



LEASES, SEVERED IMPROVEMENTS AND TITLE INSURANCE

WLTA Seminar

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Leasehold Materials

- Exhibit A - Checklist
- Exhibit B - Paragraphs
- Exhibits - Examples

Leaseholds

Note that ALTA Commitment & Policy Forms & Guarantees expressly require separate identification of

- (1) the "*estate or interest*" covered, and
- (2) the vestee of that interest

What is a Lease?

- Right of possession
- Differs from easement
- It's not a license or permit
- New chain of title
- Both lessor and lessee can deal with their interests

What is a Lease?

- Same rules as for a deed or mortgage:
 - ◆ Grantor & grantee
 - ◆ "Conveyance" (grant) language
 - ◆ Signed & acknowledged
 - ◆ Legal description
 - ◆ Recorded (in the chain of title)
 - ◆ Plus: stated term (not perpetual)

What is a Lease?

- Lessee starts a new chain of title
- Lessor and lessee can each convey and encumber their respective interests (subject to the other)

Common Leasehold Issues

- Easements & other encumbrances against each estate
- Merger of fee and leasehold
- Subordinations

Common Leasehold Issues

- Form of "conveyance" by lessee:
 - ◆ Assignment?
 - ◆ Sublease?
 - ◆ A "deed"?
 - ◆ A combination?

Common Leasehold Issues

- Taxation - estates
- Policy amount
- Option to purchase
- Right of first refusal

Less Common Issues

- Bankruptcy - by either lessor or lessee
- Severed improvements
- Condominiums

Less Common Issues

- Early termination
- Oil & gas leases
- Space leases
- Community land trusts

Easements

- Leases often in malls, small and large =
 - ◆ Need insurable access
 - ◆ Often REA - but not always
- Easements encumbering
 - ◆ Granted by lessor
 - ◆ Granted by lessee
- Severance - access, support, etc.

Merger Issues

- Lessee assigns leasehold estate to fee owner - Why?
 - ◆ Maybe attempt to terminate lease - maybe not
- Fee owner conveys fee title to lessee - Why?
 - ◆ May be fulfillment of an option - maybe something else



Merger Issues

Never presume merger when fee
and leasehold acquired by the
same party

Don't ignore the lease

Check with counsel or
underwriting

Merger Issues

- Recharacterization?
 - ◆ If the lease was a disguised financing vehicle (*sale/leaseback*) - may have a problem
 - ◆ Does it clog the equity of redemption (if it's financing)?
 - ◆ "Let's just terminate the lease instead of foreclosing"

Merger Issues

- Example for no merger
 - ◆ Lender has lien on the fee
 - ◆ Lessee then *subordinates* (mortgage lien on both estates)
 - ◆ Lender forecloses against both - but wants lease to remain for assignment



Merger Issues

Separate discussion
for how the
subordination is
accomplished...

Subordinations

EXAMPLE 1:

Fee lender wants priority over the lease - so it can:

- kick the tenant out if the mortgage is foreclosed, or
- Terminate the lease, or
- Re-lease the land to new lessee



Subordinations

EXAMPLE 1:

Best if lessee joins in
mortgage

But OK if lessee signs
separate agreement



Subordinations

EXAMPLE 2:

Leasehold lender wants the fee owner to subordinate
Common when lessor and lessee related (parent lease to subsidiary)



Subordinations

EXAMPLE 2:

Separate Agreement not
appropriate

Fee owner should join in
the mortgage



Subordinations

A subordination
establishes relative
priority of two competing
LIENS

Fee title is not a "lien"



Subordinations

Refer requests to insure subordination of the fee owner by separate agreement - rather than joinder - to underwriting



Subordinations

*Non-Disturbance
and Attornment*

What are they?

