

THE C & D NEWSLETTER



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ESCROWS

In California, most real estate transactions, and many other business transactions, are handled through an independent escrow. This Newsletter shall discuss the nature and requirements of an escrow, the role and duties of the escrow agent and the procedure to open, conduct and close or cancel an escrow.

Nature of Escrow. An escrow allows each party to make performance of its obligations conditional upon performance by the other party. Thus, in a transaction utilizing an escrow, each party deposits the documents, funds and other items necessary to close the transaction with a neutral third party who serves as their mutual agent. The escrow holder has the legal responsibility to protect the money and documents and to consummate the agreement of the parties only when each side has fulfilled all of its obligations under their agreement. The escrow agent monitors the performance of the conditions of the agreement between the parties, handles communications with the parties and other interested persons, keeps appropriate records and is responsible for the actual recording, delivery and disbursement of documents and funds. The escrow agent has a fiduciary responsibility to both parties, and is obligated to comply strictly with the terms of the escrow instructions. The escrow agent has no obligation to do things that are not required by the escrow instructions. For example, the escrow agent is not required to resolve disputes between the parties over the meaning or effect of particular provisions in the escrow instructions.

Selecting an Escrow Agent. Any independent third party may serve as the escrow agent; however, the most commonly used escrow agents are independent escrow companies, title insurance companies, banks, savings and loan associations, and trust companies. Professional escrow agents - those that perform escrow services for compensation - must be licensed, must have special qualifications, and must comply with special regulations.

In Southern California, almost all real estate escrows are handled by independent escrow companies; in Northern California, most escrows are handled by the escrow departments of title companies. In selecting an escrow agent, the following criteria should be considered: (a) the reputation of the escrow company in the community; (b) the financial strength and stability of the escrow company; (c) the knowledge, experience and competence of the escrow officers; and (d) the location and accessibility of the escrow office. While escrow fees do vary, there usually is not a substantial difference in the fees that various escrow companies charge. Therefore, cost is usually not a factor in the selection of an escrow agent, except in large transactions where escrow fees are more likely to be subject to negotiation. In some cases, a financial institution may require that the escrow be handled by their escrow department. And, if the financing arrangements are particularly complex, the use of the lender's escrow department may facilitate the funding of the loan.

Opening Escrow. The retention of the neutral third party to act as escrow agent, and the drawing up of escrow instructions is frequently referred to as "opening escrow" even though as a technical matter, these steps are not legally sufficient to create an escrow. An escrow is formally opened only when the parties to the escrow sign a binding contract, called escrow instructions.

Once the escrow is opened, the escrow agent becomes the mutual agent of the parties to the escrow. If a valid escrow has not been created, the neutral third party serves only as an agent for the depositor of the instruments or funds, and the depositor may, therefore, revoke the deposit at any time.

Escrow Period. During the escrow period, the escrow agent performs all of the necessary clerical duties to close escrow. In a typical real estate escrow, the escrow agent will perform the following duties:

- (a) Prepare escrow instructions;
- (b) Order the preliminary title report;
- (c) Obtain loan payoff demands and beneficiary statements from existing lenders, and request full reconveyances of any deeds of trust to be paid off in escrow;

- (d) Obtain documents necessary to pay or clear off any mechanics liens or other liens against the property;
- (e) Obtain documents necessary to calculate closing costs, such as property tax statements, rent rolls and insurance policies;
- (f) Obtain instructions and loan documents from any new lender;
- (g) Prorate taxes, interest and rents;
- (h) Obtain title insurance for the buyer and/or the lender;
- (i) Arrange the transfer of the fire insurance policy or instruct the buyer to obtain a new policy;
- (j) Arrange for the proper execution of all documents and the delivery of all necessary documents into escrow;
- (k) Record all documents, such as grant deeds, deeds of trust, and reconveyances, after all conditions to the transaction have been performed;
- (l) Disburse all funds to the proper parties.

In a typical real estate transaction in Southern California, the buyer will pay one-half of the escrow fee, the lender's charges for loan assumptions or the lender's charges for a new loan (which may include the loan fee, credit report fee, an administrative fee and prepaid interest), a loan tie in fee in connection with a new loan (usually based on \$1 per \$1,000 on the new loan account), the fire insurance premium (which is usually prepaid for one year), charges for the lender's ALTA title insurance policy; tax prorations, and recording fees. The seller will typically pay one-half of the escrow fee, real estate commissions, reconveyance fees, prepayment fees and other fees to pay off existing loans, charges for the CLTA title insurance policy; documentary transfer tax; and pest control charges for the report and completion of any work.

Closing Escrow. The delivery and recording of all documents and the disbursement of funds deposited into escrow and the performance of other items necessary to complete the underlying transaction is usually referred to as "closing escrow", however, technically an escrow closes upon the performance or fulfillment of all of the terms and provisions specified in the escrow instructions.

In order to close a real estate escrow, the escrow agent must have escrow instructions signed by both parties, signed loan documents, a certified check or other immediately available funds for the full amount of the purchase price and other closing charges, and a signed grant deed and other necessary documents and instruments. Typically the lender reviews the entire escrow package at least 24 hours prior to the actual recording date so that it can be sure all documents are properly signed and in order; if everything is in order, the lender will disburse the loan proceeds to the escrow agent. After the escrow agent has received all documents and funds, the escrow agent delivers all documents which need to be recorded to the title company, which reviews them to be certain that they are properly signed and in order, and then records them. The title to real property changes legally at the time of recording. After recordation of all documents, the escrow agent will disburse funds to the seller, holders of all loans, real estate agents and other persons, in accordance with the escrow instructions. The escrow agent will also mail out final closing statements to each party setting forth the receipt and disbursement of all funds, and will send out original documents, such as promissory notes, title insurance policies, and fire insurance policies, to the proper party.

Termination or Cancellation of Escrow. An escrow terminates when (a) all of the terms and conditions of the escrow have been performed or fulfilled (i.e. - when escrow closes); (b) when a condition to the close of escrow, such as obtaining financing, or approval of the physical condition of the property, has not been fulfilled; (c) when escrow is abandoned or canceled by mutual agreement of the parties; or (d) when it is canceled by one party due to another party's failure to perform a term or condition of the escrow instructions. If the escrow is canceled, the escrow company may charge a cancellation fee for the cost of the preliminary title report and their work to date.

Importance of Escrow Instructions. The escrow instructions constitute a legal and binding agreement on the buyer, seller and escrow agent. It is, therefore, important that the escrow instructions fully and accurately reflect all aspects of the transaction to be consummated. If the escrow instructions are based on an underlying agreement, such as a real estate purchase agreement, the escrow instructions should provide which document controls in the event of a conflict between the provisions of the escrow instructions and the purchase agreement. Without such a provision, the escrow instructions will generally govern the transaction, since the escrow instructions are signed after the purchase agreement.

In order to prevent future disputes, the escrow instructions should provide for specific dates (rather than time periods, such as ten days after escrow opens) for the performance of obligations, and should provide for a specific closing date on which escrow will close or be canceled. If liquidated damages are desired, both buyer and seller must each initial a specific provision in the escrow instructions. Since most escrow instructions are written in legal language, professional review by a qualified attorney is recommended.

This complimentary newsletter is intended to provide general information. Because of the complexities and constant changes in the law, it is important to seek professional legal advice before acting on any of the matters covered herein.