Risk Reduction and Transaction Enhancements

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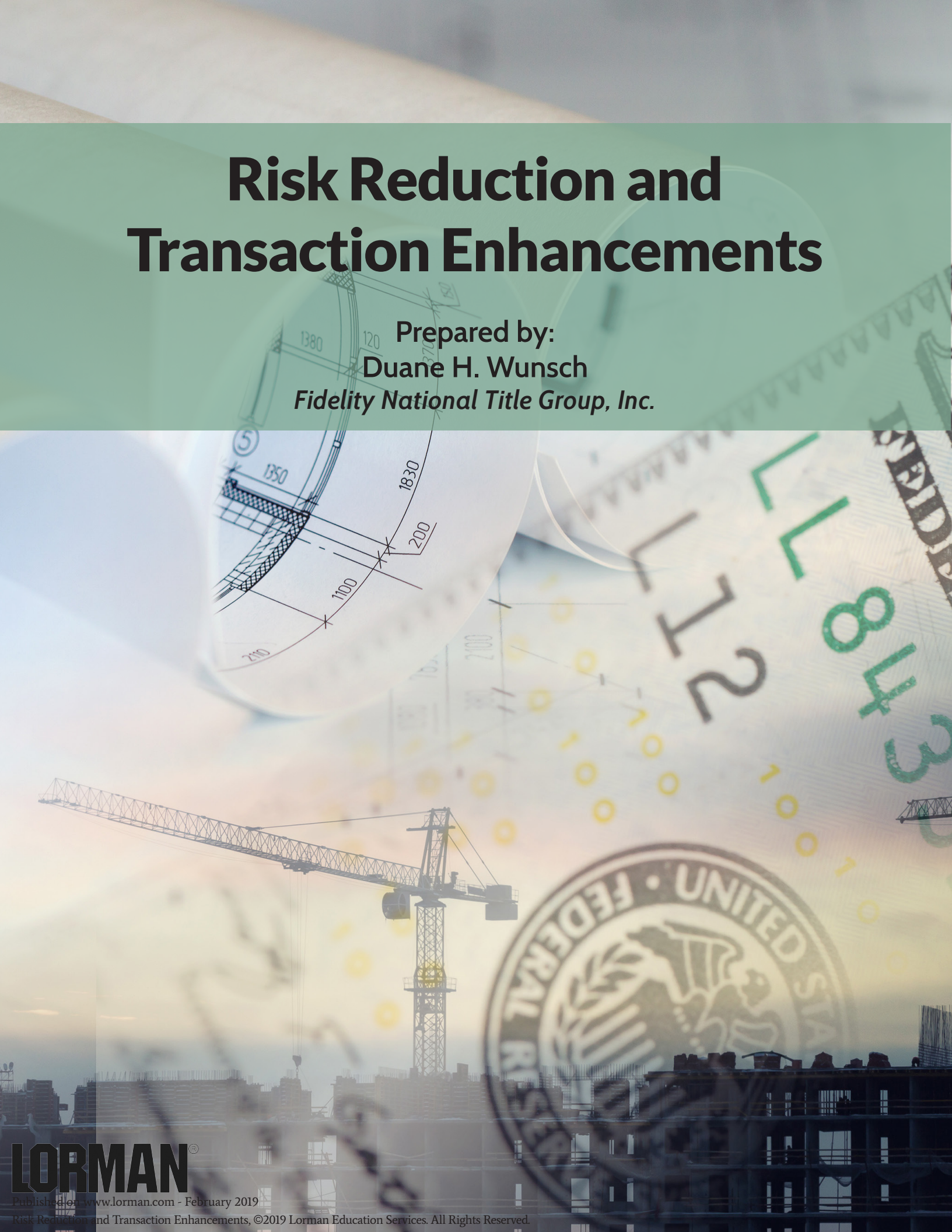

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Published on www.lorman.com - February 2019

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KEYS TO UNDERSTANDING LAND RECORDS

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I. RISK REDUCTION AND TRANSACTION ENHANCEMENTS

A. Avoidable Real Estate Title Pitfalls

It is sometimes difficult to comprehend, explain or reconstruct the reasons why purchasers proceeded to close the transaction without regard to adverse matters impacting their ownership that were apparent or discoverable at the time. The following are some examples:

- Construction of a new apartment building upon lands of an adjoining owner. (Exhibit 43).
- Construction of a residential building and landscaping within highway right of way. (Exhibit 44.)
- Construction of an industrial building over the top of a storm sewer. (Exhibit 45)
- Obstruction of a private access road. (Exhibit 46)

A careful evaluation of the title prior to the closing is the means by which title defects or encumbrances of the kind illustrated are to be avoided. As among the professional parties whose expertise can be relied upon to avoid or manage the risk of such problems are attorneys, land surveyors, and title agents.

As a consequence of risks associated with ever-present challenges to the validity of conveyances, inaccuracies in the public land records and indexes to the records, misfeasance of records custodians, and exposure to statutory liens that disturb the priority of mortgages, a trade group or industry providing insurance to purchasers and lenders and facilitating new forms of coverage that correlates closely to investor demand was formed. The industry, comprised of the nation's title insurers, title agencies and approved attorneys, is the title insurance industry, and its principal national professional organization, of which many are members, the American Land Title Association ("ALTA").

The ALTA has introduced and promulgated several policy forms that are accepted in the real estate and mortgage lending marketplace, and periodically revises the policy forms in response to investor and consumer demand. The latest policy forms, due to their popularity, are issued by all of the nation's title insurers, and where filed and approved by the state's regulator, available in the state. In certain states, such as New York and Texas, other non-ALTA policy forms are mandated for use, or are available

in addition to the ALTA policy form. State title organizations active in promulgating policy and endorsement forms include the California Land Title Association ("CLTA").

B. Obtaining Title Insurance Coverage: Current Choices

Policies of title insurance are standardized forms of title guarantee that are pervasive in the real estate marketplace. Although title insurance is widely regarded as standard in form, title insurance policy forms continue to evolve on state and national levels. What does title insurance consist of in its most basic form? What alternative forms of title insurance policies are available?

1. Basic coverage: What risks does title insurance cover?

   a. Claims not detectible from the public land records

      The title insurance policy identifies only the name of the current, not past, owner and the mortgages that have not been satisfied. However, as seen by purchasers and lenders who become insureds under the policy, title insurance contains, in its most basic form, compelling protections that did not exist under other forms of title guaranty, and in its most advanced form, opportunities for strategic planning and sophisticated risk assumption available through a responsive title insurance organization.

