

Title Insurance for the General Practitioner:

SOME INSIDER TIPS



By
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FAST FACTS

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For residential transactions, standards for many title insurers require searching back only to the last purchase money warranty deed and purchase money mortgage.

To protect your client, you should ask the title company to provide you with a marked title commitment at closing.

Title insurance for lenders and buyers is a key component in modern real-estate transactions. Yet the role of title companies is frequently misunderstood. Title companies have a dual role in real-estate transactions: one as an insurer of the title to real property, the other as escrow agent.

In the role of title insurer, the title company issues title insurance policies, of which there are two main types: an owner's policy and a loan policy. Subject to exclusions, exceptions, and conditions, an owner's policy of title insurance insures against loss or damage due to:

- Title being vested other than as stated in the policy;
- Any defect in, or lien or encumbrance on, title;
- Unmarketability of title; and
- Lack of access to and from the land.

A loan policy of title insurance further insures against loss or damage due to:

- The invalidity or unenforceability of the lien of the insured mortgage;
- The priority of any lien or encumbrance over the lien of the insured mortgage;
- Lack of priority of the lien of the insured mortgage over certain statutory liens for services, labor, or material; and
- The invalidity or unenforceability of any referenced assignment of the insured mortgage.¹

Like other insurance policies, title insurance policies contain exceptions and exclusions from coverage. Unless removed by the insurer, a loan policy of title insurance contains exceptions for (a) rights or claims of parties in possession not shown of record; (b) encroachments, overlaps, boundary line disputes, shortages in area, and any other matters that would be disclosed by an accurate survey; (c) easements or claims of easements not shown by the public records and existing water, mineral, oil, and exploration rights; and (d) any lien, or right to a lien, for services, labor, or material imposed by law and not shown by the public records. Unless deleted by the insurer, an owner's policy of title insurance contains the same exceptions, plus exceptions for (a) restrictions on the use of the premises not shown of record; and (b) dower or homestead rights, if any, of the wife of any individual insured or any individual shown to be a party in interest.² These exceptions are known as "standard exceptions," which may be deleted by a title company upon receipt of affidavits, a survey, and any other items that the title insurer requires.

The second role of title companies is that of escrow agent. As escrow agent, the title company is an agent for the lender, and may be a dual agent for the buyer and seller, until all conditions have been satisfied and the transaction closes. An escrow agent must faithfully follow the written and accepted instructions of the principals, and can be held liable for not following written

escrow instructions based on breach of contract or breach of fiduciary duty or both. Unlike the title insurance policy, there are *no* limits of liability, exceptions, or exclusions for breach of contract or fiduciary duty unless otherwise agreed to in writing by the principals.

With that background, here are some tips on the effective use of title insurance and title insurance companies:

Tip #1

Don't close a deal without title insurance.

Nothing in the law requires a buyer or lender to obtain title insurance. However, the idea that a party can do without title insurance because of a low risk of claims is dangerous. According to the American Land Title Association (ALTA), in 2005 over \$748 million in claims was paid by title insurers in the U.S. Title insurers pay claims arising from (a) construction liens, (b) fraud and forgery, (c) expired powers of attorney, (d) title examiner's oversights, (e) recording and indexing errors, (f) conveyances by incompetent persons, (g) undisclosed marriages, and (h) transactions by unauthorized individuals.

Tip #2

Title insurance companies do *not* search the entire chain of title in the public records.

For residential transactions, title search standards for many title insurers require searching back only to the last purchase money warranty deed and purchase money mortgage in the chain of title. Further, title companies rely on the Michigan Marketable Record Title Act,³ which provides that any person with an unbroken chain of title to an interest in real property for 40 years, with no instrument purporting to divest the owner of title, has marketable record title to that real property interest.

Tip #3

Get a survey.

