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Authors:

[Craig D. Hardwick](#)

The Pointy End of Title Insurance

In the movie *The Mask of Zorro*, Antonio Banderas, playing the masked vigilante, is asked if he knows how to use a sword. He succinctly replies, “Yes. The pointy end goes into the other man.”

A tool is only helpful if you know how to use it. In this respect, swordplay has something in common with title insurance. Recently, I helped a client perform due diligence on some commercial real estate he wanted to buy. I sent him a lengthy email explaining the risks presented by the state of the seller’s title and waited for my client to compliment me on my astute legal analyses. Instead, he asked, “Do I really have to read all this? I thought I was buying title insurance so I wouldn’t have to worry about it.”

My client was viewing title insurance as a shield, which it certainly is. But it can also be an effective sword if you know how to wield the preliminary title report prepared by the insurer in advance of its issuance of the policy. The next time you are in escrow to buy a piece of real property, you will almost certainly receive a preliminary title report as part of your due-diligence package. When you get it, don’t just shove it in a drawer and ignore it. Reading the report and the recorded documents referenced in the report will help you answer the questions below and allow you to take corrective steps that are crucial to any purchase.

Does the Seller *Really* Own the Land I’m Buying?

This is the most basic question answered by the title report. The report will disclose how ownership of the property is vested. Absent outright fraud (as in the old cliché about buying the Brooklyn Bridge), the vested owner identified in the report will normally be the seller named in your purchase and sale agreement. But occasionally the report will disclose discrepancies, such as where the agreement identifies a corporate owner by its trade name rather than its legal name, or where the agreement fails to name a spouse having a community property interest in the land. Identifying and correcting such discrepancies early in the escrow process will help avoid last-minute delays when it comes time to close escrow.

Am I Buying the Land I think I'm Buying?

Now that you know who it is you're buying from, you need to confirm what it is you're buying. The title report will contain the property's "legal description," which identifies the land far more precisely than a mere street address. The legal description can be a simple one-paragraph reference to a recorded parcel or tract map, or it can be a multi-paragraph (or multi-page) "metes and bounds" description prepared by a surveyor that traces the property's perimeter using precise angles and distances. A good title report will often also include a copy of a county assessor's map or other site plan showing the location of the land relative to surrounding properties.

You—or an attorney experienced at deciphering legal descriptions—can use the description and map to verify that you're getting all the land you think you are getting. Review of the legal description can alert you to problems such as the acreage of the land being less than specified in the purchase agreement, the inadvertent omission of a parcel in a multi-parcel transaction, gaps between parcels, or the lack of access to a public road.

What Are All those "Exceptions" Listed in the Report?

Even if the title report proves, more or less, that your seller owns the property, that doesn't mean you'll have absolute control of the property once you become the owner. The title report will include a list (often a long list) of "exceptions" to the insurance coverage that will be provided by the title insurance policy at the close of escrow. These exceptions generally fall into one of three categories: (1) rights of third parties to use some or all of your property; (2) rights of third parties to prevent you from using your property in certain ways; and (3) rights of third parties to sell your property and keep the money. The most common types of these exceptions are discussed below.

Liens

Title exceptions can include a variety of liens encumbering the property as security for the payment of the owner's obligations. Some exceptions show liens voluntarily created by the owner through mortgages and deeds of trust. Others are liens imposed by taxing authorities to secure the payment of delinquent taxes. Occasionally, the list of title exceptions includes liens created by judgment creditors to secure payment of amounts owing by the property owner as a result of litigation. The beneficiaries of these liens all have the right to sell the property without the owner's consent (and without *your* consent once you become the owner) and keep some or all of the sale proceeds. For this reason, purchase and sale agreements generally require the seller to remove all such liens at or before the close of escrow. You will want to make sure that any liens appearing on your title report are removed before you become the owner of the property.

Easements

The title report will likely identify one or more documents creating "easements" affecting the property. These give persons other than the landowner the right to use the land. Once granted, easements usually last for years—often forever—unless and until the beneficiary of the easement agrees to remove or relocate the easement. Some easements may grant utility companies the right to install and operate above-ground or underground wires, pipelines and conduits. Others may grant neighboring landowners the right to place fences or other encroachments on portions of the property. Still others could grant third parties the right to walk or drive across the property to reach "landlocked" parcels having no direct access to a public street. Easements may be *non-exclusive* (requiring the easement holder to share the affected portion of the land with the owner) or *exclusive* (allowing the easement holder to prevent the owner from entering or using the easement area).

