



Carolina Update

NCLTA's Exclusive Report to its Members

President's Message

By Candice E. Williams



So much is going on with the North Carolina Land Title Association right now, that every day brings new changes. This article has especially been a challenge to write, because every time I start, I have to edit it to reflect the new

status of our current initiatives. Currently, I am writing this newsletter "on the heels" of sending letters to two senators from my district in support of Senate Bill 803, entitled "An Act to Address Hidden Liens to Protect Bona Fide Purchasers For Value and Lenders in Real Estate Transactions; and to Make it a Felony to Make a Written False Statement of Sums Due or Paid for Labor or Material Furnished to Real Property". Senate Bill 803 has been our latest hot button issue and we are working diligently with the help of David Ferrell, our lobbyist, to revise the current mechanic's lien statute to include a provision for notice of commencement that would eliminate the problem of the "hidden lien" that has plagued our industry, homeowners, and lenders. (See related article on page 6.)

Senate Bill 803 is not the only initiative we have been working on. Last week we filed our second amicus brief, this time to the Supreme Court of North Carolina, in the matter of *Johnson v. Schultz*, COA08-133, 671 S.E. 2d 559. Our position is that the Court of Appeals' decision to reverse and remand judgment was incorrect and the trial court's decision should be re-instated. Please see the article on page 2 by NCLTA General Counsel Chris Burti for an excerpt from his article, "Risk of Loss for Attorney Defalcation."

On April 23rd, the revised 2008 Ethics Opinion FEO 13 was adopted by the Ethics Committee of the North Carolina State Bar. The revised opinion will be re-published in the next *State Bar Journal* for comment. This has been a long journey for us, but the revision is a good compromise and hopefully addresses the concerns of those members of the practicing bar who had been opposed to the opinion. At the Real Property Section Annual Meeting of the North Carolina Bar Association, we were well represented by Kim Rosenberg, chair of our Loss Prevention Committee, on a panel discussion of the proposed opinion. If you were not present at the meeting, I highly encourage you to view the video of the CLE.

The Real Property Section held its Annual Meeting from April 16th-April 18th at The Homestead. Debbie Brittain, state manager for Chicago Title, planned the cocktail reception, and it was a huge success. This year was different because NCLTA took care of the reception directly instead of burdening the Real Property Section staff. Debbie managed to put on a very nice event and keep costs down at the same time! We very much appreciate all the title company sponsors who donated (see page 6 for a list). I also extend our appreciation to new Attorney Member Eric Spence of Smith Moore Leatherwood in Raleigh who helped coordinate NCLTA's booth with Kim Rosenberg.

Be on the lookout for the final results of the above-mentioned initiatives; local presentations on the new NCLTA mechanics' lien forms; and information on NCLTA's next Annual Convention in Wild Dunes, September 17th-September 19th. Once again I would like to thank the members of the Real Property Section; practicing members of the bar; and all others who have supported us over the past year. I look forward to seeing you at Wild Dunes in September.

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Update on Johnson v. Schultz

Carolina Update is the official publication of the North Carolina Land Title Association. It is distributed quarterly to title insurance company members, attorney members, and other persons interested in the title insurance industry. Readers are encouraged to submit articles to the newsletter. The opinions and statements of guest writers do not necessarily reflect the policies or opinions of NCLTA.

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In our Fall 2008 newsletter we reported that NCLTA had filed an amicus brief in the case of Johnson v. Schultz, COA08-133, 671 S.E. 2d 559. The Court of Appeals would consider the issue of which party (buyer or seller) should bear the risk of loss in the event of defalcation by the closing attorney. The text below is entirely excerpted from an article entitled "Risk of Loss for Attorney Defalcation" written by Chris Burti, vice president and senior legal counsel, Statewide Title, Inc. and general counsel to the NCLTA Executive Committee. NCLTA believes the matter was wrongfully decided by the Court of Appeals and will submit an amicus brief to the Supreme Court of NC in the pending appeal.

In an opinion of a divided panel of the North Carolina Court of Appeals in *Johnson v. Schultz*, COA08-133, February 3, 2009, the Court considers who bears the risk of loss as between buyer and seller in a residential real estate sale where the closing attorney misappropriates the proceeds due the sellers after recording. The trial court determined that the risk should fall upon the plaintiff-sellers with the Court of Appeals reversing and remanding the judgment.

