

PENN ATTORNEYS

TITLE ALERT

DATE: 6/27/07

RE: Title Alert 2007-21

Bankruptcy and Qualified Intermediaries

Please be advised that First American has distributed the below Home Office Underwriting Bulletin regarding recent bankruptcy filings by Qualified Intermediaries, those companies who assist taxpayers in transactions commonly known as "1031 Exchanges". As always, feel welcome to contact your servicing Penn Attorneys office with any questions.

This bulletin is being provided as a reminder, as previously set forth in HONA 1051, and supersedes that bulletin. Recent bankruptcy filings by Qualified Intermediaries ("QI's") conducting tax-deferred exchanges (26 U.S.C. §1031) have raised concerns regarding the pre and post-petition actions of these entities, Preferential transfers occurring within 90 days of a bankruptcy filing by the QI are subject to being set aside, as are post-petition transfers not specifically authorized by the bankruptcy court. If your transaction involves a QI dealing with relinquished or replacement property, you should adhere to the following practices:

Run the QI's Name in the General Index If Title is Passing Through the QI

Title personnel must run the name of the QI in the general index for bankruptcy filings **ONLY IF** title is passing through the QI. This search should be limited to the county where the property is located, i.e. a national bankruptcy filing search is unnecessary and a separate search of the bankruptcy indices is unnecessary.

If the exchange transaction involves direct deeding from the taxpayer to a buyer of the relinquished property, or from a seller to the buyer (taxpayer/exchangor) of the replacement property, you need not run the QI in the general index for bankruptcy filings.

Sales from or to QI's in Bankruptcy Require a §363 Order

If your search reveals that the QI is in bankruptcy, a §363 bankruptcy order must be obtained, specifically authorizing the sale of the relinquished property or the purchase (and concurrent transfer to the taxpayer) of the replacement property. Moreover, if you have actual knowledge that a QI is in bankruptcy, even if a petition is not recorded and there will be direct deeding, you must obtain an order authorizing your transaction. If an order cannot be obtained, the transaction must not be handled. Arguments that the QI is operating in the ordinary course of business will not change these requirements.

Special Limitation on Giving Creditors' Right Coverage in Exchange Transaction

If a QI files bankruptcy within 90 days of the transfer of replacement property to the taxpayer, the bankruptcy trustee may avoid the deed as a preferential transfer (even if there is direct deeding) since the taxpayer may have been preferred over other unsecured creditors of the QI. Clearly, the impending failure of any given QI cannot be determined beforehand. Therefore, it has been a longtime practice to issue creditors' rights coverage in exchange transactions only when the QI is First American Exchange Company (or another First American controlled QI), a title insurance company, a subsidiary of a title insurance company, or a bank or savings association.

In any transaction in which you are being asked to provide some type of creditors' rights coverage, you must ask if the transaction involves a QI, if it does, creditors' rights coverage **SHOULD NOT** be provided, subject to the following exceptions:

1. Creditors' rights coverage may be given to an owner and/or lender for the replacement property when usual creditor's rights underwriting guidelines are followed. You must also be mindful of creditors' rights issues that may exist between the seller and buyer (taxpayer). There should always be some indicia that the sales price reflects present fair market value, as established by a third party (i.e. objective) appraisal or open market exposure of the property through a multiple listing services, as well as independence of the parties to the transaction.
2. Creditors' rights coverage may be given to an owner and/or lender for the relinquished property when usual creditor's rights underwriting guidelines are followed.

Penn Attorneys Title Insurance Co.

State Headquarters
900 State Street, Ste 320
Erie, PA 16501
814-454-8278 * 800-352-2216

erie@pennattorneys.com

Eastern Pennsylvania Office
New Bridge Center, Ste 317
480 Pierce Street
Kingston, PA 18704
570-288-1108 * 800-929-4024

epro@pennattorneys.com