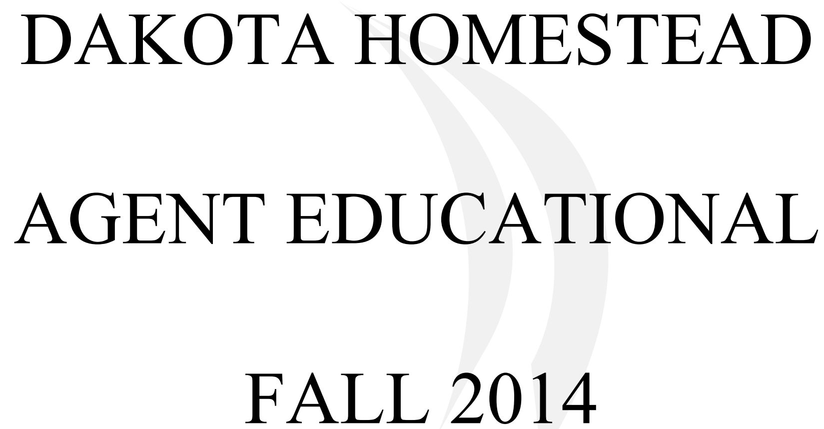

DAKOTA HOMESTEAD

AGENT EDUCATIONAL

FALL 2014

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South Dakota Real Property Transfer on Death Deeds

In the most recent legislative session, the South Dakota Legislature passed the South Dakota Real Property Transfer on Death Act ("Act"). It is found in SDCL 29A-6-401 on. The Act is similar to the Uniform Transfer on Death Act which about a dozen other states have enacted too. The purpose of the Act is to create a way by which real property can transfer via a Transfer on Death ("TOD") deed from the grantor to the beneficiary/grantee upon the grantor's death, without the need for a probate. Basically, the goal of the Act is to create a mechanism for transferring real property that is akin to a payable on death bank accounts. The Act becomes effective on July 1, 2014 throughout all of South Dakota. Below is a brief summary of what the Act all covers, how it works, and some underwriting guidelines for dealing with TOD deeds.

General Information on the Act

At its most simple form the **Act allows for the transfer of property by a property owner (think grantor) (the "transferor") to one or more beneficiaries (think grantees) (the "beneficiary") by an instrument called a transfer on a death deed ("TOD deed"). The TOD deed transfers the property from the transferor to the beneficiary on the transferor's death.** The Act and the TOD deed are separate and distinct from other real property transfer methods that we have. Pretty much all of the rules as to how they work and apply are all contained in the Act.

The TOD deed MUST contain the following:

1. Contain the essential elements and formalities of a properly recordable inter vivos deeds (basically it must comply with the title standards for a deed to be recorded);
2. State in the deed that the transfer to the designated beneficiary is to occur at the transferor's death

3. Be recorded BEFORE the transferor's death with the register of deeds where the property is located.

In simple terms, the TOD deed has to comply with what we already require for other types of deeds. The major different is that it has to specifically state in the TOD deed itself that the transfer is to occur at the transferor's death. This is different from pretty much every other deed, where the transfer occurs at the execution of the deed. Just like other deeds it needs to be recorded with the register of deeds where the property is located. A difference is that there is the timing requirement – the TOD deed needs to be recorded PRIOR to the transferor's death, not after. The beneficiary does NOT have to know about or have accepted the TOD deed during the transferor's life, nor is consideration necessary.

TOD Deeds can be revoked in several ways. First, TOD deeds can be revoked if all or part of the TOD deed itself includes express revocation or inconsistent language the results in the deed being deemed revoked. Additionally, TOD deeds can also be revoked if "an instrument of revocation" is executed and recorded that expressly revokes all or part of the prior TOD deed. Finally, TOD deeds can be revoked by the recording of another deed by the transferor while they are alive which expressly revokes all or part of the TOD deed. Instruments or deeds executed to revoke a prior TOD deed need to be acknowledged AFTER the TOD deed was acknowledged (can't have a revocation instrument acknowledged prior to the TOD deed being acknowledged). Such instruments or deeds MUST be recorded PRIOR to the transferor's death (otherwise the TOD deed is still effective and the property transfers according to the TOD deed's terms). If there are multiple transferors, revocation by one does not impact the interest of the other transferors. Thus, to revoke a TOD deed by joint-owners of property, all of the living joint owners must revoke it. After the TOD deed is recorded, revocatory acts on the deed (like writing revoked on the instrument, tearing it up, etc.) do NOT work to revoke the TOD deed.

While the transferor is alive, the TOD deed does not impact the transferor's ownership of the property. The TOD deed does not impact the transferor's ownership interest in the property, nor does it

affect the interest of secured and unsecured creditors of the transferor. During the transferor's life, the beneficiary has NO interest in the property because of the TOD deed. Thus the property at issue is NOT subject to claims by the beneficiary's creditors while the transferor is alive.

The result of that is that the property at issue is still subject "to all conveyances, encumbrances, assignments, contracts, mortgages, liens, and other interests which the property" is subject to at the time of the transferor's death. The TOD deed transfers property WITHOUT covenant or warranty of title. This is the case even if the TOD deed itself has language in it stating that it includes covenant and warranty of title. Basically, the beneficiary is stepping into the shoes of the transferor when the transferor dies as if they received a quit claim deed from the transferor at the transferor's death.

Beneficiaries are able to disclaim all or part of their interest in the property. Their disclaimer works the same way a disclaimer does for any other property interest and is controlled by SDCL 29A-2-801. The disclaimer MUST be recorded with the register of deeds where the property is located for it to be effective.

Upon the transferor's death, the transferor's creditors and personal representative still have some rights to impact the property that was transferred to the beneficiary by the TOD deed. Creditors or the PR can bring an action against the beneficiary within the first 6-months after the transferor's death (longer time-frame for Department of Social Service actions). Creditors or the PR have to allege in the action that there is insufficient property in the deceased transferor's estate to pay for the debts and obligations of the estate. If no probate petition is filed within the first 30-days after the transferor's death, there is a presumption of evidence that the property in the estate is insufficient to pay the transferor's debts and obligations. The beneficiary's liability to the transferor's creditors and PR is only up to an amount equal to the value of the property transferred at the transferor's time of death. If there are multiple TOD deeds, all of the beneficiaries of all of the TOD deeds are jointly and severally liable to the transferor's creditors and PR.

Purchasers for value and lenders who acquire an interest in the property from the beneficiary take free and clear of any claims or liabilities of the transferor's estate, provided they have no actual knowledge that the transfer was improper. Thus innocent third-parties with no knowledge of any claims or actions by the transferor's creditors or PR receive the property free of those claims.

When the transferor dies, at least one beneficiary has to file and record a document called the "affidavit of confirmation." There will be a form for this in the statutes when they become effective on July 1st. The Affidavit of Confirmation basically includes the important information regarding the property, including:

(1) Names and addresses for the surviving beneficiaries;
(2) Names of deceased beneficiaries (and the names and addresses for their contingent beneficiaries);
(3) Date of the transferor's death;
(4) Legal description of the property (or property interest) to be transferred to the beneficiaries;
(5) Statement that the South Dakota Department of Social Services was notified of the transferor's death.

A certified copy of the transferor's death certificate (along with certified copies of any deceased beneficiaries' death certificates) MUST be included with the Affidavit of Confirmation.

Impact on Title World

All of the detail provided above provides a summary of what the Act does and how TOD deeds work. When it comes to how you are going to see TOD deeds in your day-to-day business operation, it should be like this. After July 1st, TOD deeds can be used by transferors. Thus you may start seeing TOD deeds recorded with your local register of deeds. They will be filed and indexed as part of the land record. Aside from that though, TOD deeds do NOT have an impact on real property until the transferor's death. Below are some brief underwriting guidelines:

1. **ALWAYS review the TOD deeds to ensure that the comply the statutory requirements**:
    a. Contain the essential elements and formalities of a properly recordable inter vivos deeds (basically it must comply with the title standards for a deed to be recorded);
    b. State in the deed that the transfer to the designated beneficiary is to occur at the transferor's death
    c. Be recorded BEFORE the transferor's death with the register of deeds where the property is located.
2. **Transferor still alive and property still in transferor's name:** If the title to the property is still held in the name of the transferor and the transferor is still alive, you need to disclose the TOD deed as a note on Schedule B, Section II. The TOD deed does not need to appear as a special exception.
3. **Transferor still alive and property being conveyed to a third party:** If you are being asked to insure a transaction where the transferor is still alive and is attempting to convey the property covered by a TOD deed to a third party, you need to examine the deed being used. Specifically, you need to see if the deed contains express revocation language in it regarding the TOD deed.
    a. If it does, then no further requirements are needed as the TOD deed will be revoked by the recording of this new deed.
    b. If the new deed does not contain such language, you need to include such a requirement for the revocation of the TOD deed.
4. **If you learn that the transferor is deceased and you are dealing with the transferred property:**
    a. If you learn that the transferor is deceased, check to see if the Affidavit of Confirmation, along with a certified copy of the transferor's death certificate, has been recorded with the applicable register of deeds. If one has not, the recording of the Affirmation of Confirmation (with the necessary certified death certificate) needs to be a requirement.

b. The following requirement needs to be in the commitment for TOD deeds the same as any other property with a deceased individual: "Evidence satisfaction to the Company that the Estate of (name of decedent transferor), deceased, is not subject to the Federal Estate Tax, pursuant to the Internal Revenue Code 26 U.S.C. Sec. 6324(a)."
c. If you are being asked to insure a sale or mortgage on the transferred property within 2-years of the death of the transferor you must contact your underwriter for guidance. There are additional requirements necessary given the ability of the transferor's creditors and personal representative to make a claim to the transferred property.

Conclusion

The Act and TOD deeds are a new area of the title world that we are all going to be working through for the next while. If you come across one and have any questions, please contact Chris and Eric about it. Either is more than happy to provide help and guidance. The facts surrounding each TOD deed are important and can impact what you need to do and show on your commitments and policies.

On the next few pages are some examples showing how TOD deeds work and a cheat-sheet that contains the most important points about TOD deeds. Copies of the TOD deed forms are also included.

Examples

Example 1. T (trasnferor) executes, acknowledges, and records a TOD deed for Blackacre. B (beneficiary) is the named beneficiary. Who has an interest in the property and when:

- T has an undivided, 100% interest in Blackacre while T is alive
  - B has NO interest during T's life
- B has an undivided, 100% interest in Blackacre after T's death (provided B survives T)

Example 2. T executes, acknowledges, and records a TOD deed for Blackacre. B is the named beneficiary. Sometime later, T executes, acknowledges, and records a warranty deed to C which contains an express revocation of T's prior TOD deed. Who owns the property now and at T's death:

- C owns an undivided, 100% interest in Blackacre both now and at T's death

Example 3. T executes, acknowledges, and records a TOD deed for Blackacre. B is the named beneficiary. Sometime later, T executes, acknowledges, and records a second TOD deed for Blackacre to C, which contains expressly revoking "all my prior TOD deeds concerning Blackacre." Who owns Blackacre now and at T's death:

- T owns an undivided, 100% interest in Blackacre while T is alive
- C has an undivided, 100% interest in Blackacre after T's death (B has no interest)

Example 4. T executes, acknowledges, and records a TOD deed for Blackacre. B is the named beneficiary. Sometime later, T executes, acknowledges, and records a revocation form expressly revoking "all my prior TOD deeds concerning Blackacre." T dies with a will leaving Blackacre to C. Who owns Blackacre:

- C by virtue of T's will
  - B has no interest because the prior TOD deed was effectively revoked by the recording

Example 5. T executes, acknowledges, and records a TOD deed for Blackacre naming B, C, and D as beneficiaries (equal shares to each). Sometime later, T dies, with B and C still alive (D predeceased T). Who owns Blackacre:

- B ½ interest; C ½ interest

Example 6. T executes, acknowledges, and records a TOD deed for Blackacre naming S (T's spouse) as the primary beneficiary and B as the alternative beneficiary. Prior to T's death, T and S divorce. At T's death, who owns Blackacre:

- B an undivided, 100% interest
    - Under SDCL 29A-2-804, unless expressly stated otherwise in some instrument, divorce acts a revocation on all revocable dispositions/appointments

Example 7. T executes, acknowledges, and records a TOD deed for Blackacre naming P as the primary beneficiary and A as the alternative beneficiary. At T's death, both P and A are dead, but P's child, C, is still alive. Who owns Blackacre:

- C – South Dakota Antilapse Statute works to prevent the transfer from lapsing (failing)

Transfer on Death Deed Cheat Sheet

1. TOD deeds need to be recorded while the transferor is still alive
    a. MUST be recorded after July 1, 2014
2. BUT TOD deeds are not effective until the transferor's death
    a. AND beneficiary needs to survive transferor (typically by at-least 120-hours)
    b. Beneficiaries can disclaim too (disclaimer needs to be filed with ROD's office)
3. TOD deeds are basically like quit claim deeds – transfer only what interest the transferor had and contain no warranties (even if they have warranty language in them)
4. While transferor is alive, beneficiaries have NO INTEREST in real property at issue
    a. Thus we don't need to search the beneficiaries while the transferor is alive
5. If transferor is married, spouse should sign TOD deed (or it needs a non-homestead recital)
6. If property owned in joint tenancy – last surviving joint tenant MUST have signed TOD deed
7. TOD deeds can be revoked in several ways:
    a. TOD deed itself contains revocation language
    b. Instrument of revocation recorded that expressly revokes all or part of the TOD deed
    c. Other recorded TOD deed or instrument (like a warranty deed) with revocation language
8. Revoking instruments need to be acknowledged AFTER the TOD deed being revoked was acknowledged AND recorded prior to transferor's death
9. If there are multiple transferors, revocation by one does NOT revoke the other's interest
10. Creditors of the transferor can bring an action during the 6-months (DSS has longer) after transferor's death calming probate estate is too small without TOD property
    a. If no probate is filed within 30-days of transferor's death – presumption that the estate is insufficient to pay its debts
    b. Purchasers for value and lender take free and clear for any claims (knowledge is key)
11. Beneficiary needs to fill an "Affidavit of Confirmation" upon transferor's death with ROD
12. **SHOW ALL TOD DEEDS ON SCHEDULE B-II**

