ATTORNEY GENERAL OPINION NO. 77-101

Mr. Oliver J. Estes
Commissioner
Savings and Loan Department
624 Mills Building
Topeka, Kansas 66612


Synopsis: A leasehold interest constitutes real estate within the meaning of K.S.A. 17-550 (1976 Supp.). However, where improvements on the leased land remain personalty, a security interest therein must be perfected by a security agreement and financing statement, rather than by the real estate mortgage which embodies the security interest in the leasehold estate.

Dear Mr. Estes:

You have inquired as to the legality of a mortgage loan made by Colonial Savings and Loan Association on the security of an assigned lease and the improvements situated on the leased property. K.S.A. 17-5507 (1976 Supp.) requires every real estate loan to be secured by "a mortgage or other instrument constituting a first lien, or the full equivalent thereof, upon the real estate securing the loan...." Loan No. 6316 is secured by a mortgage covering a leased parcel of land and a vacation cabin constructed thereon. The cabin was built by the mortgagors on a leased parcel of land near the Cedar Bluff Reservoir under a permit granted by the Kansas State Park and Resources Authority. The cabin was appraised in June of 1975 for $25,200.00. Loan No. 6316, for $20,000.00, was granted on July 8, 1975, at 8.75% per annum for a term of nine years. (The term of the mortgagor's permit is ten years, commencing December 10, 1974. The mortgagor has the option to extend the permit's duration in ten-year increments through December 9, 2024.) An assignment of the lease was obtained, but the association did not obtain a subordination agreement from the lessor.
I agree with the conclusion of the association's attorney that the permit constitutes a lease agreement. K.S.A. 77-201(8) (1976 Supp.) defines real estate to include "land, tenaments and hereditaments, and all rights thereto and interest therein, equitable as well as legal." Thus, the leasehold interest embodied by this permit is real estate, and Colonial's mortgage constitutes a first lien thereon. First National Bank in Dallas v. Loman, 193 Kan. 349, 395 P.2d 313 (1964) involved a security interest in a leasehold estate. The court held that the security interest was properly perfected through a mortgage, and that the lessee's interest constituted "real estate". Furthermore, K.S.A. 84-9-104(j) (1976 Supp.) provides that the Uniform Commercial Code does not apply to the "creation or transfer of an interest in or lien on real estate, including a lease or rents thereunder...." This indicates that the U.C.C. provisions for perfection of security interests do not apply to security interests in leasehold estates, leaving these security interests to be perfected by the means available at common law. In addition, K.S.A. 79-3101 provides:

"...the words 'real property' and 'real estate'... shall include all property, a conveyance or mortgage of which is entitled to record as real property or interest therein under the laws of this state. The words 'mortgage of real property' shall include every instrument by which a lien is created or imposed upon real property, notwithstanding that the debt secured thereby may also be secured by a lien upon personal property."

Since the Loman case, supra, found that a mortgage of a leasehold interest is entitled to record as an interest in property, the mortgage under discussion here constitutes a "mortgage of real property".

The security interest in this particular leased parcel of land involves the additional factor that the land itself is leased by the Kansas State Park and Resources Authority, but is actually owned by the United States and leased by the Authority under the provisions of the Memorandum of Understanding between the United States and the Authority. In the event that the Memorandum is terminated, the United States may terminate the lessee's permit. However, the permit provides that in the event of termination of the Memorandum of Understanding, the United States shall be deemed to "stand in stead of the Authority as grantor for the remainder of the term of this Permit...." As long as the Authority is grantor, the permit could not be terminated prior to expiration of the stated term except in case of default by the Permittee. Should the United States become the grantor, the permit could be terminated without
the necessity of default by the Permittee. Knowing this, the Association made this loan, indicating that they were relying on the value of the cabin more than the value of the leasehold interest as security for the loan. It is also important to note that the permit stipulates that:

"...neither this Permit nor interest therein shall be transferred by the Permittee, without the written consent of the Authority made by the officer executing this permit on behalf of the State of Kansas...."

The assignment of the permit executed by the mortgagor would seem to constitute an "interest" in the permit, and thus, require the written consent of the Authority. Without that consent, the assignment would be open to challenge by the Authority.

Assuming that the permit assignment was consented to by the Authority and is valid, and that the mortgage on the leasehold estate fulfills the requirements of K.S.A. 17-5507 (1976 Supp.), it is still necessary to consider what interest, if any, the Association has in the cabin erected on the leased land. It is evident from the value of the cabin, and the amount of the loan, that the cabin itself was, in the Association's eyes, an important part of the security for this loan. The mortgage filed by the Association covers the leased land and the vacation cabin constructed thereon. The Association's attorney, in his opinion, has indicated that the mortgagor's right to remove the cabin upon termination of the lease is a real property interest, because of the parties' intent, expressed in the mortgage, that the improvement should become real property. However, although the mortgagor and mortgagee may have intended the property to become realty, the permit provides that the improvements erected "shall belong to the Permittee", indicating that the ownership of the land and the improvements are to remain separate. Thus, the cabin would constitute personalty, rather than realty, and a security interest therein would necessarily have to be perfected in the manner prescribed for perfection of security interests in personalty, rather than by the methods used to perfect security interests in realty. A real estate mortgage is not the proper method of perfection of a security interest in this cabin, which constitutes personalty.

In conclusion, it is my opinion that the type of loan involved here is a real estate loan under the requirements of K.S.A. 17-5507 (1976 Supp.). However, in this particular situation, it is evident
that the Association intended that the cabin, as well as the leasehold interest, provide security for the $20,000.00 loan. Under these circumstances, the loan would remain only partially secured, since the security interest in the cabin, which remains personalty, cannot be perfected by means of a "real estate mortgage".

Very truly yours,

CURT T. SCHNEIDER
Attorney General