

A Practical Guide To Title Review

(With Form)

Shannon J. Skinner

The standard title insurance policy might have some things you need and some things you don't.

The safe course is always to review the specifics of the transaction and structure the coverage accordingly.

FEW REAL ESTATE TRANSACTIONS are closed without a title insurance policy. In most real estate transactions, at least one party's satisfaction with the state of title is a key condition to the closing. Indeed, some transactions close only because of the insurer's agreement to provide coverage for a title problem that otherwise

would cause the transaction to collapse. But the title insurance policy does not magically appear at closing. Much of a real estate lawyer's effort in closing the transaction is directed to reviewing the state of title, resolving issues with the title, determining which title risks are acceptable to the client, and deciding what types of af-

Shannon J. Skinner is a partner with Preston Gates & Ellis LLP, in Seattle, Washington.

firmative coverage are appropriate for the client and the transaction. Thus, competent review of the preliminary title evidence and resulting policy is an essential skill for the real estate lawyer.

Few guides, however, exist to explain how to review the title evidence or the policy. This article discusses some practical tips for title reviews and includes as Appendix 1 a Memorandum form to be completed as part of the review process as well as a sample review/memorandum. A note about surveys: Conducting a comprehensive title review is impossible without a current survey of the property. The following discussion assumes that a current survey is available for the title review.

TITLE EVIDENCE • The first step in reviewing title is to determine the type of title evidence under scrutiny. Preferred for most sophisticated real estate transactions is a preliminary commitment for title insurance prepared using the American Land Title Association (“ALTA”) form. The preliminary commitment is not a report on the status of title but rather is a contract in which the insurer agrees to issue a policy subject to the conditions, exceptions, and exclusions shown in the commitment. Commitments are valid for a certain period of time (generally six months) and must be extended if necessary. They are organized in much the same fashion as title policies.

Reports vs. Commitments

By contrast, title reports and abstractor’s reports are true reports on the status of title as of a certain date and do not include the assurance of policy issuance provided by a commitment. Nevertheless, the terms “report” and “commitment” are often used interchangeably and their availability varies by jurisdiction. So, as a preliminary matter, the title reviewer should determine the type of title evidence both required and available. The following discussion as-

sumes that the reviewer is reviewing a preliminary commitment.

SCHEDULE A MATTERS • The first matters to review in a preliminary commitment are those that will appear in Schedule A of the title policy. These are generally the first matters shown in the commitment and should be noted on the title review memorandum. These include:

- Date;
- Type of policy;
- Policy amount;
- Names;
- Quality of estate; and
- Legal description.

Date

The date of the commitment is important—how old is the information? Could a real estate tax payment have become delinquent since the commitment date? Has the commitment expired? Should it be updated?

Type Of Policy

The commitment will also show the type of policy the insurer is committed to issue. Most sophisticated parties in real estate transactions require a policy issued on an ALTA form if available in the jurisdiction. The question usually focuses on which ALTA form to use. The ALTA most recently revised the lender’s and owner’s policy forms in 1992. Nevertheless, many insureds (in particular institutional real estate lenders) insist on the 1970 or 1970 with 1984 revisions form of policy. Because one of the main differences in the 1992 form is the inclusion of the “creditor’s rights exception,” which is objectionable to many proposed insureds, any issues with the form of policy should be raised early. This will provide the insurer with adequate time to review the draft documents and

transaction structure to determine if it is comfortable removing the creditor's rights exception. This issue may be easily resolved in a typical mortgage loan transaction but may be quite difficult in a post-foreclosure policy or leveraged buy out transaction, so addressing this issue sooner rather than later is beneficial.

As between the 1970 and 1970 with 1984 revisions forms, many insurers prefer the later version because it narrows the definition of "public records" to be the traditional real estate records (and not other public records such as the Federal Register) and expressly excludes environmental matters unless a lien therefor is recorded in the records in which these liens should be recorded (often the federal courthouse for CERCLA liens). Because insurers have argued that the 1970 form of policy did not include any coverage for environmental matters (being "police power" matters excluded under Exclusion 1), some insureds prefer the 1984 revisions so as to at least have coverage of recorded environmental liens.

