

## **GETTING TO INSURABILITY: COMMITMENT REQUIREMENTS AND EXCEPTIONS**

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### Disclaimer

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- I. Why do we have the requirements and exceptions in our Commitments? Why are they there? What do they mean?
  - a. Generally speaking, we have requirements and exceptions in commitments to inform the proposed insured what needs to be done before the company is willing to insure and what specific matters will be excepted from coverage.
  - b. Just as there are variations among different real estate titles, each policy of title insurance will vary according to unique matters, specific to a property and transaction. Requirements and exceptions are in part the tools used to craft coverage specific to a particular title.
  - c. Title insurance does NOT cover everything under the sun relating to real property. Coverage is limited by the enumerated covered risks, exceptions, exclusions and conditions found in the policy. Requirements and exceptions are crafted in light of the covered risks provided in the policy.
  - d. Title commitment requirements are found in Schedule B-I of the Commitment. They seek to eliminate all risks associated with the enumerated covered risks in the policy, as well as address any extra-hazardous risks associated with the title or the parties to the transaction. Extra-hazardous risk consists of defects or irregularities discovered in a title search and/or the nature of the grantors or grantees. Examples include, but are not limited to, inadequate legal descriptions, lack of access, estates, business entities, defects in a deed in the chain of title, deeds of trust, judgments, mechanic's liens, lis pendens, etc. Requirements tell the proposed insured what needs to be done to render the title insurable. Requirements can be as simple as requiring the release of a security instrument, or as complicated as seeking a court order to quiet title. Absent extra-hazardous risks, requirements tend to mirror the covered risks in the policy. (See Schedule B-I requirements below)
  - e. Not all matters affecting a title can be eliminated. It's rare to find a title that is unaffected by some kind of voluntary or involuntary encumbrance. And even if such a case is found, the property is still subject to taxation. Title commitment exceptions exclude from coverage matters of record affecting the real estate, unreleased encumbrances (known and some unknown), taxes and extra-hazardous risks. These exceptions are found in Schedule B-II of the commitment. If such matters were not excepted in the final policy, their presence could be grounds for a claim. (See Schedule B-II exceptions below)

f. A closer look at standard “Schedule B-1: Requirements”

Schedule B-1 contains requirements that must be fulfilled for the title insurance to be issued. While the order of these requirements is not important, every title commitment, regardless of the transaction, will usually contain a certain number of “standard” requirements. The ALTA Commitment Form has very little to offer in this regard, and title insurers differs as to what requirements should be standard in every commitment. The most common standard requirements (and comments thereto in brackets) are as follows:

1. *The Proposed Insured must notify the Company in writing of the name of any party not referred to in this Commitment who will obtain an interest in the Land or who will make a loan on the Land. The Company may then make additional Requirements or Exceptions.*

[Comment: the title producer needs such information to create the Commitment appropriately. For example, assume that a title search is ordered based on a sales contract between Robert Miller (purchaser) and Samuel Layton (seller). Of course, the seller’s name is researched in the land records to evaluate what liens, if any, are on title. But the purchaser’s name is also researched because it is possible that an IRS lien is recorded in the land records where the property is located. If that is discovered, a title producer would take exception to that lien because IRS liens may have priority over the funding lender’s lien, which the title producer is insuring. With that in mind, suppose now that Robert is the only one on the loan, but Robert wants his girlfriend for 11 years (Betty Silvermain) to also be on title with him. Since Betty is not on the loan, Robert did not think to involve her in the process but intends to mention at closing that Betty should be put on the deed. That will not give the title producer time to research Betty’s name in the land records to discover if she has (for instance) an IRS lien recorded against her. It is for this reason a proposed insured must notify the title producer of such matters.]

2. *Pay the agreed amount for the interest in land and/or mortgage to be insured.*  
[Comment: If the lender doesn’t make the loan, or the purchaser doesn’t pay for the property, there is no obligation to issue title insurance.]
3. *Pay the premiums, fees, and charges for the Policy to the Company.*

[Comment: If the title company is not paid, there is no obligation to issue title insurance—you can't get something for nothing!]