In 2005, the defendants entered into a contract to purchase the plaintiffs' property using the North Carolina Bar Association's standard "Offer to Purchase and Contract" form. The buyers hired Donald A. Parker to represent them in the closing of the transaction that was held at his office in January of 2006. He was the only attorney involved in the closing. He drafted the deed for the sellers and charged them a fee for the service. The defendants provided a substantial portion of the purchase price, obtained a loan for the remainder, and all funds were deposited into Mr. Parker's trust account prior to closing. The deed and deed of trust were recorded after which Mr. Parker delivered his trust account check for the net proceeds to the plaintiff. When the proceeds check was delivered, Mr. Parker's trust account contained sufficient funds to cover the check, but it was short on the next day after having misappropriated the funds. The plaintiffs did not try to cash the check for over four months whereupon the check bounced and was returned.

The plaintiff sellers sued the buyers, Mr. Parker, the purchase money lender and its trustee. The plaintiffs sought rescission of the deed and recovery of title to the property, or alternatively,

damages. Mr. Parker admitted the plaintiffs' material allegations, and the remaining parties respectively moved for summary judgment. The trial court allowed the defendants' motion, and dismissed the plaintiffs' claims with prejudice. The Court of Appeals quoted the trial court where it stated that "the plaintiffs had to 'bear the risk of loss of the sales proceeds...resulting from the escrow agent, Defendant Donald A. Parker, having embezzled the [money]...[because] plaintiffs were entitled to receive those sales proceeds at the time of such embezzlement.'" "The court further concluded that 'Defendants Schultz were lawfully vested with title to the [real] Property on January 3, 2006, the day before Defendant...Parker embezzled the...sales proceeds. Therefore, Defendants Schultz were entitled only to the [real] Property, [and] not [to] the embezzled sales proceeds, at the time of...embezzlement [.]'"

The trial court based its decision and judgment by placing the risk of loss on the party entitled to the funds, the seller in this case. This is characterized as the "entitlement rule" by the Court of Appeals and it notes "has been 'adopted in all jurisdictions that have considered' how 'to allocate losses of money deposited in escrow.'" (citation omitted) The entitlement rule generally places the risk of loss as to escrow monies on the depositor-buyer under the theory that the escrow holder is the buyer's agent "even if the escrow holder was the seller's...attorney [The Court looks to *GE Capital Mortgage Services v. Avent*, 114 N.C. App. 430, 442 S.E.2d 98 (1994), as the only North Carolina appellate case to apply an entitlement theory..."

"In the absence of fault, the entitlement rule shifts the risk of loss solely to the party holding 'title' to the funds at the time the misappropriation occurred, a determination based on whether the escrow conditions have been fully performed at the time of embezzlement. *Id.* at 344-45, 352. If all escrow conditions have not been performed, the risk of loss remains solely with the buyer. *Id.* at 352. If all conditions have been performed, the risk of loss shifts solely to the seller. *Id.* In other words, the risk falls squarely on either the buyer or seller."

The Court wanders from this bright line and notes that the "Plaintiffs and the North Carolina

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Update on Johnson v. Schultz

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State Bar (“the State Bar”) argue that the transaction here is not an escrow. Consequently, they contend the entitlement rule does not apply and that the Schultzes as principals should bear the risk of loss due to the defalcation of their attorney or agent Mr. Parker. The Plaintiffs further argue that even if the arrangement here is an escrow, this Court’s decision in *GE Capital Mortgage Services v. Avent*, 114 N.C. App. 430, 442 S.E.2d 98 (1994), which is the only North Carolina appellate case to apply the entitlement theory, establishes that in the absence of fault, the risk of loss is then allocated based on the attorney-client relationship.”

