Chapter 9: Evidence of Title

An * in the left margin indicates a change in the statute, rule or text since the last publication of the manual.

I. General

A prudent buyer of real estate will demand that the seller furnish proof of ownership. A deed naming the seller as grantee may not be adequate proof. This deed itself, or the previous owner's title may be defective. The seller may own something less than fee simple title; title may be legally unmerchantable or may be heavily encumbered by liens or restrictions. The buyer needs to know the exact state of the seller's title. The lender also has a vested interest by virtue of accepting a mortgage as security for repayment of the loan.

"Evidence of title" is concerned with absolute proof of the nature of real estate ownership. The three major evidences of title are: (1) an abstract and opinion, (2) title insurance, and (3) a Torrens certificate of title.

II. Abstract and Opinion

All states provide for the public recording of every document by which any estate or interest in land is created, transferred or encumbered. In Colorado, the clerk and recorder of the county in which the real property is situated records the deed. (38-35-109(l)&(3) C.R.S.). This law also provides that any document affecting rights in real estate must be recorded in order to provide notice to persons other than those having actual knowledge of the document. In addition, the law provides that: "Any person who offers to have recorded . . . any document purporting to . . . affect the title to real property, knowing or having a reason to know that such document is forged or groundless, contains a material misstatement or false claim, or is otherwise invalid, shall be liable to the owner of such real property for the sum of not less than one thousand dollars or for actual damages caused thereby, whichever is greater, together with reasonable attorney fees . . . ."

Public records are a reliable history of the ownership of a tract of land. An **abstract of title** is a summary of the material parts of every recorded instrument affecting the title to a piece of real estate. Today abstractors typically photocopy the legal instrument history of a property rather than merely summarize it.

To the average purchaser, an abstract does not afford knowledge of the state of the title to the real estate. The purchaser still needs the **opinion** of an attorney to certify the legal nature of the seller's title and of any defects, liens, encumbrances, or other rights that may be disclosed in the abstract.

A. Liability

An abstractor does not guarantee title to the real estate. The law imposes only the duty to exercise due care in the preparation of the abstract. If an abstractor negligently omits or incorrectly summarizes a document, the abstractor can be held liable for any loss suffered by the purchaser. Likewise, an attorney can only be held liable for damages that are caused by

the attorney's negligence in the examination of the abstract. As an example, the attorney is liable for any loss caused by failure to discover an existing, recorded lien contained in the abstract.

B. Risks

No evidence of title can completely and conclusively reveal the exact state of the title to real property. For instance, an abstract and opinion may indicate that the seller has clear title, but if the chain of title contains a forged deed, title did not legally pass. There is no way of knowing from the abstract whether a deed is forged or not. Neither will an abstract reveal the rights of parties in possession, i.e., a valid lease. The abstract may show title in one person but another may possibly have superior right through adverse possession. Fortunately, such things rarely happen. With an abstract and opinion together with a physical examination of the property, a buyer can be reasonably certain of obtaining good title.

III. Title Insurance

Title insurance is a contract that protects the insured against loss occurring through defects in title to real property. As in other insurance policies, the property owner transfers risk of loss to the insurer. A title company will not insure a bad title any more than a life insurance company will insure a dying person.

Basically, a title insurance policy provides that the company will indemnify the owner against any loss sustained because of a defect in title, provided that the defect is not specifically excluded in the policy. Further, the insurance company agrees to defend any lawsuit attacking the title based on a claimed defect that is covered by the insurance provisions. Examples of typical standard exclusions that the policy does not insure against are:

1. Rights or claims of parties in possession not shown of record, including unrecorded easements, or leases.
2. Any facts an accurate survey would show.
3. Mechanics liens, or any rights thereto, where such liens or rights are not recorded.
4. Taxes and assessments not yet due or payable and special assessments not yet certified to the county treasurer's office.

Title policies also list exclusions of record pertaining to the specific property, such as mortgages, easements and covenants. Both standard and non-standard exclusions may sometimes be deleted or insured against if specifically requested.

