

TITLE ISSUES

TITLE INSURANCE AND NATIONAL COMMERCIAL TRANSACTIONS IN THE 1990's

DON'T LET THE TAIL WAG THE DOG!

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After the high-flying 80's, with over-inflated real estate values, commercial real estate in the 1990's is experiencing an indefinite period of consolidation. Non-performing loans are being modified, restructured or foreclosed, debt-burdened companies are seeking protection from creditors by submitting a plan of reorganization under the Bankruptcy Code, and cash-starved companies are required to secure all of their assets, not merely their real estate. In the latter instance, while the real property may constitute only 20% or less of the security for a loan, it is essential to the continued operation of the business. Therefore, it is critical to the timely closing of the loan that the lender be assured of its first lien priority by virtue of a title insurance policy.

It appears to be axiomatic, in asset-based loans, that the title insurer has a very short time-frame for completion of searches, examination of title and production of commitments. More often than not, the transaction remains in the hands of corporate attorneys until only a few weeks, if not days, remain before the expiration of a loan commitment or a so-called drop-dead date for restructuring the terms of existing financing.

In this article, I will touch upon certain recurring title issues and considerations pertaining to modern commercial transactions, whether local or national in scope.

PRELIMINARY CONSIDERATIONS

First and foremost, the back-title information that you provide with your order is crucial to our ability to work quickly and efficiently. If your property is located outside of Illinois, a property index number or street address may be insufficient to initiate a

search. Here, Chicago Title has a title plant that is unparalleled elsewhere. In other States our offices may have limited direct examination capability, depending instead upon outside attorney/agents to perform searches of grantor and grantee indices. Copies of abstracts, grant deeds, and prior title policies may be essential.

Next, Chicago Title should be given as complete and detailed a description as possible of the corporate structure of the deal, including any anticipated mergers and name changes. This will help us immeasurably to anticipate transactional issues and to aid you, the customer, in resolving them.

Custom and practice, as well as the jargon of conveyancing and title insurance, vary widely across our country. For example, a title search does not always automatically include a tax and special assessment search, UCC search, or judgement and lien search, and opinions of outside counsel may be required in order to issue usury, comprehensive and zoning endorsements. While not a substitute for local counsel, Chicago Title's national underwriters have a breadth of experience that makes them a valuable resource for you.

Similarly, recordability of documents should be addressed in advance of closing. Many States require witnesses, limit by statute those officers who may execute on behalf of a corporation in the absence of recordable resolutions or mandate the use of a special form of acknowledgement.

Often the most vexing condition precedent to recording is taxation. We are all familiar with the various transfer tax ordinances that have been enacted by municipalities throughout Illinois over recent years. Other States have bested us in the area of revenue enhancement. Many have mortgage recording taxes; some have intangible property taxes based upon the principal amount of the secured notes. A few tax the transfer of leasehold estates. Often

there are additional corporate excise, gross income, and county and municipal taxes, as well. And declaration forms may have to accompany payment of tax. Some jurisdictions will apply the tax to the maximum principle amount secured by the mortgage, regardless of the value of the real property being encumbered in that State; others will require an affidavit or tax department determination allocating property values in a multi-state transaction.

The issue of taxation becomes even more elusive in the cases of mortgage modifications and bankruptcies. Some recorders at first will see a novation in any document and demand payment of a new tax, in full, again. Often this situation can be avoided by either an affidavit or the timely intervention of our local office or agent. We have encountered recorders who have demanded payment of tax in spite of the fact that the proffered document was accompanied by a certified final order of the Federal Bankruptcy Court which specifically exempted the transaction from state and local deed and mortgage taxes. A confrontation between State's rights and Federal Sovereignty can indeed impact your transaction.

A final preliminary note regarding the Torrens system: While land registration in Cook County is being phased out of existence, it should be noted that it persists elsewhere in the country; namely, in parts of New York, Massachusetts, Hawaii, and Minnesota. A last-minute discovery that a property is governed by a Torrens Act may jeopardize the closing.

EXTENDED COVERAGE

I have rarely encountered a lender who did not require elimination of the general exceptions for parties-in-possession, mechanics' liens and matters of survey.

In most instances, these exceptions can be deleted or modified on the basis of an affidavit revealing no recent construction, a certified current rent roll and a survey, certified to Chicago Title, that meets the minimum standard detail requirements established by The American Land Title Association (ALTA) and The American Congress on Surveying And Mapping (ACSM).

But what if there has been recent construction? If it is not for ordinary repair and maintenance, then we will require information as to the nature and scope of the work, owner's and contractor's sworn statements with supporting waivers, or other satisfactory evidence that payment has been made or provided for. Title indemnities or personal undertakings may be required after review of current financial statements.

As for parties-in-possession, the lender may require an affirmative statement that none of the leases contains a right of first refusal or an option to purchase, or that each is subordinate by its terms to the lien of the mortgage to be insured. This will necessitate review of both the recorded and unrecorded leases in their entirety.

