

Lender Best Practice: Revocable Trusts

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Revocable Trusts have become more common and we want to make sure that our clients are prepared for the unique challenges these can cause. In order to assist with your review of trust agreements and loan documents, we are sharing a few observations from our reviews.

- 1. Power to Pledge as Security for Another.** Many trust agreements grant the trustee the power to borrow money and to pledge property on behalf of the trust. Much less common in trust agreements is the power to pledge or mortgage property for the debts of another. The Trust typically is the property owner, while the Borrower is the obligor under the loan. Therefore, the Trust is mortgaging the property not for its own benefit but for the Borrower's benefit. The Trustee owes a fiduciary duty to the beneficiaries of the trust, and the Trustee using trust assets to secure the debt of another if the Trustee does not have the power to do so is a potential breach of that fiduciary duty. Some state laws outlining the powers of a Trustee have included this power to pledge as security for another. If the state law does not include this power, then the Trust should expressly provide that the Trustee may pledge trust assets to secure the debt of a third party, i.e. the Borrower.
- 2. Note.** Another area where we see mistakes made is in the signature block of the note. In revocable trusts, we frequently see the Borrower and or Co-borrower are the Settlor, Trustees and Beneficiaries of the Revocable Trust. The Revocable Trust owns title to the real property being mortgaged. In such case, the Borrower, in order to pledge his/her personal assets and trust assets to repay the debt, must sign the Note in both capacities: individually and as Trustee. Further, investor guidelines require the signature block to contain the name of the trust and the date of the Trust Agreement. An example of a compliant signature block would be: Jane Doe, Individually and as Trustee of the Jane Doe Revocable Trust dated August 1, 2015. In addition to getting the signature block set up correctly, the lender should also ensure that the document is executed in accordance with the signature block. The wet signature should not conflict with the signature block. For example, if the borrower is signing individually and as trustee, then the wet signature block should not say: Jane Doe, Trustee. In this case, the signature block and wet signature conflict.
- 3. Security Instrument.** Typically, the Trust (or trusts) holds title to the real estate being pledged as collateral for the loan. When the Trust is the sole owner of the property, then only the Trustee(s) must sign the Security Instrument. When the property is owned by more than the Trust, then the additional parties must sign the Security Instrument. See FNMA Selling Guide Section E-2-06 for how to style the signature block for different fact patterns. The lender should apply the same rules outlined herein to the Inter Vivos Revocable Trust Rider.
- 4. Settlor Acknowledgement.** Investors require that the settlor or maker of the trust agree to the terms and conditions of the Security Instrument. We have seen lenders omit the settlor acknowledgment. The settlor acknowledgment can be placed on the bottom of the Inter Vivos Revocable Trust Rider or if no rider is used, the bottom of the Security Instrument. Either way works, though the language slightly differs depending upon whether the language is placed on the Rider or the Security Instrument. See signature requirements on page 16 of Section 1.08 of our Seller Guide for full details. The lender should ensure the Settlor acknowledgement is present at closing.
- 5. Closing Disclosure and if applicable, Right to Cancel.** For purposes of a trust, the lender should require the signature of the natural persons who are borrowers and the signature of the trustee/s on the closing disclosure. In addition to consumers who must be given the closing disclosures, the Right to Cancel must also be acknowledged by persons with an ownership interest in the mortgaged property. Thus, the Right to Cancel must be also be signed by the living person borrowers and the trustees of the trust.

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