DISCUSSION OVERVIEW

- Introduction

- Part One: Maintaining/Obtaining Title Insurance Coverage

- Part Two: Maintaining Other Types of Insurance

- Part Three: Avoiding the Spread of Environmental Liability

- Part Four: Avoiding Events of Default under Existing Loan Documents
INTRODUCTION

- Arm’s length sale between a buyer and seller.
  
  Versus

- Transfers that are mainly driven by estate or business planning needs unrelated to a sale of property.
  
  - A parent transfers the family home to a child for Medicare planning purposes.
  
  - A business transfers a factory from a parent corporation to a subsidiary, just to name two.

INTRODUCTION, CONT’D

- Given the nature of these transactions:
  
  - Keeping Costs Low; and
  
  - Familiarity with the property.

- Be aware of ancillary issues....
INTRODUCTION, CONT’D

- Four trouble spots to keep in mind:
  - Maintain and, if needed, obtain title insurance coverage;
  - Maintain other types of insurance;
  - Avoid the spread of environmental liability; and
  - Avoid events of default under existing loan documents.

INTRODUCTION, cont’d

- Arm’s length transaction generally do not have the same types of issues:
  - Third party needs new property, casualty and, if needed, flood insurance;
  - Phase I;
  - New Title Insurance;
  - Existing Liens
I. MAINTAINING/OBTAINING TITLE INSURANCE COVERAGE

- When transferring real estate, does the new owner need a new title insurance policy, or do they continue as the ‘insured’ under the existing title insurance policy?
  - With certain limited exceptions, an existing title insurance policy does not insure the new owner.
  - When a parent transfers real estate to a child for Medicare planning purposes, that child does not become the insured under the parent’s title insurance policy.

I. MAINTAINING/OBTAINING TITLE INSURANCE COVERAGE, CONT’D

- If the prior owner does not have title insurance then the issue becomes whether the new owner wants title insurance and this is a discussion best had with counsel.
I. MAINTAINING/OBTAINING TITLE INSURANCE COVERAGE, CONT’D

- Getting a new title insurance policy requires title work, certain title affidavits, and paying a title insurance premium, which may be cost-prohibitive for some clients.

- Offer title insurance in writing in case there is an uninsured title claim down the road.

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I. MAINTAINING/OBTAINING TITLE INSURANCE COVERAGE, CONT’D

- There are some instances where the new owner of real estate automatically becomes the “insured” for purposes of the title insurance policy held by the prior owner.

- Unfortunately, the question turns on the form of the title insurance policy.

- 2006 ALTA form policy, the term “insured” is rather broadly defined and includes, in addition to the insured named in the title policy
  - Successors to the named insured by operation of law (as distinguished from purchase) including heirs, devisees, survivors, personal representatives, or next of kin;
  - Successors by dissolution, merger, consolidation, distribution or reorganization;
  - Successors by conversion of the named insured by its conversion to another kind of entity.
A grantee under a deed delivered without consideration if:

- The stock, membership, or other equity interests of the grantee are wholly-owned by the named insured;
- The grantee wholly owns the named insured;
- The grantee is wholly-owned by an affiliated entity of the named insured, provided the affiliated entity and the named insured are both wholly owned by the same person or entity; or
- The grantee is a trustee or beneficiary of a trust created by the named insured.

The pre-2006 title insurance policies are not as broadly written. For example, under a 1992 Policy the term “insured” includes the insured named in the title policy and those who succeed to the interest of the named insured by operation of law as distinguished from purchase including, but not limited to, heirs, distributees, devisees, survivors, personal representatives, next of kin, or corporate or fiduciary successors.

Accordingly, when determining whether the new owner continues as the “insured” under the prior owner’s title insurance policy or needs their own policy, the first stop should be a close reading of the term “insured” under the applicable title policy.
II. MAINTAINING OTHER TYPES OF INSURANCE

- Very similar to the forgoing issues with title insurance, other types of insurance on real property such as property insurance, casualty insurance, liability insurance and flood insurance may not (probably do not) continue to cover the new owner of the real property.

- Always recommend to clients to in writing that they contact the various insurance companies insuring the property before the transfer takes place to make sure the new owner will have all of the insurance coverage they need in the event of an insurable loss.

