

Risks To Consider For Commercial Real Estate Gap Closings

By **Jennifer Ioli** (August 4, 2021, 6:12 PM EDT)

Despite its long tenure in commercial real estate transactions, the gap closing has been, and likely will continue to be, used with greater frequency.

The gap closing is a mechanism that allows real estate to be easily conveyed by parties who never leave the comfort of their desks — and in a COVID-19 world, their own homes. In light of the pandemic and the shift to working from home, it is vital that commercial real estate attorneys, and their clients, understand the gap closing — its virtues as well as the issues it may entail.



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Gap closings are transactions where, after documents and funds are delivered, there remains an interval of time before recording of the documents. As with traditional closings, a title policy is issued insuring title typically from the date of the most recent title commitment. The title insurance company insures the gap between the closing table and the recording of documents.

This gap may occur for any number of reasons. For instance, several states have a recording lag — meaning that even if documents are presented for recording on the day of closing, they may not be processed for several weeks. The impacts of the COVID-19 pandemic, and governmental orders restricting operations of registries of deeds and other service vendors, saw increased recording lags in the past year.

Typically, these gaps occur when the buyer is located in one state, the seller in another and the property in yet another. In these scenarios, closing is generally run through the buyer's designated title company in the state where the buyer is located. The title company is responsible for shepherding all documents, receiving and disbursing funds, and putting closing documents to record.

What's the risk?

The risk in any gap scenario is an intervening matter of record, or title, such as a tax lien or a judgment against the seller, may be recorded between the time of closing and when closing documents are recorded — the result being the buyer may not receive the quality of title that was negotiated. The parties will then look to their title insurer for coverage.

Depending on the jurisdiction, electronic recording may be an option. Many jurisdictions permit the e-filing of recordable documents, and it is likely that many more will follow suit in the future.

However, as nationwide transactions become more common, as portfolio transactions increase — buyers acquiring multiple properties, perhaps in multiple states, from the same seller — the likelihood of getting to record on closing day becomes increasingly unlikely.

In some jurisdictions, there may be a delay in the registry uploading submitted recording documents into their indices. These documents would maintain their place in line but documents further toward the front of the line would have priority even though they would not yet be available through examination of the records. Certain county records throughout the country can be weeks or even months behind at a given point in the year.

In the current climate of commercial real estate transactions, the gap closing is not just an option — it is a frequent necessity.

Who bears the risk?

So, who bears the risk? In certain states it is merely customary for title companies to insure a title without exception for the gap risk. This risk may be mitigated, in part, by updating title immediately prior to closing — thereby shortening the gap, and by the title company overnighting documents to a local agent who records upon receipt or by recording electronically.

In addition, title companies often seek to spread the risk by requiring a gap indemnity, whereby the seller indemnifies the title company for matters of record appearing between the date of the commitment and recording.

With respect to gap indemnities, it is important that the indemnitor be a financially responsible party. Frequently the holder of commercial real estate is a single asset entity whose only asset is the underlying property. Once that property has passed to the hands of the buyer, anyone looking for recourse against the now asset-less seller may find nothing but empty pockets.

The better practice is to ask a seller's parent company, or other financially viable party, to give the gap indemnity. Title companies are increasingly requiring an entity with assets behind it, rather than a special purpose entity, to backstop the gap indemnity, especially in transactions that pose a specific concern to the title company.

Lastly, it is important that buyer's counsel carefully prepare their closing instruction letter to the title company.

Among other key elements, the closing instruction letter in a gap closing should bind the title company to issue the policy in the form of the marked commitment or pro forma with no additional exceptions. Doing so will ensure that the title company is obligated to issue the same policy for which the buyer negotiated, regardless of intervening matters of record.

Though gap issues are rare, making sure a client has insurance for gap risk is imperative. Taking these steps, understanding the process and using quality title insurance companies combine to ensure that the gap closing runs smoothly and the parties receive the benefits of their bargain.

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