A similar lease examination is required in the context of a shopping center development where anchor tenants have signed leases prior to the execution of the Reciprocal Easement Agreement (REA). For example, if Chicago Title has been requested to insure common area easements (such as access, parking and the right to maintain utility facilities on the land), the underwriter must examine those pre-existing leases for non-possessory interests, use restrictions, or negative covenants affecting the common area that are inconsistent with the REA. Examples might be (a) the requirement of a higher parking ratio, (b) a more restrictive easement for building encroachments from or onto adjacent land within the shopping center, or (c) the requirement for the tenant's consent, in its sole discretion, to changes in the configuration or use of the Shopping Center as depicted on a site plan attached to the lease as an exhibit.

In order to dispose of the exceptions for possible unrecorded easements and encroachments, the Company should be provided with a current ALTA/ACSM land title survey containing the following certification:

TO _____
(name of client)

and CHICAGO TITLE INSURANCE COMPANY

This is to certify that this map or plat and the survey on which it is based were made in accordance with "Minimum Standard Detail requirements for ALTA/ACSM Land Title Surveys," jointly established and adopted by ALTA and ACSM in 1988; meets the accuracy requirements of a Class A Survey, as defined therein, and includes Items 1-5, 7-13, & 15 of Table 3 thereof.

(signed)

(seal)

Registration No.

The "class" of survey is related to land use (A-Urban, B-Suburban, C-Rural, or D-Maintain or Marshland) and the degree of precision of mathematical closure and procedures should be based upon the intended use of the land. The items of "Table 3" comprise the following additional survey requirements that might be necessary in order to issue survey-related endorsements such as access to a public way and zoning, as well as to determine whether restrictions of record may have been violated:

1. Monuments placed (or a reference monument) at all major corners of the boundary of the property.
2. Legend of all symbols and abbreviations used.
3. Vicinity map showing the property surveyed in reference to nearby highway(s) or major street intersection(s).
4. Flood zone designation.
5. Land area.
6. Contours.
7. Setback, height and bulk restrictions of record or disclosed by applicable zoning or building codes (In addition to those recorded in subdivision maps). If none, so state.
8. Square footage of all buildings.
9. All improvements (in addition to buildings, such as signs, parking areas or structures, swimming pools, etc.).
10. Parking areas and, if striped, the striping and the number of parking spaces.
11. Indication of access to a public way such a curb cuts, drive-ways marked.
12. Location of all utilities serving the property, including without limitation:
 - (a) all railroad tracks and sidings;
 - (b) all manholes, catch basins, valve vaults or other surface indications of subterranean uses;
 - (c) all wires and cables (including their function) crossing the surveyed premises, all poles on or within ten feet of the surveyed premises, and the dimensions of all cross wires or overhangs affecting the surveyed premises; and
 - (d) all utility company installations on the surveyed premises.
13. Observable evidence of cemeteries.

14. Governmental Agency Requirements:

- (a) Department of Housing and Urban Development
- (b) Veteran's Administration
- (c) Other

15. Significant observations not otherwise disclosed.

Item 12 above is extremely important in areas where utility letters are unavailable.

In those instances where there is no recent construction and improvements are located well within the property lines, a survey made in accordance with published State minimum technical standards accompanied by a surveyor's report containing the additional survey requirements listed above may be acceptable. Those surveys lack the dimensional precision of an ALTA survey and are therefore significantly less expensive.

Finally, where there is an otherwise acceptable survey available that is dated over six (6) months prior to the closing and the current owner/borrower was in title to the property at the date of survey, Chicago Title, on a case by case basis, will consider giving, to the lender only, extended coverage over survey matters in return for an affidavit of no change in the following format:

AFFIDAVIT OF NO CHANGE TO SURVEY

Re: Chicago Title Insurance Company ("Chicago Title")

Title Order No.

The undersigned, being first duly sworn, does depose and state as follows:

1. That the undersigned is an officer of _____ corporation (the "Company"), is authorized to execute this affidavit on behalf of the Company and in so doing to legally bind the Company, and is of full legal age and in every respect competent to certify to the statements contained herein;
2. That the Company is the owner of record of the property described in the above-numbered commitment for title insurance.
3. That the property is improved with _____ (type of improvement)
4. That the survey (the "Survey") made by _____ of _____, dated _____,

Order No. _____, is a correct and complete representation of all improvements now located on the property described in the above-referenced title commitment, and accurately depicts the current state of facts on the Land.

5. That, subsequent to the date of the Survey, the Company has not made or caused to be made any structural improvements or structural additions to existing improvements on the property described in the above-referenced title commitment.

6. That the undersigned makes the foregoing statements on behalf of the Company for the purpose of inducing Chicago Title to issue its policies of title insurance pursuant to the above referenced commitment. The Company hereby agrees to indemnify and hold harmless Chicago Title from all liability, loss or damage of any nature including reasonable attorneys' fees, arising out of any false or inaccurate representation made herein.

