

What You Need To Know About Title Insurance In International Real Estate Transactions

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Title insurance has at last gone global.

GLOBALIZATION IS AFFECTING even the practice of commercial real estate law, and the availability and extent of title insurance in international real estate transactions is a matter of growing interest to commercial real estate lawyers. This article will explain what international title insurance is, when you might need it, and how to use it.

WHAT IS INTERNATIONAL TITLE INSURANCE? • Modeled after the American Land Title Association policies sold in the United States, international title insurance policies protect insureds against both known and unknown defects in a property title, including:

- Boundary disputes;
- Restrictive covenants;

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- Right-of-way issues;
- Adverse possessions;
- Lost deeds; and
- Leasehold defects.

In addition, these policies:

- Confirm that property title is good and marketable;
- Insure against costs or legal expenses necessary to defend title; and
- Provide coverage against a range of other problems such as fraud, forgery and mortgage invalidity.

How Much Does It Cost?

The premium for an international title insurance policy is generally \$3.50 per \$1,000 of liability plus the cost of searching and examining the real property records. Unlike the practice in the United States, the title insurance company will often require that the proposed insured pay a non-refundable initial charge before any work is undertaken. This charge, to cover the out-of-pocket costs of local attorneys and searchers, is usually calculated as a percentage of the proposed premium, and is typically less than \$10,000. In the Caribbean and Latin America, including Mexico, the premium rate can be slightly higher (\$5.00 per \$1,000), although it does drop to \$3.50 per thousand above \$10 million of liability. Nonetheless, in countries where a title insurance company has a local operation, the rates are set locally and are generally well below the \$3.50 per \$1,000 rate. In these countries, an upfront deposit is usually not required.

WHAT ARE THE OBJECTIONS TO INTERNATIONAL TITLE INSURANCE? • In the United States, title insurance is accepted as a necessary part of any real estate finance transaction. But this is not yet the case internationally. In many countries, the answer to the question

“Is title insurance available?” is likely to be some version of the following:

- “You don’t need it; we have a perfect registry system”;
- “We rely on attorney opinion letters”; or
- (Best of all) “What’s title insurance?”

Needless to say, the added cost of a title insurance premium is also an issue. Each of these objections arises out of longstanding custom and use—an “if it isn’t broken, don’t fix it” mentality—as well as unfamiliarity with the process and the product.

Why Can’t I Rely On Registry Systems And Government Guarantees?

Every country has some sort of property registry system. Some registry systems are much better than others. However, no registry system is perfect and no registry system is backed by a no-fault, 100-percent government guarantee. More typical is the registry system that has some shortcomings, or a governmental guaranty that is available after all other recourse has been exhausted, and in amounts much less than the property value. For many transactions, these registry systems and government guarantees might be sufficient. But in a high-value transaction, the assurance of a strict liability insurance policy backed by a U.S. Fortune 300 company may be necessary, not only from a risk-avoidance perspective, but from credit-enhancement and marketing points of view as well, especially when the ownership of the fee or mortgage later will be syndicated or securitized.

At a minimum, when a lender agrees to rely on a registry system and a government guarantee, instead of title insurance, the lender should fully understand the limitations, if any, to the guarantee and the process and cost of enforcement.

What's Wrong With Legal Opinion Letters?

In certain U.S. jurisdictions, title diligence is established by a lawyer's opinion letter, which in turn is backed up by a title insurance policy. Why in the United States marketplace isn't the opinion letter on its own considered sufficient? A lawyer's opinion letter may be of little help. If an investor or lender has relied on an opinion and later has a title problem, the lawyer might not assist in its resolution. A lawsuit against the lawyer would have to show that he or she was negligent in failing to follow the local standard of care—an uncertain and costly process, particularly when no title insurance company is contractually obligated to supervise and pay for the litigation.

What's The Local Standard Of Care?

Now picture the same difficult process in a foreign country where few investors, lenders, or their counsel (who may not be nationals of that country) even know the local standard of care. For example, in some parts of Mexico, the standard of care may involve searching no more than seven years of registry records, even though interests older than that may still be good. A lender relying on such an opinion might have difficulty proving negligence by the lawyer who failed to address a 10-year-old mortgage. In any event, that lender would be financing the litigation or trying to collect its costs from the borrower. By contrast, if title insurance were in place and a mortgage had been overlooked, the title insurer would be contractually obligated to defend the claim at its expense and, if unsuccessful, pay the insured lender's losses.

