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REAL ESTATE

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By Brad Dashoff and John Antonacci

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Understanding Real Property Interests

REAL ESTATE

As you might remember from your property class in law school, real property interests can be acquired and held in several different ways, including as an owner, a possessor, or a party entitled to some future or contingent interest. This article briefly touches on the most common real property interests, and how such interests might be typically applied in “real-world” transactions.

Ownership Interests

Fee Simple Interest. The most common estate for owning a real property interest is the “fee simple absolute,” often shortened to “fee simple.” A fee simple property interest is the broadest estate described under law, and has the following distinguishing features: (i) the owner of a fee simple property interest has the sole power to dispose of such property interest; (ii) upon the current owner’s death, and in the absence of instruction (i.e., a will), the property interest automatically transfers to an owner’s heirs; and (iii) the property interest continues until the current holder dies without heirs. In most situations when a single buyer wishes to acquire real property, typically such buyer will want to acquire a fee simple interest (with no others having joint interests, future interests, or possessory interests that could supplant the buyer’s interest in the real property).

Joint Estates. Joint estates allow two (or more) parties to own title to real property at the same time. However, there are different types of joint estates, each with distinguishing characteristics:

Joint Tenancy. In order to have a joint tenancy, four different “unities of ownership” are required:

1. **Time.** Each owner must receive title at the same time.
2. **Title.** Each owner must receive title via the same deed or instrument.
3. **Interest.** Each owner must receive the same proportionate and equal share of ownership.
4. **Possession.** Each owner must have the identical right of possession. Unlike a tenancy in common (discussed later), a joint tenancy includes the right of survivorship (i.e., the interest held by each joint tenant, upon the death of such joint tenant, will pass to the other joint tenants). If a joint tenant sells or conveys its interest in the real property to a third party,

then the joint tenancy is broken, and a tenancy in common is deemed to have been created.

Tenancy by the Entirety. This is a specific type of joint tenancy that arises between a husband and wife when a single instrument conveys real property, but nothing is stated in the conveying instrument about the nature of such couple's ownership. A tenancy by the entirety entitles a surviving spouse to take title to all of the real property upon the death of the other spouse.

Tenancy in Common. With a tenancy in common, there is no limit as to the number of individuals who can share ownership of a particular parcel of real property. Tenants in common hold one unity or requirement that is similar to a joint tenancy: the right of possession. However, unlike joint tenancies, upon the death of a co-tenant, the interest of the deceased will pass to such co-tenant's heirs (not to the other co-tenants). This type of co-ownership allows each co-owner to choose who will inherit the tenant in common interest upon such co-owner's death. Tenancies in common have often been used among co-owners of multi-unit properties, who each wish to have exclusive usage rights to a particular area of the property, without the formalities associated with establishing condominium regimes, or when ownership needs to be separately held for other reasons (e.g., in connection with a property exchange pursuant to Section 1031 of the Internal Revenue Code [IRC] of the United States). Although each tenant in common owns an undivided property interest (i.e., none of the tenants can exclude the others from any portion of the property), the rights of particular tenants in common can be limited and modified by contract, using what is commonly called a "Tenants In Common" or "TIC" Agreement. Under a TIC Agreement, and unlike joint tenancies, the tenants in common can agree to have unequal shares in the underlying real property. One key feature that may be included in a TIC Agreement is an option that allows some owners to buy out the interests of the other tenants in common. If considering such a mechanism, then the parties must negotiate to establish when the buy-out may be exercised, when or if an exercised buy-out can be refused, and what are the agreed upon buy-out prices. Since the laws governing joint estates and tenancies in common can vary from jurisdiction to jurisdiction, the drafter of such contracts must be aware of the pertinent local laws, which could potentially supersede any written TIC Agreements.

Future Interests and Possessory Interests

Future Interests. When your client is deciding whether or not to acquire a particular property interest, it is important to determine whether any future or contingent interests in such property exist. A future interest may exist with a prior owner of such property (as with a right of reversion), or a contingent interest may exist with third parties (as with options to purchase, or rights of first offer).

It is more common to encounter rights of reversion when a prior owner of a particular parcel of property was a governmental or municipal entity, and in such cases, typically the reversionary right is triggered when the current property owner fails to comply with certain covenants, conditions, or restrictions placed upon the property. For example, when the government conveys property to a developer to build and lease affordable housing for the citizenry, the government places covenants, conditions, and restrictions on the property, which run with the land (i.e., cannot be changed), and which limit the use of the property for that particular purpose. If the developer fails to comply with those covenants, conditions, and restrictions, then the government retains the right to recapture the property from the developer. Note that some states limit the ability to create reversionary interests, and others may not enforce them if the restriction on use violates public policy.