Update Underway

ALTA is currently in the process of a comprehensive update of its loan policy form. Unlike earlier form changes, which primarily addressed legal developments, the current undertaking promises to substantially update the policy to deal with changes in the mortgage finance marketplace as well as the title industry. Look for promulgation of this form by early 2006. The new form could well become the policy of choice for lenders.

The Practicalities

An additional issue may be that not all title company offices in all counties have the earlier policy jackets. Although the ALTA has not withdrawn any of the forms, some offices simply do not stock the earlier jackets and must obtain them from a regional underwriting office.

Policy Amount

The amount of the proposed policy and premium are also shown in the commitment. The insurer should know this amount as early as possible to enable it to determine if the policy will be "high liability"—one needing special internal underwriting approvals. The face amount of the policy is a limit on the amount that the insurer is obligated to pay (together with defense costs). In addition, damages are also capped by the value of the property (without the alleged defect) and the loan amount plus interest (for lender's policies), so the insured does not benefit from either over- or underinsuring its interest. The ALTA 1992 policy forms contain co-insurance provisions, so underinsuring is especially ill advised with these policies. Lender's policies for loans that have negative amortization or future advance features may require special endorsements or a larger face amount, as may owner's policies for property on which the owner expects to construct significant improvements.

Is Co-Insurance Or Reinsurance Needed?

The policy amount should also trigger some thought about whether co-insurance or reinsurance is required. If the policy amount is larger than the insurer's self-imposed limits or those imposed by the client, work should begin early on identifying co- or reinsurers and providing appropriate preliminary information to them. Co- and reinsurance can also add to the cost of the title insurance and these costs should be identified early in the transaction. Often, the cost can be reduced by keeping the co- and reinsurance in the same family of title companies.

Premium Amount

The premium for the policy should also be noted with the amount. This is the appropriate place to inquire about the basis for the premium. Were any applicable discounts (such as

short-term, reorganization or builder's rates) used? Are other insured transactions occurring simultaneously (such as purchase and related financing transactions) for which special rates are available?

Names

It is surprising how often the name of the proposed insured and the name of the vested title holder do not match the draft legal documents. For example, the purchaser's lawyer may learn that the party that signed the purchase and sale agreement is not fully vested in title (perhaps title is vested in a partnership or is jointly held with a spouse), which may raise questions about the enforceability of the agreement. The lender's lawyer may learn that the draft loan documents describe a borrower who is not in title (perhaps a name change or inter-entity transfer has occurred, or a partner never transferred title into the partnership). Resolving any discrepancies here is important. The answer may be as simple as adding a "who took title as" note to the vesting to describe name changes resulting from marriage or merger, or as difficult as requiring a deed to transfer title to the correct entity or re-underwriting a loan for the vested entity.

Quality Of Estate

A quick glance at the type of estate is in order to be sure that the type of estate is as expected. Of course, fee simple estates are most common, but lesser estates, such as a vendee's interest in a land sale contract, a leasehold estate or an easement, will be shown here if applicable. More than one type of estate will also be shown if different parcels are vested differently.

Legal Description

The final important item in the Schedule A matters is the legal description. It may be presented in metes and bounds, platted lots, or sec-

tions. A critical part of reviewing the title is determining that the legal description is identical to that shown on the survey:

- In tracing a metes and bounds description around the survey back to the point of beginning, are there differences between the vested legal description (usually the one selected by the insurer from the last deed) and the on the ground measurements? How are these discrepancies explained?
- Are there typographical errors in the title commitment legal description when compared to the survey?
- For a platted legal description, have boundary line adjustments or short plats changed earlier plats? Has the plat been recorded or are the references to an unrecorded or unapproved preliminary plat? Is a copy of the whole plat included in the exception documents? Are the metes and bounds descriptions from the original plat shown on the survey to help determine if the lot has been correctly depicted?

Easements

The legal description is also the place to show appurtenant easements that are being insured. By describing an easement estate in the Schedule A description of the "Land," e.g., "together with an easement for ingress and egress created by document recorded under no. xxxxx," the policy insures that the insured holds a valid easement (subject to the terms and conditions of the easement and any prior encumbrances on the easement, all of which will be shown in the Schedule B exceptions).

SCHEDULE B MATTERS • Schedule B of the title policy contains the general exceptions from coverage, the special exceptions, and the endorsements.