      The term basic coverage, as used here, is coverage against liens, defects and encumbrances that requires no point-by-point negotiation, and that is implicit in the policy. Among the most basic protections afforded by title insurance is coverage against invalidity of conveyances due to fraud or forgery, or lack of a signature essential to the insured mortgage's validity. The title insurer with which the writer is associated recently defended or paid loss involving the following claims that were triggered by what it submits was basic coverage under the policy:

      - Judgment liens the result of judgments that were docketed against the seller of land and that were against the owner's former name, a name spelling not revealed by the seller, and that consequently went undetected at the time of closing. However, the judgment creditor's attorney became aware of the debtor's sale of real estate without payment to the creditor. When threatened with enforcement of the judgment liens, the purchaser's title insurer paid the judgment creditor.

      - A lawsuit for slander of title brought by the ex-spouse of the property owner, claiming that because her co-ownership interest in their former real estate was not unequivocally divested by the parties' divorce judgment, the lender who refinanced the owner's pre-divorce mortgage should have

its lien set aside. The title insurer and property owner negotiated a settlement with the plaintiff.

- A lawsuit brought against the developer of a subdivision by a party claiming title to a portion of the land within the perimeter of the subdivision. The description of the plaintiff's deed overlapped with the description of the recorded subdivision plat. The title insurer negotiated a settlement with the plaintiff.

- An underground gas pipeline not shown by the subdivision plat but that was exposed during excavation for the construction of new single family homes. The pipeline company's easement was recorded in the office of the register of deeds, but was particularly difficult to find from a title search. The title insurer paid diminution in value to the homeowners caused by the pipeline easement.

- A zoning ordinance enacted for a historic district requiring that before any exterior building renovation occurs, city approval be obtained. The ordinance to which a map was appended lacked any precise description, and was not detected from a search of the land records. The title insurer employed counsel for the insured owner to secure the city's approval of his building plan.

In contrast to the above occurrences, and to the credit of the vast majority of sellers, after having reviewed the title insurance commitment's listing of liens, the seller that notices an omission has called attention to the existence of the matter, allowing the payment of the claim and avoidance of post-closing litigation.

2. Matters not covered by the basic policy

The title risks briefly surveyed above are not those that in any sense were negotiated between the title insurer and the insured. Coverage against these risks was a part of the basic coverage under the policy. However, title insurance does not assure that the insured will bear no risk whatsoever, and the insured is presumed to understand that certain potential adverse matters may conceivably survive the closing and the risk of their enforcement will be born by the insured.

3. Policy primer

a. Who is protected?

i. Parties to the transaction: Purchaser, seller, broker and land surveyor

The policy of title insurance is a contract to indemnify against loss caused by defects in the title or encumbrances on the title. Though it is widely recognized that several parties rely on the commitment for their own purposes, title insurance indemnifies the named insured, not others. Title insurance does not impart umbrella-like coverage to all participants in a transaction. For

example, title insurance does not indemnify a seller who is liable for loss sustained by the insured as the result of a breach of the warranties of title. On the contrary, the seller that breaches the warranties contained in a deed could become obligated to reimburse the title insurer for loss by reason of the title insurer's right of subrogation. See e.g. Schorsch v. Blader, 209 Wis. 2d 401, 563 N.W.2d 538 (Ct. App. 1997). (A seller concerned about eliminating its contingent liability for breach of warranties could arrange to purchase its own separate policy, known as a vendor's policy.) Similarly, title insurance does not indemnify a real estate broker against loss she incurs from claims of the purchaser alleging misrepresentations concerning the title. Though the land surveyor who prepares a new land survey may read the commitment for the legal description, and in doing so, believe the commitment to offer some measure of information, the commitment does not protect the land surveyor from survey errors or omissions. Finally, a loan policy of title insurance does not protect a purchaser who pays for her mortgage lender's policy, but neglects to purchase an owner's policy that separately protects her interest as the owner.

ii. The purchaser

The named insured, too, can sometimes wrongly assume he is protected when in fact he may have failed to maintain coverage when transferring the property to himself or an affiliated person or entity. Occasionally, the loss of coverage occurs when estate or business planning is done, but insurance coverage is overlooked. Under the latest ALTA Owner's Policy form, the 2006 Policy, the trust to which, after date of policy, the insured owner transfers his title is covered under the policy. However, under the 1992 policy form, the trust is not covered under the policy, and the insured must purchase an endorsement naming the trust or face the prospect of a denial of coverage. (Under the 1992 ALTA Policy, the trust is not a party within the definition of the term "insured" in the Conditions and Stipulations.) Similarly, an investor who owns land individually and then conveys it to a limited liability company (LLC) of which he is the sole member may also find that after the conveyance, unless he obtains an endorsement to his title policy naming the LLC as an insured, there is no coverage under the 1992 Owner's Policy.

b. What type of potential coverage exists?

i. Liens and encumbrances

Inevitably, situations will arise in which the title proves to be other than what the purchaser believed it was based on a reading of the title insurance policy. For example, an easement that burdens the property, though recorded in the office of the register of deeds, may have been inadvertently omitted from the policy. Similarly, a lien, such as a mortgage, federal tax lien or property taxes, may have been omitted from the policy. In such cases, the policy Conditions and Stipulations govern the measurement of the loss and obligation to pay. In most cases of errors or omissions of liens and

encumbrances, the policy provides a methodology satisfactory to the insured to pay for loss. An insured owner is entitled to payment in an amount necessary to remove the lien. Blackhawk Prod. Credit v. Chicago Title Ins. Co., 144 Wis. 2d 68, 423 N.W.2d 523 (1986).

ii. Policy limits

Mortgages, liens and easements are capable of measurement. However, in other instances, the insured may not be satisfied with the policy's measurement of loss. For example, in the event that the title insurance policy omitted, as the result of a searching error, a notice revealing a violation of environmental laws, the insured may conceivably suffer a compensable loss. In such instances, will the insured have a cause of action against the title insurer for damages exceeding the policy limits?

iii. Liability in excess of the policy

In several jurisdictions, liability in tort is imposed upon the title insurer. In these states, the title insurer has an independent duty to search and disclose reasonably discoverable defects in the title. Joyce Palomar, Title Insurance Companies' Liability for Failure to Search Title and Disclose Record Title, 20 Creighton L. Rev. 455 (1986-87). However, many states impose no such duty to search and disclose on the title insurer.

> "…The issuance of a title commitment does not …constitute an independent undertaking by the insurer to search the title for the benefit of the insured. Rather, the title commitment 'generally constitutes no more than a statement of the terms and conditions upon which the insurer is willing to issue its title policy…'" citing Lawrence v. Chicago Title Ins Co., 192 Cal. App 3d, 70, 74-75 (1987).
>
> Greenberg v. Stewart Title Guar. Co., 171 Wis. 2d 485, 492 N.W. 2d 147 (1992).

