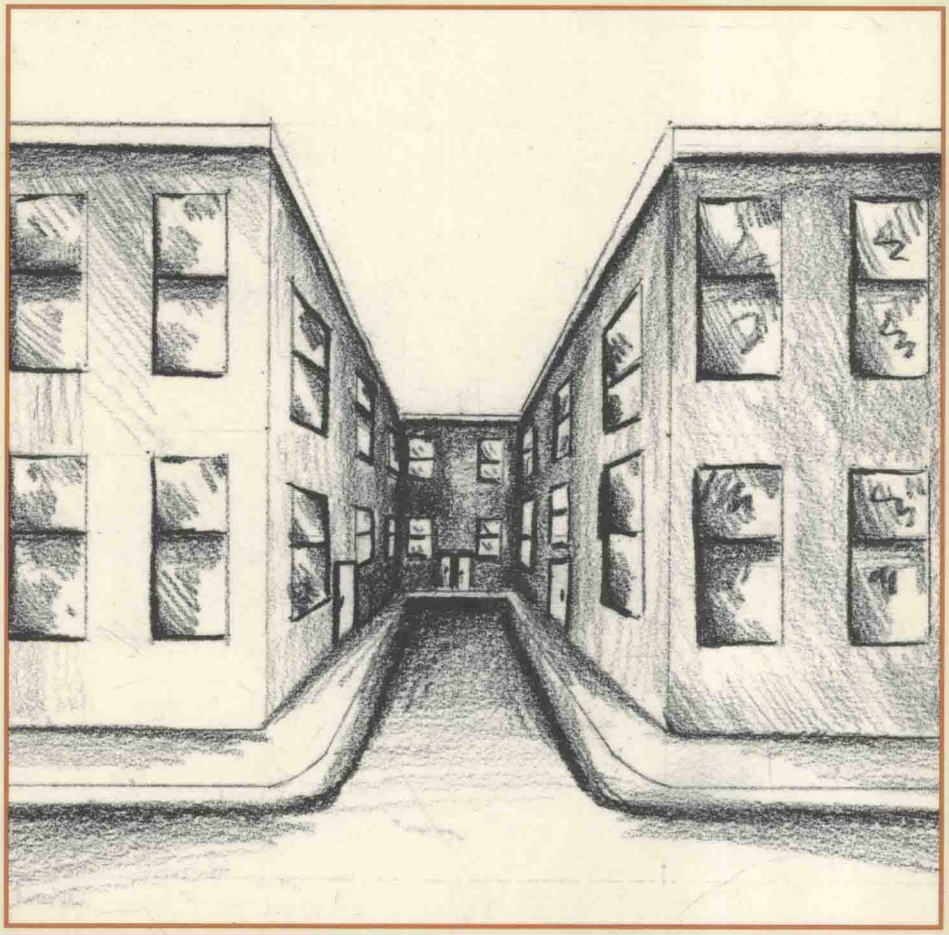
EXAMPLES & EXPLANATIONS

Real Estate Transactions

Fourth Edition

Barlow Burke



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Examples and Explanations
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Examples and Explanations

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Preface

This book is intended to supplement law school elective courses in real estate conveyancing and transactions, mortgages and finance, and business planning and investment in real property. First-year students whose basic property course deals with real estate transactions will also find the first part of the book helpful. *Real Estate Transactions: Examples and Explanations* covers basic information needed for these courses and deals with the issues and leading cases likely to be discussed in class. It is divided into three parts: transactions, financing, and business planning.

Real Estate Transactions: Examples and Explanations begins with simple residential transactions and proceeds to more complex commercial transactions. It discusses the various actors who play a role in these transactions and presents them in the chronology in which they are likely to appear. This book traces the general organization of the leading casebooks on the subject.

Explanations of the examples (or problems) are provided for your convenience. After reading the examples, I recommend that you pause to think about your answer. You will profit from considering your own explanation, and you may enjoy arguing with mine. That kind of mental engagement is the real value of a book like this.

The four editions of this book have been prepared during very different real estate markets. Many of the additions to the current edition reflect changes in the marketplace.

This edition has retained the most valuable features of its predecessors: condensed documents of various types, abridged statutes, and, above all, example after example. New examples emphasize trends in the current market. Examples from the previous editions that proved especially instructive have been retained.

My hope is that this book will help students to understand the issues and cases that comprise real estate transactions, a fascinating and basic field within the general practice of law.

