March 2008

Chicago Title EXAMINER

VOLUME 2 / ISSUE 1

Tales From the Vault – Claims Stories

When times are tough, so are the questions asked! A few scary construction scenarios:

Your client is purchasing property, planning to either build new improvements or substantially add to those already in existence. Do you discuss restrictions with your clients? Do you check for amendments, signed by the developer or the association but not necessarily your predecessor in title (who may not have voted, or may not have voted for, the amendment)? Under G.S. 47F-2-117(c), "An amendment shall be indexed in the Grantee index in the name of the planned community and the association and in the Grantor index in the name of each person executing the amendment." G.S. 47C-2-117(c) provides similarly for a condominium. Since most amendments do not require unanimous consent, and only requires vote of those approving, not execution of the document, the amendment may and often is only signed by the association and thus indexed only in the association's name as grantor and grantee and the condominium as grantee.

Your client is running short of construction funds and needs to increase their construction loan. You are closing the "modification". Be sure to get a subordination from all potential lien claimants (i.e. "contractors" dealing with the owner) under Chapter 44A, Article 2, subordinating their inchoate potential lien to the modified loan. Do not try to rely on any earlier subordination or waiver since you are advancing new money and may even be, effectively, creating a novation!

Your client is purchasing new construction, or planning construction with a local builder. What due diligence should you offer to assure that your client is not going to end up in litigation with a distressed builder – whether as purchaser or as an owner contracting? We suggest that all liens against the builder be considered, discussed with the title insurer, and possibly with your client, even if not against the particular property. They may be an indication that your client is next in line for a visit from the sheriff, or litigation because of stalled construction and "subs" filing claims of lien. Does the builder have a good reputation in the community and a long history as a reputable quality reliable contractor? Do you recommend that your client obtain interim waivers at the time of each draw to protect themselves from 1st, 2nd or 3rd tier subcontractors filing subrogation claims under G.S. 44A-23? What other advice do you give your clients to assist them in avoiding stalled construction while they negotiate or litigate about insufficient construction funds to double-pay unpaid subs for contractor defaults?

Mechanics' liens are a significant source of claims all of the time, but especially in a downtrend in the economy. So we, like all title insurers, welcome conversations with you that can help all of us prevent the "hidden liens" from arising - protecting your clients, you and us!

Chicago Title is proud to offer a new and improved Owner/Borrower/Contractor Affidavit and Indemnification Agreement that more clearly addresses the rights and joinder of parties needed to avoid or minimize these risks to your lender and owner clients, for title insurance purposes. The new form is available on our website, www.northcarolina.ctt.com.

Your job just got easier!

Chicago Title EXAMINER
150 Fayetteville Street, Ste. 570
Raleigh, NC 27601

POSTAGE

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CALENDAR OF EVENTS

March 11
CREW Charlotte Membership Meeting
Westin / Charlotte

March 13
March Madness Tip-Off Open House
CTIC Monroe Office

March 13
CTIC Customer Coffee
Coffee Affair / Morehead City

April 8
CREW Charlotte Membership Meeting
Westin / Charlotte

April 10
CTIC Customer Coffee
Island Brews / Southport

April 17
Customer Appreciation BBQ
CTIC Morehead City Office

April 22
Paralegal Seminar for CPE Credit
Comfort Suites / Gastonia

April 23
Paralegal Seminar for CPE Credit
Crowne Plaza Resort / Asheville

April 23
Administrative Professionals Day

May 1-3
NC Bar Real Property Section Annual Mtg
Grove Park Inn / Asheville

May 8
CTIC Customer Coffee
Coffee Affair / Morehead City

May 8
Customer Appreciation BBQ
CTIC New Bern Office

June 12
CTIC Customer Coffee
Coffee Affair / Morehead City

(NOT SO) QUIET ON THE WATERFRONT

CTIC UNDERWRITING TEAM

Trouble is brewing along the waterfront of historic downtown New Bern.

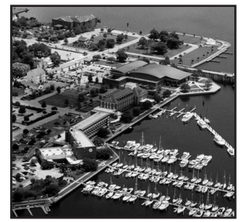
In 1984 the City of New Bern entered into a development agreement with the owner of what has become the Sheraton Hotel. At the time, the agreement was intended to help resurrect the downtown New Bern waterfront which had become blighted. In exchange for developing a hotel along New Bern's riverfront, the developer was provided the right to build and to maintain a marina on the Trent River. The project was part of the genesis that did, in fact, revitalize downtown New Bern into the quaint waterfront community that it is today.