A real-world example of a future interest can typically be found when a large landowner (such as a farm) sells its property in phases. In these cases, the buyer may want the right to buy more of the seller's property, once the seller decides to sell more. As a result, the buyer often negotiates for a purchase option and right of first refusal, to be recorded in the land records, which specifies that before the

remainder of the seller's property can be sold, it must first be offered to the buyer (often at a stated price, or some discount of market), and the buyer then has the option to purchase that property.

Possessory Interests. The most common form of possessory interest is the leasehold estate, which you may recall includes the following varieties:

- the tenancy for years (i.e., a tenancy whose duration is known from the moment of its creation);
- the periodic tenancy (e.g., a month-to-month lease);
- the tenancy at will (i.e., a tenancy that may be terminated by either the landlord or the tenant upon notice); and
- the tenancy at sufferance (i.e., a tenancy arising when a party wrongfully remains in possession after a prior, lawful possession expired).

In today's world of commercial real estate transactions, the most common form of leasehold interest is the tenancy for years.

Understanding Deeds

Deeds are the legal documents that transfer ownership of real property interests from one party to another. Although deeds tend to be fairly short documents, they embody the whole purpose behind the underlying transaction (the transfer of real property), and therefore the deed is an essential component of every real estate purchase and sale transaction. Upon consummation of the real property transaction, the deed is recorded at the local county courthouse or recorder's office where the property is physically located. In a deed, generally the party conveying the property is called the "grantor," while the party receiving the property is called the "grantee." Often, the grantee will want to require that the deed contain certain covenants of title, or assurances that the grantor possesses good and marketable title, with the right to convey the property free and clear from undisclosed encumbrances. Different types of deeds offer varying levels of a grantor's covenants of title, and following is a general description of each type of deed. However, it is important to note that:

- Although different states may use the same term for a particular type of deed (e.g., a "general warranty deed"), the covenants of title actually required for that deed could vary by jurisdiction.
- Different states and local jurisdictions have differing requirements for the types of deeds that may be used when conveying real property interests, including differing requirements for the form and presentation of the deed.
- Therefore, a lawyer must be familiar with the laws of the jurisdiction where the property is physically located prior to preparing and submitting a deed for recordation.

Deeds are fairly short documents that tend not to be technically complex. The following paragraphs will provide an overview of the typical qualities and characteristics for the following most common types of deeds, which will help determine the type of deed that may be appropriate for your client's needs. Keep in mind that state laws vary and the prudent practitioner needs to check local statutes to ensure they use the proper form of deed. The most common types of deeds include:

- General warranty deeds
- Special warranty deeds
- Grant deeds
- Quitclaim deeds

General Warranty Deed

A buyer of real property is best protected by having the property conveyed via a general warranty deed. A general warranty deed expressly guarantees the

grantor's good and marketable title to the property and the grantor's unfettered right to sell the property to the grantee. The guarantee is not limited to only the time the grantor owned the property, but instead extends to the entire chain of the property's ownership (as may be limited in time by certain state or local statutes). In other words, the grantor not only guarantees that clear title was received from the previous owner of the property, but also guarantees that no other parties, past or present, retain an interest in the property. In addition, a general warranty deed also typically includes the following covenants of title:

Covenant of Seisin: A covenant that the grantor has an estate (or the right to convey an estate) of the quality and size that the grantor purports to convey (i.e., the grantor has both title to and possession of the property at the time of conveyance to the grantee).

Covenant to Convey Free from Encumbrances: A covenant that the property is being conveyed to the grantee without any liens or encumbrances (except for those specifically disclosed in the deed).

Covenant of Quiet Enjoyment: A covenant ensuring that the grantee will not be disturbed, or dispossessed of the property, by grantor or a party having a lien or superior title (claimed by or through grantor or any of grantor's predecessors in title).

Covenant to Defend Title: Most importantly, a covenant ensuring the defense of title against claims of all third parties (even if the claim related to a prior period when the property was owned by a party other than the grantor and grantee), and if title is discovered to not be clear (also known as "defective" title), then grantor will compensate the grantee for any resulting damages. Some examples of defects in title include claims of previously unknown heirs, claims of lenders/mortgagees, outstanding tax liens, judgment liens, or materialmen's liens.

Special Warranty Deed

With a special warranty deed, the grantor limits the title warranty given to the grantee to anyone claiming by, from, through, or under the grantor (but not any predecessors in title). By using a special warranty deed, the grantor is only warranting to defend title against grantor's own actions or omissions, and the grantor does not warrant to defend against title defects that existed before the grantor's ownership of the property. The special warranty deed is not nearly as protective of the buyer as is the general warranty deed, and therefore, sellers prefer special warranty deeds over general warranty deeds for conveying real property interests.