The majority agreed with the Plaintiffs that the arrangement did not constitute an escrow, “and consequently, in accordance with equity, the risk of loss here should fall on those parties who had an attorney-client relationship...” a further declaring that their “holding is consistent with the equitable principle that ‘where one of two persons must suffer loss by the fraud or misconduct of a third person, he who first reposes the confidence or by his negligent conduct made it possible for the loss to occur, must bear the loss.’” The court notes that it could not find “a single North Carolina case which defines an escrow” and looks to a dictionary definition. “An escrow,’ as a general rule, is created when the grantor parts with all dominion and control of a instrument or money by delivering it to a third person or a depository with instructions to deliver it to the named grantee upon the happening of certain conditions. It is an instrument which by its terms imports a legal obligation, and which is deposited by the grantor, promisor or obligor, or his agent with a stranger or a third party, the depository, to be kept by him or her until the performance of the condition or the happening of [a] certain event and then to be delivered over to the grantee, promisee, or obligee. ‘Escrow’ by definition means ‘neutral,’ independent from the parties to the transaction... Thus, when, pursuant to an agreement, money is left in [the] hands of the attorney or agent of one of the parties, an escrow is not created; however, in some jurisdictions, one may be the escrow agent of both parties to an escrow if there is nothing inconsistent or antagonistic between his acts for the one and the other.”

The Court recites a description of a typical “deed and money” escrow, “[s]oon after entering into a contract for the sale of the realty, or perhaps simultaneously, the buyer and seller agree upon a person to serve as escrow holder. The parties agree that the buyer will deposit with the escrow holder some portion of the purchase price, and the seller will deposit an executed deed and related documents. Jointly or separately the parties set forth instructions for the escrow holder. Ordinarily the buyer instructs the holder to release the purchase price to the seller when a valid deed has been recorded and a title insurance policy has been issued, after a title search has shown that the seller has marketable title. The seller instructs the holder to record and deliver the deed to the buyer when the purchase price has been deposited.”

The Court concludes (we believe erroneously): “In the instant case, the record is completely devoid of any evidence tending to establish the creation of an escrow between the parties, including any escrow instructions to Mr. Parker from the buyers (the Schultzes), the sellers (the Plaintiffs), or the lender (State Farm Bank). Furthermore, here, the only ‘conditions’ that appear in the record are those provided in the parties’ ‘Offer to Purchase and Contract[.]’ In contrast, in *Avent*, the Court explicitly mentioned that there was an ‘escrow agreement,’ requiring the ‘escrow agent,’ who was the buyer’s closing attorney, to deliver the remaining sales proceeds to the seller once the seller cancelled the prior lender’s deed of trust. *Avent*, 114 N.C. App. at 431-32, 442 S.E.2d at 99. Hence, based on the above definitions and law, the arrangement in the instant case does not appear to be a formal escrow.” We feel that the Court’s imposition of a requirement for a written escrow agreement to establish an escrow is in error. There is no requirement for a written agreement in order to establish a trust, either under the common law or as explicitly codified in N.C.G.S. Section 32C-4-407. There should not be one judicially imposed for what is an analogous arrangement, an escrow.

The Court then, without specifying a rule for transactions not deemed an escrow, goes on to interpret *Avent* as establishing a rule that the risk of loss “should be allocated based on the attorney-client or agency relationship in accordance with equity.”

The Court, in conclusion, states a new rule that where: “(1) one attorney is used to handle a residential real estate closing, (2) the attorney misappropriates the remaining balance of the purchase price owed to the seller, and (3) the risk of loss must be allocated to one or more parties, courts should first consider the existence of fault. However, if fault does not exist and the risk must be allocated between essentially “innocent” parties, courts should then consider which parties had an attorney-client relationship with the wrongdoing attorney and impose the risk of loss on those parties. Where multiple parties to the transaction have an attorney-client relationship with the offending attorney, the risk of loss should be shared among them.”

The case was then remanded to the trial court for findings in conformity with this rule.

Around the State

Master Title Agency, LLC, has a new address:

8640 University Executive Park Dr., Suite B, 2nd floor, Charlotte, NC 28262

Stewart Title of the Carolinas is moving at the end of May to 521 East Morehead St., Ste. 320, Charlotte, NC 28202. All other information remains the same.

Two **Chicago Title** branches have new addresses:

Minette Van Goethem

Chicago Title Insurance Company
302 E. Pettigrew St., Suite 110 (27707)

P.O. Box 51925

Durham, NC 27717-1925

Durham

Phone: (919)682-3018;

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RESPA Update

In the Winter 2009 *Carolina Update*, we reported that HUD had published its final RESPA rule in November of 2008. Significant changes were made to the Good Faith Estimate and the HUD 1/1A. Use of the new Good Faith Estimate and HUD 1/1A was to become mandatory on January 1, 2010. Well, don't get too excited about these changes yet.