General Exceptions

The general exceptions are the standard off-record exceptions that apply to all properties rather than those recorded against the specific property. The first four general exceptions are fairly standard nationally and are:

- Exceptions for rights of parties in possession;
- Encroachments, boundary, and other matters that an accurate survey would disclose;
- Easements not shown by the public records; and
- Construction and worker's compensation liens.

The remaining general exceptions vary somewhat by jurisdiction and include exceptions for taxes not shown by the public records, reservations in federal patents, utility service charges, navigation and water rights issues and Native American treaty rights. Whether some, none, or all of the general exceptions remain in the title policy depends on the type of policy requested.

Extended Policies

ALTA policies come in standard and extended forms. A policy becomes "extended" by removing some or all of the general exceptions. A lender's policy is almost always extended coverage and usually all of the general exceptions are removed from the lender's policy (unless special issues are present for the particular property, such as a waterfront title or land on an Indian reservation). An owner's policy may also be extended, but this often involves removing only the first four general exceptions. This is because the risk of loss is much greater with an owner's policy. A defect that causes in a decrease in the value of the insured estate can result in a claim under an owner's policy, whereas that same decrease in value would have to result in inadequate security for the loan after a default (so that the lender was not paid in full) before a loss arises under a lender's policy. Thus, with this more direct possi-

bility of loss, most insurers are not willing to remove all of the general exceptions in an owner's policies. This issue can sometimes be negotiated with the insurer. Notes about the general exceptions that are to remain or be deleted should be shown in the title review memorandum.

Special Exceptions

The next Schedule B-I section contains the special exceptions affecting the particular property described in the commitment. This section contains:

- Easements;
- Covenants;
- Conditions;
- Restrictions;
- Encumbrances;
- Court actions;
- Taxes; and
- Matters relating to the parties (such as issues relating to partnership agreements, authority questions and marital status).

The title reviewer must examine each of the recorded documents corresponding to a special exception and briefly describe the exceptions in the title review memorandum. Each easement or other item that can be located on the survey must be so located. In general, the title reviewer should be looking for exceptions that may cause a problem for the client, either as an owner of the property or a possible future owner (if the client is a lender). These include matters that:

- Interfere with the improvements (such as easements that run under buildings or mineral reservations that allow surface excavation);
- Interfere with the use of the property (such as covenants requiring residential use when the property is commercial); or
- Impose unusual costs on the owner (such as large governmental or owners' association assessments or mitigation covenants).

Some exceptions may have expired or been superseded by later exceptions; these should be deleted. This is also a good place to watch for reciprocal easements that may be shown only as exceptions but have not been added the legal description to obtain affirmative insurance for the appurtenant portion.

Negotiating Deletion Of Exceptions

Experience and familiarity with the client's requirements are key in deciding which title exceptions are likely to be acceptable. In preparing the title review memorandum, it is helpful to separate the exceptions that are potential candidates for removal. This section is the one that may need the most work to ensure that the necessary steps for deletion are taken. Just because an exception is unacceptable does not mean that it automatically disappears; often, the lawyer must discuss the issue with the title officer; obtain releases from satisfied lien holders; provide a current rent roll to remove old, unrecorded leases; require lien releases or bonds for construction liens; or obtain letters from government agencies about the satisfaction of developer obligations. Even the acceptable exceptions may need further work to clarify locations, dollar amounts or particular obligations. Noting the "to do" items in bold or other highlighting with the name of the responsible party in the memorandum is helpful.

The Insurer Isn't An Adversary

The process by which exceptions are removed or refined as closing nears should be viewed as a joint exercise in which the title insurer is a key partner. The insurer is not an adversary against whom points can be scored by removing as many exceptions as possible. The goal is to conclude a closing with a title policy that accurately reflects title with the coverage provided and risks shown that are acceptable to the client. The lawyer is not doing the client any

favours by insisting that the insurer remove an exception on an underwriting basis (when the insurer agrees to take the risk as a business matter without solving the underlying title defect) without the client's full awareness that a possible issue remains that could result in a claim. Many clients would prefer to have the problem solved at the outset, if possible, adjust loan underwriting requirements (e.g., require holdbacks or additional guaranties), negotiate a decrease in the purchase price or perhaps avoid the deal altogether, rather than rely exclusively on a potential claim against the insurer. And, most definitely, the lawyer never should make the decision to ask the insurer to remove or insure over exceptions that will still truly affect the title without consultation with the client. The client must approve of the continued existence of the title defect and agree to rely on a potential claim, which will take time and perhaps litigation to resolve, to compensate it if losses arise from the defect.