4. Policy forms

a. The American Land Title Association

The ALTA owner's policies and loan policies are widely regarded as standard forms. The ALTA revised the standard policy forms in 1970, 1987, 1990, 1992 and 2006. Although it may be possible for insureds, by special request, to obtain ALTA's pre-2006 policy forms, most insureds will prefer the latest 2006 policy form. ALTA has also introduced policy forms that are specifically designed for residential property. In addition to policy forms, ALTA has promulgated a number of standard loan policy and owner's policy endorsements, which are revised periodically.

b. The California Land Title Association ("CLTA")

The California Land Title Association has also promulgated policy forms, the issuance of which is confined to western states, but is better known outside California for a multitude of policy endorsement forms, which are issued nationwide.

c. Proprietary policy forms

Finally, individual title insurers have recently developed and promoted the use of their own non-ALTA policy forms, introducing or marketing these selectively in certain locales. Title insurers periodically design and issue at the request of individual customers, stylized endorsements which afford coverage lacking in the policy, or imparting affirmative coverage against a specifically identified matter

5. The commercial market: endorsements options

Residential purchasers and lenders have a choice of policy forms, and coverage varies considerably. In residential transactions, policy forms variations are due largely to marketing efforts of individual title insurers that have been addressed to broad constituencies, including mortgage bankers and consumers. However, in commercial transactions, except for the choice of year (1970, 1987, 1990, 1992 or 2006) there is no variation concerning the choice of policy form, but a significantly greater selection of endorsements that the commercial property purchaser and lender may ultimately obtain that modify the provisions (the policy Conditions, and the policy Exclusions). The prevalence of endorsements in commercial transactions is a reflection on the pre-closing negotiations that take place between counsel and title insurer over various issues.

6. Policy and endorsement form revisions

It should be noted that the content of policy provisions (Conditions and Exclusions) have been revised by ALTA on several occasions, most recently in 2006. ALTA endorsements too are the subject of ongoing discussions. Title insurer office and insured alike occasionally fail to note that Paragraph 2 of Schedule A of the commitment identifies or should identify the name of the policy form to which the title insurer commits to issue upon fulfillment of the requirements, and the choice may prove to have important consequences for the insured.

a. Residential loan policy forms

The ALTA has continued to promulgate, and individual insurers have continued to develop, policy forms of various types. Many are designed for insuring residential property only. ALTA loan policies designed for residential property include:

- ALTA Residential Limited Coverage - Junior Loan Policy (08-01-12)

- ALTA Short Form Residential Limited Coverage - Junior Loan Policy (4-02-13)
- ALTA Short Form Residential Loan Policy (12-3-12)
- ALTA Expanded Coverage Residential Loan Policy - Assessments Priority (04-02-15)
- ALTA Expanded Coverage Residential Loan Policy - Current Assessments (04-02-15)
- ALTA Short Form Expanded Coverage Residential Loan Policy - Assessments Priority (04-02-15)
- ALTA Short Form Expanded Coverage Residential Loan Policy - Current Assessments (04-02-15)
- ALTA Short Form Residential Loan Policy - Current Violations (04-02-15)

Loan policy forms that display or contain coverage more expansive than that contained in the standard ALTA 2006 Loan Policy may entail underwriting criteria or search and examination measures that are different from that followed when underwriting the ALTA 2006 Loan Policy.

b. Residential owner's policies

The ALTA also promulgated a residential owner's policy, the ALTA Homeowner's Policy (Rev. 12-02-13) that contains coverage more expansive than that contained in the standard ALTA 2006 Owner's Policy. In contrast to the 2006 ALTA Owner's Policy, the ALTA Homeowner's Policy contains 32 different Covered Risks, including Covered Risk 23, which provides coverage to the insured if "forced to remove… existing structures which encroach onto an easement or over a building set-back line, even if the easement or building set-back line is excepted in Schedule B." The ALTA Homeowner's Policy is not available in all states. In those states where the policies are available, the title insurer's underwriting criteria may differ significantly from that used when issuing the ALTA 2006 Owner's Policy.

c. Commercial title policy forms

Although the title industry and individual insurers continue to develop policy forms that may appeal to the residential mortgage banking industry, and to consumers, a commercial policy as such has not been developed. Therefore, the ALTA 2006 Owners Policy and 2006 Loan Policy continue to be the only ALTA policy form designed for commercial property.

d. Title industry endorsements

The ALTA continues to promulgate standard title insurance policy forms that are designed to satisfy a broad spectrum of prospective purchasers and lenders, and although the forms are widely accepted, they do not offer coverage to fit every situation and issue. The existence of an endorsement by topic indicates that the industry has addressed the matter with sufficient frequency that a form has been developed for future use. The ALTA and the CLTA have promulgated a

multitude of policy endorsement forms, available with both owner's policies and loan policies. Individual insurers also developed and promoted their own proprietary policy and endorsement forms.

i. Referring back to the underlying policy

The policy endorsements are designed to delete or modify any number of policy provisions, including exclusions, conditions and stipulations, or standard exceptions. Conversely, when the title insurer has determined that it cannot safely include all of the insuring provisions of the policy at the time of the policy's issuance, the title insurer may delete certain of the policy's insuring provisions, and thus reduce rather than expand coverage.

ii. Owner-only, lender-only, endorsements

Certain endorsements are designed for and available with only loan, not owner's, policies. Although many of the endorsements are promulgated by the ALTA or by title insurers nationally, their availability and premium charges may as a practical matter vary with the specific transaction, the jurisdiction, the title insurer, and even the county.

7. Extended coverage

a. Exclusions and exceptions contrasted

All title insurance policies contain two types of provisions, exclusions and exceptions, which reduce or limit coverage described in the policy's insuring provisions. Certain of the policy exclusions and exceptions alike may be manually deleted or omitted entirely. Alternatively, they may be modified in important respects, which occur when certain of the standard endorsements discussed in the previous section are issued. As compared with policy exceptions, policy exclusions were designed to be an inseparable part of the ALTA policy. Exclusions from coverage are statements of the types of risks which though they may be contained within the generality of the insuring clauses, which are generically outside of the title insurance undertaking. Because of the nature of the exclusions, insurers are extremely reluctant to delete or modify them. "Exclusions and exceptions are similar in that each class of items limits the coverage of the policy. However, exclusions refer to subjects beyond the ambit of the policy, while exceptions are matters generally within the scope of the insuring provisions." J. Bushnell Nielsen, Title Escrow Claims Guide, §12.1 at 345 (1996). Perhaps the main practical distinction between exclusions and exceptions is the degree to which title insurers have authorized their modification, respectively, by authorized title agencies in the field as compared with retaining centralized underwriting control.

