

3-23-2011 Weekly Insight

What is the Mysterious "GAP" in Title Insurance?

The question, "What is the GAP?" is seldom asked because it is not understood by investors and, frankly, many don't care. It may be the old proverb, "What you don't know can't hurt you" as the skier went sailing over a 2,000 foot cliff. However, the GAP is a very important part of every transaction if you are a buyer and want to make sure you get "good title" to your purchase.

The "GAP" is the time period between the closing of the sale and purchase transaction when a title commitment is issued to the buyer and the actual recording of the seller's deed. Upon recording, an actual title policy can be issued by the closing agent – this recording period can take from one day to several weeks. In between, the title in the public record is in the name of the original seller and technically, but illegally, the former owner can use the property as collateral for a loan, sell to an investor for cash, use as collateral with a bail bondsman to get out of jail, get a loan or a bunch of other devious deeds!

The guys at the title insurers vary in their definition, but generally they call the GAP exceptions the following:

"Defects, liens, encumbrances, adverse claims or other matters, if any created, first appearing in the public records or attaching subsequent to the effective date or attaching hereof but prior to the date the proposed insured acquires for value of record the estate or interest or mortgage thereon covered by this commitment"

In a traditional closing between a seller and a buyer, the closing transaction usually takes place on the same day. Occasionally, there are "escrowed" closings where the funds from the buyer and the signed documents from the seller come together on different days. Generally, the seller signs the required documents and the buyer signs his documents and brings money, and the closing happens. The deed is recorded and the buyer goes forward with his plans for the property. There is no "GAP" if the deed is recorded the same day as the closing – except for the time between when the closing takes place and someone goes to the Clerk's Office to record the deed – maybe a few hours.

Let's next look at a double closing where the original owner/ seller ("A") sells to an investor ("B") and investor ("B") sells to end-buyer ("C"). Often this A – B and B – C transaction is called a "flip" and it can be illegal if not done properly. Even with a cash buyer ("C"), legal problems can exist where the "A" seller is doing a short sale or the investor ("B") is using "C's" money for his closing. Proper disclosure and often times the use of transactional funding is a must to keep these types of closings legal.

Moving further into the transaction, the closing agent for the above two-sided closing takes the two deeds ("A") and ("B") to the recording office and records the deeds, in the same order as their execution ("A" and then "B") and the title is legally transferred. Again, this is true if the same closing agent is doing both sides at his office. The title insurance policy for the end-buyer ("C") is effective when the deed from the investor seller ("B") is recorded.

But what if the A to B transaction is in Tampa and you are in Miami? The Tampa closing agent assembles the signed closing documents that were mailed to the investor "B" to sign and gets a Limited Warranty Deed ("LWD") signed by the original seller ("A"). The closing agent then sends the LWD to the Clerk of the Court in your county for recording. When the title is recorded, the title policy becomes effective. However, between the closing date and the recording date (the GAP) there is no title policy coverage in effect.

Now I should explain the coverage of a title policy, you should know that title insurance insures the past, NOT the future. The title policy you get at closing insures the title to the property to be free of defects since the last title policy. There are exceptions and exclusions, but anything that happens after the title policy commitment is issued at the closing is not covered. The title commitment is only a commitment and is not a valid policy until after the seller's deed is recorded. TO AVOID THIS, IF ASKED, SOME TITLE COMPANIES WILL EXPEDITE THE RECORDING OF YOUR DEED (MAYBE FOR AN ADDITIONAL CHARGE, BUT MAYBE NOT) SOME WILL NOT DO IT, BUT IT DOESN'T HURT TO ASK.

Having said all that, the GAP dramatically comes into play when the first closing agent (out-of-area) sends off the deed to be recorded and it takes 5 – 8 days to finally get posted in the public record. But what if the "B" to "C" closing agent won't close that leg of the transaction until the deed is recorded in the public record AND it is also shown in the attorney's internal network (3 – 5 more days), the buyer "C" could be at risk from the original seller doing something that uses the title as collateral or where a lien is filed against the property.

Some investors won't close until they see the seller's name in the public record. This is being overly cautious and likely their attorney told them to do this. It has probably resulted in more lost deals than if the buyer had closed "timely" with the investor, but that's an individual choice.

Here is the bottom line – Who then is responsible if something happens in the GAP? Remember there will always be a GAP of a few seconds or minutes to days or weeks. The answer is --- Not the seller, not the closing agent (unless he really, really "delayed" the recording of the deed), not the title insurer, and not the buyer! The culprit is the original seller on title who created a fraud on the buyer. Court action will then be required to clear the title.

Some closing agents have gone to "electronic recording" of documents – in the counties where they are available. In these cases, the GAP can be measured in seconds. Again, it is not available from all closing agents and in all counties.

It would be convenient to get a GAP insurance endorsement as a policy rider to cover this anomaly, but it is only offered in a few states and Florida is not one them.