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Condominium Unit Title Insurance

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CONDOMINIUM UNIT TITLE INSURANCE

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A condominium unit is real property and, as such, is insurable under all current forms of title insurance policies, including the almost nationally accepted forms of the American Land Title Association ("ALTA"). As such, the owner's policy insures against loss sustained by the insured by reason of the following four coverages:

1. Title to the estate or interest described in Schedule A being vested other than as stated therein;

2. Any defect in, or lien or encumbrance on, the title;

3. Unmarketability of the title;

4. Lack of a right of access to and from the land.[1]

The ALTA loan policy[2] furnishes all four coverages to a condominium unit mortgagee plus four additional coverages:

5. The invalidity or unenforceability of the lien of the insured mortgage upon the title;

6. The priority of any lien or encumbrance over the lien of the insured mortgage;

7. Lack of priority of the lien of the insured mortgage over any statutory lien for services, labor or material:

(a) arising from an improvement or work related to the land which is contracted for or commenced prior to the Date of Policy; or

(b) arising from an improvement or work related to the land which is contracted for or commenced subsequent to Date of Policy and which is financed in whole or in part by proceeds

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[1] *ALTA Owner's Policy*, at IV-9 (October 17, 1992) [hereinafter *Owner's Policy*].

[2] *See ALTA Loan Policy*, at IV-13 (October 17, 1992) [hereinafter *Loan Policy*].

of the indebtedness secured by the insured mortgage, which at Date of Policy the insured has advanced or is obligated to advance;[3]

8. The invalidity or unenforceability of any assignment of the insured mortgage, provided the assignment is shown in Schedule A, or the failure of the assignment shown in Schedule A to vest title to the insured mortgage in the named insured assignee free and clear of all liens.[4]

Because a condominium unit is a unique form of real property whose ownership is normally founded upon compliance with a state statute and certain documentation,[5] the title insurance industry developed a form of condominium endorsement. Without a special endorsement, standard exclusions from coverage in both the Owner's Policy and the Loan Policy would leave a condominium unit owner or mortgagee unprotected against violation of state condominium statutes or subject to liens for common charges.[6] The endorsement to supplement the basic insuring provisions of ALTA policies was promulgated at the urging of attorneys for condominium unit owners and their mortgagees. The ALTA Condominium Endorsement Form 4 became available on June 1, 1987. The endorsement was later revised on March 27, 1992,[7] and a supplementary endorsement Form 4.1 was adopted by ALTA on October 17, 1992.[8]

This article will examine the need for these endorsements and what they add to the basic ALTA policy coverage. Initially,

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[3] In New York, insuring provision 7 is deleted from the Loan Policy. Instead, a broader form of coverage is added to both the Loan Policy and the Owner's Policy by a New York Endorsement which provides insurance against loss by reason of "[a]ny statutory lien for services, labor or materials furnished prior to the date hereof, and which has now gained or which may hereafter gain priority over the estate or interest of the insured as shown in Schedule A of this policy." *Standard New York Endorsement for Use with ALTA Loan Policy*, at V-3 (September 1, 1993).

[4] *Loan Policy*, *supra* note 2, at IV-13.

[5] Examples of these documents include a declaration, by-laws, plats and maps.

[6] *See* JOYCE PALOMAR, TITLE INSURANCE LAW, §9.07 (1997).

[7] *See* ALTA Endorsement 4 (Condominium), Appendix A, *infra* p. 194. The ALTA Condominium Endorsement Form 4 was adopted in New York on September 1, 1993.

[8] See ALTA Endorsement 4.1 (Condominium), Appendix B, *infra* p. 196. Form 4 and Form 4.1 are identical with two exceptions. In those states where the association lien for common charges has been granted a super-priority status, Form 4.1 is used and assures only that the insured interest has priority and that no amount is due or lien is in existence for condominium association charges at the date of the policy.

it must be noted that a title examination normally will disclose the recording of the declaration, by-laws, plans, and possibly a set of restrictive covenants, easements, etc. These documents will be listed on Schedule B-1 of the title policy.