Title insurers generally do not authorize their agencies to delete or modify policy exclusions without the title insurer's case-by-case authorization. Title insurers typically seek to exert and retain centralized underwriting control over the deletion of the policy exclusions. However, title insurers do authorize their agencies to delete or modify policy exceptions, a practice that has a direct impact upon the successful marketing of title insurance. Although exclusions and exceptions alike describe matters against which there exists no coverage, exceptions tend to characterize substantive real property defects or encumbrances, real or potential, the existence of which can be investigated, and the risk of which can be quantified or eliminated by the title insurance provider.

Exceptions are of two types: *Standard exceptions* and *special exceptions*. Although the precise language of standard exceptions varies, standard exceptions are substantially as follows:

i. Any encroachment, encumbrance, violation, variation, or adverse circumstance affecting the Title that would be disclosed by an accurate and complete land survey of the Land. ("standard survey exception")

ii. Easements or claims of easements not shown by the public land records.

iii. Rights or claims of parties other than Insured in actual possession of any or all of the property.

iv. Any lien or right to a lien, for services, labor, or material heretofore or hereafter furnished, imposed by law and not shown by the public records ("un-filed mechanic's or materialmens' liens exception")

v. General taxes for the year _____and subsequent years, not yet due or payable.

vi. Special taxes or assessments and special charges, if any, payable with the taxes levied or to be levied for the year _____and subsequent years.

b. Owner's policy and loan policy exceptions contrasted

Title insurers have extended wide latitude to their agencies in deleting policy exceptions from loan policies issued to residential lenders, because the risk of loss is low. However, title insurers tend to retain more control over the modification of owner's policy exceptions, and also over the modification of exceptions contained in loan policies involving commercial property. The reason for the title insurer's retention of greater underwriting control is that under the owner's policy, the discovery of the title defect triggers an immediate obligation to indemnify under the policy, but no such obligation exists under the loan policy.

Defining and measuring actual loss under a title insurance policy is not the same for the owner who has title to property, and a mortgagee who holds only a security interest in the borrower's title. The fee interest of an owner is

immediately diminished by presence of lien since resale value will always reflect the cost of removing the lien. A mortgagee's loss cannot be measured unless the underlying debt is not repaid and the security for the mortgage proves inadequate. Green v. Evesham Corp., 179 N.J. Super. 105, 109, 430 A.2d 944, 946 (1981). For a mortgagee, title insurance undertakes to indemnify against loss or damage sustained by reason of defects or title or liens upon the land, but does not guarantee either that the mortgaged premises are worth the amount of the mortgage or that the mortgage debt will be paid. Demopoulos v. Title Ins. Co., 61 N.M. 254, 255, 298 P.2d 938, 939 (1956); Couch on Insurance, §57:189, 205 (2d ed., 1983 & 1986 supp.).

Blackhawk Prod. Credit v. Chicago Title Ins. Co., 144 Wis. 2d 68, 423 N.W.2d 523, 525 (1986).

The very existence, indisputable as it may be, of a title defect, lien or encumbrance does not trigger an immediate obligation of the title insurer to pay the insured mortgagee. In most cases, the mortgagee's loss cannot possibly be established until the confirmation at sheriff's sale fixes both the value of the mortgagee's security interest and the value of the property obtained at the foreclosure. See Karl v. Commonwealth Land Title Ins. Co., 20 Cal. App. 4th 972, 24th Cal. Rptr. 2d 912 (1993), aff'd, 70 Cal. Rpr.2d 374 (1997). The loan policy continues in force in favor of an insured lender that acquires the property by foreclosure or a conveyance in lieu of foreclosure, but the coverage is that in effect as of the date of issuance of the policy. The loan policy does not, upon the mortgagee's purchase at sheriff's sale, "convert" to an owner's policy with its loss measuring methodology, but requires an analysis of the lender's recoupment of principal and interest at point of sheriff's sale. CMEI, Inc. v. American Title Ins. Co., 447 So. 2d 427, 428 (Fla. Dist. Ct. App. 1984); Blackhawk Prod. Credit v. Chicago Title Ins. Co., 423 N.W. 2d at 525. As a result of the important distinction between loan policy and owner's policy with regard to timing of a loss, title insurers are more willing to extend to lenders coverage against matters described in the policy exceptions.

c. The standard survey exception

i. When no plat of survey is provided

The standard policy exception least likely to be removed from the policy is the standard survey exception. Historically, the survey exception was phrased as: Unrecorded easements, discrepancies or conflicts in boundary lines, shortage in area and encroachments which an accurate and complete survey would disclose. Although title insurers have routinely authorized the deletion of the survey exception from the ALTA loan policy when insuring mortgages involving residential property, they do not authorize the survey exception's deletion from the ALTA owner's policy unless a current land survey containing a satisfactory surveyor's certificate is provided for the title company's examination. Reluctance to remove the survey exception stems from the possibility that the title insurer could become obligated to pay for

loss for the forced removal of the building, if constructed so it encroaches on a boundary line or easement.

ii. When a plat of survey is provided

Once it has received the land survey, the title insurance provider proceeds to examine the survey for encroachments of buildings, fences, retaining walls, and roof overhangs, for building setback violations, and for road right of way encroachments by loading docks, underground vaults, sidewalks and other obstructions.

iii. Importance of the surveyor's certificate

Title insurers regard the scope of the surveyor's certificate as important to their decision about whether the survey exception will be deleted. Survey certificate forms vary widely, and there is no single form deemed by the title insurance industry as a prerequisite to extending coverage over survey matters. However, at a minimum, the surveyor should certify that he has examined the property for encroachments, that the survey depicts all buildings, structures, fences and improvements, and that the description represents a complete and accurate description of the land.

iv. What does removal of the survey exception mean?