The date of a title policy is very important. The title insurance company guarantees against loss occurring because of defects existing on or before the date of the policy. Defects that come into existence after the effective date of the title policy are not covered.

A. Owner's vs. Mortgagee's Policies

Title insurance companies will issue a separate policy to the owner and to the mortgagee (lender). An owner's policy protects the owner's equitable interest in the property and is not transferable. Upon resale, the new purchaser must obtain a new or reissued title policy. A mortgagee's policy protects the mortgagee, and only to the extent of the mortgagee's interest

(loan balance). A mortgagee's policy does normally transfer if the note and mortgage are sold together (an assumption).

Unlike other insurance, title insurance premiums are a one-time, up-front fee. Premiums are based upon the amount of insurance purchased. Premiums charged by title companies must be filed with the Colorado Division of Insurance and are available to the public. The owner's equity is only protected by an owner's policy.

B. Title Insurance Commitments

Shortly after receiving an order for title insurance, the company will issue a commitment showing what it is willing to insure and under what circumstances. Commitments are usually issued free of charge if there is a contract of sale on the property. If ordered prior to entering into a contract, or for a purchaser "to be determined" (TBD), the title company must make a charge for the commitment.

The use of title insurance may not relieve the purchaser of the need for legal advice on the title. A title insurance company may avoid liability through exclusions that may affect future marketability of title. It may be prudent for a purchaser's attorney to examine the title insurance commitment and its exclusions. Sufficient time should be allowed in the contract timeline if the buyer elects an attorney examination.

Title insurance policies are the most popular evidence of title in urban areas. Abstracts are physically cumbersome and when large blocks of mortgages or trust deeds are sold to banks or other financial institutions, the investors usually prefer a title policy.

C. Division of Insurance

The Colorado Division of Insurance regulates title insurance companies. The real estate commission and division of insurance strive to create a homogenous regulatory environment for the two industries, particularly in the closing of real estate transactions. Toward this end, the division of insurance developed a set of questions and answers relating to statutory and regulatory requirements. The real estate commission has endorsed the answers.

Question: How do I comply with the requirement for "good funds?"

Answer: There are three primary ways to comply with the "good funds" section:

A) Using funds that have been deposited and are available for immediate withdrawal, (e.g., wire transfers, checks that have been deposited two to three days in advance of closing, or electronic fund transfer between two separate accounts in the same bank.

B) As a consequence of an agreement with the financial institution in which the funds are to be deposited and the financial institution upon which the funds are drawn. This would include so called "tri-party" agreements (between mortgage broker, warehouse bank, and title company); the written guarantee of the bank upon which an earnest money deposit is drawn; or cashier's, certified, or teller's checks (under the theory that these instruments have the agreement for immediate withdrawal of the issuing institution).

C) Close the transaction, wait for the money to become available for withdrawal, and then disburse.

Question: How can I close and have money be disbursed at the table?

Answer:

A) The funds have been deposited in the title company's financial institution and they are available for immediate withdrawal. This includes wire transfers and checks deposited in advance.

B) Certified, cashier's, teller's checks and other instruments as defined by Federal Regulation CC, 12 CFR, Part 229.10(c), are considered "good funds" by the division of insurance and allow for immediate disbursement under the theory that these instruments have the agreement for immediate withdrawal of the issuing institution.

C) By virtue of a "tri-party" agreement or any written agreement wherein the bank upon which the check is drawn agrees to guarantee to the title company that funds are available for immediate withdrawal.

Question: How do I make my earnest money deposits acceptable under the definition of "good funds?"

Answer: By depositing them with the title company two or three days in advance; converting them to cashier's, certified, or teller's checks; electronic or wire transfers; or by virtue of a written agreement with the bank upon which the funds are drawn.

Question: Why can't I receive a free "TBD" commitment? Is there any alternative?