How Easily Can I Collect On A Damage Award?

Even if negligence in connection with a lawyer's opinion letter is proven, determining and collecting damages is difficult. Professional indemnity insurance is not always required of

lawyers in foreign countries, and few carry it in amounts like those in the United States. Some foreign lawyers have access to local law society indemnity funds, but many of these have problems, too. The fund in the U.K. became insolvent and closed a few years ago, and the fund in Hong Kong was diminished when its primary reinsurer became insolvent. It is difficult to quantify the number of claims against attorneys over their title opinion letters because presumably a number of such claims are dropped or settle without ever reaching a courtroom. Nonetheless, even if there are relatively few such claims each year, the potential barriers to restitution may be unacceptable in a high-value commercial transaction.

When a lender agrees to rely on an opinion letter, instead of title insurance, the lender should first determine that the local attorney rendering the opinion carries liability insurance and in what dollar amounts.

OTHER ADVANTAGES OF INTERNATIONAL TITLE INSURANCE • Besides providing insurance coverage, international title insurance performs a number of practical functions.

Insurer As Expediter

On a very practical level, title insurance can be a solution to delays or problems in following traditional local title examination practices, especially in multi-site and cross-border transactions. Some recent examples:

- A UK property company obtained a loan from a UK lender to be secured by a ground rents portfolio. To avoid a due diligence exercise in which solicitors would have had to examine over 90,000 titles that made up the portfolio, a title insurance policy insured the lender against title losses. The policy saved large amounts of time and expenditures of legal fees;

- A Hong Kong developer was attempting to terminate the existence of one of its subsidiaries, whose assets consisted of a loan portfolio, which was to be transferred to a local mortgage company. The mortgage company required certain buyback and other guarantees that would have prevented the developer from collapsing its subsidiary. In lieu of the guarantees, title insurance covered the loans and the assignments of them to the mortgage company, which allowed the developer to avoid contingent liabilities in the subsidiary and collapse it out of existence;
- A U.S. insurance company encountered a title issue in connection with the acquisition of a property in London. There was a question whether a sub-lease had been created without the freehold owner's permission. Title insurance protected the purchaser against the issue, avoiding the need for title opinions, guarantees, and other costly arrangements.

A title search can involve far more searches than simply the local property registry. In certain parts of the metropolitan area of Sydney, Australia, a diligent lawyer might have to do dozens of local authority searches. In many cases, title policies cover the risks of not having done these searches, thus saving time, the cost of obtaining the searches from the municipal authorities, and the lawyers' review time.

Insurer As Business Consultant

Title insurance companies also serve as local business consultants, providing a network of regional real estate experts and professionals to assist in financing, due diligence, document production, and other risk-elimination processes. In 2003, a United States-based petroleum company retained a major real estate consulting/management firm to streamline the petroleum company's property division. In an effort to make procedures for property acquisitions in the Caribbean/Central America as similar as

possible to those in the United States and to overcome issues and concerns about local title advice, a title insurance company was asked to provide title insurance on local retail service station site acquisitions.

Fraud Protection

The incidence of fraud in mortgage lending, through identity theft and otherwise, is increasing rapidly world-wide against residential mortgage lenders, particularly in Canada and Australia. One highly publicized incident in the Vancouver area included a lawyer's participation in the fraud, and involved mortgage losses in excess of \$50 million. Some, but not all, of the mortgages were title insured. The balance relied on the assurances in a lawyer's opinion letter, which typically excludes fraud from the matters it addresses.

With respect to fraud cases, to the extent government registration guarantees exist, they may be difficult to collect upon. Fraud cases often involve the expenditure of considerable additional attorneys' fees. Title insurance not only provides protection for fraud, but it also pays for attorneys' fees to enforce the mortgage and investigate the fraud.

Defense Costs: Recent Claims

Many international lenders, investors, and attorneys today know that title insurance is more than a document to be filed away after the premium is paid at closing. Rather, it creates an ongoing partnership, often for decades. Some recent examples:

- A major UK grocer obtained title insurance for an easement to allow employees to get from an offsite parking area to the store site. Shortly before the busy year-end holiday season, the owner of the property traversed by the easement attempted to block it. Without the easement, the grocer's employees would have had to park in the customer lot, leaving limited

parking available for customers. The title insurer resolved the claim within days, allowing the employees to use the off-site lot and the customers to use the lot at the store site;

- In Nicaragua, a title insurer is currently providing defense to a developer insured for a housing project. A prior deed from the local municipality is being challenged by the current, soon to be lame-duck administration of that municipality, apparently on the basis that the earlier administration did not charge enough for the land. Although the municipality's suit is likely to fail, the policy coverage provides for the legal defense at the title company's cost, not the insured developer's.