Forms

REVOCABLE TRANSFER ON DEATH DEED

Notice to Owner: This deed will transfer ownership of the property described below when you die. You should carefully read all of the information on this form. You should consult a lawyer before using this form.
This form must be recorded with the register of deeds before your death or it will not be effective. Any change to this deed must also be recorded to be effective.
Identifying Information
Owner(s) of Property Who Join in This Deed:
____
____
Address:
Marital Status of Owner(s):
Legal Description of Property:

____
____
____

Beneficiary or Beneficiaries
I revoke all my prior transfer on death deeds concerning the property, and name the following beneficiary(ies) to receive the property (in equal shares, and as tenants in common, and not as joint tenants with rights of survivorship, unless I say otherwise):
Name and address of Beneficiary(ies)
____
This transfer is ____ / is not______ subject to the requirement that the named beneficiary survive me by one hundred twenty hours.
Name and address of Contingent Beneficiary(ies)
____
If no primary beneficiary survives me, I name the following contingent beneficiary(ies) to receive the property (in equal shares, and as tenants in common, and not as joint tenants with rights of survivorship, unless I say otherwise):
____
____
____
Transfer on Death
I hereby convey and transfer upon my death all my interests (whether now owned or hereafter acquired) in the described property to the above listed beneficiary(ies).
Before my death, I may revoke this deed, or any part of this deed.
Exempt from Transfer Fee: § 43-4-22(18)
Signature(s) of Owner(s) Who Join in this Deed

__________ ________________________________
(signature) (date)

__________ ________________________________
(signature) (date)
Acknowledgment
(acknowledgment)

REVOCATION OF TRANSFER ON DEATH DEED

Identifying Information
Owner(s) of Property Who Join in This Revocation:

____

____

Address:

The undersigned, as the owner on the transfer on death deed recorded on (date) __________ in Book _______ of _______, Page _____ in the office of the register of deeds of __________ County, South Dakota, affecting real property legally described as follows: (legal description) ____ hereby revokes the previous transfer.

Dated
Signature/Address
Acknowledgment

AFFIDAVIT OF CONFIRMATION AND SURVIVORSHIP FOR TRANSFER ON DEATH DEED

State of South Dakota
County of _________________
I, ________________________, being first duly sworn on oath, state that to my personal knowledge:

1. ________________ (Decedent) is the person named in the certified copy of the Certificate of Death attached hereto.

2. On the date of death, Decedent was an owner of the property in ______________ County, South Dakota, legally described as follows: ___________________________________ and Decedent was the transferor in a transfer on death deed (Deed) recorded on _____________, as in Book ______ of _____, Page _____, in the office of the register of deeds of ______________ County, South Dakota.

3. The name(s) and address(es) of the Designated Beneficiary(ies) named in the Deed who survived the Decedent is(are):

____

____

____

4. The name(s) and address(es) of the contingent beneficiary or person who takes under the anti-lapse statutes and who survived the Decedent.

____

____

5. The Designated Beneficiary(ies) named in the Deed who did not survive the Decedent is(are):

____

____

Certified copies of Certificate(s) of Death for any deceased Designated Beneficiary(ies) is(are) also attached hereto.

6. Notice of the death of the Decedent has been given to the South Dakota Department of Social Services and it has been determined that no assistance was provided or that any obligation for reimbursement to the department has been satisfied.

Affiant
Notary

JUDICIAL FORECLOSURE REVIEW AND NOTICE CONSIDERATIONS

(1) **SD Statutes:** Judicial Foreclosure in South Dakota is a/k/a "foreclosure by action" and is done pursuant to SDCL 21-47 ("long-term" a/k/a 1-year redemption mortgages) and SDCL 21-49 ("short-term" a/k/a 180-day redemption mortgages).

(2) **Purpose and Venue:** A judicial mortgage foreclosure is a circuit court suit commenced by a record mortgagee against the owner of the property encumbered by the mortgage and all junior encumbrancers following the mortgagor's default under the terms of the mortgage. The purpose of the action is ultimately to pay off the outstanding loan balance due to the mortgagee via judicial sale of the mortgaged premises. A judicial mortgage foreclosure must be commenced in the circuit court of the county where the mortgaged land is located.

(3) **Title Insurance:** In order to properly insure a property that has been or will be subject to a completed judicial mortgage foreclosure, it is essential that you be familiar with the judicial mortgage foreclosure process and are aware of the key foreclosure documents to locate and review.

(4) **Location of Foreclosure Documents:** All of the relevant judicial mortgage foreclosure documents will be located in the mortgage foreclosure file located at the (circuit court) Clerk of Courts Office and/or recorded at the Register of Deeds Office.

(5) **Sequence and Documentation:** From start to finish, the following provides the chronology of a typical judicial mortgage foreclosure action in South Dakota as well as all of the ***foreclosure documents** you should locate and be aware of:

***Summons**
***Complaint**
***Notice and Admission of Service and Return of Service**
***Lis Pendens**
***Order Granting *Default Judgment* or Order Granting Summary Judgment**
****Affidavit of Non-military Status (if applicable)***
***Affidavit of Publication**
***Sheriff's Return**
***Certificate of Sale**
***Sheriff's Deed**

And being further specifically identified and discussed as follows:

1) Commencement of the action: Filing and serving of Summons and Complaint.

***Summons:** The Summons will be located in the foreclosure file at the Clerk of Courts Office. The Summons is essentially a written demand made by the foreclosing lender on any named Defendant to either timely answer the Complaint or suffer the consequences as stated in the Summons. The foreclosure action is commenced as to each named Defendant upon the serving of the Summons on such Defendant along with a copy of the Complaint.

***Complaint:** The Complaint will be located in the foreclosure file at the Clerk of Courts Office. Basically, the Complaint states the lender's claim (money owed and now due under note), its legal cause of action and the relief sought (foreclose mortgage securing note and

selling mortgaged land to recoup debt), and the identity of any named Defendant as well as the interest such party holds in and to the mortgaged property.

The mortgage foreclosure action is commenced upon the filing of the Summons and Complaint.

2) <u>Commencement of the action: Named Defendants and service of Summons on them - Actual Notice required</u>.

QUESTION:
AT THE COMMENCEMENT OF THE ACTION, WHO SHOULD BE NAMED AS DEFENDANTS IN THE SUMMONS AND COMPLAINT AND WHO SHOULD BE SERVED WTH THE SUMMONS AND COMPLAINT?

ANSWER:
AT THE COMMENCEMENT OF THE ACTION ***AND PURSUANT TO SD STATUTE***, THE NAMED DEFENDANTS SHOULD BE THE PERSONS / ENTITIES REQUIRED TO BE SERVED - BEING THE MORTGAGOR / OWNER AND ANY PERSON OR ENTITY THAT HOLDS AN INTEREST IN THE MORTGAGED LAND JUNIOR TO THE MORTGAGE BEING FORECLOSED.

<u>Example</u>:

Mortgage from owner, Guy Banister, single, to Texas School Book Depository Funding is in default.

Summons and Complaint for mortgage foreclosure filed October 22, 2014.

As of that date, the following persons / entities held an interest in the property junior to that of the mortgage being foreclosed:

CIA Investments – HELOC
Carlos Marcello – UCC financing statement
Alek Hidell - docketed money judgment
Abraham Zapruder – docketed money judgment
County of Cuba – county aid lien

Therefore, in order for the subsequent foreclosure judgment, if any, to be effective against any of them, the following parties would need to be named as Defendants and served *(via personal service or by admission of service)* a copy of the Summons and Complaint:

Guy Banister, CIA Investments, Carlos Marcello, Alek Hidell, Abraham Zapruder, County of Cuba

3) <u>Commencement of the action: Proof of Service on (actual notice to) named Defendants</u>.

QUESTION:
AT THE COMMENCEMENT OF THE ACTION, (1) how do we know who the named Defendants should be, and (2) how do we know they were properly served?

ANSWER:

(1) Record and judgment searches should disclose to you who / which parties held an interest in the mortgaged property at the commencement of the action and thus who should be named as Defendants and served.

(2) ***Notice and Admission of Service and Return of Service:** A review of the foreclosure file should establish that all named Defendants were properly served through *personal service or by admission of service*. Such proof of service is established by filed Admission(s) of Service or Return(s) of Service signed by all named Defendants.

NOTE: Unless the owner / mortgagor and any party that holds a subordinate interest in the mortgaged property at the commencement of the action are properly served and receive actual notice of the mortgage foreclosure action, the judgment of foreclosure and the foreclosure will be ineffective against them.

4) <u>Commencement of the action: Recording of Lis Pendens and Constructive Notice to subsequent purchasers and encumbrancers</u>.

***Lis Pendens:** Though optional, a Lis Pendens (a/k/a "notice of pendency of judicial action") *should* be recorded at the commencement of every foreclosure action.

LET'S DISPELL THE FALLACY RE THE EFFECT OF A RECORDED LP!

Please be advised, the recording of a Lis Pendens at the commencement of the foreclosure action (or any judicial action) does ***<u>NOT</u>*** prevent subsequently filed liens from attaching to the property. *Rather, liens will attach to the property just like normal and regardless of the existence of a previously recorded Lis Pendens.*

SO WHAT'S THE EFFECT OF A RECORDED LP?

The recording of Lis Pendens at the commencement of a foreclosure action simply serves to provide notice, *constructive notice*, to all ***<u>subsequent</u>*** purchasers and/or encumbrancers of the property that acquire an interest in the property ***<u>after</u>*** the foreclosure has commenced.

Thus, through operation of the constructive notice of the foreclosure action provided by the recorded Lis Pendens, all such subsequent purchasers and/or encumbrancers of the property will be bound by the foreclosure judgment just as if such parties were named as Defendants in the foreclosure action and had received actual notice of the foreclosure action (and will ultimately be foreclosed out unless they redeem).

IMPORTANT TITLE INSURANCE CONSIDERATION!

Do not make the mistake of believing a recorded Lis Pendens prevents subsequent lien attachment and therefore not showing the interests of post-Lis Pendens recording purchasers or encumbrancers of the property in a Commitment issued where the foreclosure is not yet complete. Again, these liens will attach to the property regardless of the existence of a previously recorded Lis Pendens.

Like lienholders that held an interest in the property at the commencement of foreclosure, post-Lis Pendens recording lienholders will have a statutory right to redeem the property during the redemption period.

In addition, the foreclosure could be dismissed prior to foreclosure judgment (or foreclosure judgment debt paid prior to foreclosure sale).

THUS, TO AVOID MISTAKES / POSSIBLE CLAIMS - ALWAYS SHOW ALL SUCH POST-LIS PENDENS RECORDING PURCHASERS AND ENCUMBRANCERS OF THE PROPERTY IF THE FORECLOSURE IS NOT YET COMPLETE!

FOR PURPOSES OF TITLE INSURANCE, WE SHOULD CONSIDER THE RECORDING OF THE SHERIFF'S DEED AS WHEN THE FORECLOSURE IS COMPLETE.

Continuing with previous Example:

Mortgage from owner, Guy Banister, single, to Texas School Book Depository Funding is in default.

Summons and Complaint for mortgage foreclosure filed October 22, 2014.

Lis Pendens recorded October 22, 2014 regarding mortgage foreclosure.

As of October 22, 2014, the following persons / entities held an interest in the property junior to that of the mortgage being foreclosed:

CIA Investments – HELOC
Carlos Marcello – UCC financing statement
Alek Hidell - docketed money judgment
Abraham Zapruder – docketed money judgment
County of Cuba – county aid lien

Therefore, in order for the subsequent foreclosure judgment, if any, to be effective against any of them, the following parties would need to be named as Defendants and served *(via personal service or by admission of service)* a copy of the Summons and Complaint:

Guy Banister, CIA Investments, Carlos Marcello, Alek Hidell, Abraham Zapruder, County of Cuba

In addition, the following parties purportedly obtained an interest in the property on the following dates (after Lis Pendens recording and prior to the filing of any foreclosure judgment):

Earl Warren **-** docketed money judgment on October 28, 2014
Allen Dulles **-** docketed money judgment on November 15, 2014
John Connally **-** docketed money judgment on November 22, 2014
Arlen Specter **-** docketed money judgment on November 22, 2014

Because the above parties did not hold an interest in the property at the date the foreclosure action was commenced …

And because a Lis Pendens was recorded commensurate to the commencement of the foreclosure

The following statements are true:

(1) The docketed money judgments of Earl Warren, Allen Dulles, John Connally and Arlen Specter all ***DO*** attached as liens to the property owned by Guy Banister; but
(2) Earl Warren, Allen Dulles, John Connally and Arlen Specter have received notice, *constructive notice*, of the foreclosure action; and thus
(3) Earl Warren, Allen Dulles, John Connally and Arlen Specter will be bound by the foreclosure judgment just as if such parties were named as Defendants in the foreclosure action and had received actual notice of the foreclosure action (they too can redeem but ultimately will be foreclosed out if they don't).

QUESTION:
What happens if no Lis Pendens is recorded at all or there is a delay in its recording following the commencement of the action and judgments / liens are filed in the interim?

ANSWER:
As with any judicial action, a judgment stemming from such action will only be effective against the persons / parties that receive actual notice of the action or receive constructive notice of the action via a Lis Pendens that was recorded ***before*** that person / party received an interest in the property.