When the title insurance provider has in fact deleted the survey exception, it may not necessarily be clear what physical intrusions have been indemnified against as a result. Subsurface intrusions, such as septic drain fields, farm drain tile lines, gravesites, geological sites, building foundations or rock strata, when not occupied by any landowner under a claim of right, may nevertheless constitute physical features detrimental to the interests of the insured owner. Kayfirst Corp. v. Washington Terminal Co., 813 F. Supp. 67 (D.D.C. 1993). It was held that the removal of the standard survey exception did afforded coverage against annual fees assessed by the city against the insured owner for an encroachment by the insured of an underground parking structure within the right of way of a city street. First American Title Ins. Co. v. Dahlmann, 2006 WI 65, 291 Wis. 2d 156, 715 N.W.2d 609 (2006).

d. Easements or claims of easements not shown by the public land records

Since utility easements are often attributable to underground improvements, which are not visible at the site, title insurers may not agree to remove the exception for easements or claims of easements unless they are first provided with a American Land Title Association – American Congress on Surveying & Mapping (ALTA-ACSM) survey which specifically certifies that the surveyor has reported all easements, including observable evidence of drains, telephone, telegraph, or electric lines: water, sewer, oil or gas pipelines on or across the property, and specifically including underground easements. The surveyor

certifies to this assurance by way of Item 11(b), Table A of the 2005 ALTA-ACSM optional survey responsibilities and specifications.

Prescriptive easements may exist for footpaths, private roads, shared well, drain tile lines, sewer service lines that may not be apparent from an inspection of the site. Private roads or trails in recreational areas may be shared by users, the identity of whom may be impossible to ascertain, even from an inspection of the site. Those who make seasonal use of roads or paths bay acquire a prescriptive easement for the continued right to do so, even though the use thereof does not occur regularly throughout the calendar year. Widell v. Tollefson, 158 Wis. 2d 674, 462 N.W.2d 910 (1990).

e. Rights or claims of parties other than Insured in actual possession of any or all of the property

Title insurance providers do not visit land they undertake to insure. Consequently, title insurance providers do not have a reliable first hand source of information from which to determine whether there are in possession of the land persons who derive an estate or interest in the land through periodic tenancy or by adverse possession. Tenants and neighboring landowners who have acquired portions of the insured premises by adverse possession nevertheless constitute persons having interests potentially inimical to that of the insured.

The practical means by which evidence of occupants has been elicited have been one or a combination of a current land survey or an owner's affidavit revealing the identity of persons in possession.

f. Unfiled mechanic's or materialmens' liens or construction liens

i. Mechanics' liens are "secret" liens

Mechanics' or materialmen's liens are accorded to persons who furnish material, labor or improvements to real property. They are entirely statutory, and in many states constitute liens against real estate for a period of time without any need for filing any lien instrument in the public land records. The title insurer, therefore, has no first hand source of information from which it can investigate the possible existence of construction liens. In those instances in which the insured seeks coverage against un-filed construction liens, title insurers have established two classes of criteria. The first is applicable to real estate known to involved new construction of improvements, and the second applies to all other types of property.

ii. Sites that entail enhanced risks

When the property to be insured involves new construction of a building, or an addition thereto, title insurers do not provide insured owners with coverage against un-filed construction liens unless the title insurance provider has acted as the construction escrow disbursing agent for the construction mortgage

lender. In such cases, it is sometimes possible, assuming that the title insurance provider has had prior favorable experience with the contractors involved in the construction project, to arrange for a combination of indemnifications, affidavits, lien waivers and bonds, which when taken together will serve as the basis for the title insurer's coverage against un-filed construction liens. Situations of this kind are usually arranged for or negotiated well in advance of funding, and require considerations which are beyond the scope of this material.

iii. Advance notice of request for coverage is advised

When the property to be insured involves property other than that involving new construction, title insurers may agree to accept an owner's affidavit which confirms that no construction had occurred as conclusive of the existence of un-filed construction liens. However, neither the insured owner nor the insured commercial real estate mortgage lender should assume in advance of closing that the title insurance provider will in fact afford coverage against un-filed construction liens, as this issue is a direct reflection on the credibility and past experience with the proposed seller/owner, which the title insurance provider may seek to investigate and from which it may seek further assurances.

8. Adaptations

Title agents are aware that their commercial customers require individualized non-standard coverage to match the issues the prospective insured has identified as germane to its intended property use. Customers include attorneys who represent commercial developers and purchasers, and their lenders, and the issues frequently involve property access, boundaries and zoning. The refinement of coverage, pricing and receptiveness on the part of title insurance providers in entertaining complex issues will reflect the agent's and title insurer's previous experience with these issues within the jurisdiction and the customer's credibility with the agent.

a. Access

Residential transactions that involve the sale of an existing single family dwelling seldom expand a discussion about access beyond resolving the straightforward inquiry: Does a transferable right of vehicular access to an adjoining road exist? Commercial real estate transactions require establishing the right of the landowner to exercise the kind of access that will support a viable commercial enterprise. Coverage proposals relating to access tend to be unique to the site and anticipated land use, and responsive title insurance coverage format is therefore difficult to standardize.

i. ALTA policy access

All title insurance policies contain insuring provisions, without which the policy form would consist of a real property profile. The 2006 ALTA Owners

Policy contains ten (10) Covered Risks. (Exhibit 47) Of these, that which is inseparable from the policy is a provision which assures against a lack of ownership ["(The insurer) insures … against loss or damage…by reason of… 1. Title being vested other than as stated in Schedule A…"]. It is inconceivable that the provider would propose or that the insured would acquiesce in the deliberate omission of this valuable insuring provision. However, another of the Covered Risks is not uniformly associated with the function of title insurance is a brief provision concerning a right of access ["(The insurer) insures… against loss or damage… by reason of… 4. No right of access to and from the Land."] What does Covered Risk 4 mean in the context of the range of potential difficulties the insured may conceivably encounter during their tenure?

The question of whether there exists a lack of a right of access as defined by the ALTA Owners Policy is, due to regulatory and physical/topographical variations prevailing in the locality of the land, a more complex issue. What kind of access does a title insurance policy, assuming its operative insuring provision has not been modified elsewhere in the policy, assure: (i) Vehicular or pedestrian? (ii) Commercial or residential? (iii) Intensive or sporadic?

