

Newsletter

October 1993

LETTER FROM THE CHAIR

Last month we announced one of the two winners of this Section's award for the best paper in a law school seminar. The other winner is Jill Fukunaga, a third year student at the William S. Richardson School of Law, and we extend our congratulations to her. The presentation of the \$250 awards to each of the recipients

was made at the annual law school awards ceremony. The annual meeting for the Section year will be held on Tuesday, December 7th, at the Plaza Club from 7:30 a.m. to 9:00 a.m. Representative David Hagino will be our featured speaker and will discuss development in the Kakaako area and the involvement of the State of Hawaii in general. Notices and registration forms for the meeting have been mailed to each member of the Section. If you did not

receive (or can not find) your registration form, you can obtain another form by contacting me at 528-4200.

Deborah Macer Chun
Chair, Real Property and
Financial Services Section
Hawaii State Bar Association ■

INNOCENCE IS ENOUGH

By Ken Counts

Law enforcement's use of forfeiture is currently undergoing increasing scrutiny by the courts, Congress and the media. The general public's awareness of forfeiture has been heightened by this ongoing debate over how and to what extent forfeiture should be used against those who violate the law. Unfortunately, it has also given rise to a perception among the general public that their property can be seized and forfeited, despite their innocence, because they unknowingly dealt with someone who used, acquired or transferred their property in violation of the law. This misperception, that innocent property owners are unable to take any steps to protect their property interests from seizure and forfeiture, adversely affects both the property owner's ability to protect their ownership interests and law enforcement's ability to uncover and investigate illegal activity.

The success of law enforcement in attacking any criminal activity is directly dependent upon the assistance and support of the community in which the criminal activity occurs. If innocent property owners who discover their property is being used in violation of the law do not notify law enforcement, because they are afraid they will lose their property, the illegal use of property will continue unabated. Law enforcement will lose vital information necessary for the discovery, investigation and prosecution of major criminal offenders. And property owners, who know of and tacitly approve of the illegal use of their property, face the loss of their property. Therefore, it is extremely important that all property owners, particularly real property owners, clearly understand that the property of an innocent owner cannot be forfeited.

A property owner is considered innocent under the law if the owner:

1) lacked knowledge of the offender or offense subjecting the property to forfeiture,

2) did not consent to the illegal activity subjecting the property to forfeiture,

3) took all reasonable steps to prevent any illegal activity which would subject the property to forfeiture, and

4) took all reasonable steps to prohibit known or suspected illegal activity which would subject the property to forfeiture.

Therefore, property owners who are aware of the illegal use, acquisition or transfer of their property and permit the illegal activity to occur or continue are not innocent. Their property, or property interest, can be forfeited.

Landlords who unknowingly rent to drug traffickers and subsequently learn their property is being used as a place to store, manufacture, distribute or sell illegal drugs, but take no action, are not innocent and risk the loss of their property. Landlords in this situation cannot safely ignore ongoing criminal activity. Landlords can take independent action

to remove the tenant or prohibit the illegal activity by the tenant. Landlords can contact law enforcement and provide information about the known or suspected illegal activity occurring on the property.

Sometimes independent action to remove a tenant may be impossible, impractical or ill advised. On the other hand, contacting law enforcement may encourage overreporting of "suspicious" activity by over cautious landlords; however, this alternative is free, simple, always available and can and often does provide useful information to law enforcement. Contacting law enforcement also establishes the landlord's lack of consent to the illegal activity being reported.

The fact that innocent property owners may be required to take some action to protect themselves from the criminal acts of others is not burdensome, and is not a novel concept introduced by the enactment of forfeiture laws. Criminals have always caused problems for the innocent individuals they come into contact with in the course of violating the law. Landlords, mortgage holders, and other real property owners have always had to guard against the risks of dealing with criminals, and law enforcement can not eliminate those problems. A criminal's ability or willingness to pay rent or make a mortgage payment has always been adversely effected by law enforcement's decision to indict, arrest, prosecute or forfeit assets unrelated to the innocent property owner. A criminal is also more likely to be the victim of theft, vandalism or violence which may directly or indirectly effect the innocent owner or the innocent owner's property. Law enforcement has no interest in adding to the problems innocent property owner's already face in dealing with criminals. Law enforcement and real property owners do have an interest in working together to solve a mutual problem, the illegal use of real property.

