Houser Henry & Syron LLP

# COMMERCIAL TITLE INSURANCE – DO YOU REALLY NEED IT?

Would you buy a used car without checking its condition or receiving some warranty from the dealer? Why then would you buy real estate or a commercial or industrial building without checking its condition and title thoroughly and buying insurance against unregistered or hard to verify claims relating to the property?

In a typical commercial real estate purchase or mortgage loan transaction, lawyers conduct due diligence searches on the property's title. "Title" refers to the legal ownership of property. Searches are made to identify any registered and unregistered claims against the owner and encumbrances that attach to the property. Depending on the circumstances, title insurance reduces the need for these searches by insuring against risks of claims against and defects in the real estate title.

**What is Title Insurance?**

Commercial title insurance is an insurance policy that protects a purchaser or mortgage lender against losses from defects in a property's title. Having a defect in the title can restrict the property owner's ability to sell, mortgage or develop the land and may reduce the value of the land.

Depending on the policy, title insurance protects the insured against losses from:

- Unknown defects in title (a defect in title prevents the property owner from having claims free ownership of the property);
- Unregistered liens against the property's title (e.g. where the previous owner had unpaid utilities, unregistered easements, municipal work orders etc.);
- Encroachment issues (e.g. where a structure on one property encroaches onto a subject property);
- Title fraud; and
- Errors in surveys and public records.

Where the insured is a purchaser, a typical title insurance policy compensates losses up to the purchase price of the property. Where the insured is a mortgagee, coverage generally extends to the outstanding mortgage principal.

**The Limits of Title Insurance**

Title insurance compensates for economic loss but does not guarantee every defect in title will be fixed. Sometimes the insurer will repair the defect. A repair may involve litigation with third parties to obtain recourse. In some cases the insurer will pay compensation for economic loss. A commercial purchaser, for example, may prefer to know all title issues that affect a property before it acquires that property. Being compensated for an incurable title defect may not satisfy a developer if they end up stuck with a property they cannot develop.

There are also some losses which title insurance does <u>not</u> cover. These include:

- Title defects that were known by the insured when the property was purchased;
- Environmental hazards, such as soil contamination;
- First Nation land claims;

- Problems that would only be discovered by a new survey or inspection of the property;
- Liens or encroachments not listed in public records;
- Zoning bylaw violations committed by the insured property owner; and
- Non-title related issues, such as property damage.

To illustrate the limits of title insurance, the 2014 Ontario Superior Court decision *Zabanah v Capital Direct Lending Corp. and Chicago Title Insurance Company* ("**Zabanah**") demonstrates the importance of understanding the limits of your title insurance policy.

Zabanah bought a second mortgage for investment purposes. The property was also subject to a first mortgage in favour of a third party. The second mortgage was protected by title insurance; however the policy excluded claims for losses associated with the property's first mortgage.

The mortgage debtor went bankrupt and the mortgaged property was sold by the first mortgage holder under a power of sale. After the net proceeds were paid to the first mortgagee, nothing was left for Zabanah. Zabanah made a claim for her losses to the title insurer but the claim was denied.

Zabanah argued at trial that the title insurer provided compensation for losses suffered as a result of the debtor's bankruptcy. The court, however, rejected this claim. The court said that the title insurer did not provide "investment insurance". What the plaintiff insured was a valid and enforceable second mortgage, which was subject to a pre-existing first mortgage. The plaintiff's losses were the result of the first mortgage's prior right to the proceeds of sale of the mortgaged property. Zabanah's losses were excluded under the title insurance policy and she was not entitled to compensation for the value of her lost mortgage investment.

**Our Practice at HHS**

When buying a building, we recommend a full search of the registered title and off-title searches and enquiries to ensure that the property can be used as the purchaser intends. We also typically perform the same full title search when acting for a mortgage lender. Title insurance can eliminate the need for some searches or supplement the searches by insuring over specific matters. On the other hand, if a client is purchasing vacant land it is not uncommon to obtain title insurance instead of performing all the available title searches or requiring a new survey of the property. In deciding between title insurance and a lawyer's investigation of title, each situation must be looked at independently.

Should you like further information, please do not hesitate to contact one of our experienced commercial real estate lawyers. We would be happy to help.

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***About Houser Henry & Syron LLP***

For over 75 years, Houser Henry & Syron has helped entrepreneurs and private companies of all sizes grow and prosper. We provide a range of business law services - from assisting with day-to-day legal requirements to providing strategic counsel on highly complex transactions. We are uniquely positioned to provide high-quality legal advice, tailored to the specific needs of our clients, at a reasonable price.