The ALTA policy does not insure that a public street abuts the premises or that if a street does abut the premises, that the street has been improved for vehicular use. Title & Trust Co. of Fla. v. Barrows, 381 So.2d 1088 (Fla. App. 1979); Hocking v. Title Ins. & Trust, 37 Cal. 2d 644, 234 P.2d 625 (1951). When compared with other assurances that a prospective purchaser might conceivably seek prior to closing, ALTA Owners Policy Covered Risk 4 affords a basic kind of access coverage. The policy neither identifies by dimension or location the specific point, abutment, corridor or road name by which access is afforded, nor specifies the extent to which an access thoroughfare is open and improved for vehicular travel. Purchasers seeking an enhanced form of coverage should timely request an endorsement that assures the type of access the insured seeks in connection with its intended usage of the premises.

ii. Special access coverage

Title insurance providers neither make personal inspections of the real property they insure nor routinely secure public road information of the kind which enables them to issue an endorsement, ALTA Endorsement 17 - Access and Entry. (Exhibit 48) Therefore, the Access Endorsement is usually not available unless the title insurance provider is in receipt of a current ALTA land survey which contains the land surveyor's determination that the right of way of the public road depicted therein is contiguous with the insured premises, and that curb cuts, driveways and other indicia of access in fact exist on the site. The title insurance provider may, depending upon the specific content of the land survey, require separate documentation confirming that the municipality, county, town which maintains the road, or the State, has authorized the construction and maintenance of the driveways at the site.

b. Zoning

Although it has historically been excluded from coverage by Exclusion 1 of the title insurance policy, zoning coverage is available through two different forms of ALTA endorsements. ALTA Endorsement 3.0 provides the insured with an assurance identifying the district within which the insured land is located and the permitted uses thereof. ALTA Endorsement 3.1 (Exhibit 49) assures the insured of the identity of the district and the uses, but also assures that the ordinances have not been violated with respect to: (a) area, width or depth of the land as a building site, (b) floor space area of the structure, (c) setback of the structure from the property lines, (d) height of the structure, and (e) number of parking spaces. The 3.1 Endorsement was modified in 2003 to add an assurance that the premises do not violate the ordinances with respect to parking spaces.

C. Useful Indemnities

1. Types of indemnities

Indemnities if properly prepared provide the landowner the advantage of flexibility not otherwise possible when attempting to consummate a sale or financing in advance of resolving the validity of or amount owed to the holder of a mortgage or statutory lien. Escrows are routinely created as an incident to real estate transactions for a variety of contingencies or transactions, including mortgage loans that finance new construction, earnest money, completion of improvements the seller is obligated to pay for, unreleased liens, and property exchanges. The terms and conditions of escrows and fees charged by escrowees will vary depending upon the type of issue. In many cases, the escrowee will not agree to undertake any escrow duties unless an escrow agreement that is satisfactory to the escrowee is prepared and entered into by all necessary parties.

2. Indemnities for unsatisfied liens

Title insurers and agents are unlikely to find indemnity proposals appealing unless the amount necessary to release the lien, defect or encumbrance for which the escrow is to be created can be denominated monetarily with a high degree of certainty. For example, judgment liens are universally appropriate to the indemnity because judgments entered by the court are by definition in an amount certain, which (with interest) when tendered to the lien holder requires the creditor to issue a satisfaction of judgment, provided that the escrow agreement so allows. Title agents tend to disdain indemnities that entail the holding of funds for more than a year. For example, a title insurer would likely agree to hold funds pending the expiration of the lien of a judgment that is about to be time-barred by statute, but refuse to hold funds pending the expiration of the lien filed only recently. The reason: The title agent would find acceptable, the retention of funds for the soon-to-expire judgment lien acceptable, but unappealing the administrative cost of holding funds for many years, and then trying to find the party to whom the funds were owed, prohibitive.

3. Indemnities for disputed property ownership interests

   Occasionally, real estate is owned by two or more parties who cannot agree on a sale price or on how the net proceeds of sale are to be divided between them. For example, one co-owner may have paid property taxes, insurance and maintenance, and seek credits for such payments from the other co-owner. Or the co-owners may be parties to an ongoing divorce proceeding, the property settlement for which has not been agreed upon. In contrast to judgment liens, the value of the interest of a co-owner in real estate depends upon variables that without adjudication by a court could prove impossible to quantify. Consequently, title agents would likely decline to consummate a closing for the sale of real estate without the contemporaneous conveyance by all co-owners as grantors; though a cause of action for partition against the non-signing co-owner may in fact exist, the title agent would find objectionable a proposal that a closing be consummated by tendering payment to a non-consenting co-owner after the closing in the hope that the non-consenting co-owner will execute a deed upon receipt of payment of his designated share of the proceeds based upon a property appraisal.

   In some instances, there is agreement among the co-owners that the property should be sold to the purchaser, but the disagreement is over the division of the resulting net proceeds. In the event that the parties contesting the title as co-owners agree to accept the purchaser's offer and not to contest the title of the purchaser, an agreement by all co-owners incorporating these terms could be prepared in which the net proceeds of sale are held, subject to a future determination by the court over how the proceeds are to be divided.

4. Title insurer's right to disburse

   Indemnities will typically afford the title insurer with the unilateral option to pay the lien holder in the event of any enforcement proceeding brought by the lien holder that reaches what the parties agree is a critical point. A failure on the part of the title insurer or title agent to pay the lien holder at some point during the enforcement proceeding would expose the title insurer to an obligation to pay the lien holder an amount that exceeds the funds that are held by the title insurer. The point that the parties to the indemnity may conceivably agree upon, will vary, and may including the commencement of a foreclosure action, the entry of judgment of foreclosure, or the entry of a judgment of foreclosure and expiration of the depositor's right of appeal. Although contrary provisions can conceivably be negotiated with the title agent, title agents tend to use standardized lien escrow agreements.

D. <u>Using, Maximizing land Records Information During the Housing Downturn</u>

Public land records of the kind discussed here are those that impart constructive notice to prospective purchasers and encumbrancers of real estate of liens, defects and encumbrances that impair the title. Public land records are valuable principally because, aside from the occasional custodial foibles resulting in their malfunction, they are transparent, comprehensible and credible in informing the reader having a trained eye

who retrieves them. By timely consulting the public land records, the prospective purchaser can thus ascertain the status of title, assess the prospective of obtaining clear title, and if he proceeds to consummate the closing for the purchase, price the anticipated investment accordingly. Similarly, the prospective mortgage lender can determine what priority it will achieve if and when its loan is disbursed. Public land records are available for those who chose to use them and who after making a proper analysis, determine the identity of the owner and lien holders and, ultimately, the amounts owed them.

1. Consequences to purchasers and lenders of disregarding the public records

Of course, for those who deliberately choose not to consult the public land records, or who carelessly ignore or misinterpret their contents, the consequences of the consummating the purchase or financing can be dire. Prospective purchasers are bound to ascertain at their peril whether there are judgments against the seller which, having attached will remain liens against the property in the hands of the purchaser. R. F. Gehrke Sheet Metal Works v. Mahl, 237 Wis. 414, 297 N.W. 373 (1941). The same is true for the professional intermediary or advisor who discourages the client or purchaser from examining the public land records. Thus the real estate broker who advised the purchaser that "title insurance would be a waste of money" and not to let the "title insurance thing blow the deal because (the property) was a good deal," was liable to the purchaser for negligence and breach of fiduciary duty for damages in the amount of the difference between the price actually paid for encumbered property and the negotiated purchase price. Zee v. Assam, 336 N.W.2d 162 (S.D. 1983). A lender contemplating making an additional advance pursuant to its mortgage who after discovering a judgment lien and requesting that the judgment creditor subordinate its lien, proceeded to make the advance over the judgment creditor's objection, was held to retain priority only up to the amount of the original indebtedness, and beyond that, the judgment creditor had priority. Michael Shea Co. v. Sheehan, 21 Mass. L. Rep 111 (Mass. Super. 2006). The assignee of a $75,000 mortgage that after recordation of a second mortgage in the amount of $775,315 advanced the sum of $1,230,000 (16 times greater than the original loan amount) pursuant to the mortgage's dragnet clause, was held to have constituted an entirely new loan not a modification of its existing $75,000 mortgage, and was thus subordinate to the intervening second mortgage. Nature's Sunshine Products v. Watson, 227 UT App 383, 174 P.3d 647 (Utah Ct. App. 2007).