DATED:

By _____
(name of signatory printed) Its (title of signatory)

Notary Public

My commission expires:

Subscribed and sworn to

before me this _____ day

of _____, 199 ____

TRANSACTIONAL ISSUES

Creditors' rights has been the most controversial transactional issue in recent years. Principles of bankruptcy law relating to fraudulent transfers and preferential transfers must be considered by real estate lawyers in light of the potential for recharacterization or equitable subordination of secured interests by the Bankruptcy Courts. The following exclusion was adopted by the American Land Title Association in April of 1990 in recognition of the argument by most insurers that the title industry is not capable of successfully analyzing the financial structure of loan transactions:

"Any claim, which arises out of the transaction creating the interest of the mortgagee insured by this policy, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors' rights laws."

However, upon request, Chicago Title will consider modifying

or deleting the exclusion where little or no risk is perceived or in certain titles arising out of bankruptcy or deeds-in-lieu of foreclosure.

On October 17, 1992 a new loan exclusion was adopted by the ALTA as follows:

"Any claim, which arises from the transaction creating the interest of the mortgagee insured by this policy, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors' rights laws, that is based on:

- (i) the transaction creating the interest of the insured mortgagee being deemed a fraudulent conveyance or fraudulent transfer; or
- (ii) the subordination of the interest of the insured mortgagee as a result of the application of the doctrine of equitable subordination; or
- (iii) the subordination of the interest of the insured mortgagee being deemed a preferential transfer except where the preferential transfer results from the failure:
 - (a) to timely record the instrument of transfer; or
 - (b) of such recordation to impart notice to a purchaser for value or a judgment or lien creditor."

The timely recording of documents seems all the more critical due to the language of this exclusion. If more than 10 days have elapsed between closing and recording, the mortgage lien may not have been timely perfected and may become a transfer on account of an antecedent debt which is subject to the voiding powers of a trustee in bankruptcy. It also makes it more important than ever that draft documents be given to title insurers for review in advance of closing so that they can be reviewed for recordability as well as insurability.

Insuring titles in loan transactions coming out of bankruptcy presents different challenges. The underwriter will want an unappealable final order of the Court making certain specific findings. For example, the order might approve additional interest provisions that might otherwise be considered excessive and result in a recharacterization of the loan as a joint venture, or confirm the priority of an amended and restated mortgage relating back in time to the date of recording the mortgage. Such findings may be critical to the decision whether or not to issue a shared appreciation endorsement where the lender's participation is over 50%, or to issue a datedown endorsement to an existing loan policy without raising intervening matters as exceptions to title. If we have no opportunity for input in the early stages of the proceeding, and the order is already entered,

then there may be little that an underwriter can do absent a supplemental court order.

We are often asked to insure the lender's nominee in a deed-in-lieu transaction. The underwriter should be provided with a current appraisal substantiating the excess of loan balance over fair market value, current operational payables information to identify the universe of creditors, the draft settlement agreement and deed, and a complete copy of the partnership agreement as amended (if the debtor in title is a partnership). We will want to establish that the agreement provides for payment at or before closing of outstanding bills and contains solvency representations, and that the deed negates merger of the mortgage and fee interests. More importantly, we must be satisfied that the parties to the agreement are authorized to make such a transfer — if there is a limited partner, is its consent required?

The availability and form of certain transactional endorsements such as Usury, Doing Business, Fairway, Non-Imputation and Revolving Line Of Credit will depend in great part upon State laws and insurance department regulations, if any. Nonetheless, in many States the form may be tailored to fit the circumstances of the transaction, so be sure to request specimen endorsements as early as possible.

CONCLUSION (WITH CLOSING METAPHOR)

State law, real estate practice and title insurance regulations differ from State to State, causing a variation of cost, production time and availability of policy forms and endorsements.

The common denominator, however, is that the sooner you consult your national underwriter, the more likely he or she will be able to accommodate your reasonable requests (and even some unreasonable ones!). This collaborative effort will ensure that title insurance performs the function for which it was intended — to grease the wheels of commercial transactions.

We at Chicago Title appreciate your business and your continued confidence in our ability to assist in closing complex transactions with reliable, aggressive and creative underwriting, and, most importantly, on time.

We are soliciting ideas for possible subjects for future *TITLE ISSUES*. If you are interested in submitting ideas for subjects, complete the form below and submit to:

Chicago Title Insurance Company
171 N. Clark Street, ML 04RS
Chicago, Illinois 60601-3294
Attn: Sharon Marszałek
Chicago Metro Marketing

SOLICITATION FOR IDEAS: Subjects for future *TITLE ISSUES*

NAME: _____

DATE: _____

TITLE: _____

COMPANY / FIRM: _____

ADDRESS: _____

TELEPHONE NUMBER: _____

SUBJECT: _____