT OF THE ILLINOIS LAND TRUST MODEL

By using the Illinois Land Trust model, title to the property was placed in the trust. As a result, the original owner was no longer in title, resulting in the owner's inability to convey or further encumber the property. In the event that the borrowers/first beneficiaries experienced financial problems, the creditors of the borrowers/first beneficiaries would have no direct claim against the real property. Accordingly, a judgment lien could not be placed against the trust property. In the event that the borrowers/first beneficiaries financial issues became insurmountable, the only interest that would be affected by the borrowers filing of a bankruptcy proceeding would be their personal property interest in the trust. The real property itself would not be subject to the automatic stay of the Bankruptcy proceeding or other applicable provisions of the Bankruptcy Code.

In the event of the borrowers default under the terms of the note, the remedy would not be a real estate foreclosure, but would be the subject of a personal property sale under the Uniform Commercial Code. Under the Uniform Commercial Code, a personal property sale may be held after reasonable notice and opportunity for the borrower to cure. The terms of the trust agreement created by the trust specifically provided that reasonable notice was to be ten days. Unlike a real estate foreclosure that would take anywhere between ninety days and a full year, the interest of the borrower/first beneficiary could be divested upon complying with ten day notice of a private sale, and the borrower's failure to perform within that time. At the end of ten days, the interest of the first beneficiary would be deemed forfeited to that of the second beneficiary, at which time the right of direction held by the second beneficiary and the right to the use and enjoyment of the property held by the first beneficiary would be merged and the lenders would become the sole beneficiary under the trust. At that time, the second beneficiary would be free to transfer the property as they deem necessary.

V. THE EFFECT OF THE ILLINOIS LAND TRUST MODEL ON ANMP

In a typical subdivision trust transaction in Arizona, the seller conveys the land to the trustee - - - typically a corporate trustee and, in Arizona, typically a title insurance company - - - to be held and dealt with by the trustee under a trust agreement providing typically that the seller is the first beneficiary of the trust and the buyer is the second beneficiary; that the buyer while in default shall be entitled to possession of the property and to cause the trustee to record subdivision plats to impose subdivision type restrictions, to dedicate streets and convey portions of the property to the buyer or at his discretion, free of the trust, upon payment of specified amounts on the purchase price; and often providing even more extensive rights for the buyer, while at the same time requiring the buyer to make certain payments to the trustee for the benefit of the seller, and giving the seller the right to terminate the buyers interest in the trust in case all buyers default.

Thus, if the trust is a true trust and is not a mere agency agreement or is not a passive trust executed by the Statute of Uses, each beneficiary owns a beneficial interest in the trust, which is essentially a right to require the trustee faithfully to perform its fiduciary duties and the trustee owns the real property; The Subdivision Trust - - A Useful Device in Real Estate Transactions, 5 Ariz. L. Rev. 1, 3, George Reed Carlock.

The foregoing going description of a subdivision trust in Arizona distinguishes itself from the nature of the Illinois Land Trust. While the trustee in a subdivision trust has numerous defined responsibilities, the trustee of an Illinois Land Trust is solely empowered to transfer the property. Under the Statute of Uses, trusts are invalidated wherein the trustee's duties are non-existent. Where the trustee is not given duties and obligations, the nature of the trust will no longer be recognized.

In the Dexter bankruptcy proceeding, the enforceability of the Illinois Land Trust was questioned by Judge Randolph J. Haines. A finding by Judge Haines that the Illinois Land Trust is a "passive trust" would have resulted in a determination of the trust's unenforceability. To date, the enforceability of the Illinois Land Trust in Arizona has not been addressed, and has been resolved through various stipulations with parties who have raised this as a defense as to the enforceability.

The use of the Illinois Land Trust helped facilitate the actions that were undertaken by the principals of American National Mortgage Partners and other entities. Specifically, no title insurance was ever obtained in order to facilitate these transactions. Accordingly, the lending LLCs which were to have been secured by deeds of trust recorded prior to the creation of the trust, never received verification that the deeds of trust were recorded. In many instances, the deeds of trusts were in actuality not recorded. As a result, title to the property remained in the trust, free and clear of liens.

Often times, foreclosures of the first beneficiary's interest were completed without notice to either the first or second beneficiaries, and the foreclosures resulted in the subsequent transfer of the properties without notice or the consent of the second beneficiaries.¹

There are instances in which the sales were completed without the knowledge of the second beneficiaries, and the properties were transferred to "insiders." When the properties were obtained by the "insiders," the "insiders" then used the properties as further security to obtain new financing. The "insiders" financial statements were used to obtain the financing, the property was then encumbered, with the new lender obtaining a first position on the property. Any interests of the investors were thereby subordinated to the new lender due to the non-recording of any instruments which would have placed the new lenders on notice of the existence of the investors' claims.

¹ In the case of the Castle loans, purported foreclosures occurred which resulted in the first beneficial interest of Dexter and related entities being transferred back to the second beneficiaries. The properties were then transferred to ANMP 74th Street, without the knowledge or consent of the investors.

As stated previously, the enforceability of the Illinois Land Trust under Arizona law is an unresolved question. The unenforceability of this type of documentation could prove devastating to the investors in the estate. At most, an unenforceable trust would result in an equitable lien, subject to judicial foreclosure. At worst, an unenforceable trust would result in an unsecured position. To date, the Receiver has been able to resolve the enforceability of the trusts through negotiated settlements with the borrowers.