If no Lis Pendens is recorded before a person / party obtains an interest in the property, that person / party must be served and receive actual notice of the foreclosure action in order for the judgment to be effective against them. This essentially would require constant and repeated record / judgment searches be obtained prior to the filing of the foreclosure judgment in order to serve and actually notice all post-foreclosure commencement lienholders.

Thus, prudent practice would dictate that a Lis Pendens would ***always*** be recorded commensurate with the filing of a foreclosure action in order to ensure that all parties are properly noticed of the foreclosure action and all parties will ultimately be foreclosed out.

QUESTION:
Is it necessary that the Lis Pendens be released of record?

ANSWER:
NO - if a judgment of foreclosure is granted and filed, such judgment will discharge the Lis Pendens by operation of law.

South Dakota Title Standard 6-06. Lis pendens--effect of judgment.
The entry of judgment in an action for which a lis pendens has been filed discharges the lis pendens.

5) ***Order Granting Default Judgment or Order Granting Summary Judgment:** This is A document in the foreclosure file that: 1) establishes the default of the borrower under the mortgage, 2) specifies the exact amount of debt the lender is owed, and 3) orders the property to be sold at sheriff's sale so lender can be paid the debt owed.

    PLEASE BE ADVISED – IF A "DEFAULT JUDGMENT" WAS OBTAINED – an "*Affidavit of Non-military Status" of the owner/debtor must be made and should be filed of record. The Soldier's and Sailor's Civil Relief Act prevents mortgage foreclosure against active duty military.

6) ***Affidavit of Publication:** Look for this in the foreclosure file. The Notice of sheriff's sale must be published for two (2) consecutive weeks for a 180 redemption mortgage and for four (4) consecutive weeks for a 1-year redemption mortgage.

7) ***Sheriff's Return:** This document is made by the sheriff that conducted the Sheriff's sale and evidences he conducted the public sale according to law. Look for this in the foreclosure file.

8) ***Certificate of Sale:** This document is signed by the sheriff and given to the highest purchaser (or foreclosing lender if no bids cover that lender's owed debt) at the sale and evidences that party's purchase of and/or interest in the property. The holder of this document is entitled to receive the sheriff's deed upon the running of the redemption period. The Certificate of Sale MUST be recorded in the Register of Deeds office within TEN (10) days of the date of sale for a 1-year redemption mortgage and within TWENTY (20) days of the date of sale for a 180-day redemption mortgage.

    The redemption period begins to run:

    1-year redemption mortgage – from the date of sheriff's sale.

    180-day redemption mortgage – from the date the Certificate of Sale is recorded.

    The redemption period lasts:

    1-year redemption mortgage – *no less than 1 year*, and can be extended.

    180-day redemption mortgage – *no more than 1 year*, and can be shorted to sixty (60) days via court order as a result of owner abandonment of the property.

    NOTE: when dealing with the FEDs as junior lien holders, watch out for federal statutory redemption periods – usually the FEDs have NO LESS than 1 year to redeem regardless of what the mortgage says (federal tax lien – IRS – have NO LESS than 120 days to redeem no matter what mortgage says or if the redemption period is shortened)

9) ***Sheriff's Deed:** Will be issued to Certificate of Sale holder, or non-owner redemptioner, after redemption period has terminated. Provides good title free and clear of all interests and liens of owners and junior creditors listed in the Summons and Complaint that were served and received actual notice of the foreclosure action as well as all post-Lis Pendens purchasers or encumbrancers of the property.

“Non-Judicial Voluntary Foreclosure” vs. “Deed-In-Lieu of Foreclosure”

There continues to be confusion between a Non-judicial Voluntary Foreclosure and a Deed in Lieu of Foreclosure. The following provides a summary and discussion of each of these separate and unique processes.

A. SDCL Ch. 21-48A “Non-judicial Voluntary Foreclosure.”

SDCL Ch. 21-48A governs Non-judicial Voluntary Foreclosures (“NJVF”). Thus, NJVF is a *statutory* foreclosure procedure.

As its name implies, this statutory foreclosure procedure:

(1) Is non-judicial (no judicial action is filed, no one goes or is called to court, and no judge is involved);

(2) Is voluntary by the mortgagor in default; and

(3) If conducted properly pursuant to statute (SDCL Ch. 21-48A), has the same legal effect as a judicial foreclosure – that being the lender acquires title to the mortgaged property from the owner free and clear of junior interests and liens, which the lender can then sell to recoup its debt.

The NJVF process is essentially as follows:

(1) Mortgagor and mortgagee jointly execute a Non-Judicial Voluntary Foreclosure Agreement *with Notice of Disclosure and Cancellation form attached*. The NJVF Agreement must state that the mortgagor and mortgagee have elected to follow the alternative voluntary foreclosure procedures pursuant to SDCL Ch. 21-48A, and should state the mortgagor has no rights of redemption the mortgagee has no right to a deficiency (which terms may also be stated in the NJFV deed referenced below).

(2) Commensurate with the execution of the Non-Judicial Voluntary Foreclosure Agreement, the mortgagor conveys the mortgaged property to the mortgagee via deed.

(3) The NJVF Agreement and NJVF deed should be recorded at same time.

(4) Commensurate with the above, and via *certified mailing*, Notice(s) of Election of NJVF are mailed to all junior lien holders of record alerting them to the NJVF and advising them they have 60 days from the date of certified mailing to redeem the property or their interest in the property will be foreclosed and extinguished.

(5) Provided no junior creditor redeems and upon the running of the 60 day redemption period, an Affidavit from the mortgagee or mortgagee’s attorney is made and recorded stating that a NJVF was pursued, all elements of SDCL 21-48A were complied with, all relevant junior creditors received notice of the NJVF and their right to redeem via certified mailing, the 60 day redemption period has terminated, no such junior creditors redeemed, and the mortgagee now holds title to the property free and clear of all interests.

It is advised that copies of the certified mailing receipts be attached to and recorded along with the above Affidavit in order to prove all relevant junior creditors received notice of the NJVF and their right to redeem. Most attorneys do this.

FINAL NOTES:

(1) Don't trust or be fooled by the title of the NJVF deed. If a NJVF is conducted, logic would dictate the deed of the mortgaged property from mortgagor to mortgagee would be titled "NJVF Deed." But alas, and often is the case, the title of a NJVF Deed may range from Warranty Deed, Quitclaim Deed, or even "Deed in Lieu of Foreclosure." The latter of these rightly causing the most confusion and tricking many to believe a Deed in Lieu of Foreclosure is being or will be completed. Regardless of the title of NJVF deed, the existence of the recorded NJVF Agreement, its reference to SDCL Ch. 21-48A as well as its required statutory contents, among other considerations detailed above, should alert you to the fact that a NJVF has been or will be completed.

(2) Watch for NON-MERGER language in NJVF deed and be aware of its effect. It is common for non-merger language to be contained in the NJVF deeds these days. In the event a NJVF deed contains non-merger language, you must require the mortgage being foreclosed via the NJVF be released of record following the completion of the NJVF. (If the NJVF deed does NOT contain non-merger language, then the mortgage being foreclosed via the NJVF would be released via operation of law just like in a completed judicial foreclosure – and thus you wouldn't have to require it be released of record.)

B. Deed in Lieu of Foreclosure ("DIL")

(1) As previously stated, DIL and NJVF are confused with each other though they are completely different things. While a NJVF is a statutory foreclosure mechanism pursuant to SDCL 21-48A and forecloses out junior lienholders just like a judicial foreclosure will, a DIL is not done pursuant to any statutory scheme and there is no mortgage foreclosure. As the name implies, this scheme is *"in lieu of foreclosure."*

(2) In lieu of mortgage foreclosure, a DIL is simply an agreement between the mortgagor and mortgagee whereby the mortgaged property is given up by the mortgagor and conveyed to the mortgagee in exchange for mortgagee's record satisfaction of the mortgage. Again, there is no foreclosure and no one, not the mortgagor and not any junior lien holders, get foreclosed out.

(3) Thus, it would be unwise for a lender to engage in a DIL unless their mortgage was the only lien that encumbered the subject property. Because a DIL does not foreclose out anyone, the lender will simply step into the shoes of the mortgagor and acquire title to the property "as is", liens and all, if any.

(4) Also – when you think of DIL (or know you are dealing with a DIL in connection with title insurance) the first thing that should come to your mind is **get an "*ESTOPPEL AFFIDAVIT*" from the mortgagor.**

(5) That is because a DIL is subject to subsequent attack for variety reasons and by several sources. Primarily from: (1) the mortgagors who may subsequently claim the DIL was unfair, forced upon them, and not arm's length, and (2) a bankruptcy trustee who may assert in a subsequent bankruptcy of the mortgagor that the DIL amounted to an avoidable preferential transfer. At

any rate, the estoppel affidavit from the mortgagor is meant to reduce the risk of such attacks by such parties. An estoppel affidavit is meant to protect the lender.

(6) An estoppel affidavit should contain recitals from the owner/ borrower attesting to the fairness of the transaction, the value of the property, the amount of debt owed, the consideration paid (land in exchange for debt relief), the borrower was in default under the mortgage and was also insolvent at the time of the execution of the deed, that the borrower was not subject to coercion, fraud, oppression, duress, and/or undue influence by the Bank or anyone else, and any other factors that show the intention of the borrower to make a genuine arms-length agreement and transfer of the property in exchange for elimination of the mortgage debt of equal or gretare value.

(7) Please be advised that if the mortgagor has "substantial equity" in the property being conveyed via the DIL, DHTIC will **NOT** insure such a transaction. Substantial equity in the property is any percentage in excess of fifteen percent (15%) of the fair market value. In the vast majority of cases, the only way to establish if the mortgagor had substantial equity in the property is to require a new appraisal of the property and compare that appraisal value to the outstanding mortgage debt at the date of the DIL.

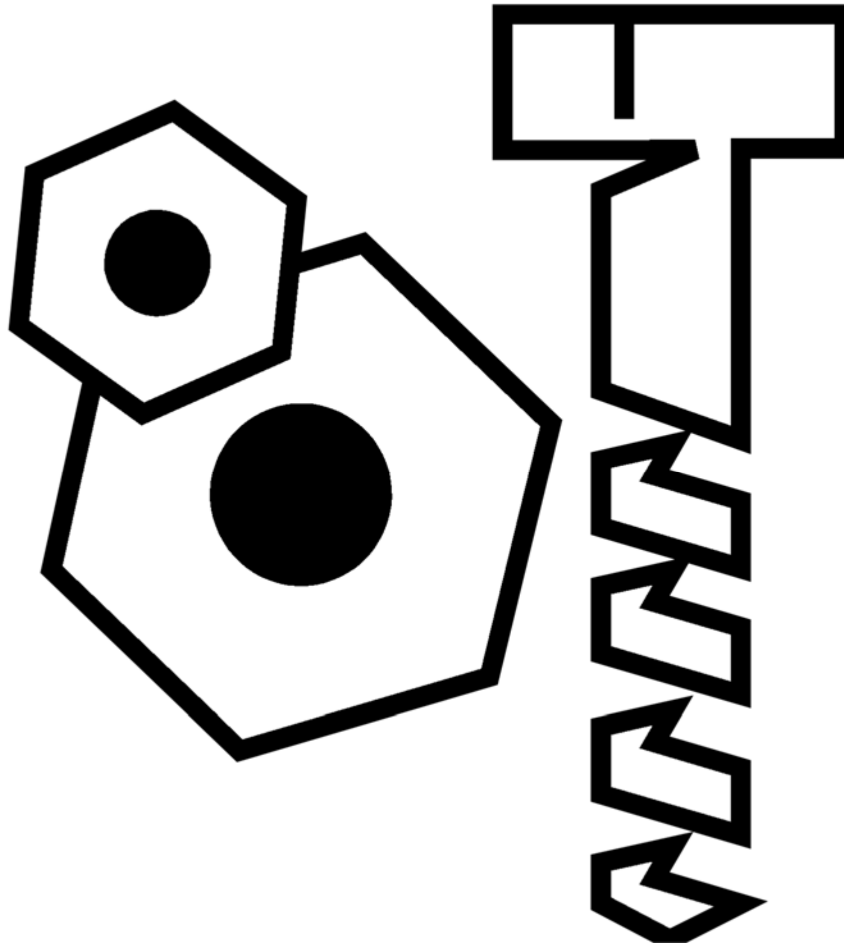
Thus, the title insurance underwriting equation for potentially insuring a DIL is:

DIL = ESTOPPEL AFFIDAVIT + NEW APPRAISAL.

(8) Lastly Watch for NON-MERGER language in a DIL deed from mortgagor to mortgagee. If it has any such non-merger language, require lender to satisfy mortgage of record.

Nuts & Bolts:

Review of Title Issues



Insurable Property

The most fundamental aspect of title insurance is often the one that we think and talk the least about – "is this piece of property even insurable?" In the course of your day-to-day title operations orders come in, commitments get prepared, and closings happen on each piece of property. For the majority of the property we deal with, the answer is of course it is insurable property. BUT there are several important and more common than you think situations where the question – can I even insure this property – needs to be asked before going forward. Here are the types of property you need to be on the lookout for:

Indian Land

We could spend a whole day just talking about the various issues present when it comes to Indian Land, how to identify it, what to do about it, and whether it is insurable or not. The key thing to remember is that if you think are dealing with property that may or may not be Indian Land (like Reservation Property, land owned by the Tribe, ect.) then you MUST call Chris or Eric to see whether Dakota Homestead can insure the transaction. In the vast majority of cases, Indian land can only be insured via the inclusion of very strict Indian land exceptions in all commitment and policies – no exceptions.

Personal Property

We have seen several examples lately where the parties are severing a building or structure from the real property and selling that building/structure as part of a contract. Thus the land we will be owned by one party and the building/structure by another.