A survey is generally required to delete the standard exception for matters of survey from an owner's policy of title insurance. While title insurers will often issue a loan policy deleting the standard survey exception without a survey, lack of a survey may result in other problems. For example, title companies search the records only for the property description provided by the customer; if this description is incomplete, title to a portion of the property may not be searched without anyone realizing the omission. In one memorable transaction, the customer provided a metes and bounds legal description that matched the last warranty deed, the description used by the tax assessor, and the last two commercial mortgages recorded on the property. When the survey arrived on the day of closing, everyone involved was surprised to discover that the supplied legal description described only a parking lot and not the industrial building being

sold. When it comes to land, a picture is indeed worth a thousand words.

Tip #4

Most title companies charge a reduced premium for a prior policy, even if issued by a different insurer.

All title insurers in the state of Michigan are required to file with the Michigan Office of Financial and Insurance Services their rate schedule, and to charge premiums according to the filed rates. The rates for most, if not all, title insurers include a lower rate for policies issued based on a prior title policy, regardless of which insurer issued the prior policy. Ask for a lower “reissue rate,” even if a different insurer issued the prior title policy.

Tip #5

Get a marked commitment at closing.

Once a closing occurs, the title company sends documents to the register of deeds for recording. Depending on the county, recording could take from one day to a few months. Some registers of deeds do not immediately record documents delivered by a title company, but rather require title companies to place their documents for recording in a designated location, for review and recording at a later date. The title policy is only issued after the register of deeds certifies to the title company that the county’s records are complete as of a date after the date the insured deed or mortgage was recorded. To protect your client, you should ask the title company to provide you with a marked title commitment at closing, where the title company marks its commitment with a pen to:

- change the effective date of the commitment to “date of recording of vesting deed” or “date of recording of insured mortgage”;
- delete the word “proposed” from the phrase “proposed insured” in Schedule A of the commitment;
- change the name of the owner from the seller to the buyer, if title is conveyed;
- indicate that all requirements to the issuance of a policy have been met, including the payment of real property taxes and assessments, any outstanding mortgages, and other liens; and

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- delete any exceptions to coverage that the insurer is willing and able to delete.

Tip #6

Carefully consider the effect of the form of conveyance on the grantor’s owner’s policy of title insurance.

Practitioners frequently ask about the form of deed to be used when conveying property from an insured to a related party (such as an individual conveying to a trust for estate planning purposes). Under the 1992 title insurance policy forms (in use before 2007), the definition of “insured” is the person named in the policy as an insured and anyone who succeeds to the interest of the named insured by operation of law, as distinguished from purchase. The 1992 policy forms also provide that coverage continues for the insured only so long as the insured (a) retains an estate or interest in the land, (b) holds an indebtedness secured by a purchase money mortgage given by a purchaser from the insured, or (c) has liability by reason of covenants of warranty made by the insured in a conveyance of the property. Thus, the 1992 forms of title insurance policies do not continue to insure a grantor who transfers title by quitclaim deed into a grantor trust (unless an additional insured endorsement is purchased at that time), but do continue to insure an owner who transfers title into a trust by a warranty deed. In 2006, ALTA promulgated new title insurance policy and endorsement forms. Now in use in Michigan, one of the changes in the new owner’s policy is that the definition of “insured” includes a “grantee of an insured under a deed delivered without payment of actual valuable consideration conveying the title (1) if the stock, shares, memberships, or other equity interests of the grantee are wholly-owned by the named insured, (2) if the grantee wholly owns the insured, (3) if the grantee is wholly-owned by an affiliated entity of the named insured, provided the affiliated entity and the named insured are wholly-owned by the same person or entity, or (4) if the grantee is a trustee or beneficiary of a trust created by a written instrument established by the insured named in Schedule A for estate planning purposes.”⁷⁴ Thus, under the new ALTA forms, the grantor in a number of conveyances will continue to be insured under its title insurance policy notwithstanding the form of deed used.

Tip #7

If you represent a lender, obtain a closing protection letter.