Looking To The Future

One additional thought to remember in addressing immediate title concerns is that others dealing with the title in the future may not be happy with the current resolution of a title problem. That is, even though the client may be satisfied to close the transaction with affirmative insurance over a particular title problem, future lenders or purchasers may not be so agreeable and future title insurers may not be willing to provide the same coverage in later policies.

Subordinate Matters

The items to be shown in Schedule B-II of a lender's policy should also be noted in the title review memorandum. These are the items to be insured as subordinate to the insured mortgage. Often, these include tenant leases for which subordination agreements will be recorded at closing or junior financing. Of course, there is no such schedule for an owner's policy, so items

that do not affect the insured estate (such as financing on tenant equipment in a fee owner's policy or fee financing that grants the tenant nondisturbance in a leasehold policy) may need to be introduced with a special note indicating that the following item does not affect the insured estate. Even though an exception may not affect a particular interest, most insurers still prefer to show the item with a special note if the item is recorded against the property.

Notes And Follow-Up

The last part of Schedule B often contains requirements and notes of items the insurer needs before the policy issues. These include requirements to deliver entity documents (including evidence of authority), affidavits to clear up identity issues (for example, to remove judgments that are against persons of similar names) and requirements to provide a survey and affidavits regarding construction and tenant matters (if extended coverage is requested). Again, the lawyer or paralegal reviewing the commitment should assign parties to provide this information and coordinate these efforts to be sure no loose ends delay closing.

Endorsements

Depending on the jurisdiction, endorsements may be available to expand or tailor coverage in the title policy. These endorsements may apply generally or be tailored to address an issue for the specific property. The available endorsements may number as few as a handful in states where the title insurance industry is heavily regulated or over 100 in states following the California model. In some states, special endorsements can be written if a form endorsement does not cover the issue. In others, substantive changes to endorsement forms must be approved by the state insurance commissioner.

Cost

The charges for endorsements vary from zero (such as comprehensive endorsements on lender's extended policies) to thousands of dollars for endorsements that are calculated as a percentage of the premium for the basic policy (for example, zoning endorsements). More title companies now impose charges of several hundred dollars for endorsements that were once free, so counsel should not just provide a wish list of every conceivably applicable endorsement without considering a cost-benefit analysis. Also, costly endorsements should be raised at the outset when discussing the premium for the policy to determine if any applicable discounts apply. Nevertheless, endorsements are often an inexpensive way to address issues that may have otherwise stalled a deal or cost more in attorneys' fees to provide comparable assurances.

Owner's Or Lender's Policy?

When reviewing endorsements, it is important to remember whether they are for an owner's or lender's policy. Because of the more direct risk of loss associated with owner's policies, some endorsements are available for lender's policies to address issues on which the insurer is willing to take the risk for a lender, but not an owner. Certain endorsements may also be appropriate for an extended coverage policy but not a standard policy. In addition, some endorsements may be desirable for the 1992 form policies that are not needed for the 1970 forms (e.g., endorsements deleting the arbitration provision for policies of less than \$1 million or deleting the creditor's rights exclusion). No endorsements may be necessary for a small standard coverage owner's policy, while a dozen or more may be appropriate for a sophisticated commercial lender's extended policy.

Some Common Endorsements

The following is a partial list of some endorsements to be considered, if available in the jurisdiction, for an extended coverage policy on a commercial property:

- *Comprehensive*—provides lender with assurances about the status of covenants, conditions, restrictions, and encroachments;
- *Easements*—provides insurance to lender, and sometimes owner, about the effect of the exercise of easement rights or encroachments onto easements;
- *Covenants, reverters*—provides owner and lender with assurances about the effects of violations of covenants or deed reverters;
- *Minerals*—insures owner and lender against damage to improvements resulting from the exercise of minerals reservation;
- *Access*—insures owner and lender that the land abuts a public, open street or that an appurtenant easement provides access to a public street. Can be modified in some states to provide that street can be accessed from property (i.e., just because street abuts does not mean that access is not somehow restricted). These endorsements address practical access, because the ALTA policy only insures legal access (which may be as little as pedestrian access);
- *Survey*—insures owner and lender that the land described on Schedule A of policy is same land as shown on a particular survey;
- *Contiguity*—insures owner and lender that certain parcels of land described in Schedule A are contiguous with one another;
- *Loan features*—endorsements are available to lenders to address special loan features, such as variable interest rates, negative amortization, revolving line of credit loans, additional advances, truth in lending and usury issues;
- *Zoning and subdivision*—insure owner and lender about current zoning and permitted uses of property and status of legal description as not violating subdivision laws;
- *Assessments*—insures lender that street improvement assessments not shown in Schedule B-I do not have priority over mortgage;
- *Modification, partial release*—insure lender that insured mortgage, as modified, retains priority, except as shown (usually all intervening matters will be shown), or that later partial release has not impaired priority;
- *Assignment*—insures subsequent holder of mortgage that mortgage has not been released or modified and that assignment is valid;
- *Foundations*—insures construction lender that foundation has been built within property boundaries;
- *Intervening lien*—insures construction lender that exclusion 3a (defects created or assumed by insured) will not apply to deny coverage for construction liens even though lender did not fully disburse construction loan;
- *Fairway*—insures owner against lapse in coverage resulting from changes in partnership interests that technically cause a dissolution of the insured partnership under state law;
- *Leasehold*—if the insured estate is a leasehold, the ALTA 13 (owner's) or 13.1 (loan) endorsement are essential. This endorsement, promulgated in 2001, replaced the older leasehold form of policies and are important to adapting the policy to address leasehold issues (e.g., measures of damages, tenant improvements, value of estate);
- *Nonimputation*—insures owner that insurer will not deny liability solely by reason of knowledge imputed to owner from a partner or other agent of owner whose knowledge is imputed by law to the entity (used with transfer of partnership or other beneficial interests or at request of passive financial investor);
- *Aggregation*—insures lender in multistate transaction that the coverage under multiple policies may be aggregated and available as a total for losses on any of the covered properties, up to the maximum amount of the policy.

WHAT'S NEXT? • Producing a title review memorandum, including a “to do” list, assists in keeping track of the issues revealed in the review process. With the client’s approval, this memorandum can be circulated to all interested parties and in particular to those assigned tasks in the memorandum. Continuous follow-up is important to be sure that all issues are promptly attended to.

Get A Pro Forma Policy

Preparation of a pro forma policy may also be appropriate at this point. A pro forma policy is a specimen of the actual policy to be issued. It takes more time before closing to have the insurer prepare a pro forma and negotiate its coverage, but the policy will then be available without delay following closing, saving time at the end of the transaction. Pro forma policies can also be attached to contracts or escrow instructions as an easy short-hand description of the policy required at closing. Pro forma policies are certainly appropriate in complex transactions when time permits. In negotiating the pro forma, however, care must be taken not to ignore the commitment and its requirements for policy issuance or to forget that work must continue on eliminating exceptions.

Due Diligence Review

Obtaining a title insurance policy is not a guaranty that all matters addressed in the policy have in fact been resolved to all parties’ satisfaction. It means that the insured and the insurer have agreed on a satisfactory contract of indemnity for the matters covered by the policy. This does not necessarily substitute for other due diligence, including examining zoning and other land use matters, physically inspecting the property, talking with neighboring landowners and so on. Obtaining extended coverage, even if available without a survey (as it sometimes is for lenders on a risk-underwritten

basis) most certainly does not eliminate the need for careful review of a complete and current survey of the property.

THE POLICY • After all of the hard work in reviewing the title commitment and survey and resolving outstanding issues, the time following closing is not the time to rest on one’s laurels. Mark the calendar to be sure that the policy is timely delivered. And, once delivered, carefully proofread the policy to be sure that it complies with the insured’s instructions for policy issuance. Was the correct jacket attached? Were all requested endorsements included? Were all exceptions deleted that should have been and no new ones shown? If any corrections need to be made, promptly return the policy with instructions on the changes and calendar again the date by which the corrected policy should be returned. When sending the original policy to the client, be sure to keep a copy of the jacket and not just the policy “innards.”