4. *Instruments in insurable form which must be executed, delivered and duly filed for record:*

(a) *Warranty deed from \_\_\_\_\_, citing marital status, if applicable, to \_\_\_\_\_, vesting fee simple title in the real estate.*

(b) *Deed of Trust from \_\_\_\_\_ to the Trustees to be named for insured lender.*

[Comment: In short, if the transaction involves a transfer of title, there must be a deed recorded. (The sales contract often specifies which kind of deed—general or special warranty.) If the transfer involves a loan, there must be a deed of trust recorded.]

5. *You must provide an Owner's Affidavit satisfactory to the Company.*

[Comment: The "Owner's Affidavit" is a document which covers a hodgepodge of title matters. By obtaining an affidavit from the owner that such matters do not apply to the property, the title producer brings such issues to the fore and preserves a right of recovery against the owner for the benefit of the title insurer if such matters do in fact prove to apply. The owner's affidavit is discussed at greater length below.]

6. *Satisfaction and release of record the following item(s):*

[Comment: Any lien reported on the title search must be listed here. Such liens must be paid (*i.e.*, satisfied) and released or otherwise disposed of to the satisfaction of the title insurer. Routinely, this includes the seller's loan, so the seller's deed of trust is referenced here. Additionally, there may be judgments or liens recorded against the current seller or prior owners—these must also be referenced here. Sometimes, the deed of trust from a prior owner remains unreleased—that must also be referenced here.]

7. *If survey coverage is required in the Owner's Policy, provide a copy of a satisfactory current survey of the property subject to review by the Company. If ALTA Homeowner's Policy (01/01/10) is chosen by purchaser, and no survey is obtained, covered risks 21, 22, 23, and 24 will be deleted from the Owner's policy.*

[Comment: Ordinarily, a title insurance policy will cover matters such as easements, encroachments, building restrictions, etc. Often these are found in the land records. Sometimes they are not. For example, perhaps the length of the search is not long enough to discover an easement recorded 100 years ago. Furthermore, some matters like encroachments are not intentionally recorded in the land records at all because they are accidental. The only way to discover these kinds of matters (old or accidental) is to obtain an accurate survey. Unless such a survey is obtained, there will be an exception in the owner's policy for any matter that could have been revealed by an accurate survey. Furthermore, if such a purchaser selects an ALTA Homeowner's Policy (01/01/10), not only will there be an exception, but certain coverages will be eliminated altogether. We will review the coverages of the Homeowner's Policy in more detail in the next unit of the course.

In summary, if an owner wants "survey coverage," then the owner must get a survey that would expose such matters. For lenders and loan policies, however, it is a different story. Loan policies present less risk than owners' policies because a loan policy becomes operative only when foreclosure occurs. And because loan policies present much less risk than an owner's policy, survey coverage is given to lenders regardless of whether a survey is ordered.]

8. *Pay all taxes, charges, assessments, levied and assessed against subject premises, which are due and payable.*

*Real Property Taxes are paid through \_\_\_\_\_.*

*Real Estate Taxes ( \_\_\_\_\_ [tax year] assessment)*

*Parcel ID#: \_\_\_\_\_*

*Amount: \$ \_\_\_\_\_ per year (due \_\_\_\_\_ )*

*Next Due: \_\_\_\_\_*

*Assessment Information for \_\_\_\_\_ [tax year]*

*Total: \$ \_\_\_\_\_*

*Tax information must be verified with local taxing authorities.*

[Comment: According to statute, real estate taxes, if unpaid, create a lien on the subject property that is superior to all others. Therefore, it is essential that real estate taxes be paid. This requirement says as much and gives details about those taxes: the date that taxes are paid through, the applicable assessment year, that tax parcel identification number, the annual amount due and when it is due, the due date of the next payment, the current assessment, and the total amount due. Such items can change, so at the end of this requirement is a qualification: “tax information must be verified with local taxing authorities.”]