Credit Enhancement

In the United States, when title to real property in a securitized transaction is insured by a national underwriter, that transaction will receive a more favorable credit rating from the applicable credit rating agency than it would had the title not been insured. The more favorable a transaction's credit rating, the lower the risk to return on investment and, therefore, the less the principals have to give away to attract investors. In recent years, international securitized transactions involving real estate have not capitalized on the credit enhancement offered by title insurance. International offices of the major ratings agencies and credit enhancement providers are not yet fully acquainted with the operation and financial resources of title insurance companies and the benefits of title insurance.

As international markets become more "Americanized," title insurance industry ana-

lysts expect an increasingly greater use of title insurance to enhance the credit of transactions going to market. Such an attitudinal shift may be underway. In 2003, an Australian lender decided to undertake a securitization program for its residential loans. To facilitate the securitization process, to obtain credit enhancement and to streamline mortgage origination and settlement, the lender included title insurance in its mortgage protocol.

CONCLUSION • For over a century, there was no title insurance in the United States and properties were conveyed, leased, and mortgaged in the normal course, and at the pace, of business in the marketplace. "Caveat emptor" was the rule of the day. In the 1800s, even one of America's greatest presidents, Abraham Lincoln, lost two of his family's farms because of title defects. But as losses increased and market practices evolved, title insurance became the rule, not the exception.

Today, globalization is the driving force in international commerce. The Internet continues to increase transaction speed and promote uniform systems and processes. The emergence of international standards for commercial mortgage-backed securities exemplifies this trend. The cash flow derived from securities in title-insured loans logically is more reliable than in uninsured loans in which there is a risk of a title loss. International lenders are becoming more familiar with the protections and benefits of title insurance, and, consequently, it is playing an increasingly greater role in the evolution of standardized international transaction systems and processes.

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APPENDIX

Nations For Which International Title Insurance May Be Provided

(Note: This list is provided by the First American Title Insurance Company. International Title Insurance for other countries may be available on a transaction-by-transaction basis.)

- Africa/Middle East: Israel, South Africa;
- Asia/Pacific: Australia, Guam, Hong Kong, New Zealand, Northern Marianas Islands, Japan, Macau, Singapore, South Korea;
- Canada;
- Caribbean: Anguilla, Antigua & Barbuda, Aruba, The Bahamas, Barbados, Bonaire, British Virgin Islands, Cayman Islands, Curacao, Dominica, Dominican Republic, Grenada, Guadeloupe, Jamaica, Martinique, Puerto Rico, Saba, St. Barthélemy, Sint Eustatius, St. Kitts & Nevis, St. Lucia, St. Martin, Sint Maarten, St. Vincent & Grenadines, Trinidad & Tobago, Turks & Caicos Islands, United States Virgin Islands;
- Europe: Czech Republic, France, Germany, Greece, Hungary, Italy, The Republic of Ireland, Poland, Slovakia, Spain, Turkey, United Kingdom (England, Scotland, Northern Ireland, and Wales);
- Latin America: Argentina, Belize, Brazil, Chile, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Peru.

PRACTICE CHECKLIST FOR**What You Need To Know About Title Insurance In International Real Estate Transactions**

Firmly established in the United States, title insurance is not widely used abroad. However, the growth of international commercial mortgage-backed securities markets and the need for uniformity in these markets is creating a demand for international title insurance.

- What does international title insurance do? Among other things, it:
 - ___ Confirms that property title is good and marketable;
 - ___ Insures against costs or legal expenses necessary to defend title, and provides coverage against a range of other problems such as fraud, forgery, and mortgage invalidity;
 - ___ Often helps avoid delays or problems in following traditional local title examination practices, especially in multi-site and cross-border transactions;
 - ___ Provides protection against fraud and also pays for attorneys' fees to enforce the mortgage and investigate fraud;
 - ___ Gives the insured access to the insurer's network of regional real estate experts and professionals to assist in financing, due diligence, document production, and other risk-elimination processes.