During a recent FBI investigation in Honolulu a search warrant was executed at the residence of an individual who was the subject of a drug trafficking and money laundering investigation. A substantial amount of drugs, cash, documents and assets subject to seizure were seized at the subject's expensive, leased condominium. The rental agent was contacted and asked to confirm information about the tenant's use of cash, use of aliases, and other information helpful

to the ongoing investigation of the tenant. The rental agent subsequently notified the landlord/owner who lived on the mainland. The owner immediately telephoned the FBI terrified that his property had been seized or was in the process of being seized. He was concerned that he would need to take immediate legal action or risk the loss of his condominium.

The owner was assured that unless the FBI had substantial information that he knew of or consented to the tenant's use of the condominium to engage in drug trafficking the FBI would have no practical reason to pursue the forfeiture of his property, and in fact, would be unable to do so under the law. The owner confirmed he had no knowledge of the tenant other than as an apparently ordinary tenant, and he was told the FBI did not have any information to the contrary. The owner simply lost a tenant. The owner did not have to justify or defend his lease of the condominium, nor did he have to reclaim his property. The owner merely had to locate another tenant.

Congress authorized the forfeiture of real property, because real property is used by drug traffickers, money launderers, child pornographers, gamblers, members of organized criminal enterprises and other criminals to violate federal law and to facilitate the violation of federal law. Criminals at every level must use and do use land, farms, residences, businesses, offices and buildings to conduct their various enterprises and to shield themselves, their associates and their illegal activities from the public and from law enforcement. Ownership of real property provides the criminal with the means to control, protect and isolate illegal acts and illegal businesses. The head of an organized criminal enterprise needs a covert location to conduct business where privacy is assured to the same degree as a drug trafficker or a child pornographer. These criminals also utilize real property to invest, conceal and/or enjoy the profits made from their illegal activities. In order to deprive these criminals of the means necessary to violate the law, or to facilitate the violation of the law, and to deprive them of their profits, forfeiture laws have been enacted and utilized in an effort to enhance the enforcement of the law.

The FBI investigates the following violations of federal law which permit the

forfeiture of real property in a civil and/or criminal proceeding:

1. Controlled Substances Act
Civil - Title 21, U.S.C., Section 881
Criminal - Title 21, U.S.C.,
Section 853
2. Prohibition of Illegal Gambling
Businesses
Civil - Title 18, U.S.C., Section 1955(d)
3. Sexual Exploitation of Children
Civil - Title 18, U.S.C., Section 2254
Criminal - Title 18, U.S.C.,
Section 2253
4. Money Laundering
Civil - Title 18, U.S.C., Section 981
Criminal - Title 18, U.S.C., Section 982
5. Racketeer Influenced and Corrupt
Organizations
Criminal - Title 18, U.S.C., Section 1963
6. Gathering or Transmitting Defense
Information
Criminal - Title 18, U.S.C.,
Section 793(d)
7. Gathering or Delivering Defense
Information to Aid
Foreign Government
Criminal - Title 18, U.S.C.,
Section 794(d)

During any criminal investigation conducted by the FBI, the FBI will attempt to identify, locate and investigate property which may be subject to seizure and forfeiture. The forfeiture of property will be pursued where feasible, as part of the criminal investigation, to deprive the criminal of illegal profits or the means to commit, conceal or facilitate criminal activity. In order to forfeit real property for facilitation of the illegal activity, the government must establish a substantial connection between the real property and the violation of the law. The forfeiture of property, however, is never the principal objective of any investigation. The enforcement of the law and the prevention or elimination of the illegal activity is the principal objective of law enforcement and the principal objective of forfeiture.

Therefore, innocent owners of real property, which is or may otherwise be subject to forfeiture are protected by statute, regulation and/or Department of Jus-

tice/FBI policy. All the statutes listed above, except for Title 18, U.S.C., 1955(d), contain an innocent owner provision which exempts the property of an innocent owner from forfeiture. Department of Justice/FBI policy also protects the innocent owner in the absence of any statutory protection.