9. *Run PACER report on current owners to determine if bankruptcy has been filed. If any party is in bankruptcy, the Company must receive a satisfactory, final and non-appealable\* Court Order (a) authorizing the transaction to be insured, or (b) declaring the property exempt. In a Chapter 7 Bankruptcy the trustee may give written notice the real estate is abandoned. Additional requirements or exceptions may be made upon review. (\*After the 14-day appeal period has passed without appeal.)*

[Comment: Once a debtor declares bankruptcy, all his property—both real and personal—come under the jurisdiction of the bankruptcy court. No deed or deed of trust or any such document may be executed by that debtor until the bankruptcy court so orders and such order becomes non-appealable. “PACER” stands for “Public Access to Court Electronic Records”; it provides on-line access to U.S. Appellate, District, and Bankruptcy court records and documents nationwide. By entering an individual’s SSN, a title/settlement agent can confirm whether an owner of real estate is currently in bankruptcy—otherwise, we run the risk that any document he executes is void, triggering a claim.

10. *Examination of the appropriate public records in the name(s) of the purchaser(s) of the property proposed to be insured and described in this title commitment, and disclosure to the Company of all liens and judgements in favor of the United States. Unless released of record or otherwise disposed of to the satisfaction of the Company, such liens and judgements will appear as exceptions in Schedule B, page 1 of the final policy.*

[Comment: this last requirement is counterintuitive. Why would we search the purchasers' names? They are not on title. How could any lien filed against them attach and trigger coverage under a title insurance policy? Put simply, the answer is this: *While the IRS has stated that a purchase money mortgage interest (PMMI) has priority over previously recorded federal tax liens, the IRS's position is far from conclusive, as evidenced by numerous court cases where this issue has been litigated.*]

Of course, this is only one commitment to illustrate the basics. Once you get beyond the basics, it's time to start thinking about what special requirements you need to put into a commitment based on the title work. Is your insured an entity? Is your seller an estate? Is your transaction a foreclosure? Is there a life estate involved? Does the property abut water? These issues and many more may trigger unique requirements for your commitment. For a comprehensive list of sample requirements, contact your title insurer.

g. A closer look at standard "Schedule B-1: Exceptions"

Schedule B-2 contain exceptions to coverage—items that are not going to receive coverage in the final title insurance policy. Like the "Requirements" section, there are the following "standard" exceptions that should accompany every commitment:

*Schedule B of the policies to be issued will contain exceptions to the following matters unless the same are disposed of to the satisfaction of the Company:*

1. *Defects, liens, encumbrances, adverse claims or other matters, if any, created, first appearing in the public records or attaching subsequent to the effective date hereof but prior to the date the proposed insured acquires for value of record the estate or interest or mortgage thereon covered by this commitment.*

[Comment: The commitment is only accurate up to the Effective Date. But closing and recordation happens sometime after—days, weeks, even months. The time between the Effective Date and the time of recordation is called "the gap". This language excepts from coverage any matter appearing of record during this time. Of course, it would be natural for the insured (particularly the lender, who reviews the commitment) to want coverage during this period. That is why in Virginia, after settlement, a "bring-down" must be performed prior to recordation. In other words, after settlement a title searcher must research the title from the Effective Date to the present. If nothing has changed, then the

documents for the transaction may be recorded and this exception may be removed from the final title policy. Not only is this exception removed, but as we will see later on, the insured is given specific coverage for this “gap” period in the section entitled “Covered Risks.”]

2. a. *Any lien, or right to lien, for services, labor, or material heretofore or hereafter furnished, imposed by law, and not shown by the public records.*

[Comment: A lien for services, labor or materials is called a “mechanic’s lien,” and such liens are ordinarily given special priority—even over a previously recorded deed of trust, which is one of the things a title agent insures. (This is another exception to the “first in time, first in right” rule.) But according to the statute that creates this lien, it must be recorded to be enforceable. That is why a title agent will research the land records before drafting a commitment. If the title agent misses a mechanic’s lien duly recorded, the insured will have coverage. But note the language of the exception—this is excepting from coverage any such lien “not shown by the public records.” We cannot provide coverage for matters that are not part of the land records system. That would be *risk assumption*, and as mentioned earlier, a title agent is in the business of *risk elimination*.]

b. *Any discrepancies or conflicts in boundary lines or shortage in area or encroachments, which a correct survey or any inspection of the premises would disclose; Such state of facts discoverable by an accurate survey and inspection of the premises.*

*NOTE: If ALTA Homeowner's policy is chosen by purchaser, and no survey is obtained, covered risks 21, 22, 23, and 24 will be deleted from the Owner's policy.*

*NOTE: Deleted from an ALTA Short Form Residential Loan policy unless specifically excepted below.*

[Comment: This is known as the “survey exception,” which was referenced above in Requirement No. 7. To reiterate: the only way to discover some kinds of matters is to obtain an accurate survey. Unless such a survey is obtained, the exception above will be inserted into the final title policy with certain Covered Risk (related to survey coverage)

eliminated. If an owner wants “survey coverage,” then the owner must get a survey that would expose such matters. But for lenders, survey coverage is given as a matter of course, with or without a survey, because the risk is far less.]