On May 7th the U.S. House of Representatives voted 300-114 in favor of a bill (HR 1728) that would, among other things, halt implementation of the final RESPA rule and require HUD to work with the Federal Reserve Board to issue joint, cooperative RESPA and Truth in Lending rules. Following passage of HR1728, HUD Secretary Shaun Donovan announced HUD still planned to go forward with changes to GFE and HUD-1. This development leaves the question of when and if the RESPA changes will take place up in the air. We will now have to wait and see what action the Senate takes with respect to the final RESPA rule. Stay tuned.

Welcome

New Members

At the February 10, 2009, NCLTA Executive Committee meeting the following members were approved:

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Web: www.manningfulton.com

NCLTA extends its Heartfelt Condolences

To the Family of

JAMES R. MAHER

American Land Title Association Executive Vice President, 1988-2007

The Beach is Calling: NCLTA 2009 Annual Convention

Can you hear the waves softly lapping the beach already, and the seagulls flying overhead? The NC Land Title Association is returning to The Boardwalk Inn at Wild Dunes Resort, Isle of Palms, SC, for its 2009 annual convention, September 17-19. Located at the northern end of the Isle of Palms, one of Charleston's barrier island beaches, the Wild Dunes Resort is a gated, 1,600-acre, oceanfront community that includes the AAA Four Diamond-rated Boardwalk Inn that will be NCLTA's headquarters. The Inn combines the classic elegance of Charleston with the casual atmosphere of the islands. The Inn encompasses 93 impeccable guest rooms and suites as well as The Sea Island Grill and Lounge and a beautifully landscaped tropical pool complex, pleasing to even the most discerning of guests. The Resort also boasts two championship-caliber golf courses, top-rated tennis program, and a nationally ranked recreation program.



2009 Annual Convention Chair Carolyn Clark Snipes has prepared an education-packed agenda addressing some of the most pressing title and real estate legal issues of the day. Christopher Vaughn of Carruthers and Roth will lead off Friday's CLE session with a talk about mechanics liens issues and related claims. Neale Johnson of Smith Moore Leatherwood will discuss the closing protection letter and statutes of limitations. Margaret Shea Burnham will return to present a session on contract issues with respect to consideration and survival clauses. Phyliss Craig-Taylor, a new professor at Charlotte School of Law, will cover recent cases, while NCLTA lobbyist David Ferrell will bring us up-to-date on legislation affecting the title industry. Robert Hobbs, chair of the Real Property Section Council, will highlight current activities while Jack Rattikin of Rattikin Title Company in Fort Worth, Texas, will give us a national view from the American Land Title Association. Finally, NCLTA Executive Committee members Taby Cruden, Kim Rosenberg, and Chris Burti will give an overview of the new NCLTA Lien Forms.

Registration materials and a preliminary schedule are expected to be available in June. So mark your calendars and be ready to join us in Wild Dunes, September 17-19!

Thanks to our Convention Sponsors!

The following companies and law firms have donated towards supporting the NC Land Title Association 2009 annual convention at Wild Dunes Resort, September 17-19, on the Isle of Palms, SC:

**Saturday Morning Breakfast
& Refreshment Break**
Roberts & Stevens, P.A.

CLE Binders
Carruthers & Roth, P.A.

Speaker Presentations
Ward and Smith, P.A.

(Ten more companies have pledged their support, and NCLTA is currently awaiting receipt of their payments.)

Convention Calendar

**NCLTA 2009
Annual Convention**
September 17-19, 2009
Wild Dunes Resort
Isle of Palms, SC
www.wilddunes.com

**2009 ALTA
Annual Convention**
October 21-24, 2009
The Breakers
Palm Beach, FL
[http://www.alta.org/
meetings/meeting.
cfm?meeting=SAM2009Ann](http://www.alta.org/meetings/meeting.cfm?meeting=SAM2009Ann)

**NCLTA 2010
Annual Convention**
September 16-18, 2010
Hilton Garden Inn
Kitty Hawk, NC
[http://hiltongardeninn.hilton.
com/en/gi/hotels/index.
html?ctyhocn=ORFKHGI](http://hiltongardeninn.hilton.com/en/gi/hotels/index.html?ctyhocn=ORFKHGI)

**2010 ALTA
Annual Convention**
October 13-16, 2010
Manchester Grand Hyatt
San Diego, CA
[http://www.alta.org/
meetings/meeting.
cfm?meeting=SAM2010Ann](http://www.alta.org/meetings/meeting.cfm?meeting=SAM2010Ann)

**NCLTA 2011
Annual Convention**
September 15-17, 2011
The Grove Park Inn
Resort & Spa
Asheville, NC
www.grovecparkinn.com

Update on Mechanics' Lien Legislation

Senate Bill 803 - "An Act to Address Hidden Liens..."

