

## Title Insurance Products for Co-Ops: Rethinking Strategy

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Over the past several years, the prices for New York area cooperative apartments have soared. With such higher values comes a commensurately greater impact in the event of a title loss, and yet, until recently, title insurance products offering protection comparable to that which is available for real estate have been limited.

Historically, cooperative apartment buyers and their lenders instead have relied on the assurances of competent due diligence backed up by the malpractice insurance of their attorneys. But in the new pricing stratosphere where ordinary two bedroom co-ops are trading in the several-million-dollar range, attorneys, too, are faced with greater potential risk for even the smallest error.

Traditionally, lenders and buyers have required title insurance protection for loans on and acquisitions of real estate and condominiums. Because a cooperative apartment is not real estate but a purchase of an interest in personal property in the form of stock in a corporation (that either owns a fee or leasehold interest in an apartment house) together with a long-term lease of a particular apartment, many lawyers have not obtained title insurance protection for their clients on the purchase or financing of a cooperative apartment unless there was a particular, known risk. Liens for security interests against cooperative units are perfected by Uniform Commercial Code filings against the owner's name, indexed in certain counties, such as in the city of New York, in the land records in the county in which the cooperative building is located.

### [The Usual Case](#)

In a typical transaction, the purchaser's attorney asks the search company to perform a Cooperative Apartment Lien Search, which searches for UCC filings, judgments and liens against the cooperative corporation or sponsor in an initial sale or the seller in the case of a subsequent sale. Where the purchaser intends to use lender financing to acquire the unit, the lender generally requires searches to be run against the purchaser as well. The search reveals whether there are any security interests perfected and attached to the shares of stock and whether there are any judgments or other liens filed against the seller and, if applicable, the purchaser. The search will also furnish information as to any open mortgages of record on the building.

A diligent practitioner will also review the minutes of the last year's board of directors meetings of the cooperative corporation to check for any pending costly capital improvement projects or potential litigation. Usually, this is the extent of due diligence in a cooperative unit acquisition. No title insurance is purchased.

Note that, in the case of a condominium unit or other real estate sale, a title insurance policy will likely be part of the transaction. Counsel can explain to its client just what protection the client has, when it arises and what to do if the policy protection must be relied upon.

None of this is the case with respect to a Cooperative Apartment Lien Search. The issuer's liability is presumably based only on a cause of action in negligence of the company in conducting its search, which is often difficult to establish.

Most companies impose a limitation on liability in their Cooperative Apartment Lien Search. Furthermore, the protections of a title insurance policy that the real estate practitioner is accustomed to are not available in the Cooperative Apartment Lien Search. There is no duty to defend the title nor to bear the cost of any defense.

Sometimes, where there are concerns about the source of title (e.g., a sale out of bankruptcy or a divorce, for example), a Title Insurance Rate Service Association Inc. (TIRSA) leasehold title insurance policy may be purchased for the benefit of the purchaser of the unit and/or its lender. The policy insures the purchaser against any adverse matter that would attach to or encumber the shares of stock it is purchasing in the cooperative corporation. A TIRSA lender's policy insures the lender, who has taken possession of the stock certificate and filed a UCC-1 financing statement putting the world on notice of its security interest in the shares, that it has a valid, perfected, lien.

Additionally, the title insurance company can issue a TIRSA cooperative endorsement to either policy, insuring that the cooperative corporation has been duly formed and has good title to the cooperative's land and building. This endorsement also insures that maintenance charges on the unit have been paid through the transfer date. The premium for the TIRSA leasehold title insurance policy with the cooperative endorsement is 70 percent of the standard rate charged for policies on real property.

Although cooperative leasehold title insurance has long been available in New York, because the ownership interest being purchased is personal property not real property and, accordingly, coop purchase loans are not secured by leasehold mortgages but rather by pledge agreements secured by UCC 1 filings, such insurance has never become customary.

#### [New Insurance Product](#)

Recently, however, a moderately priced insurance product which specifically insures a buyer's title to its cooperative interest has become available. The new Eagle 9 (r) UCC Cooperative Interest Insurance Policy for Buyers<sup>1</sup> affords coverage against loss or damage if any person other than the insured has rights in the Cooperative Interest (defined in New York's version of Article 9 of the UCC Code to mean "an ownership interest in a cooperative organization, which interest, when created, is coupled with possessory rights of a proprietary nature in identified physical space belonging to the cooperative organization"), a security interest, or if there is a creditor lien or a federal or state tax lien in any portion of the cooperative interest. The Buyer's Policy also insures against loss if there is a claim under the policy's other insuring clauses arising out of an adversary proceeding filed by or against a secured party under the Federal Rules of Bankruptcy Procedure 7001 (2) to determine the Unencumbered Status of the cooperative interest or that the insured did not have rights in the cooperative interest.

#### [Situations That Are Insured](#)

The following are some of the not inconceivable situations the Buyer's Policy insures against:

- A person other than the insured claims rights of ownership.