The basic thrust of the Condominium Endorsement is to insure against loss by reason of non-compliance with the requirements of the applicable condominium statutes and other provisions frequently found in the documents. It insures against most violations of any restrictive covenants contained in the condominium documents and provides insurance to a condominium unit first mortgagee against loss of priority of the insured mortgage by reason of charges and assessments provided for in the condominium documents. Additionally, the ALTA Condominium Endorsement insures against any obligation to remove improvements due to encroachments by other units or any of the common elements, failure of title resulting from a right of first refusal, or loss or damage by reason of the unit not being entitled by law to be assessed as a separate tax parcel. Of course, a special condominium endorsement can be negotiated and custom crafted, subject to state regulatory restrictions, but the standard ALTA endorsements are usually the only ones available and utilized.

This article will examine the seven additional items of insurance coverage contained in the ALTA Condominium Endorsement, noting the variations between the original June 1, 1987, endorsement, the March 27, 1992, revisions, and its variation from the October 17, 1992, Form 4.1.

Paragraphs one and two in each of the forms are identical and read as follows:

> The Company insures the insured against loss or damage sustained by reason of:
>
> 1. The failure of the unit identified in Schedule A and its common elements to be part of a condominium within the meaning of the condominium statutes of the jurisdiction in which the unit and its common elements are located.
>
> 2. The failure of the documents required by the condominium statutes to comply with the requirements of the statutes to the extent that such failure affects the title to the unit and its common elements.[9]

These provisions insure that the unit is part of a valid statu-

[9] *ALTA Endorsement 4*, *supra* note 7; *ALTA Endorsement 4.1*, *supra* note 8.

tory condominium and that the documents do not adversely affect title to the unit. In most states, it is possible to create what is sometimes referred to as a "common law condominium." With proper and extensive documentation, it is possible to convey a physical part of a building. That documentation should deal with the relationship of the parcel conveyed to the balance of the structure and the land upon which it stands. However, the contemporary notion of condominiums existed in various parts of the world hundreds of years ago without any known special statutory basis. It is normally preferable, however, to be in compliance with the condominium statute of the particular jurisdiction, since those statutes not only sanction this type of subdivision of the parcel, but also create valuable additional rights that could not be claimed by a common law condominium. Although the various state statutes differ in numerous details, these statutes usually create valuable and desirable "bundles of rights" for purchasers, owners, and lenders. Those rights usually deal with the operation of the condominium, termination, eminent domain, insurance, separate unit taxation, and the creation and priority of liens for common charges. Some statutes also contain valuable consumer protection provisions.[10] Subsequent and more sophisticated statutes such as the Uniform Condominium Act ("UCA")[11] and the Uniform Common Interest Ownership Act ("UCIOA")[12] have not only provided for the aforementioned rights but have provided flexibility as to expansion or contraction of a condominium, leasehold condominiums, borrowing powers, and numerous other matters.

While paragraph one of the Condominium Endorsement deals with the unit not being part of a statutory condominium,

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[10] *See, e.g.*, ALA. CODE §§ 35-8A-401 to -417 (1991); N.C. GEN. STAT. §§ 47C-4-101 to -113 (1996). For example, the condominium acts in Alabama and North Carolina each have sections that require offering statements to provide specific information to purchasers. *See* ALA. CODE § 35-8A-403 cmt.; N.C. GEN. STAT. § 47C-4-103 cmt. The first comment to each of these sections notes that "[t]he best 'consumer protection' that the law can provide to any purchaser is to insure that he has an opportunity to acquire an understanding of the nature of the products which he is purchasing." ALA. CODE § 35-8A-403 cmt.; N.C. GEN. STAT. § 47C-4-103 cmt. However, there is further explanation that such is "difficult to achieve" in connection with the purchase of condominiums "because of the complex nature of the bundle of rights and obligations which each unit owner obtains." ALA. CODE § 35-8A-403 cmt.; N.C. GEN. STAT. § 47C-4-103 cmt.

[11] UNIF. CONDOMINIUM ACT (amended 1980), 7 U.L.A. 199 (1997).

[12] UNIF. COMMON INTEREST OWNERSHIP ACT, 7 U.L.A. 1 (1997).

paragraph two deals with the adverse effect on title to the unit if some of the required statutory documents do not comply with all of the statutory requirements. Usually, the basic statutory condominium documents are the declaration, by-laws, and plans.

