THE TITLE INSURANCE COMMITMENT

AND

CLOSING LETTERS

By: Reginald A. Long, Esq.

Pursuant to the New Jersey Title Act, title insurance companies are required to make a determination as to insurability prior to issuing an insurance policy.[1]In order to determine the insurability of property, the title company will examine title to the property ("title examination") and issue a title insurance commitment to insure based on the result of the title examination. The title insurance commitment is a binding agreement between the title company and the proposed insured to provide title insurance covering the proposed insured interest in specifically designated parcel(s) based on the result of the title examination. The title insurance commitment is comprised of two components which include the jacket and the schedules. Specifically, the jacket outlines what is contained in the coverage and what is excluded. Whereas, the schedules identify the coverage amount, insured parties, property associated with the coverage, terms and conditions of the coverage and all title exceptions. Additionally, in order to protect the prospective insured against fraudulent actions of the closing agent or approved closing attorney, the title insurance company will issue a closing letter to the prospective insured. The closing letter serves to indemnify against loss of settlement funds resulting from fraud or dishonesty of the designated title insurance agent in handling the funds or as a result of the agent's failure to comply with the closing instructions.

[1]N.J.S.A. 17B;17-1*et seq.*

Title Insurance Commitment

The title insurance commitment jacket component contains the terms and conditions which apply in order to make the title insurance commitment effective. Accordingly, in those cases where the terms and conditions contained in the jacket of the title insurance commitment have not been met, the title insurance company may deny liability. The jacket contains both the coverage provided in addition to the exclusions to the coverage provided. Generally, exclusions modify the coverage provided by specifically excluding coverage for certain items. For example, under the terms and conditions of the title insurance commitment, the title company is not liable for title defectswhich were known to the proposed insured and yet went undisclosed by the proposed insured to the title insurance company which effectively constitutes a "knowledge exclusion" from the coverage of the title insurance policy. It should be noted that the "knowledge exclusion" is not applicable if the undisclosed matter is recorded in the public records and constitutes constructive knowledge. Accordingly, the title insurance company may not deny liability solely because of constructive notice of a matter which has been imputed to the insured by the public records.[2]Therefore, even if the insured has actual knowledge of a title defect, the exclusion will not apply if the defect involves a matter that is recorded and thus constitutes constructive notice. Additionally, another example of an exclusion from coverage under the title insurance policy that is included within the terms and conditions contained within the jacket of the title insurance commitment are those matters which do not constitute title maters or that are not within the expertise of the title insurer which is referred to the "police power exclusion." It

[2]Shaver v. National Title & Abstract Co., overruled by 494 SW. 2d 154, (1973) (insurer cannot deny liability by reason of the existence of an easement of record that is constructive notice to the insured; Zions First National Bank v. National American Title Insurance Co., 749 P.2d 651 (Utah 1988).

should be noted that exclusions are strictly construed against the insurer and in favor of the insured.[3]

The title commitment contains three schedules, schedule A, schedule B-I and schedule B-II. Specifically, schedule A contains the effective date ("board date"), identifies the proposed insured, indicates the policies to be issued including amounts, sets forth how title is currently vested and provides description of property to be insured. Schedule B-I sets forth the requirement for insuring title, which among other things includes disposition of certain liens, the creation of insurable interest, and payment of premium. Schedule B-II sets forth the exceptions to title which includes real estate, liens not being disposed of, easements, restrictive covenants and survey matters.Mortgage tenders and their counsel have developed a distinction between exceptions to free simple absolute title called "permitted" and "non-permitted" exceptions, simply put, the lender will agree to close the mortgage and accept a mortgage policy subject only to "permitted" exceptions thereto. The initial task of the buyer's attorney then becomes to differentiate between the so called "permitted" exceptions and the "non-permitted" exceptions.

