Legal Title versus Equitable Title

by Kelly Troy on June 7th, 2011

This may be a short article, but it's an important one – especially with regards to insuring seller-financed 'wraparound' mortgages. Since the insurance industry is founded on the principals of risk, contract law, and civil liability, properly insuring properties purchased in this manner can be a challenge, especially when titled in a trust, and the issue of '*legal*' title versus '*equitable*' title often arises with regards to who has an 'insurable interest' and who doesn't.

<u>EQUITABLE TITLE</u> – This type of title refers to **the actual enjoyment and use of a property without absolute ownership**. It is the interest in the property held by a buyer (vendee) under a purchase contract, contract-for-deed, or an installment-purchase agreement. The buyer (vendee) has the right to demand that legal title be transferred <u>upon payment of the full purchase price after the final installment payment has been made</u>. This interest is transferable by deed, assignment, subcontract, or mortgage. Equitable title is conveyed to the buyer (vendee) as soon as the seller (vendor) actually countersigns and agrees to the offer to purchase. In other words, Jack agrees to purchase a home from David under a contract-for-deed' arrangement. In layman's terms, a contract-for-deed means "*you* (buyer) *fulfill your part of the contract* (pay the balance in full) *and <u>ONLY THEN</u> do I* (seller) *have the obligation to transfer the deed to you*." Jack takes 'equitable title' in the property as soon as David agrees to the contract and signs it. However, the *legal*title (which defines absolute ownership) is not formally transferred from David (seller/vendor) to Jack (buyer/vendee) until he has made his last installment payment under the contract and paid the agreed-upon amount in full, whether he pays the balance in one year or over a period of thirty years. Also, with equitable title, the vendee (purchaser) benefits from any increase in value between the date of the agreement and the final delivery of the deed once the balance is paid in full. If the property increases in value the vendee gets the increased valuation of the property; if the property value declines the vendee in turns suffers that as well.

Equitable does not give the actual *legal* title to the property like it would if a buyer were using a mortgage. Equitable Title means giving the buyer an "equitable position" in the property. ***<u>The legal title is conveyed only after the buyer has satisfied the contract</u>***.

The reason that equitable title and not legal title is conveyed in contract-for-deed purchases as mentioned above is because there is no deed of trust filed, this only occurs *AFTER-THE-FACT*once the purchaser (vendee) fulfills the contract agreement, and legal title can only be transferred by a deed.

LEGAL TITLE – **Legal title is the ownership of property that is enforceable in a court of law**, or one that is complete and perfect in apparent right of ownership and possession, but that unlike equitable title, carries no 'beneficial interest' in the property. In other words, in the example of David and Jack above, David holds the 'legal' title to the property and is the 'legal owner' while Jack only has 'equitable title'. However, with his 'legal' title, if the property goes up in value, David cannot benefit from this change and retroactively increase his sales price to Jack to make more money. As another example, if valuable minerals were discovered on the property, David could not 'benefit' from this change in the property either.

When utilizing traditional mortgage financing involving a bank or institutional lender, there is promissory note, a mortgage, and a deed of trust signed and filed. *This deed of trust is what transfers legal title from the seller to the buyer*. The seller of the property transfers legal title to the new buyer at closing because the contract price has been paid in full by the bank or lender – and now it's up to the borrower to repay the lender in installments. The buyer now has both legal and equitable title. In turn, the buyer collateralizes the bank's loan with the property being purchased and the **legal title still remains with the buyer** unless there is a foreclosure. If a foreclosure occurs on the property, the deed (and legal title) is transferred to the lender so that the lender then retains legal title.

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