Unless we are insuring the land (in which case the severed building/structure would be shown as an exclusion) this type of transaction is typically uninsurable. This is because the severed building/structure is personal property once it is no longer affixed to the land. Thus it is not real property. The same situation applies to manufactured homes. Unless they are affixed to the land (i.e. real property), we do not insure

the manufactured home itself (personal property). If you have a transaction with something odd like this going on or in the chain of title, please reach out to us prior to issuing a commitment.

Cemeteries & Burial Grounds

There are different situations where this type of property comes up. The first is what you would expect, we are being asked to insure property that includes part of a cemetery or burial ground (think the larger cemeteries each community has). The other is where a portion of someone's property has been used for burial purposes (think "family cemetery" on the old homestead).

If you know or discover that part of the property we are being asked to insure includes some portion that was used for cemetery purposes, you need to contact Chris or Eric. There are a variety of issues that come-up whenever we are dealing with a piece of property where one or more persons are buried. While there are some exceptions that can be added to the commitment and policies, the basic result is that any portion of the property which contains a burial area is likely NOT insurable.

Churches

Churches can present a challenge because of who may hold the actual title to the property (the local church or the national organization) and the presence of special restrictions when it comes to the transfer or encumbrance of church property. Typically, we need copies of (1) written authority for the church to act and (2) a copy of their by-laws to see if everything has been complied with.

Minerals

The issue of mineral rights and estates contains to be a growing issue in our business. As a practice, we as an industry do not purport to insure the mineral estate in our standard title insurance commitments and policies. The standard exceptions support that view. BUT when we are dealing the removal of those standard exceptions (like with Extended Coverage) it could be argued that we ARE insuring the mineral estate as part of our title insurance policy (which is very bad).

Thus, you should likely be included a general mineral exception on all commitments/policies. When you have some instrument purporting to severe some portion of the mineral estate, you should also be taken specific exception to it. Sample language you can use is found on the following pages.

Railroads

Given the vast area that currently existing and former railroads covered through South Dakota, the issue of railroad property comes up more often than you might expect. Title Standard 9-04 best sums-up part of the reason why railroad property is so complicated:

Title Standard: 9-04 Railroads.

When determining the status of title for lands that contain ownership by a railroad in the chain of title, you must consider the source of the title and the language of the document vesting title in the railroad. Railroads may obtain title through grants, condemnation or purchase. Language in the vesting document may state or imply a fee simple interest or easement interest buy several cases (listed below) have interpreted the interests differently depending upon the timing of the conveyance and the language of the document.

Authority: This standard provides references to begin research for railroad ownership issues. It does not provide a rule that railroads own a fee, an easement, or some other interest in the real property where the railroad is or was located.

Whenever you run across anything purporting to see title being vested with a railroad you need to contact Chris or Eric to figure out how to proceed. To help in that process, we need information on the following:

1. **How did the railroad acquire title (grant, condemnation, or purchase) and did it have fee simple or just an easement?**
2. **How has the railroad deeded out their interest and to whom?**
3. **Was the property at issue properly legally abandoned?**

To help answer those questions, we are going to need copies of the chain of title from the railroad acquisitions of the property on. Even with everything recorded in the local land record, there may still be important records, like the abandonment filed with the South Dakota Secretary of State's Office, that prevent the property at issue from being insured. (On that note, you may want to consider adding an exception like the one found on the next page to deal with records maintained at the Secretary of State's Office.) That is why each transaction is unique and needs to be reviewed prior to a commitment being issued.

Exceptions you may want in all policies:

South Dakota Secretary of State Exception:

Note: Coverage of this Policy extends only to filings in the records of the Register of Deeds, Treasurer and Clerk of Courts of (**INSERT COUNTY NAME)** County. Search was not made of filings in the Central Filing Office of the Secretary of State of South Dakota, and any filings in that office are not covered by this Policy

Specific Mineral Exception:

Any severance or reservation of the mineral estate, including that related to (insert name of instrument at issue) recorded on (insert recording date) at (insert recording info for instrument). This Commitment/Policy does not insure any mineral title or interest. No examination was made under the mineral estate purportedly created under the above recorded instrument.

General Mineral Exception:

This Commitment/Policy does not insure any mineral title or interest.

Surveys (and problems with them)

Surveys have been and continue to be an issue each of us encounter almost daily. Most of the issues stem from the difference between an official ALTA/Boundary Survey and the typical Mortgage Inspection Surveys we receive prior to closing, and what they each actually purport to cover. Additionally, all survey issues are covered by Standard Coverage, but anytime Extended Coverage is being offered, then we (the insurer) lose the protection of the general survey exception. This makes things like encroachments a much bigger issue. Below is a brief summary of surveys, when they are required, and what to do about encroachments.

Types of Surveys

Primarily we deal with two types of surveys: (1) ALTA/Boundary Surveys and (2) Mortgage Inspection Surveys. ALTA/Boundary Surveys are what surveys are typically thought of – the surveyor goes out and inspects or sets pins, the boundary lines are clearly marked, the location of all encroachments on-to and of-of the property are shown, and all easements of record are shown. Further, the surveyor on an ALTA/Boundary Survey affirmatively states that they have done all of this work and that everything is certified as shown. The problem is that ALTA/Boundary Surveys take time and are far more expensive than Mortgage Inspection Surveys – so no one wants to order them

Mortgage Inspection Surveys on the other hand are what we typically receive in to our offices. They may look like ALTA/Boundary Surveys, but they contain clear language on them from the surveyor stating that this drawing is for loan purposes only or that they performed a visual inspection only. Things that are shown on this type of survey may just be copies of previous surveys. There are no guarantees that the surveyor even inspected the property or reviewed the land record. Basically, they are just a sketch of the property, with some items shown or highlighted, like potential encroachments, which may or may not be accurate. Thus, Mortgage Inspections Surveys have very little (if any) value when it comes to the title world.

When Surveys are required:

In an ideal world, we would require a new ALTA/Boundary Survey every time Extended Coverage was being issued, but that is not realistic. Thus Dakota Homestead requires a new ALTA/Boundary Survey (one that is less than six-months old) to remove the general survey exception from policies in the following circumstances:

1. **If the property has never been surveyed or if subdivided property bares an ambiguous legal description or otherwise cannot be accurately described without the benefits of a new survey**
2. **Property that is subject to on-going or recent real improvements (new construction);**
3. ***Whenever issuing an extended coverage Owner's Policy of Title Insurance (all circumstances)***
4. **Whenever the title company feels one is necessary.**

When Surveys are not required:

If the above is when we absolutely have to have a new survey, then that must mean we do not care every other piece of property out there on survey issues, right? WRONG. Just because a new survey is not a mandatory requirement does not mean we can ignore survey issues. If you see a potential problem then you need to dig further to see if that fourth situation (the title company feels a survey is necessary) is applicable. Whenever we are issuing an Extended Coverage Lender's Policy, we are opening ourselves up to being on the hook for issues/defects that an ALTA/Boundary Survey would have revealed.

What sort of things are we concerned about then: (1) encroachments on-to and off-of the property; (2) that the legal description completely encloses the property; (3) that there are not an "islands" outside of the main insured parcel that we are insuring; and (4) that the property is located where we think it is.

Encroachments

Of all the above issues, the ones that cause the most concern seems to be encroachments. While Mortgage Inspection Surveys do not purport to show anything's actual location, they will often include a

notation that something is either encroaching on-to or off-of the property, like a fence or a concrete slab. Does the showing of an encroachment mean that there necessarily is one on the property – no – but we still have to address it. The issue becomes what to do about them on the commitment/policy.

The key thing to think about is what type of encroachment you are dealing with in all cases – major or minor. Minor encroachments are things that we would expect to see encroaching, like fences, concrete pads, plants, trees, ect. Major encroachments are things like houses, garages, or the source of access to the property. Think too in terms of how far the potential encroachment is going on-to or off-of the property and how much work it would take to fix it. If it is only encroaching a little ways and could be (relatively) easily fixed, then it is an issue we probably can live with.

How do you know if the encroachment is a major or minor one – YOU HAVE TO INVESTIGATE! You could look at the prior surveys and plats to see what they show. You could order a new ALTA/Boundary Survey to determine what is going on with the property. You can use programs like Google Earth or similar resources to see what it looks like. It could be an issue that you could visually examine yourself by driving by the property at issue. No matter what route you go, you need to figure out what the situation is so that you know how to proceed.

If you have a major encroachment issue, then you need to contact Chris or Eric because a commitment/policy cannot be issued without significant exceptions or fixes to the current situation.

If you have a minor encroachment issue and we are issuing an Extender Lender's Policy and a Standard Owner's Policy (or no Owner's), then we can remove the minor encroachment issue from the Lender's Policy ONLY (still needs to be shown in the Owner's Policy) if the Owner signs a General Indemnity Agreement. An example of that Agreement is on the next page.

GENERAL INDEMNITY AGREEMENT

(Prior authorization and approval from Dakota Homestead Title Insurance Company required before completion)

STATE OF SOUTH DAKOTA)
): §§
COUNTY OF MINNEHAHA)

This Agreement is made and entered into this **12th day of June, 2009** by and between **Corey Haim** (hereinafter "the Indemnitor(s)") and DAKOTA HOMESTEAD TITLE INSURANCE COMPANY (hereinafter "the Insurer") and **THE BEST TITLE COMPANY**, (hereinafter "the Title Agent").

WHEREAS, the Insurer has been requested to issue a Policy of Policies of Title Insurance covering the title to the following described real estate, to wit:

Lot 7 in Block 5 of Industrial Park Addition to the City of Sioux Falls, Minnehaha County, South Dakota, according to the recorded plat thereof;

AND WHEREAS, said title is subject to the following defects, objections, and/or encumbrances, to wit:

Wood fence and metal shed encroaching onto the above described (insured) property from an adjacent landowner's property as more specifically shown on the attached legal survey of Smith and Wesson Engineering dated June 5, 2009;

AND WHEREAS, the Insurer has been requested to issue its said Policy or Policies of Title Insurance without exception to and specifically insuring against the foregoing defects, objections, and/or encumbrances;

NOW THEREFORE, the Indemnitor(s), jointly and severely, hereby agree(s) as follows:

1) To fully protect, defend, indemnify and hold harmless the Insurer and the Title Agent from any and all losses and expenses including, but not limited to, court costs and attorney's fees which it may expend, suffer or incur, by reason of, or arising from its contract of title insurance or otherwise, on account of its issuing the above mentioned ALTA policy without exception for the foregoing defects, objections, and/or encumbrances;

2) That the Insurer shall have the sole authority to hire an attorney to defend the claim and may settle the claim at its discretion in any manner it sees fit to do so; and

3) That the Insurer may settle any claim without notice to the Indemnitor(s).

THIS AGREEMENT shall inure to and bind the heirs, executors, administrators, successors, and assigns of the parties hereto.

Executed this 22nd day of October, 2014.

INDEMNITOR(S)

____

Corey Haim

STATE OF SOUTH DAKOTA)
): §§
COUNTY OF MINNEHAHA)

On this the 22nd day of October, 2014, before me, the undersigned officer, a Notary Public, personally appeared Corey Haim, known to me or satisfactorily proven to be the person whose name is subscribed to the within instrument and acknowledged that he executed the same for the purposes therein contained.

In witness whereof I hereunto set my hand and official seal. *(SEAL)*

____

Notary Public

My commission expires: _________________________

Plats and Easements

We deal with plats all the time in our business, but did you know that the plat by itself can do many things? It can create the boundaries and the legal descriptions for properties within it. It can convey property. It can create public rights-of-way. It can create private easements. How does it do all this – SDCL 11-3-12 (emphasis added):

> Recorded plat as conveyance of dedications and grants marked on plat--General warranty--Use of land intended for streets and other public uses--Opening, improvement or maintenance not required.
>
> **When the plat or map shall have been made out, certified, acknowledged, and recorded as provided in this chapter, every donation or grant to the public, or any individual, religious society, corporation, or body politic, marked or noted as such on such plat or map, shall be deemed a sufficient conveyance to vest the fee simple title of all such parcel or parcels of land as are therein expressed**, and shall be considered to all intents and purposes a general warranty against the donor, his heirs, and representatives, to the donee or grantee, his heirs or representatives, for the uses and purposes therein expressed and intended, and no other use and purpose whatever. **The land intended to be used for the streets, alleys, ways, commons, or other public uses shall be held in trust to and for the uses and purposes expressed or intended. No governing body shall be required to open, improve, or maintain any such dedicated streets, alleys, ways, commons, or other public ground solely by virtue of having approved a plat or having partially accepted any such dedication, donation or grant.**

This all means that validly signed, acknowledged, and recorded plats can create public and private easements without the need to record a separate easement instrument. Thus it puts a lot of importance on reading and reviewing each plat in the chain of title in great detail to see what is going on.

What to look for

The main places you need to carefully review on each plat are the plat map and the Owner's Certificate. Typically the plat map is going to show in some way or another any potential easements on it. This could be in the form of the clearly shown public roads and right-of-ways. It could be in the form of private easements by marked-off or noted. If you see markings or notations on the plat – CHECK THEM OUT.

Along with the plat map, all Owner's Certificate need to be carefully reviewed. Typically they contain fairly common language about the owner consenting to the plat. That language usually includes something along the lines of confirming all easements, public and private, shown on the plat. In some cases the Owner's Certificate contains regular conveyance and easement language that we are used to seeing in separately recorded instruments.

More likely than not, the situation is going to be the public and private easements will be shown on the plat map, but there will be nothing more than general language in the Owner's Certificate. This is usually because while surveyors understand all of this, they typically are showing proposed easements for informational purposes. Surveyors typically are expecting that the owners are going to record some separate instrument to better define the easements shown on the plat. Unfortunately, this rarely happens.

Other Plat and Easement Issues

When reviewing the plat, make sure that everyone who owns the property described in it actually joined and consented the plat. The easiest way to do that is to compare the grantees in the most recent deeds for the properties with the people who all executed Owner's Certificates. If someone is missing – then there could be an issue with the plat being valid. You will need to consult with Eric or Chris to see what we will all need to require to fix the problem (the only surefire fix is a replat).