Permitted Exceptions

A "permitted" exception is a condition of title, generally voluntarily imposed by a predecessor in title, to benefit or burden the property being conveyed such as an easement or a declaration of restrictive covenants controlling the use of the property. Unlike most "non-permitted" exceptions, it cannot be extinguished through the satisfaction of pre-determined requirements. "permitted" exceptions can include, by way of illustration:

[3] Sinopoli v. North River Insurance Co., 244 N.J. Super. 245 (App. Div. 1990), *cert. denied* 127 N.J. 325(1990)

1. Easements;
2. Licenses;
3. Restrictive Covenants;
4. Homeowners'/condominium conditions;
5. Permits (e.g., stream encroachment, wetlands, etc.); and
6. Certain leases.

A complete title insurance commitment, or binder, should contain copies of all instruments referred to therein. Once potentially "permitted" exceptions are identified, the attorney should carefully review the instrument creating the exception to determine the nature, extent and duration of the burdens and/or benefits.

Non-permitted Exceptions

"Non-permitted" exceptions can, through varying degree of effort, be removed of record. In other words, the attorney can, and usually must, eliminate the exception from burdening the client's property. The most common "non-permitted" exceptions include:

1. Mortgage;
2. LisPendens
3. Mechanic's Liens;

4. Tax Liens
    a. Property Taxes
        i. Inchoate Lien
        ii. Added Assessments
        iii. Farmland Rollback Taxes
        iv. Tax Sale Certificates;
    b. Inheritance Taxes;
5. Federal Tax Liens;
6. Security Interests in fixtures, etc. (UCC-1);
7. Bail Bond Recognizance;
8. Environmental Liens;
9. Leasehold Interests/Life Estates;
10. Dower/Curtesy Rights;
11. Devises;
12. Survey Exceptions (encroachments, mislocated fences, walls, etc.);
13. Judgments
    a. Money Judgments
    b. Child Support; and
14. Break in chain of title.

The foregoing list of examples of non-permitted exceptions is not intended to be all inclusive, but rather illustrative of the most common types of “non-permitted” exceptions to title which attorneys are likely to encounter in New Jersey as real estate practicioners. Having identified many of the more common such exception, the attorney's next task will be to understand how to remove such exceptions.

Owner's and Loan Policies

Only the proposedinsured (successors by operation of law included)is covered by the title insurance policy issued. Third parties cannot rely on a title commitment issued to another. The coverage provided is for actual loss the proposed insured suffered in good faith reliance on the information set forth in the commitment up to the proposed policy amount. The conditions of the title policy are incorporated by reference into the commitment. Accordingly, only those who have any interest in land may obtain a title insurance policy. For example, a license to use land is not insurable since it is not an interest in land. Therefore, policies can be provided to (i) fee simple estates, (ii)leasehold estate, (iii) equitable interest under a sales agreement or installment contract, (iv) rights pursuant to an option contract, and (v) dominant servitude interest pursuant to an easement or a mortgage on any of the interest in land indicated in (i) through (v). Accordingly, the title insurance company will issue an owner's policy to those holding an equitable interest in land as reflected in items i) through v) above or a loan policy to lenders holding a mortgage on either a fee or an equitable interest in land.

Owner's Policy

An owner's policy covers the named insured as owner of property and those who succeed to the interest of the insured by operation of law such as executors of the estate of a deceased owner or a successor corporation in a merger. The insuring clauses of the owner's policy protect the insured against loss arising from (i) title to the estate or interest described in schedule A being vested otherwise than stated; (ii) any defect in or lien or encumbrance on title; (iii) unmarketability of title; and (iv) inability to access the land.