2. Market trends

When real estate values are rising and the housing market is robust, the relative incidence of liens that impair the title to a wide spectrum of properties, including new and existing homes will be significantly less than when property values are in protracted decline and the market under stress. Thus, declining real estate market conditions compel the prospective purchaser and mortgage lender to more carefully evaluate the risk of liens than would otherwise be necessary. A case in point is home equity lending, where some lenders have deliberately avoided accessing title records on the assumption that the borrower's credit report is a sufficient indicator of the borrower's liens and encumbrances. Are lenders reconciled to the losses they will sustain as the result of liens and encumbrances that impair the title, depriving them of

priority? Banking industry consumer loan losses will ultimately surface for investors and management to peruse and act accordingly. In contrast, consumers will have less tolerance for losses attributable to a failure to properly assess the title. The consumer who, after having purchased a new home, is threatened by subcontractors and suppliers of the homebuilder who filed construction lien claims, cannot spread the risk of loss across a diverse range of investments like a commercial bank, and stands to lose her entire investment as the result of unscrupulous sellers and injudicious closing practices. What measures does the investor or purchaser have at their disposal when negotiating the purchase agreement and closing the purchase of real estate in declining economic times?

3. Obtaining title information: Cost benefit analysis

A search of the title records, unless the user has in-house staff experienced in researching the records, requires that the investor employ a fee-based business or professional who understands how to find and interpret land records information. Thus, the provider of title information charges a fee for providing information in a form that is formatted and standardized. The end result of the title search that is prepared and delivered to the purchaser will vary with the locality, but may include title insurance, an abstract of title, attorney's opinion of title, and a title report, that is, an abbreviated version of the title in which the issuer certifies as to its findings. Title information derived from the public land records can be adapted to suit the needs of the purchaser or lender, depending upon the purchaser's threshold for risk and local conditions in the public records repository. Thus, the cost of title insurance may vary considerably, depending upon rates approved by the regulator and the extent of the indemnification provisions of the policy.

4. Core elements of the title

Any profile of the title to real estate will, at a minimum, include the property's description, the identity of the owner, mortgagees, property taxes, covenants, easements, and statutory liens. Lien status is also accorded to any number of secret liens, that is, liens that are not discernable from the public records, including unfiled mechanic's and materialmens' liens, liens for federal estate tax (26 U.S.C. §6324), and rights of recovery and liens of the federal government in connection with grants to hospitals under the Hill-Burton Act (42 U.S.C. §291 et. seq.). The cost of obtaining title information will often vary with the time period the search had covered: Does the search extend to settlement, or was it truncated or abbreviated to cover only a recent time period, say of the past ten (10) years of ownership history? Real estate investors vary considerably concerning risk tolerance. It is possible that a prospective investor, depending upon the property's anticipated price discount and the investor's time horizon, may be willing to sustain the risk of liens or encumbrances. For example, an investor in modest tax-forfeited properties or land remnants where the sale price is steeply discounted may decide that title research is not warranted where the property will be seasoned or held for an extended period and sold only after outstanding claims have become time-barred. An investor of older residential rental properties that will not entail new construction may decide that a search of easements, covenants and conditions is unnecessary, given the minimal risk

of such matters to prospective lenders from whom financing is sought. Title offices in the community may be willing to explore the scope of their search with the purchaser, explaining which liens and encumbrances are included and which are not, with reference to the title report. As among sources of expertise, title counsel in the locale will likely be most familiar with practical risks of claims attributable to remote or ancient liens or encumbrances and thus be willing to calibrate risk assumption accordingly. Clearly, any lack of understanding on the part of the purchaser places a burden on the purchaser to secure professional advice by obtaining counsel before negotiating the purchase agreement and consummating the closing.

5. Recordation and indexing: The burden is on the filing party

Title evaluation requires more than a pre-closing analysis. The purchaser or lender must also assure that is conveyance has been duly recorded *after* closing. In most states, a conveyance is not duly recorded unless it is duly indexed by the recording clerk. Unfortunately, recording clerks who process, on behalf of the public offices, are not immune from misfeasance or nonfeasance in their custodial recordkeeping work habits. The onus is on the party who submits their conveyance for recording to make certain that the recording clerk has in fact properly indexed the conveyance so that it will be discovered in a future search of the title. Thus, where the borrower acquired title as Susan Rodriguez, but subsequently granted a mortgage by signing her name as Susan Levine-Rodriguez, and the mortgage was indexed by the county recording clerk under the letter "L," the mortgage failed to impart constructive notice to a subsequent lender who, upon foreclosure divested the borrower and enjoyed priority as against the improperly indexed mortgage. The filer of the mortgage had failed to run an additional search to establish proper indexing, thereby subjecting the mortgagee to a loss or priority of its mortgage to a subsequent mortgage. FNMA v. Levine-Rodriguez, 153 Misc.2d 8, 579 N.Y.S.2d 975 (N.Y.Sup. Ct. 1991).