Additionally, where a plat shows public easements/rights-of-way you should look to see if the appropriate governing body has every "accepted" those grants. SDCL 11-3-12 and case law makes clear that the appropriate governing body signing-off on the plat Certificate is NOT ENOUGH to create a valid public easement. It is only where there is dedication AND acceptance that a public easement is said to exist. That acceptance can be in the form of the governing body maintaining and keeping-up the easement at issue or by something like a resolution accepting the dedication. If you believe there is a public easement shown on the plat, but not accepted by the governing body, contact Eric or Chris.

Insuring Appurtenant Easements

The main thing to remember is that when we are dealing with appurtenant easements (easements benefiting our insured property but not on it) is that typically title insurance does not affirmatively insure them. Thus while there may be access easements or other appurtenant easements that are conveyed with the deed to the property, we are not generally specifically insuring them. The exceptions are when we are either being asked to insure them or the appurtenant access easements is the only source of legal access to the property and we have no choice but to insure it. In those particular cases, here is what you need to do in order to insure the easement.

First, you must examine the written instrument that created the appurtenant easement. This could be a deed with easement language in it, a separate easement instrument, or even a plat (see the above discussion). You must look at the language to see what exactly was created, what the dimensions on the easement are, restrictions of use, and any conditions that may cause it to extinguish. You will need to confirm that the easement actually is appurtenant and that there are no merger issues either at the time it was created or since. Plus you have to check for the same things as you would on any other instrument – that it was properly executed, acknowledged, and recorded.

Additionally, you have to search both the dominant estate (our insured property) and the servient estate (where the easement is located). This means a full search on both properties. In particular you are looking for all defects, liens, and encumbrances that were no satisfied, released, or subordinated AT THE TIME THE EASEMENT WAS CREATED. Anything that could impact the priority of the easement MUST be shown as an exception impacting the appurtenant easement.

Finally, you need to issue an applicable appurtenant easement or indirect access endorsement and receive payment for it ($25).

Correcting Defects in Recorded Documents

No matter how hard each of us works to prevent mistakes, they still happen. One of the most common questions we receive is – well how do we fix (whatever the defect is)? The answer is that it depends on the specific type of the instrument and its defect.

The starting point needs to be – what is the defect. Some of the most common ones that we come across include:

- Defective acknowledgements;
- Incorrect legal descriptions or the entirely wrong piece of property being listed;
- Someone being shown or signing with an incorrect name or capacity;
- Lack of homestead recital or missing marital status;

Typically we divide up defects in to two categories – major and minor. Major defects are ones that cause the instrument at issue to lose its effectiveness and priority as compared to other instruments (think improper acknowledgements or the wrong legal description being used). Minor defects are ones that may impact the validity of the instrument, but are less likely to impact its priority (think misspelled name or missing marital/homestead status).

If the defect is minor, then perhaps it can be fixed via most people's go-to-answer – an affidavit. Any easy way to think of minor defects is this – if the Title Standards provide a fix for the defect at issue, then it is likely a minor defect. Title Standard 7-09 lays out when an affidavit can be relied on by the title examiner:

> 7-09. Use of affidavits. A title examiner may rely upon affidavits as to facts in relation to the title in the following cases:
>
> 1. From any person based on personal knowledge stating:
>
> a. The identity of any person appearing in such chain of title under names varying in the spelling thereof or in the use of initials;
>
> or
>
> b. That certain property was or was not homestead property.
>
> 2. As to marital status.
> 3. To explain ambiguous recitals in instruments of record.
> 4. Marketable record title affidavits under SDCL Ch. 43-30.
> 5. When authorized by any other statute.

Basically, all other defects which could impact priority or the validity of an instrument should be considered major defects. This includes defects like an improper acknowledgement, the wrong person or entity being listed as a grantor/grantee, the wrong legal description being used, a restriction or easement being omitted that should have been included, and other similar issues. For major defects the fixes are much more difficult and restrictive. Title Standard 7-10 lays out some of the restrictions (emphasis added):

> 7-10. Corrective instruments. A grantor who has conveyed by an effective, unambiguous instrument **cannot, by executing another instrument, make a substantial change in the name of the grantee, decrease the size of the premises or the extent of the estate granted, impose a condition or limitation upon the interest granted, or otherwise derogate from the first grant, even though the latter instrument purports to correct or modify the former.** However, marketability dependent upon the effect of the first instrument is not impaired by the second instrument.

Thus it is not as simple as having one-side of the transaction record another instrument purporting to correct the defect. The answer of "we'll just record a corrective (deed/mortgage/ect.)" typically does not work because just recording a new instrument stating "This is being done to correct X" and then fixing the instrument, without having all the necessary parties re-execute, re-acknowledge, and re-record the instrument fails to fix the defect.

When dealing with material defects, you need to remember the 4-R's:

1. Re-execute the new corrective instrument, which should reference the defective instrument;
2. Re-acknowledge the new instrument;
3. Re-deliver the new instrument (if needed)
4. Re-record the new instrument.

Title Standard 7-11 provides the same guidance:

> 7-11. Instruments which are altered and re-recorded. The act of re-recording an instrument, after it has been materially altered, does not of itself destroy the rights of the parties to the original unaltered instrument.
>
> To give effect to a material alteration of a previously recorded document affecting title to real property, the instrument must be re-executed, re-acknowledged, re-delivered and re-recorded. However, a grantor cannot unilaterally derogate from a previous grant; *see* Standard 3.4.
>
> A material alteration to an instrument is defined as an alteration which changes the legal effect of the instrument or the rights and liabilities of the parties to the original instrument.

Beyond all this, anytime something is being recorded as a corrective instrument, it really needs to correctly document and reflect what is being fixed. This means that the title should be changed to something like "Corrective Warranty Deed" or "Corrective Mortgage." In addition, it should clearly include a notation on the instrument like:

> **"This (Deed/Mortgage/Instrument) is being recorded to correct the previously recorded (Deed/Mortgage/Instrument) that was recorded on (insert recording date). It is being recorded to specifically address the defect with the (describe the prior defect)."**

Examples of Common Defects and Fixes

Below are some examples of the most common defects we see and the correct fixes that should be taken to resolve the issue.

- Example 1 – Incorrect legal description in deed
  - Fix – record corrective deed with correct legal description that is executed and acknowledged by all grantors AND grantees
- Example 2 – Incorrect grantee in deed
  - Fix – record corrective deed with correct grantees that is executed and acknowledged by the grantor, correct grantee, AND the incorrect grantee from the prior deed
- Example 3 – Defective acknowledgement because person signed in the wrong capacity
  - Fix – record corrective instrument with correct capacity listed in the instrument and acknowledgement, has to be re-executed and acknowledged
- Example 4 – Defective Mortgage (typically incorrect legal description or wrong mortgagor capacity)
  - Banks will often want to just record a "corrective mortgage" that crosses out the problem, but is not re-executed and acknowledged by the borrower – BAD, BAD, BAD
  - There are two ways to fix materially defective mortgages:

- Option 1 – record a completely brand new mortgage with all the correct information in it, and satisfy the prior incorrect mortgage
  - This option would for-sure result in a new priority date for the mortgage
- Option 2 – record a corrective mortgage that references the prior defect, and is properly re-executed and re-acknowledged by the borrowers
  - You need to note in your file that when this new corrective mortgage gets released/satisfied, the prior mortgage needs to either be referenced or have a separate release/satisfaction recorded for it as well

Acknowledgements

Anytime you are reviewing documents, whether they are in the chain of title or especially if they are part of the new transaction, you MUST carefully review all acknowledgements. This is because the risks and problems that result from bad acknowledgements (lack of priority even if recorded, invalid instruments, bankruptcy trustees setting aside conveyances, ect.) is so great and potentially costly. Under South Dakota law, a defective acknowledgement can be challenged for up to 10-years from the date of recording. Further, there is only a 30-day grace period to properly correct an improper acknowledgement without impacting priority. To complicated matters further, South Dakota does NOT have something like a notary affidavit that allows for just the notary to record something which would fix the defect.

Given all that, below is a brief list of what you should be paying particular attention to:

- Making sure the name and capacity of all parties are correct (need to compare with commitment);
- Correct acknowledgement language is used (no individual language for an entity)
- That the person actually signs / signed before the notary at that time
- No one who needed or should have signed is missing

Tax Deeds

While we could spend an entire day just covering tax deeds and the various issues with them, here is a very brief summary of some of the most common questions and issues related to tax deeds. Let's start by looking at Title Standard 26-01, which lays out the basics of tax deeds:

> 26-01. Tax title. Neither a tax deed issued pursuant to any of the provisions of SDCL 10-25-12, nor any combination of such deeds, terminates the rights of the owner who owned it prior to its sale for taxes, unless there is:
>
> (a) A judgment in a quiet title action;
>
> (b) A marketable Record Title Affidavit pursuant to SDCL 43-30-7 (using as a "root of title" the tax deed from the county);
>
> (c) A deed conveying the prior owner's interest.

Basically, a tax deed is going to be good against all other persons, except for perhaps the prior owner, just by the very fact that a tax deed was issued. In order for it to be perfected against the prior owner (who may have a constitutional due process interest that is not extinguished by the tax taking process) we need either (1) a quiet title with the prior owner named; (2) an effective Affidavit of Possession; or (3) a deed from that prior owner.

Each time you see a tax deed in the chain of title, you should be looking to see which one of those is present. If none are, then something will have to be done prior to us insuring the property without exception. Additionally, you should be reviewing the chain of title to make sure that everyone who had an interest in the property prior to the tax taking (like prior creditors) received proper notice of the tax sale. If they did not, there could be an issue with their interest not being properly extinguished.

Finally, I have prepared and attached a chart which breaks-down who is all entitled to notice of the county's intent to take by tax deed and the type of notice they are entitled to receive:

Who gets notice:

- Served upon the owner of record (SDCL 10-25-3)
    - Requires personal service (SDCL 10-25-5)
- Upon the person in possession of the property (SDCL 10-25-3)
    - Requires personal service (SDCL 10-25-5)
- Upon the person in whose name the property was taxed (SDCL 10-25-3)
    - Requires personal service (SDCL 10-25-5)
- Upon the mortgagee named in any unsatisfied mortgage of record (plus their assignees of record too) (SDCL 10-25-3) and any lienholders, creditors of record, and other interested persons of record with the County ROD, Treasurer, or Clerk of Courts (SDCL 10-25-3)
    - Requires service in one of two ways: (SDCL 10-25-5)
        - Served by any manner allowed by law for the service of summons OR
        - Publication in the local newspaper for at least 2 successive weeks
            - BUT have to send to any person served by publication a true copy of the notice through US mail (registered or certified mail, return service requested, needs all postage pre-paid) to their last known address

Here are what SDCL 10-25-3 and 10-25-5 say specifically:

10-25-3. Persons entitled to notice of intention to take tax deed. The notice of intention to take a tax deed shall be served upon the owner of record of the real property so sold, upon the person in possession thereof, upon the person in whose name the property is taxed, upon the mortgagee named in any unsatisfied mortgage in force upon the real property of record in the office of the register of deeds of the county in which the property is located, and if the mortgage has been assigned and the assignment thereof placed upon record in the office of the register of deeds, then upon the assignee in lieu of the mortgagee named in the mortgage. The notice of intention to take a tax deed shall also be served upon any lienholder, any creditor of record and other interested person as may appear from the records in the office of the register of deeds, the county treasurer or the clerk of courts. The county treasurer may obtain any title information necessary to identify persons who appear from the records to be interested in such real property as owners, mortgagees, lienholders or otherwise.

10-25-5. Service of notice of intention to take tax deed--Personal service--Publication--Mailing. Personal service of the notice shall be served upon the owner of record of the real property, upon the person in possession of the real property, and upon the person in whose name the real property is taxed in the manner provided by law for the service of summons. All other persons mentioned in §§ 10-25-3 and 10-25-4 may be served in the manner provided by law for the service of summons or the notice may be served by publishing the notice once a week for at least two successive weeks in a newspaper printed in the county where the real property is situated, and if no newspaper is printed in the county, in the nearest legal newspaper printed in the state. In addition to the service by publication, the holder of the tax certificate shall send to any person served by publication a true copy of the notice through the United States mails, properly addressed, to the last known address of the person. The notice to the mortgagee or the mortgagee's assignee shall be directed to the mortgagee or assignee to the address appearing in the mortgage of record, or in the assignment thereof. The notice to a lienholder or to any other interested person as may appear from the records in the office of the register of deeds, the county treasurer, or the clerk of courts shall be sent to the last known address of the person. The notice shall be sent by registered or certified mail, return receipt requested, with all proper postage prepaid.

Other Title Stuff

- Remember – it is okay to say NO. No owner, purchaser, or lender has a right to a title insurance commitment/policy or that it is free of exceptions. We each try hard to make sure that is what they get, but sometimes the title issues are too big or the risk too great for it to happen.
  - On that same note – you do not always need to try and clean-up the commitment before it goes out. Often the goal is to remove exceptions before the commitment gets sent out. The problem is that there are just some exceptions that cannot be easily removed, so rather than try and fix it all up-front by yourself, consider sending the commitment out and working with the various parties to remove the exception AFTER they ask about removing it.
- Be sure to find out what specifically the owners and lenders want to insure and whether it is Extended Coverage or Standard Coverage. The amount of work to fix and concern over issues is drastically different depending on the answer.
- Remember to use the various resources at your disposal, including:
  - PACER to search bankruptcies;
  - Google Earth and Maps to look at properties with potential issues;
  - South Dakota Secretary of State's (and other states') website to search businesses;
  - Court files for:
    - Civil judgments;
    - All divorce proceedings for judgments and transfers of property that are ordered but have not been recorded;
    - Probates and other actions related to deceased individuals;
- Always be sure to receive copies of and review the following:
  - Contract for Deeds (full contracts to see if there are any restrictions);
  - Trust Certificates for trust property
  - Corporate/Business resolutions authorizing the sale of the property
  - Personal Representative Letters of Appointment

TAX-DEFERRED EXCHANGES UNDER I.R.C. § 1031

1. I.R.C. §1031 - In General.

   A. **Definition.** "No gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment." *§ 1031 (a)(1).*

   B. **Tax Deferred not Tax Free.** Exchanges under § 1031 are "tax deferred" and not "tax free." The tax basis and liability in the property disposed of will simply be transferred to the property acquired. Thus, in the event the property received in the exchange is subsequently sold for cash ("cashing-out"), the previously deferred tax must be reported and paid.