Loan Policy

Loan policies insure not only the original mortgagee but also the assignee of the insured mortgage as of the original date of the title insurance policy. The coverage provided by the loan policy continues if the mortgagee forecloses and acquires the property during the foreclosure sale. It should be noted that in the event of a foreclosure by the mortgagee, the title insurance policy held by the mortgagee remains a loan policy and does not convert to an owner's policy. Also, it should be noted that the loan policy does not insure the validity of an assignment of the mortgage or that assignee takes clear title to the mortgage unless the assignment of the mortgage is specifically shown the schedule A of the loan policy and the assignee is a named insured. When a mortgage is assigned after the original settlement, the new lender may obtain an endorsement to loan policy naming them as the insured under the original policy and insuring that they have title to the mortgage. The insuring clauses of the loan policy protect the insured against loss or damage arising from (i) title to the estate or interest described in schedule A being vested otherwise than as stated; (ii) any defect in or lien or encumbrance on title; (iii) unmarketability of title; (iv) inability to access the land; (v) invalidity or unenforceability of the insured's lien; (vi) lack of priority of the lien of the insured mortgagee over any statutory lien for labor, services or material arising from an improvement of work related to the land which is (a) contracted for or commenced prior to the date of the policy, or (b) contracted for or commenced subsequent to the date of the policy and which is financed in whole or in part by proceeds of the indebtedness secured by the insured mortgage which at the date of the policy the insured has advanced or is obligated to advance; and (vii) invalidity or unenforceability of any assignment of the mortgage provided the assignment is shown in schedule A, or the failure of the assignment shown in schedule A to vest title to the insured mortgage in the named insured assignee free and clear of all liens.

The Gap Period

A common observation made during the review of the title commitment is that the effective date is usually a few weeks (perhaps months) prior to the date that the commitment was prepared. The reason for this is that the county clerk's offices are always behind in recoding land record documents. While a document may be delivered to the county and accepted by the county clerk for recording, generally, the document will not be indexed and established of record for several weeks. Each county has what is known as a "board date," which is the date to which the county clerk certifies the recording of documents. The time period between the clerk's receipt and acceptance of the document and date that the document is actually recorded is commonly referred to as the "gap period,"In order to protect the party in interest during the gap period, New Jersey has established a fairly unique procedural device referred to as the "notice of settlement." A notice of settlement is filed immediately upon receipt by the county clerk and it puts the world on notice of the transaction between the parties. More importantly, the legal effect of filing the notice of settlement is that any subsequent matter that is recorded after the Notice of Settlement is filed will take subject to the pending transaction. This device is extremely important to the parties and the title company because it serves to limit or sometimes eliminate the gap period altogether.

Closing Letters

The closing letter serves to indemnify against loss of settlement funds resulting from fraud or dishonesty of the designated title insurance agent in handling the funds or as a result of the agent's failure to comply with the closing instructions.[4] The letter is frequently issued to lenders; however, in some instances it is issued to purchasers. If the closing letter is not issued, the title company may not be liable for defalcations by the title insurance agent since the closing agent may not be regarded as the title company's agent for escrow, closing and disbursement of funds. It should be noted that this position has been rejected by the contrary view that an approved closing attorney retained by the buyer was the agent of the title insurer for its dealings with the buyer in effectuating title insurance; consequently, the title company was liable for the attorney's theft of closing funds.[5] The closing letter inures to the benefit of the borrower on a loan secured by a mortgage on one-to-four family dwellings, and it should be noted that it does inure to the benefit of lender's assignee or investor. Also, the closing letter excludes liability because of failure of an approved attorney to comply with closing instructions that require title insurance protection inconsistent with that set forth in the title insurance commitment or the title binder. For example, closing instructions that require the removal of a specific title exception listed on the schedule B or compliance with the requirements that are provided in the schedule A

---

[4]Gosdin, James L. Title Insurance: A Comprehensive Overview. Chicago: American Bar Association, 1996

[5]Sears Mortgage Corp. v. Rose, 134 N.J. 336 (1993) (title insurer also breached duty of good faith and fair dealing in failing to advise its insured of the insurable risk of defalcation and to offer coverage of that risk); Clients' Security of the Bar of New Jersey Fund v. Security Title & Guaranty Co., 134 N.J. 358.

are not considered inconsistent. Furthermore, loss of funds resulting from the insolvency of a bank is not a covered risk unless the closing agent or approved attorney fails to comply with written closing instructions. If the closing is conducted by an approved attorney, the addressee must receive a title binder or title insurance commitment before the actual transmission of the closing instructions. The protection provided to the beneficiaries of the closing letter is effective when the addressee signs and returns the closing letter.[6]

[6]Gosdin, James L. Title Insurance: A Comprehensive Overview. Chicago: American Bar Association, 1996