The city has long owned a thirty-foot wide strip of land along the waterfront where it constructed an attractive river walk. In the 1984 agreement, the city granted easements across this strip to the Sheraton for access to the marina. Sometime thereafter, the Sheraton owner requested and received an easement in submerged lands from the State of North Carolina and the Department of Administration. The easement was granted pursuant to NCGS §146-12. For many years now, the Sheraton has operated a public marina on the river in front of its hotel and provided short and long term mooring for vessels. Until recently, there had been no issue.

Late in 2007 the owner of the Sheraton, the Raleigh-based Soleil Group, Inc., notified slip renters in the marina that it intended to increase its docking fees for the marina. Under the proposed fee schedule, the Soleil Group would nearly double the monthly rental charges and impose a forty-foot boat length minimum. Many of the occupants of the marina were incensed at the drastic increase in fees. They were further aggravated when plans to sell boat slips became public. Many of the slip renters simply abandoned the marina, but a group of those who stayed banded together to form New Bern Citizens Against Water Access Rights Encroachment ("New Bern AWARE" or "AWARE").

In recent weeks, New Bern AWARE has gone on the offensive. They have organized petition drives and community meetings. They have appeared en masse at meetings of the Board of Alderman. Their message is that they want the City of New Bern to assert its rights as the riparian owner and to take control of the marina for the benefit of all New Bernians. AWARE has requested that the Department of Administration review whether the grant of the easement in submerged lands to the Sheraton was proper.

Pursuant to NCGS §146-12, the North Carolina Department of Administration (the "Department") is granted the authority to grant easements in submerged lands.



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WHAT'S INSIDE!

SOAP BOX

Heather Clark

Commercial Underwriter

Heather has worked in the Greensboro office of Chicago Title for over nine years and has been a commercial underwriter since 2007. She has already excelled at that position, receiving many customer compliments for her work. She has worked on several complex transactions, including a multi-site transaction for R. H. Barringer Distributing Company and Barringer Leasing, LCC. John Barlow of Tuggle, Duggins & Meschan, PA represented Barringer and stated that Heather was extremely helpful and made the transaction go smoothly. He said they "couldn't have done it without her." Heather also handled a four site referral from Oklahoma. The referring attorney was so impressed with her work that he not only praised her for exemplary service, but also advised he would be referring other clients to the Greensboro office of Chicago Title in the future. Heather's dedication to her job and willingness to provide outstanding customer service make her a true asset to the Greensboro office of Chicago Title.

WELCOME LIZ!

On December 10, 2007, Liz Chernewych joined Chicago Title as Manager of our Monroe office. Liz comes to us with 18 years experience in the legal real estate field, most recently with the firm of Weaver Bennett & Bland. Her prior experience includes duties as a real estate closing paralegal and management responsibilities for a title company in Ohio. Liz is married with two young boys who keep her busy. Please join us in welcoming Liz!

SAFE HARBORS - §1031 EXCHANGE NEWS

Do Vacation and Second Homes Qualify for IRC §1031 Treatment?

It has been established that vacation or second homes held by the Exchanger primarily for personal use do not qualify for tax deferred exchange treatment under IRC §1031. There has been no clear direction when a second home has mixed use, what proportion of rental versus personal use would qualify the property as held in a trade or business. Neither has there been clear direction when a second home qualifies as held for investment. In Moore v. Commissioner, T.C. memo 2007-134, the Tax Court held that properties held for personal use with the mere hope or expectation of gain did not establish investment intent.

The IRS issued Revenue Procedure 2008-16, providing safe harbors effective March 10, 2008, under which the IRS will not challenge whether a dwelling unit that is either a relinquished property or a replacement property in a §1031 exchange qualifies as property held for use in a trade or business or for investment purposes. A dwelling unit is defined as "real property improved with a house, apartment, condominium, or similar improvement that provides basic living accommodations including sleeping space, bathroom and cooking facilities."

The safe harbor for a second home to qualify as relinquished property in a §1031 exchange requires the Exchanger to have owned it for twenty-four months immediately before the exchange, and within each of those 12-month periods the Exchanger must have 1) rented the unit at fair market rental for fourteen or more days, and 2) restricted personal use to the greater of fourteen days or ten percent of the number of days that it was rented within that 12-month period.