   C. **Exchange of Properties without Receipt of Proceeds required.** In order to qualify for tax-deferred treatment, there must be an "exchange" of property. The sale of property followed by the immediate investment of sales proceeds into like-kind property does NOT fall within the scope of § 1031. The key element to an "exchange" under § 1031 is the taxpayer's non-receipt (direct/actual or indirect/constructive) of proceeds from the disposition of property. This, it has been said, is the *only* formality required for a § 1031 exchange. Guerin, *Taxation of Real Estate Transactions,* §12.26.

   E. **Exchange Reported on IRS Form 8824.** Exchanges must be reported on Form 8824, Like-Kind Exchanges. This form reports the computation of both the *realized* gain and the *recognized* gain.

2. Requirements of I.R.C. § 1031(a)(1).

   A. Three (3) requisites to exchanging under § 1031(a)(1).

      (1) **Property Requirement.** Property, whether personal or real, must be the subject of the exchange.

         a. **Exceptions** - Property disqualified from Section 1031 treatment under 1031 (a)(2):

            - Stock in trade or other property held primarily for sale (This includes ***property held by a developer or other dealers in property***) *((a)(2)(A)).*

              NOTE: A person is a "dealer" in real estate if it holds real estate *primarily* for sale to customers in the ordinary course of its business. Persons selling real estate who are deemed to be a "dealer" in such property recognize gain as ordinary income, whereas those holding real property for investment purposes recognize capital gain on its sale. This result occurs because inventory is excluded from the statutory definition of a capital asset. *Section 1221(a)(1).* Furthermore, in order to obtain the benefits of a like-kind exchange under Section 1031, the property disposed of and the property acquired must either be held for investment or for use in a trade or business. In either case, inventory property, such as property considered as "dealer" property, will not qualify for the benefits of § 1031.

- Stocks, bonds, or notes *((a)(2)(B))*.
- Other securities or evidences of indebtedness or interest *((a)(2)(C))*.
- Interests in a partnership (or an L.L.C.) *((a)(2)(D))*.
- Certificates of trust or beneficial interests *((a)(2)(E))*.
- Choses in action [a personal right not reduced into possession, but recoverable by a suit at law or other right of action] *((a)(2)(F))*.
- Real property located in the U.S. exchanged for real property located outside the U.S. *((h))*.

(2) **Qualified Purpose Requirement.** Both the "Relinquished Property", the property disposed of, and the "Replacement Property", the property acquired as a result of the exchange, must be held for a *qualified purpose*.

a. *Only property held by the taxpayer for either productive use in a trade or business or otherwise for investment qualifies for 1031.* Personal residences, vacation homes, and other like personal use property, by implication, are ineligible for non-recognition treatment under § 1031(a)(1). *Ltr Rul 8915012.*

b. Simple examples of property held for productive use in the taxpayer's trade or business include productive farmland owned by a farmer or corporate office buildings owned by a corporation.

c. Neither IRC § 1031 nor the Regulations define "held for investment," although the Regulations provide that unproductive real estate held by a non-dealer for future use or future appreciation is held for investment. *Reg § 1.1031(a)-1(b).* Simple examples of property held for investment include an apartment rental complex held by a landlord or appreciated hunting land not subject to the (more than incidental) personal use of the taxpayer.

d. It is elementary that real property held for productive use in the taxpayer's trade or business may be exchanged for property that will be held by the taxpayer as an investment and vice-versa (i.e. farmland used as part of a farmers business exchanged for 2 bare lots in a growing residential subdivision held for future use and appreciation).

e. The intent of the taxpayer at the time of the exchange is crucial. The taxpayer's purpose for holding the relinquished property and the replacement property is determined at the time the exchange takes place. *Rev Rul 57-244, 1957-1 CB 247.*

f. There is no statutory or regulatory holding period for either the relinquished or replacement properties. The length of holding, however, is but one consideration the courts will use in order to determine the intent of the taxpayer regarding property disposed of or acquired in an exchange. The IRS will most likely take the position that the property was not held for a qualified purpose if it was acquired immediately prior to the exchange, or was disposed of immediately thereafter. *Rev Rul 84-121, 1984-1 CB168; Rev Rul 75-992, 1975-2 CB 333.*

g. Although there is no authority for the notion, it is generally accepted that a (2) two-year holding period is sufficient to qualify either the relinquished or replacement properties for non-recognition treatment.

(3) **“Like-Kind” Requirement.** The Relinquished Property must be “like-kind” to the Replacement Property.

a. Real property “like-kind” requirement.

i. The fact that real estate is improved or unimproved is not material, for that fact relates only to the grade or quality of the property and not to its kind or class. *Treas Reg §1.1031(a)-1(b).*

ii. “Real Estate for Real Estate.” ***All real property located within the U.S., if held with qualified purpose of investment or product use, is like-kind to all other such real property located within the U.S., regardless of its character.***

iii. Some common examples of like-kind real property exchanges include:

- Unimproved real property for improved real property and vice versa;
- A commercial building for 3 bare lots and vice versa;
- City real estate for agricultural/ranch real estate and vice versa;
- A tenancy in common interest for a fee and vice versa;
- An easement interest for a fee interest and vice versa; and
- Farmland for a TIC (tenancy in common interest), classified as a regulated “D” security under the SEC Act of 1933 and approved as replacement property via *Rev Proc 2002-22.*

b. Personal property “like-kind” plus “like-class” requirements.

i. Personal property held for productive use in a trade or business or for investment may be exchanged for other “like-kind” and “like-class” personal property under § 1031(a)(1).

ii. While the “like-kind” requirement for real property is broad, the “like-kind” or “like-class” requirement for personal property is much more restrictive. For example, while unimproved real estate may be exchanged for improved real estate, a car may not be exchanged for a truck. Reg. § 1.1031(a)-2(b)(2)(v), (vii).

iii. To be of “like-class”, the Relinquished and Replacement personal property must be in either the same “General Asset Class” or “Product Class”.

iv. The General Asset Classes are as follows:

- Office furniture, fixtures and equipment;
- Data handling equipment, except computers;
- Information systems (computers, etc.);
- Airplanes (except commercial passenger or freight carriers) and all helicopters;

- Automobiles, including taxis;
- Buses;
- Light general purpose trucks;
- Heavy general purpose trucks;
- Railroad cars and locomotives;
- Tractor units;
- Trailers and trailer-mounted containers;
- Vessels, barges, tugs, except those used in marine construction;
- Industrial steam and electric generation and/or distribution systems.

v. The Product Classes are from Sectors 31 through 33 of the North American Industry Classification System (NAICS), which was adopted in 2002 but not utilized for tax deferred exchanges until August, 2004 under the new regulations adopted by the IRS.

vi. If the depreciable tangible personal property does not fall within either a General Asset Class or a Product Class, the exchange may still be completed as long as the Relinquished and Replacement properties are considered to be of a "like-kind".

3. Safe harbor exchanging – "Use of a Qualified Intermediary".

A. **Safe Harbor exchanging.** The 1991 Treasury Regulations for tax-deferred exchanges under IRC §1031 established four (4) "safe harbors", which allow a taxpayer to avoid actual or constructive receipt of money or other property for purposes of completing a §1031 exchange. Although an Exchanger will not automatically be deemed to have constructive receipt of relinquished property sale proceeds ("exchange funds") if the safe harbor requirements are not met, compliance with the provisions of any safe harbor, for obvious reason, is highly advised. The four (4) 1991 Treasury Regulation safe harbor provisions provide for exchanges involving:

(1) qualified intermediaries.
(2) interest and growth factors.
(3) qualified escrow accounts and qualified trusts.
(4) security or guaranty arrangements.

NOTE: These safe harbors may be used singularly or in any combination as long as the terms and conditions of each can be separately satisfied.

B. The use of the "Qualified Intermediary" safe harbor is the most often utilized safe harbor for taxpayers engaging in exchanges for the prevention of taxpayer receipt of exchange funds.

C. **Qualified Intermediary defined.** A "Qualified Intermediary" is formally defined as a person who is not the taxpayer or the agent of or is not otherwise a disqualified person who enters into a written exchange agreement with the taxpayer and, as required by the exchange agreement, acquires the relinquished property from the taxpayer, transfers the

relinquished property to the Buyer, acquires the replacement property from the Seller, transfers the replacement property to the taxpayer. Reg § 1.1031(k)-1(g)(4)(iii).

D. **Direct Deeding between parties allowed.** Due to the allowance of "direct deeding" between the parties to the transaction, the qualified intermediary does not actually have to receive and transfer title to property as long as the legal fiction of qualified intermediary as owner is maintained. ***Rather, the qualified intermediary, via the exchange agreement, acquires exclusive possession of the net sales proceeds of the relinquished property – the "exchange funds" - thus keeping the taxpayer out actual or constructive receipt of them – and applies such funds toward the taxpayer's replacement property purchase.***

E. **Exchanger's limitation to exchange funds required.** Fundamental to the success of the use of the qualified intermediary safe harbor is that the Exchange Agreement ***<u>MUST</u>*** expressly limit the taxpayer's rights "to receive, pledge, borrow or otherwise obtain the benefits of money or other property held by the qualified intermediary" as provided by the (g)(6) limitations (actual or constructive receipt limitations).

F. Qualified Intermediaries traditionally perform the following actions in a typical exchange:

(1) Creates the exchange of properties through an Assignment of the taxpayer's interest in the relinquished and replacement properties.

(2) Holds the taxpayer's exchange proceeds in avoidance of the taxpayer's actual or constructive receipt as provided by the Exchange Agreement and Regulations.

(3) Generates all exchange documentation creating the "paper trail" of the exchange's compliance with I.R.C. § 1031 and the Regulations promulgated thereunder.

(4) Consult as to the exchange's structure and its compliance with the safe harbor. Although not the taxpayer's attorney or tax-advisor, the qualified intermediary can and should provide direction regarding maintaining the exchange within the safe harbor.

G. Disqualified parties.

(1) **Definition.** A "disqualified person" is defined in Treasury Regulation §1.1031(k)-1(k) as someone who is the agent of the taxpayer at the time of the exchange. If a disqualified person performs the exchange and holds the exchange proceeds the exchange may fail if the IRS determines that as a result of the disqualified party's involvement the taxpayer had "actual or constructive" receipt of the exchange funds. For purposes of this Regulation, a person who has acted as the taxpayer's employee, **attorney, accountant,** investment banker or broker, or real estate agent or broker within the two year period preceding the date of the transfer of the first relinquished property by the taxpayer is treated as an agent of the taxpayer at the time of the exchange and, therefore, a disqualified person.

(2) **Exception.** Solely for purposes of this Regulation, there is an exception for the performance by a person of services for the taxpayer with respect to only exchanges of property under IRC §1031 and the performance by a person of routine financial, title insurance, escrow, or trust services for the taxpayer by a financial institution,

title insurance company or escrow company. These types of services shall not be taken into account as performances of services by a disqualified person. *Treas Reg §1.1031(k)-1(k)(2).*

(3) Other disqualified persons are any parties that are considered "related parties" to the taxpayer. Related parties are defined in IRC §267(b) and §707(b)(1) as any person or entity bearing a relationship to the Exchanger, such as members of a family (brothers, sisters, spouse, ancestors and lineal descendants); a grantor or fiduciary of any trust; two corporations which are members of the same controlled group or individuals; and corporations and partnerships with more than 50% direct or indirect ownership of the stock, capital or profits in these entities.

4. <u>Types of exchanges under IRC § 1031.</u>

A. **A Direct Exchange – aka "Land Swap"** is the purest and most basic of all exchanges, which simply entail an exchange of land between two parties – i.e., "land for land." Because the exchange takes place *simultaneous to the transactions*, being a deed of property from one party in exchange for a deed of property from the other party, none of the "safe harbors" under § 1031, most relevant to the prevention of actual or constructive receipt of exchange proceeds, is required to "perfect" such an exchange. Related parties may engage in a land swap, provided such parties retain title to their respective properties for a period of at least 2 years following the completion of the swap.

B. **A Simultaneous Exchange** is an exchange in which the closing of the relinquished property and the replacement property occur on the same day, usually back-to-back. There is no interval of time between the two closings. Contrary to popular belief, this exchange *structure should be accompanied by the use of a qualified intermediary or other safe harbor.*

C. **A Delayed / Forward / Starker Exchange** is an exchange where the relinquished property is closed on first in time and the replacement property is closed on second in time (on a later date). The exchange is not simultaneous or on the same day. There are strict time frames established by the Code and Regulations for completion of a Delayed Exchange, namely the "45-Day Replacement Property Identification period" and the maximum 180-day "Exchange Period". Delayed exchanges are covered by the Safe Harbor Regulations.

