

A PRACTICAL GUIDE TO TITLE REVIEW (With Form)

Shannon J. Skinner

Shannon J. Skinner is a partner with Preston Gates & Ellis LLP, in Seattle, Washington.

The standard title insurance policy might have some things you need and some things you don't.

The safe course is always to review the specifics of the transaction and structure the coverage accordingly.

FEW REAL ESTATE TRANSACTIONS are closed without a title insurance policy. In most real estate transactions, at least one party's satisfaction with the state of title is a key condition to the closing. Indeed, some transactions close only because of the insurer's agreement to provide coverage for a title problem that otherwise would cause the transaction to collapse. But the title insurance policy does not magically appear at closing. Much of a real estate lawyer's effort in closing the transaction is directed to reviewing the state of title, resolving issues with the title, determining which title risks are acceptable to the client, and deciding what types of affirmative coverage are appropriate for the client and the transaction. Thus, competent review of the preliminary title evidence and resulting policy is an essential skill for the real estate lawyer.

Few guides, however, exist to explain how to review the title evidence or the policy. This article discusses some practical tips for title reviews and includes as Appendix 1 a Memorandum form to be completed as part of the review process as well as a sample review/memorandum. A note about surveys: Conducting a comprehensive title review is impossible without a current survey of the property. The following discussion assumes that a current survey is available for the title review.

TITLE EVIDENCE • The first step in reviewing title is to determine the type of title evidence under scrutiny. Preferred for most sophisticated real estate transactions is a preliminary commitment for title insurance prepared using the American Land Title Association (“ALTA”) form. The preliminary commitment is not a report on the status of title but rather is a contract in which the insurer agrees to issue a policy subject to the conditions, exceptions, and exclusions shown in the commitment. Commitments are valid for a certain period of time (generally six months) and must be extended if necessary. They are organized in much the same fashion as title policies.

Reports vs. Commitments

By contrast, title reports and abstractor’s reports are true reports on the status of title as of a certain date and do not include the assurance of policy issuance provided by a commitment. Nevertheless, the terms “report” and “commitment” are often used interchangeably and their availability varies by jurisdiction. So, as a preliminary matter, the title reviewer should determine the type of title evidence both required and available. The following discussion assumes that the reviewer is reviewing a preliminary commitment.

SCHEDULE A MATTERS • The first matters to review in a preliminary commitment are those that will appear in Schedule A of the title policy. These are generally the first matters shown in the commitment and should be noted on the title review memorandum. These include:

- Date;
- Type of policy;
- Policy amount;
- Names;
- Quality of estate; and
- Legal description.

Date

The date of the commitment is important—how old is the information? Could a real estate tax payment have become delinquent since the commitment date? Has the commitment expired? Should it be updated?

Type Of Policy

The commitment will also show the type of policy the insurer is committed to issue. Most sophisticated parties in real estate transactions require a policy issued on an ALTA form if available in the jurisdiction. The question usually focuses on which ALTA form to use. The ALTA most recently revised the lender's and owner's policy forms in 1992. Nevertheless, many insureds (in particular institutional real estate lenders) insist on the 1970 or 1970 with 1984 revisions form of policy. Because one of the main differences in the 1992 form is the inclusion of the "creditor's rights exception," which is objectionable to many proposed insureds, any issues with the form of policy should be raised early. This will provide the insurer with adequate time to review the draft documents and transaction structure to determine if it is comfortable removing the creditor's rights exception. This issue may be easily resolved in a typical mortgage loan transaction but may be quite difficult in a post-foreclosure policy or leveraged buy out transaction, so addressing this issue sooner rather than later is beneficial.

As between the 1970 and 1970 with 1984 revisions forms, many insurers prefer the later version because it narrows the definition of "public records" to be the traditional real estate records (and not other public records such as the Federal Register) and expressly excludes environmental matters unless a lien therefor is recorded in the records in which these liens should be recorded (often the federal courthouse for CERCLA liens). Because insurers have argued that the 1970 form of policy did not include any coverage for environmental matters (being "police power" matters excluded under Exclusion 1), some insureds prefer the 1984 revisions so as to at least have coverage of recorded environmental liens.

Update Underway

ALTA is currently in the process of a comprehensive update of its loan policy form. Unlike earlier form changes, which primarily addressed legal developments, the current undertaking promises to substantially update the policy to deal with changes in the mortgage finance marketplace as well as the title industry. Look for promulgation of this form by early 2006. The new form could well become the policy of choice for lenders.

The Practicalities

An additional issue may be that not all title company offices in all counties have the earlier policy jackets. Although the ALTA has not withdrawn any of the forms, some offices simply do not stock the earlier jackets and must obtain them from a regional underwriting office.

Policy Amount

The amount of the proposed policy and premium are also shown in the commitment. The insurer should know this amount as early as possible to enable it to determine if the policy will be “high liability”—one needing special internal underwriting approvals. The face amount of the policy is a limit on the amount that the insurer is obligated to pay (together with defense costs). In addition, damages are also capped by the value of the property (without the alleged defect) and the loan amount plus interest (for lender’s policies), so the insured does not benefit from either over- or underinsuring its interest. The ALTA 1992 policy forms contain co-insurance provisions, so underinsuring is especially ill advised with these policies. Lender’s policies for loans that have negative amortization or future advance features may require special endorsements or a larger face amount, as may owner’s policies for property on which the owner expects to construct significant improvements.

Is Co-Insurance Or Reinsurance Needed?

The policy amount should also trigger some thought about whether co-insurance or reinsurance is required. If the policy amount is larger than the insurer’s self-imposed limits or those imposed by the client, work should begin early on identifying co- or reinsurers and providing appropriate preliminary information to them. Co- and reinsurance can also add to the cost of the title insurance and these costs should be identified early in the transaction. Often, the cost can be reduced by keeping the co- and reinsurance in the same family of title companies.

Premium Amount

The premium for the policy should also be noted with the amount. This is the appropriate place to inquire about the basis for the premium. Were any applicable discounts (such as short-term, reorganization or builder’s rates) used? Are other insured transactions occurring simultaneously (such as purchase and related financing transactions) for which special rates are available?

Names

It is surprising how often the name of the proposed insured and the name of the vested title holder do not match the draft legal documents. For example, the purchaser’s lawyer may learn that the party that signed the purchase and sale agreement is not fully vested in title (perhaps title is vested in a partnership or is jointly held with a spouse), which may raise questions about the enforceability of the agreement. The lender’s lawyer may learn that the draft loan documents describe a borrower who is not in title (perhaps a name change or inter-entity transfer has occurred, or a partner never transferred title into the partnership). Resolving any discrepancies here is important. The answer may be as simple as adding a “who took