Many of the condominium statutes require that the declaration or other documents either contain certain provisions or conform to standards set forth in the statute. For instance, UCA section 2-105 sets forth fourteen necessary contents of the declaration of a condominium.[13] With respect to "Flexible Condominiums" and "Leasehold Condominiums,"[14] both of which are impermissible in many states,[15] there are additional statutory requirements in sections 2-106 and 2-107. In the states that have adopted the UCIOA, its section 2-105 also contains fourteen requirements.[16] Similarly, there frequently are other requirements, such as the "Allocation of Common Element Interests, Votes, and Common Expense Liabilities"[17] and the requirements as to "Plats and Plans."[18]

Each state has its own requirements as set forth in its own act.[19] Even those states that have adopted the UCA or UCIOA frequently have some variations from the uniform act.[20] A title insurance policy containing a Condominium Endorsement pro-

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[13] *See* UNIF. CONDOMINIUM ACT § 2-105, 7 U.L.A. at 244.

[14] *See* UNIF. CONDOMINIUM ACT § 1-103(15), 7 U.L.A. at 214 (defining a "leasehold condominium" as "a condominium in which all or a portion of the real estate is subject to a lease the expiration or termination of which will terminate the condominium or reduce its size").

[15] *See* UNIF. CONDOMINIUM ACT § 2-106 cmt. 3, 7 U.L.A. at 248 (explaining that its "requirements concerning leasehold condominiums . . . are not typically contained in the statutes of most states").

[16] *See* Richard J. Wirth, *The Uniform Common Interest Ownership Act Nonresidential Use Exemption: When an Out May not Be an Out*, 26 REAL PROP. PROB. & TR. J. 885, 886 (1992) (noting that Alaska, Colorado, Connecticut, Nevada, and West Virginia have enacted statutes based on the Act).

[17] UNIF. CONDOMINIUM ACT § 2-107, 7 U.L.A. at 250; *see also* UNIF. COMMON INTEREST OWNERSHIP ACT § 2-107(a)(i), 7 U.L.A. at 59 (requiring an allocation in a condominium "a fraction or percentage of undivided interests in the common elements and in the common expenses of the association . . . and a portion of the votes in the association").

[18] UNIF. CONDOMINIUM ACT § 2-109, 7 U.L.A. at 256; UNIF. COMMON INTEREST OWNERSHIP ACT § 2-109, 7 U.L.A. at 63.

[19] *See, e.g.*, N.Y. REAL PROP. LAW §§ 339-d to -jj (McKinney 1989 & Supp. 1999).

[20] *See* UNIF. CONDOMINIUM ACT § 2-105, 7 U.L.A. at 248 (describing the differences between Alabama subsection (a)(12); New Mexico, omitting subsection (a)(13); North Carolina subsection (a)(5); and Rhode Island subsection (a)(2)); *see also* UNIF. CONDOMINIUM ACT § 2-108, 7 U.L.A. at 250 (explaining the changes made in Alabama subsection (b) and North Carolina subsections (a),(b),and (c)).

vides valuable protection with respect to the compliance of the condominium regime and the various documents with the applicable statute.

Paragraph three of the ALTA Endorsement Form 4 was amended as of March 27, 1992 to exclude some environmental protection coverage (as underlined below), so that it now insures against loss or damage sustained by reason of:

> Present violations of any restrictive covenants which restrict the use of the unit and its common elements and which are contained in the condominium documents, except violations relating to environmental protection unless a notice of a violation thereof has been recorded or filed in the public records and is not excepted in Schedule B. The restrictive covenants do not contain any provisions which will cause a forfeiture or reversion of title.[21]

This additional insuring provision can be significant. It is quite common for one or more of the "condominium documents" to create restrictions, although it would be highly unusual for a violation to cause a forfeiture or reversion of title. It is not clear whether this protection would apply to a set of restrictions affecting all or part of the condominium recorded by a developer as a separate document, as distinguished from the declaration, bylaws, plats, and plans that are "required" by the applicable condominium statute.