D. **A Reverse Exchange** is typically an exchange in which the replacement property is purchased and closed first in time and the relinquished property is sold and closed on second in time. Under Revenue Procedure 2000-37, a revenue procedure that approved property parking arrangements with a non-disqualified person or entity, the Intermediary or EAT ("Exchange Accommodating Titleholder") may take title to the either the replacement or relinquished property (the "parked property") prior to the exchange being made with the taxpayer. Most often, the Intermediary or EAT will take and hold title to the replacement property and will remain in replacement property title no longer than 180 days or whenever the taxpayer sells his relinquished property to the Buyer, whichever is sooner. Reverse exchanges should be utilized only in a "must" situation. The taxpayer should make every effort to structure the exchange as a forward exchange, reserving the reverse exchange structure only as a matter of necessity.

E. **An Improvement or Build-to-suit Exchange** is an exchange in which a taxpayer desires to acquire a property and arrange for construction of improvements on the property before it is received as Replacement Property. Exchange proceeds can be utilized in the construction of improvements onto the replacement property. The improvements are usually a building on an unimproved lot, but may also include enhancements made to an already improved property in order to create adequate value to close on the replacement property with no boot occurring. The Code and Regulations do not permit a taxpayer to construct improvements on property the taxpayer already owns or after he has taken title to property as replacement property in a § 1031 exchange. However, Revenue Procedure 2000-37 allows the Intermediary or EAT to close on and hold title to the replacement property while the improvements are being constructed. Once the improvements are sufficient or 180 days have passed from the Intermediary's or EAT's acquisition of the replacement property, the replacement property plus the improvements are conveyed title to the taxpayer in completion of the exchange. Improvement Exchanges are done in the context of both Delayed Exchanges and Reverse Exchanges, depending on the circumstances.

5. Delayed Exchanges.

A. The concept of a deferred (non-simultaneous) exchange was approved in *Starker v. United States, 602 F2d 1341 (9th Cir. 1979).* The lapse of time between closings allowed in the *Starker* decision prompted Congress, in the Tax Reform Act of 1984, to enact Section 1031(a)(3) which restricted the time in which a deferred exchange could be accomplished. The regulations provide that a "deferred exchange" is an exchange in which, "pursuant to an agreement", the taxpayer transfers and receives qualifying property. *Treas. Reg. §1.1031(k)-1(a).* In addition, the taxpayer must meet the identification and receipt requirements of replacement property and the transaction must constitute an exchange of properties, as opposed to a transfer of property for money. *Id*.

B. Delayed exchange time periods and safe harbor requirements.

(1) **45-day Replacement Property Identification Period** - 1031(a)(3).

a. The Replacement Property Identification Period commences on the date the **first** Relinquished Property is transferred by Exchanger to Intermediary and then to the Buyer and ends at midnight of the 45th day thereafter (the "Identification Period", *Reg. § 1.1031 (k)-1(b)(2)(i)).*

b. In the case of any deferred exchange, any replacement property received by the taxpayer before the end of the identification period will in "all events" be treated as identified before the end of the identification period. *Treas Reg §1.1031(k)-1(c).* (Replacement property acquired by the taxpayer during the identification period is deemed "duly identified".)

c. In all other cases, replacement property is identified *only* if Exchanger designates the Replacement Property in a written notice to Intermediary, which notice shall be signed by Exchanger and hand delivered, mailed, telecopied, or otherwise sent to Intermediary by the end of the identification period. The Replacement Property shall be "*unambiguously described* in the written document or agreement" by a legal description, street address or other distinguishable name and shall be located in the United States. *Treas. Reg. §1.1031(k)-1(c)(3).*

(2) **Replacement property identification rules - alternative and multiple properties.**

Exchanger may identify alternative and multiple properties, **provided** that Exchanger may not identify more than the greater of:

a. **The Three-Property Rule** - Any three properties regardless of their fair market values (FMV);

b. **The 200% Rule** - Any number of properties as long as the aggregate FMV of the replacement properties does not exceed 200% of the aggregate FMV of all of the relinquished properties as of the initial date of transfer;

c. **The 95% Rule (the "Saving Rule")** - Any number of replacement properties if the FMV of the properties actually received by the end of the exchange period is at least 95% of the aggregate FMV of all the potential replacement properties identified.

(3) Exchanger may *revoke* the identification of replacement property at any time prior to the end of the identification period by providing a written notice of revocation to Intermediary signed by Exchanger.

(4) *Maximum* 180-day Exchange Period.

a. The "Exchange Period" shall commence on the same day as the "Identification Period", i.e., the date Exchanger transfers the **first** Relinquished Property to Intermediary and then to Buyer, and ends at midnight on the earlier of either: (i) the 180th day thereafter, or (ii) the due date (including extension) for the Exchanger's tax return for the taxable year in which the transfer of the Relinquished Property occurs (Reg. § 1.1031 (k)-1(b)(2)(ii)).

b. Thus, in order for Exchanger's exchange of like-kind real property to qualify for tax-deferred treatment under I.R.C. Section 1031 and under the aforementioned Regulation, it may be necessary for Exchanger to file an applicable automatic extension Form (for the appropriate taxable entity), on or before the normal due date of Exchanger's tax return in order to obtain an automatic extension for filing Exchanger's tax return **if** Exchanger's Replacement Property will not close in the same taxable year in which the transfer of the relinquished property occurred.

C. Delayed exchange mechanics.

(1) Taxpayer enters into a Purchase Agreement to sell relinquished property to Buyer. Taxpayer provides Intermediary a copy of the signed and effective relinquished property purchase agreement.

(2) Intermediary generates the relinquished property exchange documents, which consist of an Exchange Agreement, Assignment of relinquished property purchase agreement to qualified intermediary, and the Buyer's Notice of Assignment of relinquished property purchase agreement to qualified intermediary. The Exchanger *must* execute the relinquished property exchange documents *"prior to or at the time of the relinquished property closing."*

(3) *In addition, the Buyer must receive written Notice of the Assignment of relinquished property purchase agreement to qualified intermediary prior to or at the time of the relinquished property closing.* Thus, it may be necessary that the Exchanger execute the relinquished property documents prior to that closing so to insure the Buyer will receive the required written Notice of the Assignment.

(5) Intermediary coordinates with the closing agent of the relinquished property to insure all exchange documents are properly signed and delivered, if necessary, and that the net sales proceeds for the relinquished property are immediately transferred to Intermediary upon closing. Most intermediaries include § 1031 closing instructions to the closing agent of the relinquished property to insure these matters are properly completed.

(6) The Exchanger executes a deed conveying the relinquished property directly to the Buyer.

(7) Upon closing, the exchange proceeds are forwarded to Intermediary and held in its no-access trust account pursuant to the terms of the Exchange Agreement.

(8) Within 45 days of the relinquished property closing, Exchanger identifies replacement property to Intermediary via written notice.

(9) Exchanger enters into negotiations with Seller to acquire the identified replacement property. Negotiations are reduced to a written and executed purchase agreement.

(10) Exchanger provides Intermediary a copy of the signed and effective replacement property purchase agreement.

(11) Intermediary generates the replacement property exchange documents, which consist of an Assignment of replacement property purchase agreement to qualified intermediary, and the Seller's Notice of Assignment of replacement property purchase agreement to qualified intermediary. As with the relinquished property exchange documents, these replacement property exchange documents must be completed by the taxpayer, and delivered to the Seller, "prior to or in connection with closing."

(12) Intermediary coordinates with the closing agent of the replacement property to insure all exchange documents are properly signed and delivered, if necessary, and that the necessary exchange proceeds for Exchanger's acquisition of replacement property are properly transferred to closing account of the closing agent. Most intermediaries include § 1031 closing instructions to the closing agent of the replacement property to insure these matters are properly completed.

(13) The Seller executes a deed conveying the replacement property directly to the Exchanger in completion of the exchange.

6. Boot.

A. Boot is property which is received in an exchange and that is not "like kind" to the other property acquired in the exchange transaction. Boot may be defined as the "fair market value" of the non-qualified property received in an exchange.

B. Boot received by the taxpayer does not disqualify the exchange, but the taxpayer who receives boot generally recognizes gain to the extent of the value of the boot received.

C. Some common examples of Boot are:

(1) **Cash boot** – access exchange proceeds the Exchanger receives from the Qualified Intermediary during or after the exchange;

(2) **Mortgage boot (AKA "debt reduction boot")** – results when the taxpayer either pays off debt against the relinquished property (or the Buyer agrees to assume that debt) and fails to replace or assume debt in equal or greater amount against the replacement property.

D. In order to avoid Boot, the taxpayer should:

(1) Acquire "like-kind" replacement property that is of equal or greater value than the relinquished property;

(2) Use all of the exchange proceeds held by the Intermediary (the "net equity" of the relinquished property) toward the purchase and acquisition of the replacement property;

(3) Replace all debt paid off (or assumed by Buyer) against the relinquished property in a like or greater amount of debt placed onto (or assumed by Exchanger) the replacement property.

(4) Do NOT over-finance the replacement property. Over-financing the replacement property may result in the inability to use all available exchange funds in connection with the purchase of the replacement property.

E. Boot offset rules:

i. Cash paid by the exchanger to fund the exchange offsets cash boot received from Intermediary following the exchange.

ii. A reduction in debt on the replacement property can be offset by cash put into the exchange by the taxpayer. However, increasing the debt on the replacement property will not offset a reduction in the exchange equity, which results in excess exchange funds or cash boot upon the completion of the exchange. (Debt boot paid *never* offsets cash boot received because net cash boot received is always taxable.)

8. <u>Miscellaneous exchange rules and considerations.</u>

A. **IRC § 1031 notice and assignment clause in purchase agreements.** It is a good practice to include a § 1031 notice or cooperation clause in purchase agreements under which your client intends to perform either leg of a § 1031 exchange. Although not essential to the legitimacy of the exchange, the § 1031 exchange cooperation clause should be included to provide notice to the non-exchanging party that because the exchanging party is attempting to perform a § 1031 exchange with the subject property – his rights and interests under the purchase agreement may be assigned to a qualified intermediary or EAT of the exchanging party's choice.

B. **Earnest money payments made for relinquished property.** Earnest money payments made by the Buyer under the terms of the relinquished property purchase agreement do not affect the legitimacy of the exchange, even if received by the taxpayer. In order to qualify for use as exchange proceeds, however, earnest money payment must be transferred to the closing agent of the relinquished property or transferred directly to the qualified intermediary *before* the relinquished property closes and legal title transferred to the Buyer. Earnest money payments

retained by the taxpayer or his agent after the closing of the relinquished property is cash boot received by the taxpayer subject to taxation.

C. **Earnest money payments made for replacement property.** It is always permissible for the taxpayer to fund his exchange, which includes his ability to make down payments toward the replacement property (without fear of creating cash boot at the end of the exchange – see boot offset rules above). In addition, it is permissible for the Intermediary to make an earnest money payment for replacement property via the use of exchange proceeds, if the subject replacement property purchase agreement has been previously assigned to the Intermediary. The Intermediary should instruct the escrowing party of the replacement property down payment to return the down payment directly to intermediary in the event the sale fails to close in order to avoid the taxpayers actual or constructive receipt of exchange proceeds during the exchange.

D. **Only the closing and transfer of legal title affects the exchange and commences the taxpayer's IRC § 1031 clock running.** Thus, negotiations, down payments made or received, the execution of purchase agreements, etc and so on, do not affect one's ability to perform an exchange under IRC § 1031. The closing of the subject property is the only crucial happening to one's ability or inability to attempt to perform an exchange under IRC § 1031. **CLOSING IS KEY!**

E. **Related party exchanges – watch out!** Though it is possible for related parties to engage in a classic "land swap / direct exchange" of properties (provided each party does not dispose the property acquired through the swap within 2 years of their acquisition) …

Such is not the case *on the replacement property acquisition leg of an indirect (forward / delayed / Starker) exchange.* While in an indirect delayed exchange it seems to be permissible for a taxpayer to sell relinquished property to a related party, it seemingly is NOT permissible for a taxpayer to acquire replacement property from a related party – and regardless of whether or not the taxpayer retains ownership of the acquired replacement property for at least 2 years post-exchange (which is the common misconception out there).

There is one known and a few "possible" exceptions to this related party limitation. But, regardless of any possible exception or its application to the taxpayer's exchange, purchasing replacement property from a related party in an indirect exchange represents a risk issue for the taxpayer in the event the taxpayer chooses to proceed to acquire replacement property from a related party.

F. **Tax advisor, Tax advisor, Tax advisor.** With all such tax and legal advice and risk issue analysis and advice in connection with an exchange, the taxpayer must seek guidance from a competent tax advisor and/or attorney!

MISCELLANOUS CLOSING TOPICS & ISSUES

1) <u>Q: Where's most of the liability in a real transition? A: See CLOSING!</u>

In case you didn't know, most if not all liability / risk stems from the closing of the real estate transaction.

Most covered and payable title insurance claims arise from closing errors or omissions, and sometimes those which are not even really attributable to the closer but, nonetheless, passed to or absorbed by the closer.

In addition, many covered and payable claims attributable to title and or relevant title document errors or omissions, could / should be caught be the closer, but, alas, are often not.

Therefore, a closer's role in not only consummating the subject real estate deal between the parties but also reducing risk is paramount.

2) <u>The "GOLDEN RULE" for all real estate closers</u>.

(a) Just a few recent common inquiries and examples:

1. Can we disburse sales proceeds to a non-owner/seller?
2. Can we accept / rely upon a verbal payoff or lien release promise from a lender / creditor?
3. Can we hold certain sales proceeds post-closing and act as escrow agent for them?
4. Can we have a non-owner/seller or borrower or non-buyer sign non-title related closing documents (e.g., HUD, affidavits, disclosure statements, etc.)?
5. Can we change a HUD to reflect / document a 1031 exchange by a party to the transaction?
6. Can we assist / close aspects of a transaction which do not involve the insured real property, or involve personal property, etc.?

(b) The answer to all of the above inquiries is – *always follow the GOLDEN RULE!*

(c) The GOLDEN RULE for all real estate closers is:

GET IT IN WRITING FROM THE PROPER PARTY!
GET IT IN WRITING FROM THE PROPER PARTY!
GET IT IN WRITING FROM THE PROPER PARTY!