In addition, the safe harbor for a second home to qualify as replacement property in a §1031 exchange requires the Exchanger to own the vacation home for twenty-four months immediately after the exchange, and for each of those 12-month periods the Exchanger must 1) rent the unit at fair market rental for fourteen or more days, and 2) restrict personal use to the greater of fourteen days or ten percent of the number of days it was rented within that 12-month period.

For more information, please contact Jeff Hrdlicka in our Greensboro office at 336-931-0750.

PRACTICE PITFALLS
....and how to avoid them

Incorporeal Hereditaments – Not just fun to say!

Okay, we all know that the term "incorporeal hereditaments" is a term that we learned once upon a time in law school. Promptly thereafter, many of us disposed of that knowledge as a curiosity, not likely to affect us in practice. Recently, however, the Court of Appeals considered incorporeal hereditaments in a case that may affect many of us in practice. In Pottle v. Link (No. COA07-359, 2007 N.C. App. LEXIS 2557, 2007) the court visited the appropriate statute of limitations for the enforcement of an incorporeal hereditament.

FYI – The definition of "incorporeal hereditaments" according to Black's Law Dictionary is "an intangible right in land, such as an easement" (8th Ed. 2004). In North Carolina it is: "[a]nything, the subject of property, which is inheritable and not tangible or visible. A right issuing out of a thing corporate (whether real or personal) or concerning or annexed to or exercisable within the same. A right growing out of, or concerning, or annexed to, a corporeal thing, but not the substance of the thing itself." (Karner v. Roy White Flowers, Inc., 134 N.C. App. 645).

In Pottle v. Link, the plaintiffs took title to a lot in a small subdivision in New Hanover County. Plaintiffs' deeds included a thirty foot right of way for ingress and egress over other lots in said subdivision conveyed as an appurtenance. The facts of the case were not in dispute. Defendants had planted oak, holly and cypress trees within the right of way in autumn of 1996, approximately eleven years prior to the commencement of plaintiff's action. In 2004 and 2005, defendants added a post and rope fence. Plaintiffs alleged that the fence and the greenery "impede[d] vehicular traffic within and over the thirty foot easement area." The District Court granted plaintiff's motion for summary judgment and the defendants appealed.

Plaintiffs argued that the injury was similar to an adverse possession which has a limitation period of twenty years. They asserted that even though easements are incorporeal hereditaments, NCGS 1-50(a)(3), which would impose a six-year limitation, should not apply. They relied on Bishop v. Reinhold (66 NC App 379, 1984) in which the defendant's home encroached onto plaintiff's property. The Court swiftly distinguished Bishop as involving an encroachment onto fee title rather than an incorporeal hereditament.

The Court relied heavily upon Karner v. Roy White Flowers (134 NC App 645, 1999) in which the holding was that an action to enforce a restrictive covenant, as an incorporeal hereditament, must be brought within six years.

The basis of the court's decision is that all easements are incorporeal hereditaments by definition. Thus, all easements are subject to the short six-years statute of limitations in NCGS 1-50(a)(3). Of course, this means that easements can be lost rather quickly for failure to assert one's rights to the easement against an encroachment or interference.

Although encroachments and infringements onto an easement are not likely to be matters of record, title attorneys should be careful, in light of Pottle, to consider older easements and any evidence tending to show another's interference with an easement.

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NCGS §146-12(a): The [Department] may grant, to *adjoining riparian or littoral owners*, easements in lands covered by navigable waters…owned by the State for such purposes and upon such conditions as it may deem proper…. [Emphasis added]

The statute plainly states that easements should be granted to adjacent riparian owners and thus follows what is thought to be law in North Carolina that riparian rights are not severable from the riparian land.

The issue of the severability of riparian rights has not has not been directly addressed by North Carolina Courts. However, in Shepard's Point Land Co. v. Atlantic Hotel (132 N.C. 517, 1903) the North Carolina Supreme court did include the following:

"This Court has held that 'riparian rights being incidental to land abutting navigable waters cannot be conveyed without conveyance of such land…'"

There, the Court was quoting the case Zimmerman v. Robinson (114 N.C. 39, 1894) which does not seem to make such a holding. Nonetheless, it appears that North Carolina has adopted the minority position that riparian rights are not severable from the upland.

The Sheraton holds a mere access easement across a portion of the riparian lands which are owned by the City of New Bern. After several weeks of consideration of the request by New Bern AWARE to review the legality of the grant of easement in submerged lands to the Sheraton, the Department turned over the investigation to the Attorney General. At the time of drafting this article, the Attorney General had not issued its opinion.