CONCLUSION • The goal of the title review process is to examine the state of title as shown on the commitment, and, together with the client, decide on the appropriate coverages and acceptable exceptions to coverage. Title review is a critical part of the due diligence necessary to help a lender or owner decide to acquire an interest in a particular piece of property. Lawyers and their paralegals are well suited to reviewing and resolving title issues and should view this process as a joint project in which the partners are the client, title officer, surveyor, and the other party and its counsel. Producing a clear written record of the title review in a memorandum form assists with this process. It is not unusual for each project to teach something new about title and title insurance issues; finding this education fun and challenging is what sets “dirt” lawyers apart.

APPENDIX 1
Title and Survey Review Memorandum Form
MEMORANDUM

To:

From:

Subject:

_____ (“Lender”) [“Buyer”] [Loan for \$_____ to
 _____ (“Borrower”) on] [Acquisition of] _____ [project] located at
 _____ (the “Property”) Review of _____ Title Insurance Company (“Title
 Company”) Preliminary Title Commitment No. _____ dated _____ [as supple-
 mented by _____ dated _____] (the “Commitment”); and
 Review of (A.L.T.A./A.C.S.M. Land Title Survey, Job No. _____ dated _____
 (“Survey”) prepared by _____ (“Surveyor”)

I. INITIAL TITLE REVIEW

Schedule A

A _____ form of [extended loan] [standard/extended owner’s] policy required.

Proposed insured should read: _____ .

Title is vested in: _____ .

Title should be vested in: _____ .

Schedule B

General Exceptions. Will request Title Company to delete Items __ through __.

Permitted Special Exceptions. [Lender] [Buyer] will probably find the following special exceptions acceptable (the numbering of the items in this memo corresponds to the numbering of the items in the Commitment): [List items]

Schedule B. Items deleted or to be deleted: [List items]

Schedule B-II. Items to be subordinated (loan Policy only): [List items]

Recommended Endorsements: [State endorsement number and description of endorsement]

Title Company To Do List:

II. INITIAL SURVEY REVIEW

1. The Survey is a _____. The certification [appears to be in order] [does not conform to requirements and must be changed to match sample certification attached].

2. Under the ____ Section of the Survey, the Commitment is correctly identified.

3. The legal description on the Survey [is/is not] identical to the legal description in the Commitment. [Changes required:]

4. Items __ through __ of the Commitment are listed on the Survey.
 5. The information regarding the Flood Zone on the Survey is _____.
 6. The following exceptions are located on the Survey: [List]
 7. Surveyor shows the zoning designation for the Property as _____.
 8. Surveyor shows the following encroachments on the Survey:_____.
 9. Surveyor shows the total area of the Property as _____ acres or _____ square feet. [Lender/Buyer] has approved _____.
 - 10.The total number of parking spaces shown on the survey are: [List regular, compact, handicap, and total]
[Lender/Buyer] has approved _____ parking spaces.
 11. There [are/are not] wetlands on the Property.
 12. There [are/are not] cemeteries/burial grounds on the Property.
- Surveyor To Do List:

APPENDIX 2

Sample Title and Survey Review Memorandum

M E M O R A N D U M

To: Nancy Partner

From: Joe Paralegal

Date: July 29, 2005

Subject: The XYZ Life Insurance Company ("XYZ")—Loan for \$5,685,000 to Odyssey Apartments LLC, a Delaware limited liability company ("Borrower") for the Odyssey Apartments located at 2000 Space Boulevard, Perfect, Washington 98888.

Review of Good Title Insurance Company ("Title Company") Commitment No. 77777-7 dated December 19, 2004, as supplemented by Supplemental No. 1 dated January 5, 2005 (the "Commitment"); and

Review of A.L.T.A./A.C.S.M. Land Title Survey dated January 7, 2005 ("Survey") prepared by In the Field Surveying ("Surveyor").

Loan No. 262626

I. INITIAL TITLE REVIEW

A. Schedule A

A 1970 with 1984 revisions form of extended loan policy is required.

Title Company should amend proposed insured to read: "The XYZ Life Insurance Company."

Title is vested in: Odyssey Apartments, L.P., a Delaware limited partnership

Vesting owner has converted from limited partnership to limited liability company. Borrower's counsel to provide conversion documents and, if necessary, prepare deed from limited partnership to Borrower. Title Company to correct vesting into Borrower.