III. AVOIDING THE SPREAD OF ENVIRONMENTAL LIABILITY

- When it comes to environmental contamination and real property, with certain limited exceptions, every party who has owned the real property since the contamination occurred is potentially liable for cleanup costs.

- This means, for example, that when a business transfers contaminated real estate from a parent company to a subsidiary for business planning purposes, both the parent and the subsidiary are potentially liable for the costs of remediating contamination, even if no one knew the contamination was there at the time of the transfer.

- Under the environmental laws, ignorance is not bliss.
III. AVOIDING THE SPREAD OF ENVIRONMENTAL LIABILITY, CONT’D

- Under the Comprehensive Environmental Response, Compensation, and Liability Act (“CERCLA”), one way to avoid spreading liability for environmental issues is to undertake “all appropriate inquiry” (“AAI”), prior to acquiring the property.
- AAI means parties must conduct all appropriate inquiry into the past ownership and uses of the real property to qualify for the innocent landowner, contiguous property owner, and bona fide prospective purchaser defenses to CERCLA liability.
- In the last few years, the Environmental Protection Agency has updated its regulations surrounding AAI which includes, in part, hiring a consultant to prepare an environmental report for the property prior to any transfer of ownership in the property.

III. AVOIDING THE SPREAD OF ENVIRONMENTAL LIABILITY, CONT’D

- AAI requirements include:
  - Testing must be conducted by a professional;
  - Interviews with past and present owners, operators, and occupants;
  - Reviews of historical sources, such as the chain of title documents, aerial photographs, building department records, and land use records;
  - Searches for recorded environmental cleanup liens;
  - Reviews of federal, state, local, and tribal government records, including waste disposal records, underground storage tank records, hazardous waste management records, and spill records;
  - Visual inspections of the facility and of adjoining properties;
  - Evaluations of the purchaser’s specialized knowledge or experience;
III. AVOIDING THE SPREAD OF ENVIRONMENTAL LIABILITY, CONT’D

- AAI requirements include (continued):
  - Assessment of the relationship of the purchase price to the value of the property, if the property was not contaminated;
  - Information that is commonly known or reasonable ascertainable about the property; and
  - Consider degree of obviousness of contamination.

IV. AVOIDING EVENTS OF DEFAULT UNDER EXISTING LOAN DOCUMENTS

- Most Deeds of Trust contain a provision that the lender may declare the entire loan due if the borrower sells, transfers, conveys or otherwise alienates the borrower’s interest in the encumbered real estate.

- Accordingly, when a person conveys an encumbered rental home to their limited liability for asset protection purposes, the transfer may very well give rise to an inadvertent event of default under the loan entitling the lender to require that the entire loan be paid in full.
IV. AVOIDING EVENTS OF DEFAULT UNDER EXISTING LOAN DOCUMENTS, CONT’D

There are some instances in the residential real estate context, where certain lenders are prohibited from enforcing an otherwise valid due on sale clause.

IV. AVOIDING EVENTS OF DEFAULT UNDER EXISTING LOAN DOCUMENTS, CONT’D

Below is a partial list pursuant to 12 U.S.C. Section 1701j-3(d).

- Certain lenders may not exercise an option pursuant to a due-on-sale clause in connection with a real property loan secured by a lien on residential real property containing less than five dwelling units or on a residential manufactured home, upon:
  - The granting of a junior lien or other encumbrance which doesn’t transfer rights of occupancy;
  - A transfer by will or operation of law on the death of a joint tenant or tenant by the entirely;
  - Leasing the property for a term of less than three years which does not contain an option to purchase;
  - A transfer to a relative resulting from the death of a borrower;
IV. AVOIDING EVENTS OF DEFAULT
UNDER EXISTING LOAN DOCUMENTS, CONT’D

- A transfer where the spouse or children of the borrower become an owner of the property;
- A transfer resulting from a decree of a dissolution of marriage, legal separation agreement, or from an incidental property settlement agreement, by which the spouse of the borrower becomes an owner of the property; or
- A transfer into an inter vivos trust in which the borrower is and remains a beneficiary and which does not relate to a transfer of rights of occupancy in the property.

- The next time your client is transferring real estate for estate or business planning purposes, talk though these issues to avoid a wealth of potential problems down the road.
QUESTIONS??

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