Answer: If a "TBD" commitment is used by a real estate licensee to obtain a listing or by a seller to ascertain the status of the title prior to entering into a contract, this is a legitimate expense of the licensee and/or the seller. A "TBD" commitment is in fact a commitment that is ordered prior to the time of a real estate sales contract or, in the case of a re-finance, prior to the time of loan approval. Title companies must properly charge for these commitments. However, should these commitments ultimately result in a policy of title insurance, any charge made may be credited against the final title policy charge.

As noted in Section VII. B 3 (P. 7) of Regulation 88-5, a title company is not required to charge for a commitment furnished in good faith in furtherance of a bona fide sale, purchase or loan transaction which for good reason is not consummated.

Title companies give sufficient information in the form of an ownership and encumbrance report or "O&E" to allow a licensee who has a listing to perform most necessary functions. As long as all parties are treated equally, a title insurer may issue these without charge.

Question: Can title insurers continue to provide support, services or other items of value to individual real estate licensees, lenders or others?

Answer: No! Such practices are illegal under Insurance Regulation 72-3. The standards of conduct outlined in Section VII of Regulation 88-5 also continue to prohibit such practices. Only nominal expenditures for items available to all persons are acceptable under the regulation.

Question: Who pays for closing fees that are required by Regulation 88-5?

Answer: The division of insurance does not take a position on who should pay closing fees or, for that matter, the title insurance policy fees. These fees are a matter of negotiation between the parties. However, based upon local practice and custom, the division believes that these may be paid in the following manner:

A) The title insurance policy premium by the seller.

B) The closing and settlement services fee, exclusive of document preparation, by seller and/or buyer.

C) Document preparation/scrivener function by the broker/licensee.

Question: Regulation 88-5 requires title entities to provide closing and settlement services only with written closing instruction. Do we have such instruction?

Answer: Yes. Closing instruction forms are available through the real estate commission.

Bulletin No. 02-02

Joint Position Statement from the Division of Real Estate and Division of Insurance

Concerning Application of the Good Funds Laws

Issued: July 10, 2002

I. Background and Purpose

The purpose for this bulletin is to clarify the Division of Insurance and the Division of Real Estate's position with respect to application of Colorado's good funds laws to real estate transactions involving regulated entities. In particular, there is confusion in the industry regarding reconciliation of § 38-35-125, C.R.S., Colorado's good funds laws, with Division of Insurance regulation 3-5-1(6)(F) and the current practice of disbursing cashier's checks drawn on a title entity's account, pursuant to instructions of the parties and in connection with closing a real estate transaction.

Bulletins are the agencies' interpretations of existing laws or general statements of policy. Bulletins themselves establish neither binding norms nor finally determine issues or rights.

II. Applicability and Scope

This bulletin concerns all title insurance entities and real estate licensees involved in real estate closings.

III. Position Statement

The good funds statute provides, in relevant part:

> *No person or entity that provides closing and settlement services for a real estate transaction shall disburse funds as a part of such services until those funds have been* ***received*** *and are either:* ***available for immediate withdrawal as a matter of right*** *from the financial institution in which the funds have been deposited; or available for immediate withdrawal as a consequence of an agreement of a financial institution in which the funds are to be deposited or a financial institution upon which the funds are to be drawn.*

38-35-125(2), C.R.S. The same statute defines funds "available for immediate withdrawal as a matter of right" to include any wire transfer or any certified check, cashier's check or teller's check. Thus, a cashier's check or wired funds (most typically used) that have been received by the entity providing closing and settlement services are considered "good funds".

Division of Insurance regulation 3-5-1(6)(F) parallels § 38-35-125, C.R.S. and provides that "All title insurance entities shall comply with the 'good funds law'." In addition, Division of Insurance regulation 3-5-1(5)(A)(3) specifies that failure to comply with the good funds laws constitutes an unlawful inducement for the referral of title insurance business proscribed by § 10-11-108, C.R.S.

The federal courts interpreted Colorado's good funds laws in Guardian Title v. Matrix, 141 F.Supp.2d 1277 (D.Colo. 2001). The court held that good funds laws govern title entities that engage in closing and settlement services. See id. at 1279. Failure to comply with the good funds statute is a deceptive trade practice and violates insurance regulation 3-5-1. See id. at 1280-81. The court stated: "The Good Funds law was developed as a solution to 'the need to insure that the title company or other party responsible for real estate closings has 'good funds' **in hand** before closing the transactions'". Id. at 1281.