In some cases, easements are relatively harmless and may even be necessary to your use and enjoyment of the land, such as in the case of utility easements. But others can be troublesome, especially if you plan to develop the property with new buildings or other improvements. You will want to know the location and understand

the nature of each easement affecting the property before you buy the property. This information will help you determine whether you need to negotiate with the beneficiaries of those easements (either before or after you purchase the property) to have those easements relocated or terminated.

Covenants, Conditions and Restrictions

If the land you're buying is part of an office park, shopping center, or condominium complex, you will likely see one or more exceptions identifying recorded "declarations of covenants, conditions and restrictions" on all of the parcels of land within that development. These "CC&Rs" limit the manner in which each parcel of land can be used. Often, the CC&Rs also require each landowner to contribute monthly or annual fees to pay a proportionate share of taxes, insurance premiums, and maintenance costs for the common areas of the development.

Since modifying or removing the CC&Rs usually requires consent from a majority of the owners of the affected parcels—something that is very difficult for a purchaser to obtain—you will generally have to agree to buy the land subject to the CC&Rs, and you will have to abide by the CC&Rs once you become the owner of the land. Although the CC&Rs can be very long—often 100 pages or more—you (and your attorney) should read them carefully before you close escrow to make sure they contain nothing that will interfere with or prohibit your intended use of the land.

Leases

If the owner of the property has leased it to a tenant before selling it to you, the lease will continue in effect after you become the owner. Leases are normally not recorded but are sometimes referenced in a short-form "memorandum of lease" or mentioned in other recorded documents. This sometimes leads to an old lease appearing on a title report as an exception to title long after the lease itself has been terminated. Your purchase agreement should require the seller to give you copies of all existing leases for your review. You should review those carefully and question the seller

about any leases disclosed by the title report that are not among the leases given to you by the seller.

Options

Before the landowner agreed to sell the land to you, he or she may have granted someone else the right (an “option”) to buy or lease the land. After you become the owner of the land, the option holder can exercise the option to buy or lease the land from you at a specified price—even if you don’t want to sell or lease the land to the option holder. If a recorded option agreement appears as an exception on your title report, you should insist that the seller cause the option holder to formally terminate the option (and record a document evidencing that termination) prior to your becoming the owner.

Reversion Rights in “Ancient” Documents

Decades ago, it was common for sellers of real property to include language in grant deeds reserving a right of “reversion.” This language purported to cause ownership of the property to automatically revert back to the seller if the property were used for purposes prohibited by the language of the grant deed. Common examples of prohibited activities that would trigger the reversion were the sale of the property to members of certain races or nationalities or using the property for the sale of “intoxicating liquor.” Some of these restrictions were created as far back as the late 1800s, creating a risk that an unwary owner could lose ownership of the property by unknowingly running afoul of a decades-old restriction.

Fortunately, most of these reversion rights for properties in California have been abolished by state law. Racial restrictions are automatically void and unenforceable. Other restrictions and reversion rights in so-called “ancient” documents automatically expire 30 years after their creation, unless the original grantor records a notice of intent to preserve the reversion right, at 30-year intervals, under California’s Marketable Record Title Act.

OK, I've now read the report, and I'm comfortable with the exceptions, so why do I need to spend the money to buy the title insurance policy?

The preliminary title report is provided for informational purposes only. It is not binding on the title company. You want to buy the title insurance policy so that the insurance company will cover the costs of any damages you incur as a result of an easement, lien, option, lease or other right that was recorded against the property in public records but overlooked by the title company and not included as an exception in the title report and in the resulting insurance policy. You'll also want the policy because if someone later claims to own your property, or claims to have the right to buy, sell or use it, the title company will pay the legal fees you incur to defeat that claim.

Conclusion

Forewarned is forearmed—a maxim that applies to both good swordplay (à la Zorro) and good due diligence where property acquisitions are concerned. The preliminary title report can alert you to a variety of risks associated with the land you are about to buy. Some of those risks can be mitigated or removed entirely before you take ownership. Others can be managed by careful use of the property after escrow closes and you have become the owner. And some can be so great that you may choose not to purchase the property at all. When properly used, the preliminary title report is an invaluable weapon in the swashbuckling world of real estate.

For more information, please contact the author or any attorney with Frost Brown Todd's [Real Estate Practice](#).

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