Marketable and Insurable Title:
Concepts All Real Estate Professionals Should Understand
by

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The terms "marketable title" and "insurable title" are very common real estate terms which come up in every contract for the sale of real property. They are terms that are frequently used but not fully understood. It is important for real estate professionals, including lawyers, title insurance agents, mortgage brokers, lenders and real estate brokers, to understand the meaning of these terms and recognize their importance.

Common Contract Clauses

Contracts for the sale of real property usually contain provisions that require sellers to deliver marketable title and/or compel buyers to accept title that may or may not be "marketable" or "insurable." Below are a few examples of clauses that both seller's and purchaser's attorneys include in contracts. Some of the clauses may already be included in standard form contracts used in real estate transactions:

1. **"Seller, at Seller's own option, may adjourn the Closing in order to attempt in good faith to satisfy any liens or encumbrances on the subject premises, in order to deliver marketable title to the premises."**

2. **"The premises are to be transferred subject to any state of facts a survey or personal inspection may show, provided the additional facts do not render title to the premises unmarketable."**

3. **"In the event a survey and/or a title search conducted on behalf of the Purchasers discloses a condition or conditions which render the title unmarketable or uninsurable, and the Sellers shall, prior to the date of closing, be unable to correct the condition(s) resulting in said uninsurability or unmarketability, the cost of both the survey and title examination, together with all other sums applied and paid by the Purchasers to the Sellers shall be forthwith reimbursed and refunded by the Sellers to the Purchasers and this contract shall thereupon become null and void; in the event that the Sellers shall fail to make the reimbursement and refund as herein provided, such amount and the sums thereof shall be and hereby are made liens on the subject premises."**

A buyer's attorney will usually insert language requiring a seller to do whatever is necessary to deliver both "marketable title" and/or "insurable title" at Closing. In the event a seller cannot deliver marketable or insurable title then a buyer would normally be given the option of terminating the transaction and receiving a refund of the downpayment and reimbursement of certain fees paid by the buyer in connection with the purchase transaction, such as survey fees, title search fees, mortgage fees, etc.

A seller's attorney will usually insert language that allows a seller to cancel the contract if the seller is not able to deliver marketable or insurable title. In the alternative, a seller's attorney may choose to include provisions in the contract that would require a buyer to accept title to the premises "subject to" certain defects and encumbrances specifically enumerated in the Contract or an attached Rider. In those instances a buyer would be forced to accept *less* than what is considered to be "marketable" or "insurable" title.

What Does "Marketable" Title Mean?

New York case law defines "marketable title" as title which is free from "material" and "unreasonable" encumbrances, liens, judgments or defects. A buyer would not be required to accept title to real property upon which there exists a material or unreasonable defect or encumbrance. New York law requires that a standard of reasonableness be used in determining whether a certain defect or encumbrance would render title "unmarketable." This standard is the same standard used in other areas of the law, such as, personal injury cases, criminal cases, etc.

In the legal world a "reasonable person" is defined as a person who exercises certain qualities of attention, knowledge, intelligence and judgment that society requires of its members for the protection of their own interest and the interests of others. Therefore, the test of reasonableness is based on either a failure by someone to do something that a reasonable and prudent person, guided by considerations that ordinarily regulate conduct, would do, or is based on the doing of something that a reasonable and prudent person would not do. This standard does <u>not</u> require that title must be free from <u>every</u> "doubt" or "defect," but rather, it means that title should be free from those encumbrances that are "unreasonable" or "material." In other words, defects that a reasonable and prudent person, in light of the circumstances, would not be required to accept.

There are multiple issues that may render "title unmarketable" or "uninsurable," such as easements, restrictive covenants, judgments, liens (i.e. UCC filings, mechanic's liens, mortgages, home equity lines of credit, etc.), leases affecting the premises, encroachments as shown on a survey or survey reading in a title search, errors in the chain of title (i.e. errors in the names of parties, missing links in the chain of title, transfers made resulting from the death of a prior owner), etc. There exists some form of defect or encumbrance on virtually every property that is sold or transferred. But, if the above is true then how is a seller able to sell property and what purchaser would accept title to such property that is not considered to be "marketable" or "insurable"?

If There Exists a "Material" Defect Then How Can A Seller Sell?

Although there exists an encumbrance or "defect" of some kind or another on every property, there are certain types of encumbrances that are necessary. One common encumbrance is the utility company easement, which is necessary for electric and gas

companies to provide basic services. Contracts usually require that buyers take title to the premises in spite of the existence of these types of encumbrances. These provisions are known as "subject to" provisions. A buyer must accept title to the premises "subject to" certain encumbrances, normally those that are "of record" (i.e. recorded with the County Clerk) or specifically included in the Contract.

Another form of encumbrance which buyers are commonly compelled to accept is known as a "restrictive covenant." Restrictive covenants "run with the land," that is, they bind all future owners. Again, these are usually "of record." They could be separate agreements recorded with the County Clerk, they can be "Notes" on a filed Subdivision Map or they can simply be restrictions included in the Deed provided to a buyer at Closing. The latter usually requires that those restrictive covenants be disclosed to the buyer in the Contract of Sale.