A closing protection letter (sometimes referred to as an “insured closing letter”) offers lenders additional protection. A typical closing protection letter is given by the title insurance underwriter (not a title insurance agent). In the letter, the insurer undertakes to reimburse the lender for actual losses incurred by the title agent’s failure to follow the lender’s written instructions that relate to (a) the status of title or the validity, enforceability, or priority of the lender’s mortgage; (b) the obtaining of any other document required by the lender; or (c) the collection and disbursement of

monies due to the lender. The closing protection letter also provides protection from the agent's fraud, dishonesty, or negligence in handling the lender's funds and documents. Once received, a lender has recourse against the title insurer for the failures of the title insurance agent, as described in the letter.

Tip #8 Take full advantage of available endorsements; many are free.

Title insurance endorsements modify or extend insurance coverage provided under a title insurance policy. There are two types of endorsements. The first involves endorsements that change the terms of the policy itself, such as the defenses, exclusions, or terms and conditions of a policy. The second type provides affirmative insurance for specific matters. As policy forms have changed to exclude various matters, the title industry has also provided endorsements addressing practitioner requests to delete certain exclusions or policy terms. Some endorsements are available at no cost; others require payment of additional premium. The typical cost, if any, of the endorsements addressed in this article is indicated below. The actual cost of the endorsements, and the underwriting standards, may differ from insurer to insurer. While some endorsements can be issued with either owner's policies or loan policies, the coverage given under an endorsement can vary, depending on the type of policy.

A few of the more common endorsements include:

Usury endorsement (10–15 percent of the basic rate), insuring a lender against losses sustained because of a determination that the mortgage is invalid or unenforceable because the loan violates federal or state usury law.

Environmental lien endorsement, insuring the lender against damages caused by a lack of priority of the mortgage over (a) an environmental protection lien, recorded as of the policy date; and (b) any environmental protection liens provided for by state statute except those that arguably provide for "super priority."⁵

Comprehensive endorsement (sometimes referred to as an "ALTA 9"), insuring against loss or damage resulting from (a) violations of building or use restrictions, (b) exercise of rights to remove minerals, (c) encroachments, (d) certain liens for private assessments, and (e) certain options or rights of first refusal. The loan policy comprehensive endorsement also insures the priority of the insured mortgage as a result of a violation of recorded covenants, conditions, or restrictions affecting the insured property.

Creditors rights endorsement, providing coverage for claims based on fraudulent conveyances, preferential transfers, and, in the case of loan policies, equitable subordination. This endorsement can involve substantial risk, and is therefore carefully underwritten. The insured must disclose all of the details of a transaction if a creditors rights endorsement is requested, including details of the use of any loan proceeds.

Zoning endorsement (10–15 percent of basic rate). There are a few different zoning endorsements. The endorsement for

vacant land insures the zoning classification of the insured land and the uses permitted under that zoning classification. The endorsements for improved land insure the zoning classification, permitted uses, and compliance with the ordinance as it relates to setbacks, area restrictions, and, in some cases, parking space requirements. Issuance of these endorsements requires review of the zoning map and ordinance, and written confirmation from the municipality that there are no outstanding zoning violations. If rezoning has resulted in the improvements on the subject property no longer being a conforming use, an

endorsement may be obtained insuring that the structure is a permitted non-conforming use. To do so, the title insurer will require written confirmation from the municipality that the use is lawful, based on a grandfather clause in the zoning ordinance.

Arbitration endorsements vary. One modifies the policy provision requiring arbitration of disputes for policies under \$1,000,000, so that arbitration is used only if both parties agree. Another variation of the endorsement eliminates the policy provision requiring arbitration.

Title insurance can be an effective tool when representing your client in the purchase of property, or in the making of a mortgage loan. Its effectiveness increases with the increased knowledge level of the buyer's and lender's counsel. Be sure to get a survey before closing and a marked-up commitment at closing. By taking those steps, and obtaining the necessary endorsements, your buyer or lender client will be better protected against the risks inherent in real-estate transactions. ■

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FOOTNOTES

1. ALTA Loan Policy of Title Insurance (10-17-92).
2. ALTA Owner's Policy of Title Insurance (10-17-92).
3. MCL 565.101, *et seq.*
4. ALTA Owner's Policy of Title Insurance (06-17-06).
5. See, e.g., MCL 324.11101 *et seq.*, MCL 324.20101 *et seq.*