An innocent owner must in fact own the property in question and cannot be a "strawman" employed by the true owner in an attempt to conceal the true owner's identity and interest in or use of the property. The owner must establish lack of knowledge and/or lack of consent to the violation of the law subjecting the property to forfeiture. If the owner subsequently learns of criminal activity which subjects the property to forfeiture, the owner may be required to prove reasonable steps were taken to prevent or prohibit the illegal activity.

Owners of real property do face the forfeiture of their property under the law if they knowingly participate in, aid or facilitate the prohibited criminal activity; knowingly profit from the prohibited illegal activity; or fail to take any action to prevent or prohibit the use of the property in violation of the law, when reasonable steps to prevent or prohibit this illegal use are available to them. The investigation of the criminal offense, as well as the investigation of property involved in the offense, provides law enforcement with information about the relationship between the owner of the property and the criminal or criminal offense. If that investigation indicates that the owner is involved in or consents to the illegal activity being conducted, the investigation will continue to determine if sufficient evidence exists to establish that the owner was in fact involved in or consented to the illegal use, acquisition or transfer of the property.

If probable cause to believe the property is subject to forfeiture is established and a forfeiture action is to be initiated, the determination of who is an innocent owner is not left solely to the discretion of the investigating agent. The decision to initiate or continue a forfeiture action against real property must be made in conjunction with the Assistant United States Attorney, the FBI Principal Legal Advisor and the investigating agent. Furthermore, the property cannot be seized without a prior judicial determination that probable cause exists to seize the property for forfeiture.

All owners, lienholders or anyone else reasonably believed to have a legal interest in real property must be notified of the initiation of forfeiture proceedings by the U.S. Attorney's Office, and advised of their rights to contest the forfeiture, or the forfeiture of their interest in the property. Owners of property subject to a civil forfeiture proceeding may also elect to file a petition for remission or mitigation of their legal ownership interest in the property. Rulings on these petitions are made by the Department of Justice, Asset Forfeiture Office based on the with recommendations of the U.S. Attorney's Office and the investigating agency.

Innocent lienholders frequently file a petition for remission of their legal interest in the property, instead of filing a claim to contest the forfeiture of their interest in court. Lienholders may decide that this is the most cost effective means for preserving their interest in the property, when the lienholder had no connection to or knowledge of the owner who subjected the property to forfeiture outside of the lien or mortgage agreement. A petitioner will be granted remission of their interest in the real property if they can establish lack of knowledge, lack of consent and that all reasonable steps were taken by them to prevent or prohibit the acts subjecting the property to forfeiture.

However, it must be made clear that it is not the intention of nor in the best interests of law enforcement to require innocent owners to unnecessarily defend their ownership, purchase, sale, lease or mortgage of real property, when they unknowingly and innocently deal with a criminal or criminals whose illegal acts have subjected the property to forfeiture. It is in the best interests of law enforcement to investigate, prosecute and forfeit the property of those individuals, who clearly and intentionally violate the law, and to prosecute and forfeit the property of those individuals who participate in, aid or otherwise facilitate the intentional violation of the law.

It is also in the best interests of the FBI to encourage innocent owners of real property to freely and candidly discuss their dealings with and knowledge of those who violate federal law. Frequently an innocent owner may be able to provide valuable information concerning the subject of a criminal investigation. The innocent owner may provide essential or helpful information or assis-

tance in identifying the subject's criminal associates, nominee or straw purchasers, sources of funds, method of purchase or payment, method of laundering illegal proceeds, amount of illegal income, etc. This essential communication between law enforcement and real property owners is lost, if innocent owners incorrectly feel they have more to fear from the cop than the criminal.

Therefore, it is important to strongly emphasize that the FBI and the United States Attorney's Office as a matter of law and as a matter of policy will not and do not knowingly initiate forfeiture actions against innocent property owners. Both the FBI and the U.S. Attorney's Office are committed to promptly notifying anyone with an interest in real property of an intended forfeiture action, the expeditious release of seized property where appropriate, and the prompt resolution of claims of innocent ownership.