A careful reading of this coverage prompts additional questions. Although most condominiums are of residential units only, the ALTA Condominium Endorsement could also conceivably be utilized for non-residential units. Insurance against violation of a use restriction is normally avoided by a title underwriter, if for no other reason than the difficulty in ascertaining the type of use. The proliferation of home computers, for example, has increased the number of businesses being run out of people's homes. Thus, questions may also arise as to whether local zoning regulations regarding use, or some other standard, would apply to an "in home" business or professional use.

It should be noted that the insurance only deals with "present violations" as of the date of the policy. It is difficult to imagine how the violation of a restrictive covenant by the seller might result in loss or damage to the new purchaser or mortga-

[21] *ALTA Endorsement 4*, *supra* note 7.

gee.

Paragraph four in ALTA Condominium Endorsement Form 4, although seemingly applicable to loan policy coverage only, can actually be used for either form of policy. Paragraph four insures against loss or damage sustained by reason of:

> The priority of any lien for charges and assessments provided for in the condominium statutes and condominium documents over the lien of any insured first mortgage identified in Schedule A.[22]

The mortgage lien priority insured only deals with charges and assessments that were given priority by the applicable condominium statute. This usually involves the lien in favor of the condominium association for common expenses and charges. Underwriting requires an examination and understanding of the applicable statutory provision. Without attempting to review all of the statutes, both section 3-115(b) of the UCA and section 3-116 of the UCIOA give the condominium association a lien on the unit for unpaid assessments and fines levied against the unit and give that lien a priority by stating that:

> A lien under this section is prior to all other liens and encumbrances on a unit except (i) liens and encumbrances recorded before the recordation of the declaration . . . (ii) a first security interest on the unit recorded before the date on which the assessment sought to be enforced became delinquent . . . and (iii) liens for real estate taxes and other governmental assessments or charges against the unit . . .[23]

The New York statute preserves the same priority for "a first mortgage of record," and also gives the same priority to a "subordinate mortgage of record" held by the New York Job Development Authority or the New York State Urban Development Corporation.[24]

Section 3-116(b)(ii) of the UCIOA contains similar provisions, except that the common expense lien is given a priority even over the first security interest "to the extent of the common expense assessments based on the periodic budget adopted by the association pursuant to Section 3-115(a) which would have

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[22] *ALTA Endorsement 4, supra* note 7.

[23] UNIF. COMMON INTEREST OWNERSHIP ACT § 3-116(b), 7 U.L.A. at 122.

[24] N.Y. REAL PROP. LAW § 339-z(ii); *cf.* MASS. ANN. LAWS ch. 183A, § 21(a)(3) (Law. Co-op. 1996) (stating that by-laws can provide "[f]or limitations upon the first mortgages of record or the types or categories thereof which shall have priority").

become due in the absence of acceleration during the 6 months immediately preceding institution of an action to enforce the lien."[25]

Since the title policy speaks only as of its effective date, the Condominium Endorsement can only give mortgagee protection against the first six months of common expenses in a UCIOA state. Some title underwriters may even delete that risk by a modification of the coverage. A closing requirement usually requires satisfactory proof of payment of all common expense charges as of the policy date.

Because of the importance to the condominium of the ability to collect the common charges in order to provide the various services to the unit owners, some states have amended their condominium statutes to give the association a limited "super lien" that would even prime a prior unit mortgage. The argument made by the associations supporting such legislation has a certain validity with respect to large developments where the association performs many of the services that would normally be performed by a municipality.[26] The argument that is made is that common charges should be in a category similar to local real estate taxes. No title insurer can provide protection against loss of priority to a future lien under such legislation.

The ALTA Condominium Endorsement Form 4.1 of October 17, 1992 goes even further than insuring priority by substituting a new paragraph four in place of the paragraph four in the ALTA Condominium Endorsement Form 4 as follows: "Any charges or assessments provided for in the condominium statutes and condominium documents due and unpaid at Date of Policy."[27]

This Form 4.1 language insures that there are no unrecorded common expense liens unpaid as of the date of policy. Without this language an inchoate unpaid lien that existed at the date of the policy, but not filed or recorded until later, would not be covered by the policy as a post-policy lien. Under a statute such as New York Real Property Law section 339-aa, the common charges lien is effective only from and after the filing of a verified notice of the lien in the recording office in which the declaration is filed. Furthermore, the notice of lien must con-

[25] UNIF. COMMON INTEREST OWNERSHIP ACT § 3-116(b)(ii), 7 U.L.A. at 122.