Need to add appurtenant drainage easement (no. 19) to insured legal description.

B. Schedule B: General Exceptions

Title Company has committed to delete Items A through H.

C. Schedule B: Permitted Items

XYZ will probably find the following special exceptions acceptable. The numbering of the items in this memo corresponds to the numbering of the items in the Commitment.

Items 1.-2. Second half 2005 real property taxes not delinquent until November 1, 2005.

Item 3. Notice of Additional Tap or Connection Charge recorded in 2001 relating to water facilities. Borrower to provide information on amount of change.

Item 5. Re: unrecorded leasehold interests. Title Company to show this item on the Policy as follows: Rights of tenants as tenants only under unrecorded leases with no options to purchase or rights of first refusal. Borrower to provide current, certified rent roll to us and Title Company.

Item 8. Relinquishment of access and air, view, and light rights to Highway 00 contained in deed to Department of Transportation recorded in 1951.

Item 9. Easement reserved in Quit Claim Deed recorded in 1975. Easement for ingress and egress and benefiting the adjacent single family residence on tract 000 over the portion of the existing private road to Simple Boulevard lying within tract 0. Note: Referenced but not located on Survey. Surveyor is reviewing again to see whether she can locate.

Items 10.-11. Special Connection Agreement and Easement recorded in 1976. A permanent easement to Happy County Water District No. 000 for the construction, repair, replacement, maintenance and operation of a water pipeline under the Westerly 10 feet of tract 0. Contains agreement to not protest formation of a utility improvement district or any assessments therefor. Located on Survey and no encroachments shown.

Item 13. Declaration of Restrictive Covenants recorded in 1999. Covenants and restrictions re: construction of project. Run with the land and expire on December 31, 2025. Borrower to obtain status letter from City of Perfect re: all six items (e.g., traffic impacts, landscape plan, erosion control plan). If any of the improvements are installed and completed, that portion of the covenants is terminated without necessity of further documentation. If all items have been satisfied, this can be deleted. If not, request 100.19 covenants endorsement. Borrower's counsel is contacting City of Perfect to obtain status letter.

Item 14. Easement for Underground Electrical System to Super Bright Power & Light Company recorded in 1990. Standard as-constructed blanket easement document for electric transmission. Referenced but not located on Survey. Request Title Company to issue 103.3 easement endorsement.

Item 15. Cable Plus Right of Entry Agreement for Cable TV Company, recorded in 1990. Standard cablevision bulk rate account agreement. Referenced but not located on Survey.

Item 16. Utility Easement recorded in 1991 to the City of Perfect. Easement granted for public utilities (including water). Any improvements existing in the right of way will be replaced in good condition if disturbed or damaged by the City. No buildings or structures are allowed in right-of-way. Request Title Company to issue 103.3 easement endorsement. This easement was recorded in error and has a preliminary description that goes under buildings. Easement at Item 20 is the correct, final easement. Borrower needs to pursue release of this easement post-closing via City of Perfect procedures, which takes several months.

Item 18. Easement for Sewer Lines recorded in 1991 to Happy County Water District No. 000. Permanent easement for sewer lines and appurtenances. Covenants continue re: no fences, trees, bushes or shrubbery will be placed in easement area. Located on Survey and no encroachments shown.

Item 19. Reciprocal agreement for Installation and Maintenance of Drain System recorded in 1991. Contains continuing duties to maintain drain system and retaining wall on our property for benefit of adjoining owner. Also allows drainage from our property to cross adjoining owner's in 10 foot easement area. Need to add appurtenant drainage easement to Schedule A legal description. Located on Survey and no encroachments shown.

Item 20. Utilities Easement recorded in 1992 to the City of Perfect. Easement for utilities, including water and sewer. Grantor does not have right to:

- Erect or maintain buildings in easement area;
- Plant trees, shrubs, or vegetation with deep roots which would cause damage of interfere with utilities;
- Develop, landscape, etc., the easement area which would increase the costs to the City of Perfect of restoring the easement area;
- Dig or tunnel, etc., which would disturb the compaction or endanger lateral support facilities; or
- Blast within 15 feet of right of way.

Located on Survey and no encroachments shown.