*Why are they important
to us?*

Non-Disturbance and Attornment

Used when lessee
subordinates to a fee
mortgage

Usually commercial or
office space

Non-Disturbance

Means that the subordination is

CONDITIONAL

- Not absolute -



Non-Disturbance

The lender agrees that if the lease is not in default to the fee owner, the lender will "not disturb" the lessee if it forecloses



Non-Disturbance

This is a pretty significant
CONDITION

We should not insure
absolute priority when
insuring the mortgage



Non-Disturbance

*We should show the lease
and the subordination in
Schedule B - Part I*

*But that usually won't be
acceptable*



Non-Disturbance

Next-best approach:

Show lease in Schedule B -
Part II as subordinate, and

Show the subordination in

Schedule B - Part I

Non-Disturbance

Usual Approach:

Show lease in Schedule B -
Part II and show the
subordination agreement and
say "upon and subject to the
terms thereof"



Attornment

This means the lessee will recognize the lender as its lessor if the lender forecloses out the fee owner/lessor

This is **ALSO** *conditional!*

Option to Purchase

- A lease can contain an option to purchase the fee - but it's still an option
- Not insurable (usually - separate seminar)
- But it's a separate encumbrance on the fee title
- Two exceptions in Schedule B
- Don't ignore if the lease goes away

Right of First Refusal

- Can also be in a lease
- Never insurable
- Also encumbers the fee
- Two Schedule B exceptions
- Don't ignore if the lease goes away

Sublease vs Assignment

Lessee can convey it's interest

- It can sublease (still in the chain of title - sublessee starts a new chain)
- It can assign it (out of the chain of title - assignee is substituted)

Sublease vs Assignment

- Assignee has "privity of contract" with lessor
- Sublessee has no "privity of contract" with lessor

Sublease vs Assignment

When insuring either:

- Always confirm with lessor that lease is still good (estoppel)
- May need consent by lessor for transaction
- Always in writing

Bankruptcy

- Bankruptcy of either lessor or lessee must be referred to counsel or underwriting
- Court may try to avoid the lease - but might only apply to financial obligation



Early Termination

Early termination is possible - when can you ignore a lease?

Early Termination

Four ways to terminate

1. It expires by it's terms (watch for extensions or renewals)
2. Lessor/lessee mutually agree to terminate
3. Default by lessee
4. Merger (already discussed)

Early Termination

For default or mutual termination:

- Don't rely on lessor only assertions - or recorded "notice"
- Get it in writing - both parties sign & record - OR
- Approval from counsel or underwriting

Oil & Gas Leases

- Oil, gas, coal, minerals, etc. - are part of the "Land" defined in ALTA policies.
- But, not separately insurable
- So what about an oil & gas leases?
 - ◆ The lease is of the land, not the "goods" - but allowing lessee to extract them
 - ◆ The lease is probably insurable

Space Leases

A "space" lease:

Office space, mall stalls, etc.

Not usually insurable (no "good and sufficient" legal description)

But, some national commercial deals might allow it

But *only with* counsel or underwriting approval

Community Land Trust

- A form of affordable land ownership - it owns the land and leases to homebuyer
- Long term lease (99 years)
- May include severed improvements
- Appreciation doesn't go to lot owner

Community Land Trust

Not usually insurable - check with
counsel or underwriting

- Value difficult to determine
- May be a fee in some states
- May not be constructive severance
- May be mobile home or
manufactured housing unit
- Watch out for taxes



Condominiums

A leasehold condominium requires
counsel or underwriting approval

Will the landlord recognize multiple
lessees?

What if a unit owner doesn't pay
fractional rent?

Yikes!



Condominiums

A leasehold condominium requires
counsel or underwriting approval

Which to use?

A sublease?

A partial assignment of lease?

A deed?

Yikes!



Condominiums

A leasehold condominium
requires counsel or
underwriting approval

May involve severed
improvements

Yikes!



Condominiums

The developer may own the building, and assume a deed is appropriate - as to the space occupied by the unit.

But, the unit owner will also have an undivided interest in the common elements outside the building - which includes a leasehold estate.

Which to use: a *deed* or *assignment*?

Severance

- Is a subdivision
- But not side-by-side lots
- Think condominium units
- "A" owns the land
- "B" owns the improvements on that land

Severance

- But "B" needs rights of access, support and maintenance to the improvements
- Hence a lease
- Requires counsel or underwriting approval

Severance

- Need to be a deed (in the chain of title - "*constructive severance*")
- Only existing improvements - never future
- Must state that improvements "...are and will remain real property"
- Must be re-confirmed with each future transaction



Value of Improvements

Constructive severance

Requires insurer to determine
when policy is issued that
existing improvements are
real property



Value of Improvements

Constructive severance

The printed material
includes guidelines for
expressly insuring severed
improvements



Policy Amount Questions

No rate for leasehold policies

This is not a "trick" statement

Must determine the policy

amount



Policy Amount Questions

- Once the policy amount is determined, then the regular Rate Schedule is used to determine the premium
- Issue is only for owner's policies (loans are insured for the loan amount)



Policy Amount Questions

IMPORTANT:

The customer determines the amount of coverage, and presumably knows how.