[26] Examples of such services include street maintenance, garbage collection, parks and recreational activities, and a security force.

[27] *ALTA Endorsement 4.1, supra* note 8.

form to the various requirements set forth in the statute.[28]

Paragraph five of both Endorsements insures against "[t]he failure of the unit and its common elements to be entitled by law to be assessed for real property taxes as a separate parcel."[29]

This entitlement to be separately assessed and taxed is an important attribute of being part of a condominium validly formed under a statute that provides for separate taxation. UCA section 1-105, UCIOA section 1-105, N.Y. Real Property Law section 339-Y all contain such provisions.

Paragraph six reads: "Any obligation to remove any improvements which exist at Date of Policy because of any present encroachments or because of any future unintentional encroachment of the common elements upon any unit or of any unit upon the common elements or another unit."[30] This is a form of survey coverage assumed by the title insurer without the benefit of a survey; it is usually based upon a similar provision in the applicable condominium documents. In fact, it is not common conveyancing practice to require title surveys of individual condominium units in a multi-unit structure such as an apartment house. If the unit is a separate structure similar to a single family house, or even if it is a structure attached to other units, such as one of a row of houses, a title survey may be available. In those cases, unless the condominium documents or the applicable statute covers the problem, a survey reading should be done before the insurance is issued; otherwise it becomes a pure business risk on the part of the title insurer.

The last numbered paragraph is number seven which states: "The failure of title by reason of a right of first refusal to purchase the unit and its common elements which was exercised or could have been exercised at Date of Policy."[31] Many condominium documents contain a right of first refusal in favor of the association (board of managers) as a means of limited control over a sale to a purchaser deemed to be "undesirable." In practice, it is rarely exercised, if for no other reason, because most condo-

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[28] *See also* N.J. STAT. ANN. § 46:8B-21(a) (West 1989 & Supp. 1998) (stating that a "common expense" lien "shall be effective from and after the time of recording in the public records of the county in which the unit is located of a claim of lien stating the description of the unit, the name of the record owner, the amount due and date when due").

[29] *ALTA Endorsement 4, supra* note 7; *ALTA Endorsement 4.1, supra* note 8.

[30] *ALTA Endorsement 4, supra* note 7; *ALTA Endorsement 4.1, supra* note 8.

[31] *ALTA Endorsement 4, supra* note 7; *ALTA Endorsement 4.1, supra* note 8.

minium associations do not maintain a sufficient reserve fund to exercise such an option. In any event, this provision gives the unit purchaser or its mortgagee comfort that either the provision has been complied with or that there was no such provision.

The last and unnumbered paragraph of the endorsement is one that should be and usually is boilerplate in all endorsements added to a title policy:

> This endorsement is made a part of the policy and is subject to all of the terms and provisions thereof and of any prior endorsements thereto. Except to the extent expressly stated, it neither modifies any of the terms and provisions of the policy and any prior endorsements, nor does it extend the effective date of the policy and any prior endorsements, nor does it increase the face amount thereof.[32]

It should act as a reminder that the endorsement is only one part of the title policy and that none of the insuring provisions stand alone. Each provision must be read in the context of the entire policy, including the boilerplate exclusions, conditions and stipulations, Schedule B exceptions and any other endorsements.

Some of the protections contained in the Condominium Endorsement are also available to purchasers and lenders of units in a planned unit development ("PUD"). For those, ALTA has adopted its March 27, 1992, standard endorsements 5 and 5.1. These endorsements cover matters similar to those contained in paragraphs three, four, five, and seven of the Forms 4 and 4.1, except that the language of paragraph six in those forms is somewhat modified in paragraph three of the PUD forms to read: "The enforced removal of any existing structure on the land (other than a boundary wall or fence) because it encroaches onto adjoining land or onto any easements."[33]

Every title insurance policy should contain one of the ALTA Condominium Endorsement forms. It provides additional and important protection for purchasers and lenders. Notwithstanding the various assurances in the title insurance, a purchaser or lender is unwise to rely on title insurance alone without a complete understanding of what is contained in the declaration, bylaws, and any other recorded document that affects the entire project. Whatever is contained in that document will be "excepted" from the title insurance coverage by its inclusion in

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[32] *ALTA Endorsement 4, supra* note 7; *ALTA Endorsement 4.1, supra* note 8.