Ken Counts is the Principal Legal Advisor and Forfeiture Program Coordinator for the Federal Bureau of Investigation's (FBI) Honolulu Division. He has been involved in forfeiture and organized crime/drug investigations throughout his eleven year career as a Special Agent with the FBI. Prior to his assignment to Honolulu in 1991, he was assigned to Charlotte, North Carolina; Birmingham, Alabama; Washington D.C.; FBIHQ Legal Counsel Division; and Baltimore, Maryland. From September, 1986 to December, 1988, he served as a Supervisory Special Agent in the Legal Forfeiture Unit, Legal Counsel Division. He is a graduate of Duke University School of Law and a member of the North Carolina State Bar. ■

FNMA'S NEW POLICY ON REVOCABLE LIVING TRUSTS

**By Mitchell A. Imanaka
Scott Settle
Dwyer Imanaka Schraff Kudo
Meyer & Fujimoto**

The Federal National Mortgage Association ("FNMA") recently announced that it will accept mortgages secured by one-family properties for purchase under standard commitments if title to the property which is subject to the mortgage is held by the trustee of an *inter vivos* revocable trust. Previously, FNMA did not accept such mortgages for purchase under standard commitments.

Accordingly, a fairly common practice developed of first originating mortgages to settlors, individually, and then having such settlors convey the property into trust. Under FNMA's new policy, this practice will no longer be necessary.

FNMA's new policy on *inter vivos* trusts reflects a recognition by the agency that the creation of such trusts as estate planning devices has become prevalent among homeowners throughout the country. Generally, such trusts are used to avoid costly, time-consuming and onerous probate proceedings. FNMA acknowledged that lenders need the flexibility to offer financing to individuals who choose to place their assets in such trusts as estate planning devices. Previously-perceived risks associated with trustees holding title to and mortgaging properties were, upon closer examination, found to be non-existent or acceptable from the lender's standpoint.

The fact that title insurance policies that fully insure the title to properties held in such trusts are readily obtainable in large markets such as California was pivotal in FNMA's nationwide policy change. Such title insurance protects FNMA against the following risks associated with purchasing mortgages originated to *inter vivos* trusts: 1) defects in the creation of trusts or trustees' powers under such trusts, 2) the potential for material impediments to the exercise of the lender's remedies in the event of default, and 3) specific state laws that could affect the lender's relationship with the trust.

FNMA has set forth the specific eligibility criteria relating to *inter vivos* trusts and the mortgages made by the trustees of such trusts. In addition, FNMA has set forth specific documentation requirements relating to such mortgages. By delivering a mortgage originated by the trustee of an *inter vivos* trust, a lender warrants to FNMA that both the trust and the mortgage satisfy all of the following eligibility criteria and documentation requirements:

Eligibility Criteria for Inter Vivos Trusts

1. The trust must be established by one or more natural persons (the "settlor(s)").

2. The trust must be established by a written document during the lifetime of the settlor.

3. The trust must be one in which the settlor has reserved the right to revoke the trust during his or her lifetime.

4. The primary beneficiary of the trust must be the settlor. If the trust is established jointly by more than one settlor, there may be more than one primary beneficiary; provided, however, the income or assets of at least one of the settlors must be used to qualify for the mortgage and that settlor must occupy the property and sign the mortgage instruments.

5. The trust document must name one or more trustees to hold legal title to, and manage the property placed in the trust. The trustees must include either the settlor (or at least one of the settlors, if there is more than one) or an institutional trustee that customarily performs trust functions and is legally authorized to do so under the laws of the State of Hawaii.

6. The trustee(s) must have the power to mortgage the security property for the purpose of securing the loan to the party or parties who are the "borrower(s)" under the promissory note.

Eligibility Criteria for the Mortgage

1. The mortgage must be a conventional first mortgage.

2. The security property must be a one-family principal residence occupied by at least one of the settlors (including the settlor whose income or assets are used to qualify for the mortgage) or a one-family second home. The home may be a unit in a condominium, planned unit development or cooperative project. Investment properties and two to four family properties are not eligible under FNMA's eligibility requirements.

3. Full title to the security property must be vested in the trustee(s) of the trust, and there may be no other owners.

4. The lender's title insurance policy must assure full title protection to FNMA (in accordance with the requirements under the FNMA Selling Guide) and must state that title to the security property is vested in the trustee(s) of the *inter vivos* trust. The title policy must not list any exceptions with respect to the trustee(s) holding title to the security property or to the trust. Currently, most title insurance companies in Hawaii list the trust, its terms and provisions as exceptions from coverage under their standard title policies, making such policies unacceptable to FNMA. Certain title companies may

be willing to assist lenders, however, in obtaining the necessary coverage required by FNMA on a case-by-case basis. Lenders and their counsel should check with their title companies to determine whether and under what conditions coverage acceptable to FNMA is available.