An example of restrictive covenants is regularly seen in deeds to properties in new subdivisions or developments. Future owners are usually prohibited from building, or are required to build, certain types of homes (i.e. only colonial-style homes may be constructed, no ranch-style homes may be constructed, no homes larger or smaller than a certain square footage may be constructed, etc.) even where the zoning codes of the particular municipality may allow such development.

Beware of the "Subject To" Provisions!

Many of the "subject to" provisions included in a Rider or Addendum may compel a buyer to accept title that normally would be considered "unmarketable" or "uninsurable." It is not uncommon for a seller's attorney to insert language in a contract of sale requiring a buyer to take title to the premises subject to possible encroachments that may exist or that a survey may disclose. This can present potential problems.

A lender may refuse to provide financing to a buyer if there exists such an encroachment or similar defect. Yet the buyer may still be required to complete the purchase because the contract of sale requires the buyer to take "subject to" such defects and/or encroachments. Lenders and lenders' attorneys usually will not authorize the funding of a loan if there are encroachments on the property, such as a neighbor's fence, a shed, a porch, a garage or some other structure, unless the title insurance company provides the lender with insurance coverage.

Another common addition to the "subject to" clause is the "lease" clause. Many sellers lease apartments to tenants and usually the buyer will be required to take title "subject to existing tenancies." The Standard Form of Residential Contract of Sale ("Form Contract of Sale") prepared by the New York State Bar Association and the Association of the Bar of the City of New York (Version 11/00) provides that the premises will be conveyed "vacant and free of leases or tenancies."

Frequently buyers are under the impression that they are not bound by existing tenants or leasehold interests that may exist. Buyers believe they can raise rent freely, remove the tenant, etc. In instances where there is a tenant, the Seller's attorney usually

will modify the Form Contract of Sale by including in the "subject to" clause, in a Rider or Addendum, language that requires a buyer to "take title subject to existing leases or tenancies." It is important that real estate brokers or agents obtain copies of the leases from a seller at the very beginning of a real estate transaction.

Insurable Title vs. Marketable Title: What's the Difference?

Many attorneys and other real estate professionals do not fully understand the difference between "marketable" title and "insurable" title. The Form Contract of Sale requires that a seller must provide the buyer with "insurable title." In certain instances "insurable title" may be different from "marketable title."

As defined in the Form Contract of Sale "Insurable Title" is such "title as any reputable title insurance company licensed to do business in the State of New York shall be willing to approve and insure in accordance with its standard form of title policy approved by the New York State Insurance Department, subject only to the matters provided for in this contract." A title insurance company may be willing to insure an encumbrance or defect that may not be "marketable," while not being willing to provide insurance on another involving marketability.

A hypothetical situation is where a property owner who purchased certain real property discovers that his next door neighbor built a deck, many years prior to his taking title to the premises. The deck encroaches on his newly acquired property. Assume that the neighbor's deck extends onto the owner's property by several feet. The owner was not made aware of the existence of this encumbrance when he purchased but the title insurance company nonetheless provided the owner with title insurance coverage for the encumbrance.

In this case the title insurance company would be required to defend the seller against a possible adverse possession claim by the neighbor. If the property owner decides to sell the property, the property owner's title insurance company may provide the purchaser's title insurance company with indemnification coverage for the encumbrance thereby making title "insurable." Or, if the purchaser's title company elects not to provide coverage, the purchaser may elect, or in some instances may be required, to use the seller's title insurance company. In certain instances, a seller's attorney may include such a provision in the Contract of Sale (i.e. requiring the purchaser to use the seller's title insurance company if an issue such as this arises) thereby forcing the buyer to inherit the seller's problems.

It is important to note that although a seller may be covered by title insurance, title to the premises may still not be considered to be "marketable." It may however, be "insurable." The reality is that such an issue, although "insurable," can cause friction between the neighbor, the seller and even a prospective purchaser. A title insurance company may be willing to provide "insurance coverage" thereby making title "insurable," however, only a Court can determine whether or not title is "marketable." In this example the property owner may end up losing that portion of the property to the

neighbor because of an adverse possession claim even though he or she may eventually be reimbursed for the loss from the title insurance company.

Working Together!

The concepts of "marketable" and "insurable" title are complex. It is up to real estate professionals, particularly attorneys and real estate brokers, to work together in obtaining as much information from the seller before formal contracts are executed. Obtaining copies of a prior title insurance policy from a seller and providing it to the purchaser or purchaser's attorney is extremely helpful. The title insurance policy may contain information relating to exceptions, such as encumbrances or defects, which may exist on a property. Obtaining copies of existing surveys and the deed to the property are also important. Such documentation and information is helpful and allows for the possibility of potential problems or issues to be resolved early on. The key is to represent each client to the best of one's ability. Knowledge of terms such as "marketable" and "insurable," as well as other key real estate concepts, can facilitate a smooth transaction.