[33] *See generally* PALOMAR, *supra* note 6.

Schedule B-1 of the title policy. Although the ALTA Condominium Endorsement primarily deals with the most common problems which usually require attention, this does not mean that there is nothing else in the documents for a particular condominium that may not be equally significant. The only way to make such a determination is by a reading and analysis of the documents, preferably by a competent lawyer.

APPENDIX A

American Land Title Association

Endorsement 4
(Condominium)
Revised 3/27/92
Section IV-5

ENDORSEMENT

Attached to Policy No.

Issued by

BLANK TITLE INSURANCE COMPANY

The Company insures the insured against loss or damage sustained by reasons of:

1. The failure of the unit identified in Schedule A and its common elements to be part of a condominium within the meaning of the condominium statutes of the jurisdiction in which the unit and its common elements are located.

2. The failure of the documents required by the condominium statutes to comply with the requirements of the statutes of the extent that such failure affects the title to the unit and its common elements.

3. Present violations of any restrictive covenants which restrict the use of the unit and its common elements and which are contained in the condominium documents, except violations relating to environmental protection unless a notice of a violation thereof has been recorded or filed in the public records and is not excepted in Schedule B. The restrictive covenants do not contain any provisions which will cause a forfeiture or reversion of title.

4. The priority of any lien for charges and assessments at Date of Policy provided for in the condominium statutes and condominium documents over the lien of any insured mortgage identified in Schedule A.

5. The failure of the unit and its common elements to be entitled by law to be assessed for real property taxes as a separate parcel.

6. Any obligation to remove any improvements which exist at Date of Policy because of any present encroachments or because of any future unintentional encroachment of the common elements upon any unit or of any unit upon the common elements or another unit.

7. The failure of title by reason of a right of first refusal to purchase the unit and its common elements which was exercised or could have been exercised at Date of Policy.

This endorsement is made a part of the policy and is subject to all of the terms and provisions thereof and of any prior endorsements thereto. Except to the extent expressly stated, it neither modifies any of the terms and provisions of the policy and any prior endorsements, nor does it extend the effective date of the policy and any prior endorsements, nor does it increase the face amount thereof.

[Witness clause optional]

BLANK TITLE INSURANCE COMPANY

BY:_____

APPENDIX B

American Land Title Association **Endorsement 4.1 (Condominium) Revised 10/17/92 Section IV-6**

ENDORSEMENT

Attached to Policy No.

Issued by

BLANK TITLE INSURANCE COMPANY

The Company insures the insured against loss or damage sustained by reasons of:

1. The failure of the unit identified in Schedule A and its common elements to be part of a condominium within the meaning of the condominium statutes of the jurisdiction in which the unit and its common elements are located.

2. The failure of the documents required by the condominium statutes to comply with the requirements of the statutes of the extent that such failure affects the title to the unit and its common elements.

3. Present violations of any restrictive covenants which restrict the use of the unit and its common elements and which are contained in the condominium documents, except violations relating to environmental protection unless a notice of a violation thereof has been recorded or filed in the public records and is not excepted in Schedule B. The restrictive covenants do not contain any provisions which will cause a forfeiture or reversion of title.

4. Any charges or assessments provided for in the condominium statutes and condominium documents due and

unpaid at Date of Policy.

5. The failure of the unit and its common elements to be entitled by law to be assessed for real property taxes as a separate parcel.

6. Any obligation to remove any improvements which exist at Date of Policy because of any present encroachments or because of any future unintentional encroachment of the common elements upon any unit or of any unit upon the common elements or another unit.

7. The failure of title by reason of a right of first refusal to purchase the unit and its common elements which was exercised or could have been exercised at date of policy.

This endorsement is made a part of the policy and is subject to all of the terms and provisions thereof and of any prior endorsements thereto. Except to the extent expressly stated, it neither modifies any of the terms and provisions of the policy and any prior endorsements, nor does it extend the effective date of the policy and any prior endorsements, nor does it increase the face amount thereof.

[Witness clause optional]

BLANK TITLE INSURANCE COMPANY

BY:_____