Item 21. Matters disclosed by In the Field Surveying ALTA Survey dated January 7, 2005, Job No. 11111-1, as follows:

- Toe of fill encroaches approximately 2 feet, more or less, across the north property line onto the subject property;
- Wood fence located 1 foot west and 2 feet west of property line (two locations);
- End of pipe encroaches 1 foot north of property line;
- Chain link fence located up to 1.9 feet off property lines common with Lot 2 of LLLL Recording No. 22222;
- Title Company to correct typo re: "with" instead of "wits";
- Carport near Building D encroaches into sanitary sewer easement recorded under Recording No. 33333. Request Title Company to issue 103.3 endorsement.

C. Schedule B: Items To Be Subordinated

The following special exceptions should be shown in Schedule B-II as subordinate to the Lender's new lien.

Item 22. Memorandum of Lease to Metered Washing Machine Co. contains automatic subordination language (para. 5).

D. Schedule B: Items To Be Deleted

The following special exceptions should be deleted from the final policy.

Item 4. Assignment of Leases and Deposits from 1995 acquisition by Borrower of subject property from Rich Corporation, Inc.

Item 6. Borrower needs to provide Title Company with all corporate documentation relating to Borrower.

Item 7. ALTA inspection and survey requirement. Affidavit needs to be completed by Borrower re: construction liens and tenants.

Item 12. Deleted by Supplemental No. 2.

Item 17. Deleted by Supplemental No. 2.

E. Recommended Endorsements

The following endorsements should be obtained (using CLTA numbers):

- 100 (Comprehensive);
- 100.19 (Covenants re: Item 13);
- 103.3 (Items 14, 16, and 21f);
- 103.7 (Land abuts on an open street; modified to include access; see attached form for specific language);
- 104.6 (No prior assignment of leases or rents);
- 110.9 (Form 8—Environmental liens);
- 116 (Address);
- 116.1 (Survey);
- 116.4 (Contiguity);
- 123.2 (Zoning, including parking as item (v));
- Subdivision;
- Separate tax parcel

II. INITIAL SURVEY REVIEW

1. The Surveyor's Certificate meets the requirements of XYZ.
2. The Surveyor correctly references the Commitment on the Survey.
3. There is a separate section on the Survey in which the Surveyor has listed easements and agreements referenced in the Commitment specifically Items 9, 10, 12, 14, 15, 16, 18, 19 and 20. Items 10, 18, 19 and 20 were located on the survey.
4. There is a separate parking stall section on the Survey showing:
 - 82 Covered stalls;

- 6 Compact stalls;
- 50 Standard stalls;
- 4 Handicap stalls;

142 Total stalls.

The finance committee approved 144 parking stalls. Mike Smith of XYZ has approved discrepancy.

5. The legal description on the Survey is identical to the legal description in the Commitment.

6. The Surveyor states that the Property is located in Flood Zone "X."

7. The Surveyor states that the Property is zoned Center Suburban (CS). The CS zoning requires:

- Front yard setback of 15 feet;
- No side or rear yard setback.

8. Surveyor shows the total area of the Property as 186,778 square feet or 4.288 acres. Mike Smith of XYZ has approved.

9. Re: Encroachment items to note:

Toe of fill encroaches approximately 2 feet over line from the north (near Bldg. D. and detention pond);

Wooden fence encroaches slightly on westerly property line;

End of pipe is 1 foot over property line on lower northerly boundary;

Surveyor notes that underground drain lines run easterly from retaining wall to approximately 20 feet beyond property line below Bldg. OOO.

Form of 103.7 Endorsement

Attached to Policy No. :

Issued by: BLANK TITLE INSURANCE COMPANY

The Company hereby insures the Insured that said land abuts and has rights of ingress to and egress from [insert name of streets], which are physically open streets that are public streets which are maintained by the City/County of _____, Washington.

The Company hereby insures against such loss which said Insured shall sustain in the event said assurances herein shall prove to be incorrect.

The total liability of the Company under said policy, and any endorsements therein shall not exceed, in the aggregate, the face amount of said policy and costs which the Company is obligated under the conditions and stipulations thereof to pay.

This endorsement is made a part of said policy and is subject to the schedules, conditions and stipulations therein, except as modified by the provisions hereof.

BLANK TITLE INSURANCE COMPANY

By:

Its:

103.7 Endorsement