Based on the above, it is the position of the Division of Real Estate and Division of Insurance that Colorado's good funds law and insurance regulation 3-5-1 6(F) require that a title entity must have good funds **"in hand"** (e.g., wired funds, certified check, cashier's check, tellers check) **before it disburses funds** as part of its settlement services.

Further, it is the position of the Division of Real Estate and Division of Insurance that a title company which withdraws funds from its account in the form of a cashier's check, but (1) maintains complete control and possession of the check; and (2) does not disburse (pay out) until **delivery** and receipt of "good funds" relating to the specific transaction, complies with the good funds laws.

By way of example, it is common in a real estate transaction for funds to come to the closing from at least two sources, the buyer and the lender. It is also common for a seller to ask for closing proceeds in the form of a cashier's check, drawn on the title entity's account. Applying the 'good funds' law and insurance regulation 3-5-1, the title company could cause a cashier's check to be issued from its account and have the check available for the seller at closing. The title entity could not disburse to the seller until "good funds" were received or "in hand" from the buyer and lender. "In hand" means that a cashier's check has been received by the title entity or, in the case of a wire transfer, has been wired into the title entity's account.

Once the transaction closes and the cashier's check is paid to the seller, the title entity is responsible for immediately depositing the buyer's "good funds" into its account. If the transaction does not close, the title entity is responsible for immediately redepositing its cashier's check into its account. In that manner, no other customer of the title entity is harmed.

IV. For more information:

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www.dora.state.co.us/insurance

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IV. Torrens Certificate of Title

Sir Robert Torrens, a British businessman, developed a system of real estate title registration in 1857 based on the system used to register ships. The registry of ships briefly and clearly showed the condition of a ship's title by listing the name of the ship's owner and all liens and encumbrances against it. A modern comparison would be an automobile title, which shows on one document the name of the owner and any existing liens or

encumbrances. About a dozen states, including Colorado, have a Torrens Title Registration Act (Title 38, Article 36, C.R.S.).

A. Methods of Registration

To register title to land under the Torrens system, the owner files a written application with the appropriate court for the county in which the property is located. The court then holds proceedings to ascertain the state of the title. All persons known to have an interest or claim in the property are served personal notice of the registration proceedings. All other persons have constructive notice through newspaper publication. The proceedings equate in essence to a quiet-title lawsuit.

After the hearing, the court issues a decree of confirmation of title and registration. When the court's decree is filed with the registrar of titles (county clerk and recorder), an original certificate of title is issued setting forth the court's findings as to the owner, owner's interest, and all liens, claims, encumbrances and other rights, if any, against the property. The registrar then issues an "owner's duplicate certificate of ownership." Ninety days after the issuance of this decree, no person may maintain any action that challenges the findings set forth in the decree. The owner of the real estate is then conclusively presumed to have title as decreed.

B. Transfer of Torrens Title

Colorado law (38-36-155 C.RS.) related to conveying registered land reads as follows:

> An owner of registered land conveying the same, or any portion thereof, in fee, shall execute a deed of conveyance which the grantor shall file with the registrar of titles in the county where the land lies. The owner's duplicate certificate shall be surrendered at the same time, and shall be by the registrar marked "canceled". The original certificate of title shall also be marked "canceled". The registrar of titles shall thereupon enter in the register of titles a new certificate of title to the grantee, and shall prepare and deliver to such grantee an owner's duplicate certificate. All encumbrances, claims or interests adverse to the title of the registered owner shall be stated upon the new certificate or certificates, except insofar as they may be simultaneously released or discharged. When only a part of the land described in a certificate is transferred, or some estate or interest in the land remains in the transferor, a new certificate shall be issued to him for the part, estate, or interest remaining to him.

The Torrens certificate is the rarest of the three evidences of title discussed above, but it is used in certain parts of eastern Colorado.