The argument of whether to use a special warranty deed over a general warranty deed revolves around the question as to which party is in the best position to know about title defects, and how the risk of title defects should be allocated. Although sellers are arguably better positioned than buyers to discover (or have knowledge of) title defects, realistically, sellers cannot be expected to research the entire historical chain of title for a given property. As a result, most sophisticated parties rely on title insurance, which covers many types of losses that may occur if title defects are discovered. Before issuing title insurance policies, most title companies will perform a thorough search of the applicable title records to determine whether any title defects are present. If a buyer of real property is able to obtain title insurance, then that buyer need not be as concerned with accepting a special warranty deed in lieu of a general warranty deed.

Grant Deed

Grant deeds are distinguished from warranty deeds (whether general or special) in that grant deeds do not require the grantor to defend title claims (whether for all time as with a general warranty deed, or only during grantor's ownership of the property as with a special warranty deed). Note that grant deeds are not universally available in all states, so be sure to check local statutes to determine

whether use of this deed type is permitted. Typically, a grant deed only contains the following covenants of title:

- A covenant that the grantor has not previously sold the real property interest now being conveyed to the grantee.
- A covenant that the property is being conveyed to the grantee without any liens or encumbrances (except for those specifically disclosed in the deed).

In review, a grant deed transfers a grantor's ownership interest in real property, and covenants that title has not already been transferred to another party or been encumbered (except as explicitly set forth in the deed). By contrast, a warranty deed also transfers a grantor's ownership interest in real property, and explicitly warrants to the grantee that: (i) the grantor has good and marketable title to the property, and (ii) the grantor agrees to defend the grantee against third-party claims to title of the property.

Quitclaim Deed

A quitclaim deed conveys a grantor's complete interest in real property, but does not warrant or profess that the grantor's claim of title is actually valid. In other words, a quitclaim deed only transfers whatever ownership interest a grantor has in a particular property, but makes no guarantees about the extent of the grantor's interest in such property, if any. Essentially, a quitclaim deed only conveys to a grantee whatever rights the grantor has in the subject property, and makes no assurances or warranties that the grantor actually has a valid ownership interest in the subject property, but if the grantor does possess a valid ownership interest, then grantor conveys such ownership rights to the grantee. When a buyer accepts a quitclaim deed, then that buyer also accepts the risk that the grantor may not have a valid ownership interest in the property being conveyed, and there may be additional ownership interests or claims to title. Title insurance companies may be reluctant to issue title insurance policies if the subject property was conveyed to the proposed insured (i.e., the buyer) using a quitclaim deed.

Quitclaim deeds are most frequently used when there is a potential for a title defect (sometimes referred to as a "cloud" on the chain of title). Common instances where quitclaim deeds may be appropriate include:

- when there is uncertainty about whether a particular heir of a prior property owner may have a claim to the property;
- when a party may have acquired title to the property by adverse possession;
- when the division of property is necessary for divorcing couples, with one spouse signing all of his or her rights in a particular piece of real property over to the other spouse; or
- when there is a possibility that another party may have some other type of remaining interest in the property (e.g., a leasehold interest of a former tenant, or an outstanding option to purchase the property), and the current owner or prospective buyer of such property wants such other party to disclaim any such interest.

Be careful when considering a quitclaim deed, since it cuts off claims against prior owners. If the use of a quitclaim deed is part of a related party or internal transfer (e.g., as part of an estate plan), then it is important to consider purchasing an endorsement to the title policy (if available and cost effective) to ensure the grantee can claim against and through the grantor's title insurance policy.

Brad Dashoff is a senior associate in the real estate group of Pillsbury Winthrop Shaw Pittman, LLP (McLean, Virginia office). His practice includes a variety of real estate matters, such as acquisitions and dispositions of commercial properties, commercial lending, mixed use development, and the creation of private equity funds to invest in real estate.

John Antonacci is vice president and deputy general counsel of Atlantic Realty Companies, Inc., which is a full-service commercial real estate company that owns and manages a portfolio of approximately five million square feet of office and retail space throughout Virginia and Maryland. He is involved in a wide variety of real estate and corporate matters, including the following primary areas: purchase and sale transactions, commercial leasing (with a specialty in retail leasing), and commercial lending. Before joining Atlantic Realty Companies, Inc., he was a senior associate in the real estate group of Pillsbury Winthrop Shaw Pittman, LLP (McLean, Virginia office).

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