HOUSE LAWYER

Title insurance is essential in protecting your investment

BY HARVEY S. JACOBS

The turmoil in the residential real estate industry and the recent meltdown in the foreclosure process should have every prospective home buyer reexamining the often overlooked concept of title insurance. In addition to being of critical importance these days, title insurance is one of the largest components of closing costs in a home purchase or refinance. Having a basic understanding of title insurance and knowing the right questions to ask can reduce a borrower's risk and save hundreds or even thousands of dollars in closing costs.

Title insurance underwriters recently issued strict guidelines for when — and whether — they will insure the title to property that has been the subject of a foreclosure. Their concerns relate to accusations that hundreds of thousands of foreclosures might have been conducted using defective documents, false affidavits or other procedures that do not comply with the letter of the law.

Attorneys general from several states are investigating these types of foreclosuresituations nationwide. The title underwriters' concerns stem from the fact that if a foreclosure is deemed to be defective, the party acquiring that property, either at the foreclosure auction or directly from the foreclosing bank, may not get good title, and in fact, may not obtain any title at all and so lose their entire investment. However, if home buyers were savvy enough to buy an enhanced owner's title insurance policy from a reputable title insurance company, they may file a claim under their policy to attempt to recoup their losses.

Fundamentally, title insurance is intended to protect the insured from risks associated with defects in the ownership of the property. These defects can result in total losses such as in the case of a defective foreclosure, forgery or impersonation, where no title is legally conveyed. Other defects can be partial in nature, such as where a neighbor's garage or fence encroaches on the insured person's property. In those cases, title insurance might pay for the removal or relocation of the encroachments.

Two basic levels of title insurance are available from most companies. The standard policy covers risks prior to the settlement date. The enhanced policy covers risks existing before and after settlement. The enhanced policy also covers a broader range of risks. Although they cost more, the enhanced polices are well worth the investment.

Before title insurers agree to issue a policy, they conduct an extensive search of the property's owners over the past 60 years. This is called the "chain of title." The title examiner checks to make sure that the chain of title is unbroken, meaning that each seller's ownership is evidenced by a deed or other documents showing how that seller obtained the ownership. They also consult other official records such as court judgments, bankruptcies, divorces, probate matters, tax sale foreclosures, water and sewer accounts (which are liens). They look at a current survey to review the property's boundaries, to see whether any neighboring properties encroach on the property (or if the seller's improvements encroach on someone else's property.) A survey shows where public or private easements, such as power lines, may exist. They also look at front, side and back setback requirements.

Overall, title examiners are looking for any event or circumstance that would be a lien against the property. For example, a monetary judgment recorded against a borrower becomes an automatic lien against that borrower's home. These items are often referred to as "clouds on title."

There are two types of title insurance policies: owner's title insurance, which only covers the homeowner, and lender's title insurance, which only covers the lender. Owner's title insurance is optional in all transactions; there is no law or lender requirement that you purchase coverage. Premiums for the owner's policy are based on the home's purchase price. Unlike most other types of insurance, for a title policy you pay a one-time premium at the time of your home purchase. Coverage continues as long as you own the home.

Title insurance rates vary from state to state and to a lesser extent, from company to company. The approximate cost for owner's coverage in the District is $6.84 per $1,000 of coverage; in Virginia its $4.68 per $1,000, and it is $4.75 per $1,000 in Maryland.

Virtually all lenders require a lender's title policy to protect their financial interest in the property. An owner receives no benefit from the lender's policy even though he pays for it. Lender's coverage costs approximately $5.40 per $1,000 in the District, $3.48 per $1,000 in Virginia, and $3.18 per $1,000 in Maryland.

Many homeowners mistakenly think that because the settlement lawyer did the 60-year search and is providing a lender's policy, that the title must be clear. Why waste extra money on an owner's policy? This is an extremely shortsighted view for several reasons. First, even though a prudent settlement lawyer will do an exhaustive title search, that search may not uncover the very real risks present in these days of fraudulent foreclosures and/or forged documents. Second, the lender's policy does not provide any protection for the owner in the event of a successful claim. Third, part of the benefit in a title policy is that the title insurance company assumes the legal costs to defend any claim. Without an owner's policy, the owner must bear his own legal costs to defend any claim, no matter how frivolous. Fourth, the marginal cost of buying an owner's policy, when a lender's policy is being issued (a so-called "simultaneous issue") is quite small. You do not pay full premium for owner's and lender's policies when they are being issued simultaneously. Finally, an owner's policy may entitle you to discounts off future title policies if you subsequently refinance, or for your buyer if you sell your home within seven years of obtaining your owner's policy.

Because title insurance is a significant part of total closing costs in both purchase and refinance transactions, it is useful to explore whether you may be entitled to any discounts such as "reissue" or "substitution" rates. In a purchase transaction, reissue rate discounts of as much as 40 percent off your new owner's policy premium may be available if you can deliver a prior owner's title policy, less than seven years old, to the settlement lawyer when placing your title order. In a refinance transaction, you may be entitled to a similar substitution-rate discount by delivering a prior lender's title policy, issued less than seven years ago. The actual discount will vary depending upon the age of the prior policy, the amount of the prior policy and the amount of the proposed new policy.

With all the uncertainly in today's real estate market, buying the most comprehensive owner's title policy available is sound advice. But buy it at the right price. Asking questions can save you money the next time you buy or refinance a home. When refinancing with your existing lender, ask for a copy of your original lender's title insurance policy. When purchasing a home, ask your real estate agent or the home seller for a copy of any existing owner's title insurance policy written within the previous seven years. When placing a title order, provide your settlement lawyer with a complete, legible copy of any prior title policies. Finally, ask your settlement lawyer if any discounted title insurance rates are available based on your situation.

hjacobs@jgllaw.com

Harvey S. Jacobs is a real estate lawyer in the Rockville office of Joseph, Greenwald & Laake. He is an active real estate investor, developer, landlord, settlement attorney and lender. This column is not legal advice and should not be acted upon without obtaining your own legal counsel.

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