6. Liens and encumbrances revealed: Point, methodology, of analysis

A title search is often the starting point, not the culmination, of the analysis of a lien or potential lien. Once a search and examination has been completed and the title report revealing liens and potential lien claims completed, transaction counsels' task becomes that of determining which potential contestants or lien claimants must be paid and releases secured or, alternatively, which items may be disregarded. Analysis of statutory liens and lien claims, from among a myriad of different types of liens, varies from the routine to the arcane, and examination time requirements vary accordingly. Statute laws governing the lien will determine the ease with which the lien's attachment is ascertainable. For example, if the lien after having been field has become time-barred by applicable statute on the basis of a tangible filing date, the lien can simply be ignored. Most but not all statutory liens lender themselves to cursory measurement with reference to their "birth" date: A statute that provides that judgment liens expire ten (10) years after filing, requires nothing more than a momentary viewing of the public record for verification that filing occurred more than 10 years ago. Once the county docket book reflected that a judgment creditor's lien has expired, prospective lenders are entitled to rely upon that fact and make mortgage loans on the assumption that their mortgage liens enjoy priority, and they

have no obligation to take into account the possibility that the judgment creditor in the future might obtain a new judgment lien. The entry of a renewal judgment did not, as against the mortgagee whose mortgage was recorded after the judgment's expiration, related back to the date of the original judgment that had expired. Gletzer v. Harris, 2008 NY Slip Op 2223 (N.Y. App. Div. 2008). Other statutory liens may be obscure insofar as ascertaining their lifespan is concerned, because either the lien's commencement date or its expiration date is difficult to determine. For example, mechanic's and materialmens' liens in many jurisdictions attach on the date of visible commencement of improvements, a date that is unknowable from the public land records. A fine or order of restitution imposed under Subchapter C. of Chapter 227 of the Anti-Terrorism and Effective Death Penalty Act of 1996 [18 U.S.C. §3613(c)] expires the later of 20 years after entry, 20 years after the release from imprisonment of the person fined, or upon death of the individual fined, dates which the title researcher unfamiliar with the incarcerated person will be hard-pressed to ascertain.

Depending upon the governing statute, lien attachment is not necessarily transparent from an examination, albeit a painstaking one, of the public records. For example, in a state where the judgment lien attaches to the real property of the debtor in the county where the judgment lien was filed, where a debtor has entered into a contract to sell real estate and a judgment is thereafter filed against her, the debtor's interest in the real estate is said to have been converted to personalty by virtue of the contract before the judgment lien came into existence, and the purchaser receives priority over the judgment creditor. Mueller v. Novelty Dye Works, 273 Wis. 501, 78 N.W.2d 881 (1956). Furthermore, a judgment against the debtor in many states does not attach to property that is exempt from execution by the creditor. How is the exempt character of the debtor's property discoverable from an examination of the public land records? In one state it was held that the debtor may, in order to confirm nonattachment, provide an affidavit to the purchaser as evidence of the property's exempt status. Rumage v. Gullberg, 2000 WI 53, 235 Wis. 2d 279, 611 N.W.2d 458 (2000). Where the property is exempt so long as the homeowner's equity is less than $0,000, it was held that the astute homeowner may unilaterally prevent attachment of the judgment lien by perpetually refinancing their mortgages, thereby exhausting the remaining equity in the property. Hazard v. Overhead Door Co., 113 B.R. 494 (Bankr. W.D. Wis. 1990).

7. Negotiations among parties, claimants

Where the question of lien attachment defies a straightforward analysis culminating in the disregard of the potential lien, negotiations may ensue. In the event that title insurance has been obtained, the title insurer may become an active participant in the negotiations, determining which of the potential liens and encumbrances, if any, it is willing to disregard or insure against. It may not necessarily be apparent to the purchaser that the title insurer will not volunteer coverage against liens or encumbrances revealed by a search of the records, but that it must be asked to recognize or explore sometimes complex legal theories concerning lien attachment and enforceability. Discussions may include indemnification by the seller, particularly when the legal theory surrounding the potential lien's enforceability is unclear. Discussions may sometimes include an array of parties having closely

aligned or disparate interests, including title counsel, bankruptcy trustees, lender's counsel, commercial tenants, real estate brokers, general creditors, tax authorities, regulatory agencies, and law enforcement authorities. In the event that liens determined to have attached cannot be negotiated with the lien holder, barring unusual circumstances, the transaction will not close and if foreclosure ensues, the court will determine priority, in many instances leaving subordinate lien holders without recovery.

8. Capitulation: Deed in lieu of foreclosure and non-merger

Where a multitude of liens frustrates the sale of the debtor's real estate, foreclosure or a deed in lieu of foreclosure may be the only alternative. Occasionally, the mortgagee and mortgagor will have reached agreement calling for a relinquishment of the mortgagor's ownership of the real estate in exchange for a release of the mortgagor's obligations. Timely execution and recording of a deed ending the tenure of the borrower may prove valuable in preventing the attachment of more liens against eh property. However, when a deed is executed to avert foreclosure, negotiations may not necessarily have included the holders of all liens, or these negotiations may be ongoing and transcend delivery of the mortgagor's deed in lieu of foreclosure. In such instances, the mortgagee will be well advised to explore the jurisdiction's law concerning non-merger of the borrower's title, encumbered as it were by liens, with the interest of the mortgagee: Does the mortgagee retain, after having received a conveyance of the real estate by the mortgagor, its mortgage such that the mortgagee retains a right to foreclose as against subordinate lien holders? When the owner of real estate executes a mortgage, two interests are created: one, the interest represented by the mortgage, and the other, the fee title subject to the mortgage. Union of these two interests in the same entity extinguishes the mortgage debt, unless the parties to the conveyance intended otherwise. However, when an intervening lien exists, a mortgagee's acquisition of an equity of redemption does not merge its legal estate as mortgagee so as to prevent foreclosing its mortgage to defeat a second mortgage or a subsequent lien, unless such appears to have been the intention of the parties and justice requires it; and such intention will not be presumed where the mortgagee's interest requires that the mortgage should remain in force. Shelton v. La Brea Materials Co., 216 Cal. 686, 15 P.2d 1098 (1932). Generally, the mortgagee's interest determines whether a deed from the mortgagor to the mortgagee constitutes a merger. Cleary v. Batz, 225 Wis. 82, 273 N.W. 463 (1937). "Many mortgagees who accept a deed in lieu of foreclosure use various techniques intended to prevent merger of the mortgage lien into the fee simple title. Mortgagees employ these techniques to keep the mortgage lien alive in the event the deed is later set aside for legal or equitable reasons and to avoid an argument that the mortgage was discharged when the underlying debt was canceled." 3 Joyce Palomar, Patton and Palomar on Land Titles, 564 (2007).

Care must be taken by the mortgagee to appreciate the continuing risks it will sustain if it acquires the real estate through a deed in lieu of foreclosure. Though the law of the state may be favorable to the mortgagee who receives the conveyance in lieu of foreclosure, the title insurer who is asked to provide title insurance to insure the lender's interest acquired by deed in lieu of foreclosure will, after searching the title

and finding liens against the debtor, will take exception to the liens. The title insurer is unlikely to remove from its policy, without releases of the liens, the subordinate liens, instead requiring that the lender consummate its foreclosure against subordinate lien holders before regarding these liens as unenforceable. During the interim between the deed in lieu of foreclosure and the foreclosure judgment, title will remain unmarketable as a result of the existence