BUT, customer may need to discuss it with counsel or underwriting

Especially for short term leases

Policy Amount Questions

Two common methods of determining the policy amount:

Method 1:

- Full value of land and improvements
- Typical (but not absolute) for leases over 50 years



Policy Amount Questions

Practical when insuring long term leases insuring the value of improvements

But, also use when *severed* improvements expressly insured

Policy Amount Questions

Method 2:

- Multiply annual rent times remaining years on lease
- But - only use for *leasehold only* policies (not with severed improvements)
- And, practical for very short term leases
- (Or short *remaining term* for an assignment or sublease)



Policy Amount Questions

Pro Tanto

Don't be tempted

It's not the same as

Simultaneous



Leasehold Endorsements

ALTA discontinued
"leasehold" policies

Use ALTA 2006 Policies with

- ◆ ALTA 13-06 - Owner's policy (4/2/12)
- ◆ ALTA 13.1-06 - Loan policy (4/2/12)



Leasehold Endorsements

Use ALTA leasehold endorsements

- ◆ ALTA 13-06 - Owner's policy (4/2/12)
- ◆ ALTA 13.1-06 - Loan policy (4/2/12)



Leasehold Endorsements

What does the
ALTA leasehold
endorsement do?

A fee owner
would pay a
"lump sum" for
everything





ALTA 2006 Policy

It covers value of the land and improvements - as long as improvements are "real property"

ALTA 2006 Policy

- This is fine for a *fee owner*:
- If a total failure of title, the loss would be the value of everything =
- *Land and improvements*

And improvements are almost always "real property" (*Land as defined in the policy*)





ALTA 2006 Policy

This policy could also
be used to insure a
leasehold estate

BUT...



ALTA 2006 Policy

A total failure of title would have a different measurement of loss for a lessee than for a fee owner



ALTA 2006 Policy

A lessee of improved land usually simply pays rent

No extra "lump sum" for improvements



ALTA 2006 Policy

For example:

If the lessee is just "renting" a building" and the lease isn't valid - it has to move.

And, expenses involved in moving are not covered



ALTA 2006 Policy

There is no lump sum paid to lessor or contractor - if lessee must move, it just starts paying new rent for the new location

Leasehold Endorsements

Miscellaneous Items of Loss

- removing and relocating personal property
- repairing personal property
- some rental payments
- some damages