Barlow Burke

April 2006

Acknowledgments

A teacher is constantly learning and relearning the subject he teaches. I am grateful, first, to the authors of the many casebooks I have used over the years, as well as the authors of the treatises I've consulted and of the numerous law review articles and cases I've read to stay current in the field. Second, my students' comments and questions in class have proven to be a wellspring for this book. I thank them all, too numerous to mention. Third, all my research assistants over the past decade — most recently, Julie Richmond, Catherine Brown, Les Alderman, Stephanie Quaranta, Catherine Thomas, and Meryl Eschen — have pursued the answers to my questions with steady and patient research. Finally, at Aspen Publishers, Carol McGeehan, Jessica Barmack, and John Devins have provided steady encouragement. I thank all.

REAL ESTATE TRANSACTIONS

Examples and Explanations

Contents

PART ONE

Law of Conveyancing

1

Introduction to American Conveyancing

An attorney's real estate practice in this country is likely to present matters arising in residential purchase and sales (home sales, in the jargon) and/or commercial transactions involving real property. In the former capacity, the real estate attorney functions amid the work of many other actors — brokers, property inspectors, surveyors, mortgage lenders, appraisers, title abstractors, title insurance companies, to name a few of the principal ones. Succeeding chapters will deal in more detail with each of these. Often residential work comes to the attorney's attention in mid-transaction — most significantly, after the contract of sale has been executed. Thus, often in home sale practice, the attorney's role is limited by the contract, and is limited to interpreting the contract as the executory period proceeds.

In commercial transactions, the attorney's role is more akin to other areas of corporate or commercial practice. The attorney is interested in limiting the risks the client faces in proportion to the rewards the client expects. This entails a balancing of business and legal concerns in the context of reviewing the title of the property to be purchased, selecting a note and mortgage, and negotiating their covenants. The following documents detail the typical transaction:

1. The broker's listing agreement. It is the real estate broker's employment contract and defines the terms of the broker's agency with the vendor. The purchaser in a commercial transaction may employ a broker as well.

2. The contract of sale. Whether the attorney helps negotiate the contract of sale, or is given it only after the fact to interpret and implement, it is the product of two English statutes: the Statute of Frauds (1677), one of whose sections required a writing for the transfer of interests in real property, and the Statute of Uses (1535). The latter Statute, you will recall, validated a new form of future interests, known as executory interests. (Thus the period of time between the execution of the contract and the closing is known in this country as the "executory period.") Americans have taken the common law contract of bargain and sale, added the idea of an executory contract as it developed in the eighteenth century, and adapted it for use here — that is, filled it with conditions, contingencies, and "subject to" clauses. In some regions of the country, escrow instructions implement the contract.
3. The note, along with a mortgage or deed of trust. These provide the financing instruments — an IOU and a security agreement for the loan — necessary for either the vendor or a third-party (often an institutional) lender to provide a loan to finance the purchase of the property.
4. Closing documents. The deed from the vendor to the purchaser, plus a welter of documents that (1) account for the money changing hands in the course of the transaction, (2) protect the lender from defenses to the note or mortgage, (3) protect the purchaser's title as offered by the vendor (for example, the title certificate of an attorney or the title insurance policy), or (4) indicate compliance with various state and federal consumer and regulatory statutes. Americans have rarely used earlier, common law forms of conveyancing, such as livery of seisin. Instead, most American states, early in their history, adopted statutes authorizing the transfer of title to real property by simple forms for deeds and also authorizing the recordation of all documents transferring an interest in realty on the public land records, usually maintained at the city or county level. Thus from the beginning, the practice of law involving real property was a documentary practice, the documents memorialized on the public record and available later as evidence of the history of the title transferred. The system of public records relies on each and every purchaser of an interest in real property promptly recording in their turn.

An attorney may be involved in the preparation of all of these documents, ranging from filling them out to drafting them completely. Whether in residential or commercial work, the attorney is arranging a transaction that both parties consider will work to their benefit, adjusting the risks to be commensurate to the benefits expected by the client. The work is not adversarial in the same sense that litigation is — although, in changing markets and

circumstances, it can come to that. It is when markets and circumstances change or unanticipated risks arise, that professional responsibility issues also are likely to arise. Those issues are the subject of the next section.

With the Statute of Uses providing a legal mechanism for executing contracts of sale, and the Statute of Frauds requiring written contracts and deeds, Americans added another new element to their conveyances — the public record, from which vendors could show title to their purchasers.