If the attorney general finds that the easement should properly be granted only to the riparian owner, the City of New Bern, this case may become particularly interesting. The City Attorney and the Board of Alderman have maintained the position that they are not interested in taking ownership of or responsibility for the marina. According to newspaper accounts, the city has indicated its desire to do whatever is necessary to honor the 1984 agreement.

AWARE maintains that "[t]he city is trying to give away $20 million or $30 million in property rights that belong to its citizens." New Bern attorney and AWARE spokesman, Lee Bettis has stated further that "if the city wanted to sell those rights, the time to do it was when they sold the land where the hotel now stands. They didn't do that, so we are prepared to do whatever it takes to protect the legal rights of the citizens of New Bern."

In the event that the City of New Bern attempts to rectify the issue by conveying the riparian land to the Sheraton, certainly they will face the scrutiny of AWARE.

Historically, the North Carolina Supreme court frowned upon the sale by municipalities of "governmental" property (See City of Southport v. Stanly, 125 NC 464, 1899 and Carstarpehen v. Town of Plymouth, 180 NC 26, 1920). Subsequent to these cases, the General Assembly has weighed in on the issue with the passage of NCGS 160A-265 which states as follows: In the discretion of the council, a city may: (i) hold, use, change the use thereof to other uses, or (ii) sell or dispose of real and personal property, without regard to the method or purpose of its acquisition or to its intended or actual governmental or other prior use.

At least one commentator argues that the statute does not give municipalities carte blanche to sell governmental property which may include town offices, parks and the like. David Lawrence of the Institute of Government at Chapel Hill argues that the statute may be interpreted to authorize the sale of only surplus governmental property that is no longer in active use and that some consideration should be given to the prior Supreme Court cases (See Local Government Property Transactions in North Carolina, 2nd Edition by David M. Lawrence, 2000). In Watts v. Town of Valdese, the Court of Appeals considered this very issue and held that the statute did not require that property be surplus in order to be conveyed by the town.

New Bern AWARE has publicly stated its determination to see that the City of New Bern does not abdicate its responsibility to its citizens by allowing the Sheraton owners to profit handsomely by the sale of boat slips in the marina. AWARE has tempered its language regarding the fee increase for rentals and there has been reported a "settlement" in which the Sheraton owners agreed to reduce the fee increase to existing renters.

As we await the Attorney General's opinion, it seems certain that we can expect more fireworks on the New Bern waterfront as the parties attempt to resolve their differences.

LEGISLATIVE CORNER

In the legislative arena, despite this being a Short Session year, two very hot topics for real property practitioners are being actively studied: The dramatic increase in foreclosures (whether lending practices or foreclosure procedures) and railroad rights-of-way.

The Authorized Practice Committee of the State Bar continues very actively investigating settlement shops and unauthorized activities by non-lawyers. Reports are posted regularly at: http://www.ncbar.gov/programs/upl.asp.

Proposed ethics opinions affecting real estate practitioners are still being considered:
- *Proposed 2006 FEO 3 address representation by lender's counsel or trustee of purchaser at post-foreclosure REO outsale (See http://www.ncbar.gov/ethics/propeth.asp)*
- *Proposed 2007 FEO 4 provides guidance regarding seminars, gifts and distribution of business cards to potential clients or referrals. (See http://www.ncbar.gov/ethics/propeth.asp)*
- *Proposed clarification of 2007 FEO 9 regarding a lawyer's obligation to disburse closing proceeds. (See http://www.ncbar.gov/ethics/)*

In 2007, after several years in process, drafts of Uniform General Closing Instructions and Uniform Specific Closing Instructions for 1-to-4 family residential properties (and condominiums) were developed by the Mortgage Bankers Association (MBA), the American Land Title Association (ALTA) and the American Escrow Association (AEA). Current versions are published on-line at:
Uniform Specific Closing Instructions (Comment Draft 10-1-07): http://www.alta.org/images/PDF/usci_draft1.pdf
Uniform General Closing Instructions (Comment Draft 10-1-07): http://www.alta.org/images/PDF/ugci_draft1.pdf

Though the recent comment period expired at the end of January, expect new revisions and further review in the near future! Any attorney doing residential closings should be on the lookout! Please keep checking our website for the latest information and forms, constantly being posted to provide the best possible help to you, your staff and your clients.