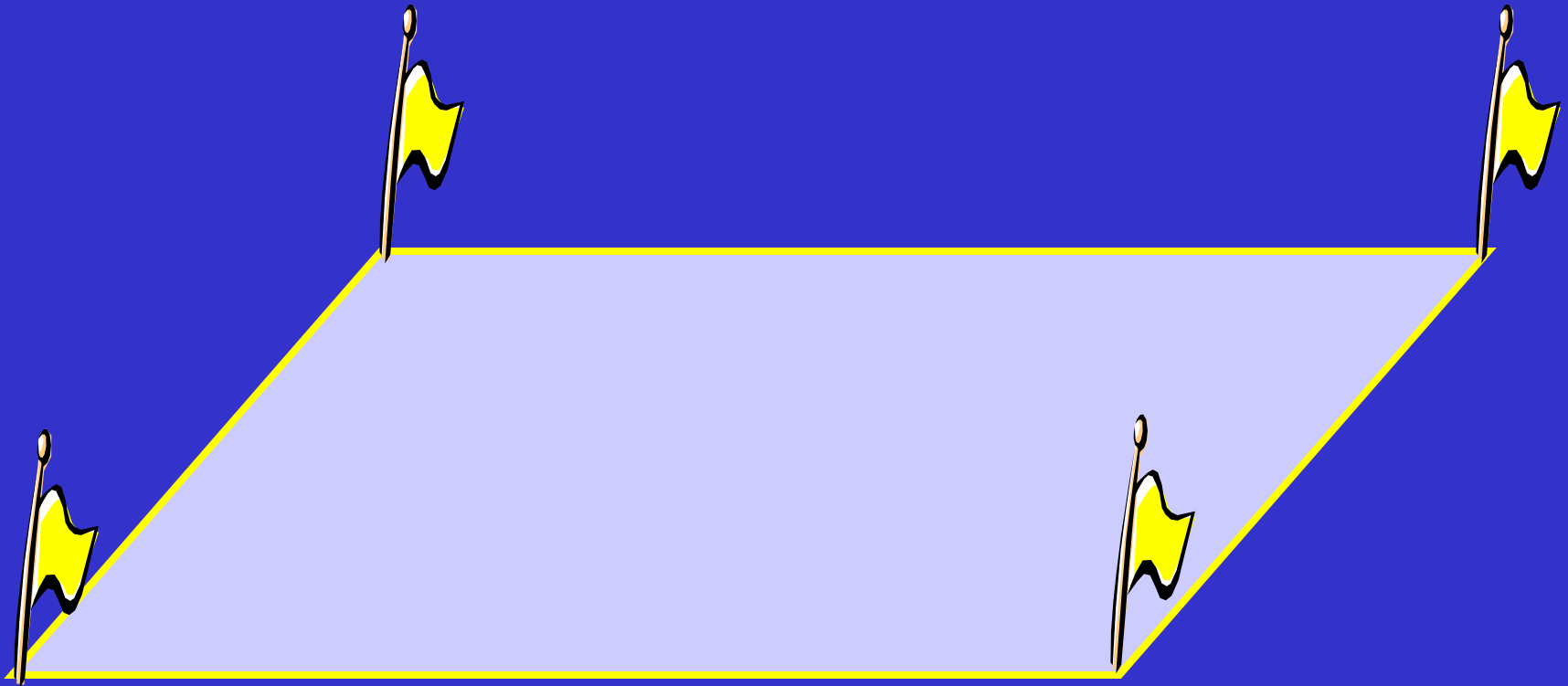


Value of Improvements

And, not all leases are the same.

What about the lessee who leases vacant land and builds improvements?