*c. Rights or claims of parties in possession not shown by the public records.*

*NOTE: These exceptions in #2 will be deleted from the loan policy upon requirements being met.*

[Comment: Again we are confronted with another matter “not shown by the public records,” which is not what title agents insure. Parties in possession of the subject property can have various rights that may affect title. Perhaps such occupants have satisfied the elements to enforce a claim of title under the theory of adverse possession. Perhaps the occupant is a tenant with an unrecorded lease. Or perhaps the occupant has an unrecorded agreement of sale. These and similar examples could create title problems later on, triggering the title insurer’s duty to defend. It is for this reason title agents should have this exception in the title policy. But take note of the “NOTE”—all of these exceptions (2a, 2b and 2c) will not appear in the final loan policy because loan policies present less of a risk.]

2. *Real estate taxes, including supplemental taxes, if applicable, and municipal charges for \_\_\_\_\_ and subsequent years, not yet due and payable.*

[Comment: unpaid real estate taxes and municipal charges can serve as the basis for another lien that is given special priority, another exception to the “first in time, first in right” rule. That is why a title agent must except from coverage all such future liens.]

4. *Matters shown on subdivision plat referenced in Schedule A.*

[Comment: A subdivision plat is often a wealth of information, showing in particular a variety of easements, encroachments, building restriction lines, etc. By excepting to any

matter shown on the subdivision plat, the title agent incorporates by reference all such matters. That is why it is critical to confirm that the Deed Book and Page Number (or Instrument Number) for the subdivision plat referenced in the legal description is correct. Otherwise, all such matters could fail to qualify as exceptions and thereby form the basis of a title claim.]

That's it for the "standard" exceptions. Beyond these there are specific exceptions based on the title work. Once again, this is only one commitment to illustrate the basics. Once you get beyond the basics, it's time to start thinking about what special exceptions you need to put into a commitment based on the title work.

II. Differences between owner's and loan policies (with respect to requirements and exceptions)

Generally speaking, requirements in the owner's commitment are the same as the lender's commitment. Exceptions can vary depending on the property and the lender's instructions. Many underwriters will lessen the requirements for the loan policy because they deem loan policies less risky than owners' policies. After all, in order for a claim to be made on a loan policy, there first needs to be a default and foreclosure. The most common requirement deleted in a loan commitment is the survey exception. Lenders may demand survey coverage without a current survey. Since lenders are typically bringing the majority of the funds to the table, their demands are often met. Absent, extra-hazardous risk, an underwriter may be inclined to give the coverage requested so that the transaction may go forward. Always confirm with the underwriter when it is appropriate to delete the survey exception in the loan policy. The survey exception is never deleted in the owner's policy without a current survey.

III. What exceptions carry over to final title policy? Which do not?

Depending on the facts involved, all schedule B-II exceptions may carry over to the final policy. In some circumstances, it is customary to eliminate certain general exceptions upon satisfaction of Schedule B-I requirements. Exceptions typically eliminated include mechanics' liens and parties in possession. An underwriter may be inclined to remove these general exceptions after obtaining an affidavit from the seller/borrower that certifies the specific risk is non-existent. Likewise, an underwriter may assume the risk of removing the survey exception from a loan policy without a current survey. Removing exceptions in the final policy is ultimately a judgment call for the underwriter. Reasons for making these decisions are grounding in specific risks present in a transaction and in light of the laws of the state in which the transaction takes place. Note, these are general exceptions only. They do not include known matters, e.g., a recorded deed of lease, a mechanics' lien or an encroachment shown on a survey. Such matters always require specific exceptions that carry over into the final policy.