- A lender attempts to enforce a wrongfully terminated financing statement. July 1, 2001 was the effective date of the revision to Article 9 dealing with secured transactions under New York's Uniform Commercial Code. Lenders and their counsel should note that when a security interest in a cooperative interest was perfected by filing before July 1, 2001, either a UCC Financing Statement Amendment (Form UCC3) filed as a "Continuation," which provides perfection of the security interest for only five years, or a Cooperative Addendum, which

provides perfection of the security interest for 50 years, needed to have been filed prior to July 1, 2006. Failure to correctly comply with the foregoing has resulted in the lapsing of numerous UCC-1 filings perfecting liens against cooperative interests. Additionally, there has been some confusion at certain recording offices regarding the provisions of revised Article 9. Certain UCC3 Continuations filed in April 2006 have an incorrect expiration date of 50 years, whereas certain UCC3 Continuations filed in June 2006 have correct expiration dates of five years. Future litigation on the validity of these filings is inevitable.

A cooperative unit is transferred without knowledge that the seller of the unit is in bankruptcy. An undisclosed bankruptcy of the seller is a significant risk for there may be nothing in the local bankruptcy records to disclose the facts. Whereas an innocent purchaser for value of real property from an undisclosed bankruptcy is protected by §549-c of the Bankruptcy Code so long as there is no notice of the bankruptcy in the bankruptcy court in the district where the property is or in the county's land records, no such protection exists for a co-op purchaser, because a co-op is not real property.

A federal tax lien filed against the seller in a jurisdiction in which he or she also has a residence is being enforced against the unit. Unless the search company is instructed to search for liens and filings in that other jurisdiction, the federal tax lien may not be revealed by the search in the initial jurisdiction.

A claim is asserted that the person transferring the unit on behalf of the seller-entity did not have the authority to do so.

Claims to ownership of the unit are asserted, or a proceeding is commenced to enforce a lien in a bankruptcy.

A lender attempts to enforce an unknown, filed but misindexed financing statement.

A unit is transferred to the insured after notice is served that a judgment is being enforced against the unit.

The federal or state government attempts to enforce a federal or New York State tax lien filed against the seller.<sup>2</sup> Note that where a federal tax lien is misfiled by a recording office (as against a "corporation" instead of against an "individual," for example), a Cooperative Apartment Lien Search would not disclose the lien. However, if the buyer or lender had purchased either a TIRSA leasehold title insurance policy or an Eagle 9 (r) UCC Cooperative Interest Insurance Policy, the insurer would be contractually obligated to defend and, if necessary, pay the claim.

A claim is asserted that the seller did not have the authority to transfer the unit due to a claim of fraud or undue influence.

A claim of ownership is asserted by an heir or legatee of a deceased seller.

A claim of ownership is asserted by a person to whom the stock and proprietary lease relating to the unit was transferred when it was claimed at closing that the stock and lease were lost.

As with other title insurance products, the insurer will also pay costs, legal fees and expenses incurred in defense of the title insured title.

The premium to purchase an Eagle 9 (r) UCC Cooperative Interest Insurance Policy for Buyers is more moderately priced than that of a TIRSA Coop Leasehold Owner's Policy. Significant simultaneous issuance and refinance discounts are available for a lender's UCC Cooperative Interest Insurance Policy.

The cooperative corporation's records and other records maintained by the managing agent depend for accuracy and completeness upon the competency, accuracy and integrity of the persons who have maintained them over the years. Total reliance on those records can result in misinformation and financial loss that may be difficult or impractical to recover. Over the course of time, managing agents change and officers of the corporation retire or sell their units, all of which can lead to missing or incomplete records and potential liability for the corporation and, indirectly, its shareholders. A Cooperative Organization Endorsement to the Eagle 9 (r) UCC Cooperative Interest Insurance Policy for Buyers can, if purchased, protect the cooperative corporation against loss if any person other than the insured unit purchaser, or his or her seller, asserts or has rights in the cooperative interest.

#### Conclusion

As New York City cooperative apartment prices continue to rise dramatically, generating commensurately greater impact in the event of a title loss, and as frequent misindexings on the part of recording offices and misfilings on the part of lenders in the wake of the July 1, 2006 revised Article 9 filing deadline occur, many buyers, lenders, cooperative corporations and their attorneys are reconsidering the protections offered by both the TIRSA Coop Leasehold Title Insurance Policy and the more moderately priced Eagle 9 (r) UCC Cooperative Interest Insurance Policy.

- 1. The new Eagle 9 (r) UCC Cooperative Interest Insurance Policy for Buyers is available only from First American Title Insurance Company of New York.*
- 2. A filed financing statement complying with §§502(A) and (B) is effective even if the Filing Office is required to refuse to accept it. §9-520(C). In addition, a misindexed record remains effective. §9-517.*

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