Lease payments are lower
than for improved land



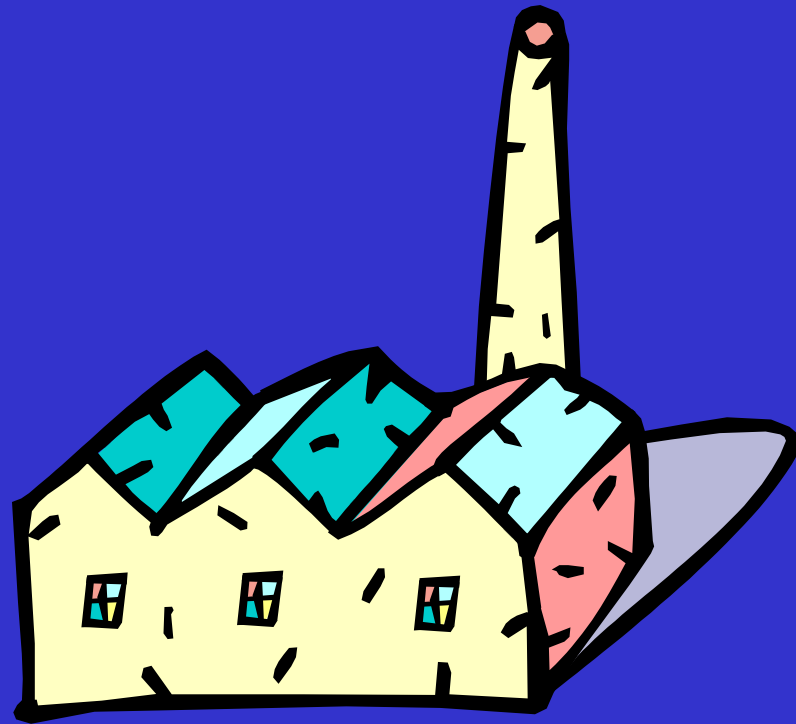


ALTA 2006 Policy

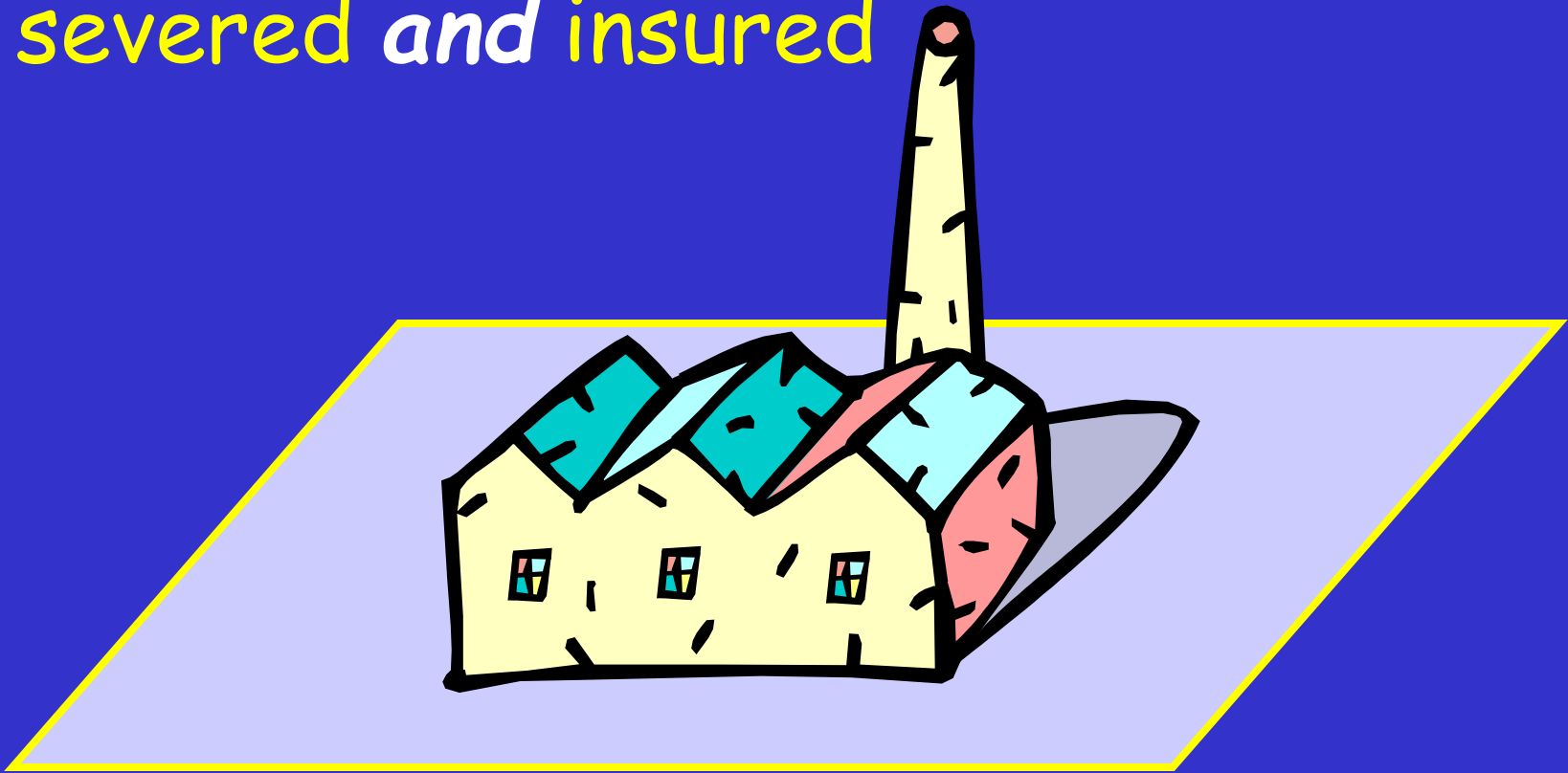
And, if the lessee built
the building?