The earliest purchasers were interested in only one interest or estate in real property — the full fee simple absolute. Anything less felt reminiscent of the feudal tenure relationships that Americans had left the Old World to escape. Thus early American legislatures enacted legal reforms to make the fee more freely alienable with regard to feudal interests: They abolished primogeniture, abolished the common law presumption for the joint tenancy with a right of survivorship in favor of the tenancy in common, and limited the common law marital estates of dower and curtesy to land seised at death. Thus far did they go to make real property free of familial interests. Yet, at the same time and in line with the view of land as a commercial commodity, state legislatures also created restraints on the fee for commercial interests (such as mechanic's liens, permission to tack junior and senior mortgages, and new forms of mortgage foreclosure) — interests unknown in Great Britain. Thus, at one and the same time, conveyancing was made both simpler and more complex.

While the public records reflected the state of the title, it yielded its answers as to what a particular grantor has to transfer with some difficulty. With the passage of time, as the records came to reflect a greater number of transfers, this difficulty became extreme. In theory, the records had to be searched on each and every transfer back to the sovereign — the proprietor of the colony, the king, or the state or federal land office patent. Eventually, on the mistaken notion that the Statute of Limitations on every conceivable common law writ had run after 60 years, that length of time came to be the period of search for real property titles. However, in states where land was obtained out of the public domain of the federal government (and so not subject to state statutes of limitations), title is often still searched "back to the sovereign."

Attorneys early acquired the skills necessary to search titles, and the law of conveyancing and title search became considered their domain. Of course, attorneys were not available everywhere. A regrettable situation (in this case!) because deeds drafted by laypersons became confused. If a deed of bargain and sale (or, in New York, a deed of lease and release) was not used, the lay conveyancer and often the attorney threw in every legal verb coming to mind. Thus the vendor would "give, enfeoff, grant, convey, bargain and sell, lease and release, covenant to stand seised, assign and transfer" whatever property it was that was changing hands. This potpourri of legal verbs eventually came to mean "what I (vendor) have, I transfer it to you (purchaser)."

Thus the quitclaim deed was recognized. This type of deed is another American conveyancing invention intended to make a title more freely transferable.

A title search is necessary because everywhere a purchaser wants to know not only that the vendor is entitled to transfer the title, but that the title is "marketable" — that is, is transferred in such a state that it in turn can be transferred to another future purchaser. Even in a quitclaim deed, therefore, the law read a standard of marketable title as an implied term. The title searching attorney's job is to determine whether the vendor is eligible to transfer the title and whether there are any liens or encumbrances attaching to it. The attorney's notes on these two issues are gathered together and arranged chronologically into an "abstract of title."

As attorneys did more and more title searches, they accumulated stacks of abstracts as their work product; these abstracts had value if and when they handled a later transfer of the same property. Some firms hired nonattorney employees as title searchers. Thus began the practice of having a lay abstractor search the title and an attorney review the resulting abstract and issue an opinion on the state of the title.

The next question was what to do about abstractor negligence. The possibility of an expensive and time-consuming lawsuit always loomed. Title insurance was devised in response to this threat. The earliest policies were designed to provide a remedy for abstracting mistakes, as well as to protect against interests that the abstractor could not discover by searching the public records. Thus title insurance policies protected against both record and non-record defects. This double coverage became their great selling point. By the beginning of the twentieth century, title insurers were established as abstractors, reviewers, and insurers of titles in many large urban areas. In rural communities, attorneys and abstractors continued to do the business of conveyancing as before. Now, however, the conveyancing industry evidenced three patterns for attorney participation. Attorneys functioned as title searchers, title reviewers, or employees of title insurance companies.

This pattern of participation still means that attorney involvement comes usually after the contract of sale is executed and the executory period under way, at a time when real estate brokers, lender mortgagees, appraisers, property inspectors, and title insurers — and in some regions of the West, escrow agents — are also involved. Some attorneys bemoan this lateness, arguing that the provisions of the contract of sale determine what will happen during the executory period and that, consequently, vendors and purchasers need legal advice while they are still able to affect the provisions of the contract.

In the twentieth century, the reform of American conveyancing patterns has been statutory. One spate of statutes took, the other didn't. First, the failed effort. From the 1890s to the 1930s, more than 20 state legislatures enacted Torrens, or title registration, statutes. Under them, a title search was performed, and a certificate of title was issued; thereafter, a transfer of the