3) <u>Closing Preparation Discussion: Communicate, read and re-read, review documents, understand the transaction, and trust no one</u>.

While it seems obvious and is easy to say at least, the necessary elements listed above to an effective and error-free closing are both labor intensive and absolutely essential, but certainly not easy (and maybe not obvious).

The following provides general yet fundamental actions a closer must take when preparing for a closing:

1. Communicate.

   Make sure you are effectively communicating with the parties to the transaction, Seller, Buyer, Lender, Contractor, Realtor, etc. *as well as with persons that prepared the commitment.*

   You should not have your first conversation with any party to the transaction be at the closing table. All parties to the transaction should be advised as to what they need to do, bring, and provide at the time of closing – in advance of closing.

   In order to effectively communicate, you'll have to have the contact information for those parties.

   Ask questions. Make sure you get and understand the answers to your questions.

2. Read, re-read and review relevant title and closing documents.

   Make sure, *in reasonable advance of the closing*, that you have received all purchase agreements (and all amendments thereto), Commitments (updated Commitment too just prior to closing), loan closing instructions, deeds, mortgages, etc., have read and re-read them, and have taken note of any issues, questions or potential defects or inconsistencies.

   In connection with your receipt and careful review of the loan closing instructions, make sure you understand what the lender is requiring and ask questions if necessary.

   Pay particular attention to portions of the loan closing instructions of which you cannot comply and make sure you are appropriately annotating such non-compliance in those closing instructions. Do not sign unabridged closing instructions / or any supplements thereto of which you cannot or did not comply.

   Your signing loan closing instructions without written objection will subject to you liability under those closing instructions for non-compliance, and regardless of the fact that you could not actually comply with them. (For example – watch out for signing unabridged "Supplemental closing instructions for Manufactured Home Riders and the like. Those things: 1) require you to sign, but 2) contain a whole host of requirements of which you have no ability to comply with.)

   In your review of the purchase agreement and all amendments thereto, are the intentions and agreements of the parties accurately reflected in the title transfer documents? Is intended property being conveyed through the deed?

   Also, do not hesitate to require a proper amendment, etc. be made and sign by the parties for any intentions of the parties not disclosed, documented or agreed to by the parties in the purchase agreement.

In your review of the deed and/or mortgage along with the Commitment (and purchase agreement), are the proper parties stated? Is the proper land / legal description being conveyed and/or encumbered? Are all marital statuses shown appropriately or does the deed and/or mortgage contain a proper non-homestead recital? Are all owners signing the mortgage? Are non-titled spouses being properly joined? Are the deed and/or mortgage executed by the grantor / borrower in the proper capacity of ownership and are their executions properly acknowledged in that same executing capacity?

As closer, you perhaps are the final safeguard to ensuring all transfer and encumbrance documents are error free and will represent enforceable instruments once recorded.

NOTE on acknowledgements. Please be advised that a defectively acknowledged instrument, though recorded, fails to impart constructive notice to subsequent purchasers and encumbrancers of the property for the period of 10 years (without issue).

NOTE 2 on acknowledgements. We encounter defectively acknowledged, though recorded, instruments ALL THE TIME!

NOTE 3 on POA's. If an attorney-in-fact will be executing documents for a grantor / borrower at closing based upon a Power of Attorney document, the closer may be the first person to actually see and review it. Please make sure the POA document: 1) is valid (signed, acknowledged and contains all essential elements of a deed of conveyance), 2) is still effective on the date of closing, not having been, revoked by the principal or terminated by his death or incapacity, 3) the action to be taken by the AIF on behalf of the principal at closing is a power specifically granted / authorized by the POA document, and 4) the capacity of the principal, as granted and delegated to the attorney in fact, **MUST** match the conveying or mortgaging of any property for which the power of attorney is exercised.

NOTE 4 on updated Commitments prior to closing. Do not close based upon an old / previously dated Commitment. Require the Commitment be updated for closing!

3. Understand the transaction.

   In connection with all of the above, it is imperative that you as closer fully understand the transaction of which you are closing. And, of course, figuring it all out at the closing table is ill-advised as mistakes may likely result.

   Thus, make sure that by the time you sit down to close the transaction, you fully understand the transaction. Only through careful preparation, reading, reviewing and asking questions prior to closing can this understanding be accomplished.

4. Trust no one.

   What I mean by this is again -- as closer, you perhaps are the final safeguard to ensuring all transfer and encumbrance documents are error free and will represent enforceable instruments once recorded.

As closer, you are closing a transaction, in most part, *based upon other parties' work product* (purchase agreement from realtor, commitment from title company, deed from attorney, mortgage from lender). And, as we all know, people make mistakes and sometimes don't even know any better.

How often do we see that the insured mortgage drafted and provided exclusively by the lender – is riddled with errors and omissions – all owners not signing, non-titled spouse not signing, erroneous legal, bad acknowledgment, etc. and so on (which we are often times and nonetheless on the hook for and have to cover under the title policy).

Thus, you can't just rubber stamp everything and just do the sign here and sign there thing assuming that all parties to the transaction have done their jobs perfectly.

Rather, you need to read, review, ask questions and YES – CORRECT OTHERS' MISTAKES – as you are the last resort.

4) <u>It's OKAY to say "NO"</u>.

DHTIC often receives inquiries and requests for assistance from closers that are poised to close transactions that, generally stated, makes them uncomfortable for one reason or another.

"Is this Russia? I'm pretty sure this isn't Russia..." Please be advised that like other businesses in the stream of American commerce, a real estate closing company is a private (non-governmental) for profit venture of which the owners thereof may or may not engage – their choice.

Thus, you are not legally obligated and no one can force you to accommodate their proposed closing transaction. The decision to close any particular real estate transaction is yours alone.

Therefore, it is <u>always</u> OKAY to say "NO" if requested to close a transaction that:

- makes you feel uncomfortable
- involves an irreputable / disagreeable / unreasonable party
- is just too complicated
- has (a) party(ies) that will not comply with the closer's Golden Rule – won't give it to you in writing
- just involves too much work / hassle / stress
- etc. and so on

The questions we often pose to closers who are poised to close transactions that, generally stated, makes them uncomfortable for one reason or another is:

IS THE CLOSING FEE YOU WILL RECEIVE FOR THIS CLOSING REALLY WORTH IT?

IS YOUR PROCEEDING TO CLOSE THIS TRANSACTION JUST SO THAT YOUR COMPETITION WON'T GET IT (AND AS A RESULT POSSIBLY OTHERS) REALLY WORTH IT?

IS THIS CLOSING REALLY WORTH THE STRESS / HASSLE / RISK?

Maybe so, and maybe not.

But, please remember, it's always OKAY to say "NO".

5) **Closers acting as "escrow agents".**

In years past and present, DHTIC has been made aware of several situations / problems / issues / pay outs that have resulted from a DHTIC agent (who also does closings) that chooses to act as a non-closing or post-closing "escrow agent" for third party proceeds or post-closing sale proceeds, which proceeds or their use is in dispute by the parties or are to be disbursed at some subsequent point and paid to a specific party upon completion of a specific happening.

If you are engaging yourself as an escrow agent, please be advised of the following before you do provide such escrow services and expose yourself and possibly your underwriter to unnecessary liability:

1. Are you getting paid? Are you getting paid appropriately?

Seems obvious, but I am now aware that some closing agents who avail themselves as an escrow agent (usually related to party dispute of funds or things to be paid post-closing) aren't even getting paid!

Please understand that your agreement to act as an escrow agent under a *written* escrow agreement *(a written escrow agreement is always necessary)* is ***NOT*** (in most instances) related to your role as a closing agent. Most post-closing escrow services are above and beyond that and unrelated to your role as closing agent. In addition, there's additional time and work that you will have to do as a result. Plus, you are exposing yourself (and possibly your underwriter) to liability!

Bottom line – get paid appropriately for your services!

2. Make sure the escrow agreement is in writing, like anything else, and is properly signed by all necessary parties thereto.

The necessary parties to an escrow agreement, being the same parties that must execute the escrow agreement for it to be enforceable (like any contract) are:

You as escrow agent.

Any person / party that could claim an interest in the escrowed proceeds.

3. Who is drafting the escrow agreement? You? A seasoned attorney? One of the parties to the Agreement?

Please be advised that you have the RIGHT, AND SHOULD REQUIRE, that all such escrow agreements of which you are acting under be drafted by a reputable attorney. Why

leave this important document, which exposes you to liability, in the hands of someone other than that (and who is not protected by a professional liability insurance policy).

If you are drafting the escrow agreement yourself – take heed – and make sure you are having a competent attorney review those documents for you.

4. **Please make sure you are carefully reviewing the subject written escrow agreement, understand it, are confident it covers all possible happenings and will not leave you holding the bag or asking later – "what am I supposed to do now?" – *before* you sign it!**

5. **In that same vein, do not hesitate to insist / require that the escrow agreement contain an "out clause" or an absolute drop dead date on which the escrowed funds will be disbursed to a specific party / account if none of the conditions precedent to the release of those funds under the escrow agreement have occurred before then.**

DHTIC is aware of a few cases where the issuing agent / escrow agent currently remains in possession of escrowed funds that were escrowed as much as 8 years ago because the conditions precedent to a release of those funds under the escrow agreement have never occurred (and the escrow agreements at issue contained no "out clause" for the escrow agent).

Needless to say in these cases, the on-going and seemingly never-ending escrow of funds have caused the issuing / escrow agent nothing but stress, hassle and additional work over the years.

In some of these cases, the issuing agent / escrow agent was never even paid a fee for the escrow service.

5. **Lastly – IT IS OKAY TO SAY "NO" – "I want no part of this!" If you feel weird about it, it's probably a bad deal to be engaged. At the very least – call your underwriter or attorney to discuss.**

6) <u>Closing 1031 exchange transactions</u>.

GOLDEN RULE: In accordance with the Golden Rule of real estate closers, you must get *written* 1031 closing instructions / permissions / documentation provided to you in order to accommodate a 1031 exchange transaction (or in any case where you are sked to operate outside the norm) whereby you will likely be asked to at least the following things:

(1) Change the HUD to reflect / document the exchange
(2) Send sales proceeds to a non-owner / seller
(3) Have 1031 documents signed and/or delivered
(4) Pay exchange related fees from closing proceeds

These *written* 1031 closing instructions / permissions / documentation could come from the Qualified Intermediary ("QI"), the Exchanger, or the Exchanger's attorney, but will most likely be provided by the QI.

Typical requested changes to a HUD for 1031: Though neither IRC S. 1031 nor the Treas. Regs. thereunder require any changes to a HUD or closing statement be made in connection with the 1031 exchange, most QI's will request such changes be made (again needs to be made in writing).

Rather, *changes to a HUD are done as a matter of exchange industry practice only*, as a HUD is a document in the stream of the exchange which can be taken advantage of to further evidence, document and establish the exchange in the closing.

Relinquished Property: Often QI's will request the closer to amend the Seller / Relinquished Property HUD:

(1) To identify the seller as some version of "1031 Exchange Corp. as QI for John Smith."

(2) To show a disbursement of seller's (net) sales proceeds to QI labeled something like "1031 funds to QI".

(3) To show the QI's / exchange fees as a seller's expense and paid via sales proceeds; and

(4) To have both QI and Exchanger sign the HUD as Seller.

Replacement Property: Often QI's will request the closer to amend the Buyer / Replacement Property HUD:

(1) To identify the buyer as some version of "1031 Exchange Corp. as QI for John Smith."

(2) To show an entry of incoming funds for Buyer regarding Exchanger's 1031 funds labeled something like "1031 funds from QI".

(3) To show the QI's / exchange fees as a Buyer's expense and paid via Buyer proceeds; and

(4) To have both QI and Exchanger sign the HUD as Buyer.

The above changes to a HUD are typical in exchange scenario, but each exchange and closing is highly fact specific, so other changes to HUDs to further reflect an exchange is quite normal. Again, any change you make to HUD as requested to accommodate a 1031 exchange must be made to you in writing / written 1031 closing instructions, from a proper / authorized party.

Completion of IRS 1099-S Reporting Form. If the Seller is engaged in a 1031, closers should still generate, complete, and give to the Seller an IRS 1099-S Reporting Form - just like in any other case of a real property sale.

Only the seller's / exchanger's information (like normal) should be used when completing this form.

The only thing to be aware in connection with completing the 1099-S when the seller has engaged in a 1031 is to check (current) Box 4. that indicates that Exchanger / transferor may receive property (or services) as part of the consideration.

Also, don't worry about the issuance of the 1099-S to Seller like normal is somehow going to defeat their intended 1031 exchange because: 1) success or failure of the 1031 is on the exchanger not you – success or failure of closing is on you, 2) you'll check Box 4. of the 1099-S, which will eventually be used to evidence the exchanger did an exchange in connection with his/her sale of the property, and 3) the exchange will report the exchange via IRS Tax Form 8824 anyway, which will control.

1031 funds to QI. I assume that most QI's will request the exchange funds be disbursed to them via wire transfer to a designated account of QI. If so, make sure the QI provides you with sufficient and written wire instructions.

Regardless of the method of payment of exchange funds to QI from Relinquished Property closing (wire, check, etc.), make sure you have that delivery method in writing and that you comply accordingly.

Direct Deeding / QI will NOT take title. Please remember that in the vast majority of exchanges (forward – delayed – Starker - all same thing), only the Exchanger will be in title at all relevant times to the Relinquished and Replacement Properties – and the QI will ***never*** come in to title to any of the exchange properties.

Thus, just like normal, the owner / seller / exchanger will deed the Relinquished Property directly to the Buyer (just like normal).

And, the Seller will deed the Replacement Property directly to the buyer / exchanger (just like normal).

The 1031 closing instructions from the QI should specifically state and make these occurrences clear.