Only covered if defined in
the *documents* as "real"
property

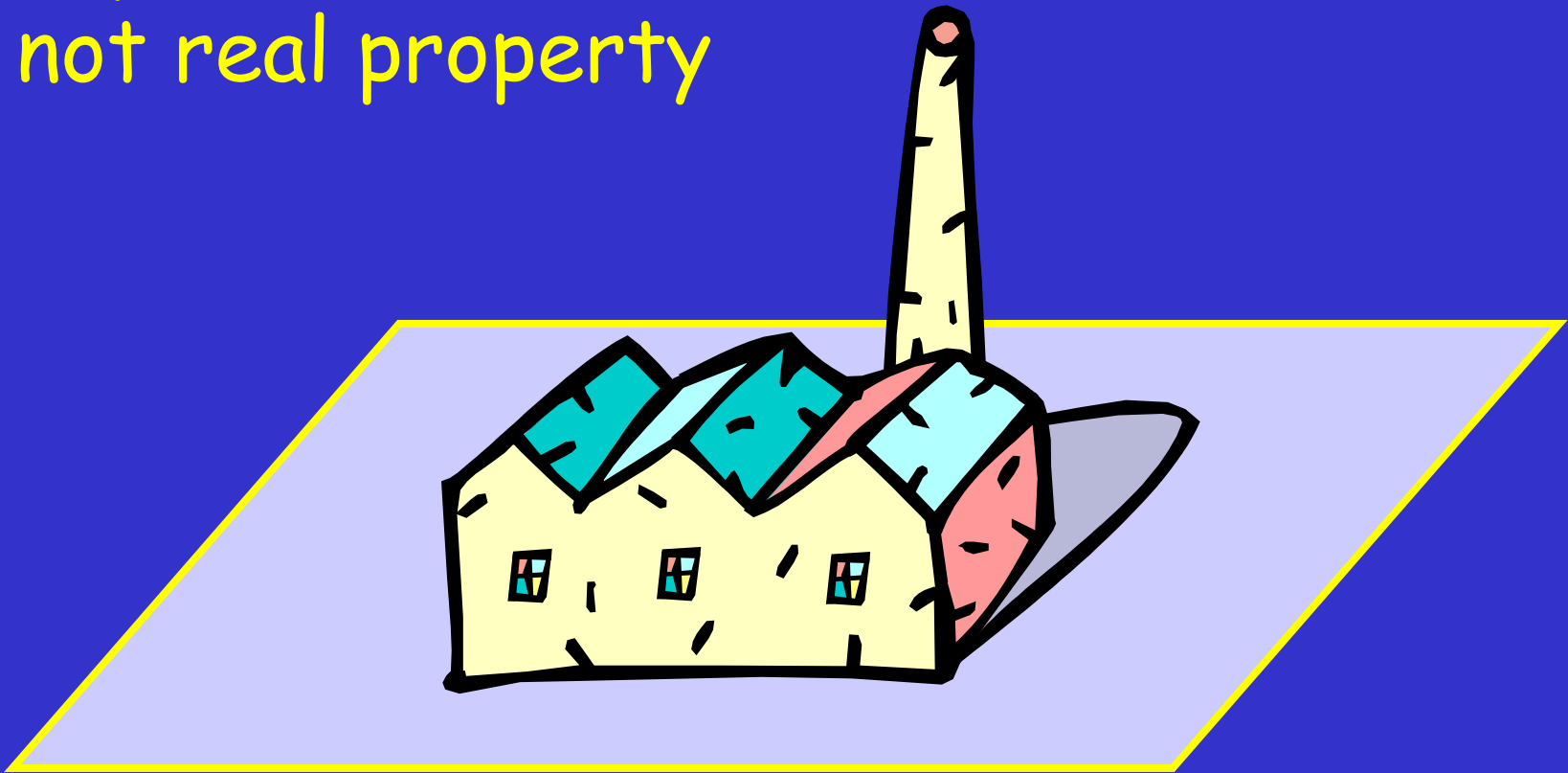
But, the lessee spends a bundle on the new building



The 2006 policy would cover that loss if the improvements are "real property" and constructively severed and insured



But the 13-06 or 13.1-06
endorsement is needed to cover the
value of the improvements - even if
improvements (severed or not) are
not real property





Value of Improvements

ALTA 13-06 & 13.1-06 Endorsements

Only requires proof (when a claim is made) that lessee actually paid for the improvements - no matter who "owns" them - this is good if there is no constructive severance



ALTA Endorsements

The ALTA endorsements are good because they work in two situations - insuring (1) a "plain" leasehold or (2) both a leasehold in the land and fee in severed improvements



ALTA Endorsements

When using the endorsements, make sure the policy amount includes the value of the improvements



ALTA Endorsements

The forms:

- exclude liability for "terms and provisions" of the lease - default by insured not covered
- include the value of improvements
- include miscellaneous items of loss

Leaseholds and Title Insurance

Refer
questions to
your state
counsel or
underwriter