5. The mortgage must be underwritten as if the settlor (or at least one of the settlors, if there is more than one) were the borrower (or co-borrower, if there are additional individuals whose income or assets will be used to qualify for the mortgage).

Documentation Requirements

1. Each trustee whose income or assets are used to qualify for the mortgage and each settlor whose income or assets are used to qualify for the mortgage must separately execute the promissory note and any necessary addenda.

2. The trustee(s) of the *inter vivos* trust must also execute the mortgage and any applicable rider. Each settlor whose income or assets were used to qualify for the mortgage must acknowledge all of the terms and covenants in the mortgage and any necessary rider, and agree to be bound thereby by placing his or her signature after a statement of acknowledgement on such documents.

3. Any other party required by the provisions of the Selling Guide to sign either the promissory note, mortgage and any necessary addenda and/or riders, must also execute such instruments.

4. FNMA has developed a Revocable Trust Rider form for use in California. This rider simply amends the definition of the "borrower" under the standard mortgage to include the *inter vivos* trust, the trustee(s) and the settlor(s), jointly and severally. This rider may also be used with little or no modification by lenders in connection with preparing mortgages to be originated to *inter vivos* trusts in Hawaii. However, FNMA does not require use of this rider, and the lender may instead amend the mortgage to include appropriate definitions and language substantially similar to the rider, or use a standard mortgage without such amendment or rider. In all cases, FNMA will require the lender to hold FNMA harmless and/or repurchase the mortgage should foreclosure proceedings occur and FNMA suffer a loss relating to any ambiguity in the application of the covenants contained in the mort-

gage. Therefore, whether or not the Revocable Trust Rider is used, preparers of mortgages made by trustees of inter vivos trusts are well advised to make it clear that the inter vivos trustee(s) and settlor(s) are acknowledging and agreeing to all of the covenants under the mortgage.

Lenders may agree to exclude institutional trustees and individual trustees (other than individuals serving as trustees whose income or assets were used to qualify for the mortgage) from personal liability under the promissory note and/or mortgage. Lenders are responsible to assure FNMA, however, that such exclusion from personal liability does not impair the note holder's power to foreclose.

Following the origination of a mortgage made by the trustee of an inter vivos trust, FNMA will permit the transfer of a beneficial interest under such trust to qualify as an "exempt transaction" under FNMA's due on sale policy if the beneficial interest is transferred to the spouse, children, parents, siblings, grandparents, or grandchildren of a settlor, or to any relative of a deceased settlor; provided that the transferee will occupy the property. In addition, FNMA will permit the

transfer of the subject property to a new inter vivos trust under which the individual who established the previous trust remains the primary beneficiary under the new trust and the occupant of the property. If the property itself is otherwise transferred, however, the acceptability of such transfer shall be determined under the standard provisions of FNMA's Servicing Guide.

FNMA's new policy of accepting for purchase mortgages originated by the trustees of inter vivos trusts should provide lenders with greater flexibility in meeting the needs of the growing number of home purchasers who have established such trusts for estate planning purposes. ■

PROPOSED CHANGES TO CHAPTER 13-16, HAWAII ADMINISTRATIVE RULES

The Board of Land and Natural Resources is proposing changes to the procedures related to the recordation of documents. In addition to addressing a number of technical issues, the proposed rules contain provisions: allowing interlineations to be initialed by the parties, as opposed to the notary, if executed outside of this State; requiring, for recordation of a judgment, the defendant's social security, general excise tax or federal identification number, or a statement

that the information is not in the possession of the party seeking recordation; and a provision specifically permitting the recordation of form documents which can be referenced and incorporated into subsequent short-form filings. Copies of the proposed changes can be obtained from, and comments can be sent to, the Bureau of Conveyances. ■

**Real Property and Financial Services Section
Hawaii State Bar Association
1136 Union Mall, PH 1
Honolulu, HI 96813**