Senate Bill 803 has been introduced in the Senate under the sponsorship of Senator Rand and assigned to the Judiciary I committee of which Mr. Rand is a member. The bill is being cosponsored by Senator Hartsell who is the co-chair of Senate Judiciary Committee II. Senator Rand has directed representatives of the NCLTA to meet and discuss the bill with those who may be in opposition to the bill. Among other things, the bill provides that a lien granted by Article 2 of Chapter 44A shall not be effective against bona fide purchasers and lenders whose interest has been recorded prior to the filing of a claim of a lien.

The North Carolina Bar Association (NCBA) Construction Law Section has taken a position opposing the bill as drafted. This was to be expected. Steve Brown, on behalf of the NCLTA, met with Gary Welch, the Construction Law Section president, and Keith Coltrain, the section council member charged with dealing with this bill, to discuss the reasons for the opposition. The primary concern was the potential burden on the courts to handle potential increased filing of protective liens prior to closings. The Construction Law Section was invited to participate in the dialogue, and encouraged to suggest any amendment to the proposed legislation that would address this concern but

eliminate the possibility of the "hidden" lien at closing. Steve Brown forwarded the Virginia Statutes regarding a "mechanics' lien agent" to Mr. Coltrain at his request with the stipulation that if a similar type provision were to be proposed for North Carolina, the provision would have to be mandatory. The differences between residential closings and commercial closings were also discussed. Steve Brown also provided Mr. Coltrain with a summary prepared by the NCLTA's bill subcommittee outlining the purposes and reasons for the bill which addresses many of the issues raised by the Construction Law Section's council members. Mr. Coltrain indicated that that document would be forwarded to the Section's members.

At present the NCBA's lobbyist, David Ferrell, has indicated that the NCBA is planning not to take a position on the legislation as an organization. This neutralizes somewhat the Construction Law Section's opposition (if it continues) to the bill, and demonstrates a split of opinion within the NC Bar regarding the bill. In addition, the bill and the previously mentioned NCLTA position summary have been forwarded to the members of the NCBA Real Property Section for their review and comment. Katherine Wilkerson, the legislative committee head for the Real Property Section, indicates opinion has been split between those who support, those who wish to amend the bill, and those that oppose it.

The lobbyists for the banks and credit unions have indicated initial support for the bill.

Following introduction of the proposed legislation David Ferrell and Steve Brown met on April 2, with a group of interested parties, many of which were in opposition to various provisions in the initial bill. Following this meeting the bill was revised to add a notice provision for lien claimants. This will allow lien claimants to file a notice in the Register of Deeds office. Filing of the notice is permissive, does not constitute a cloud on title, and (if filed prior to closing) preserves the lien rights of the claimant beyond the closing of a transaction if not satisfied or waived. The bill is still in the Senate Judiciary Committee.

Thanks to the Title Company Co-Sponsors of the NCBA Real Property Section Convention

April 17-18, 2009 • The Homestead

Attorneys Title, div. of FATIC
Chicago Title Insurance Co.
Fidelity National Title Insurance Co.
Investors Title Insurance Co.
Lawyers Title Insurance Co.
North American Title Insurance Co.
North Carolina Land Title Association
Stewart Title Guaranty Co.
Surety Land Title
The Title Company of North Carolina

NCDOT approves wording change on ALTA Short Form Expanded Coverage Residential Loan Policy (1/1/08)

In early 2009, the American Land Title Association amended the words “Amount of Insurance” to “Policy Amount” on its Short Form Expanded Coverage Residential Loan Policy that was last revised on January 1, 2008. NCLTA submitted this amended form to the North Carolina Department of Insurance which approved it for use in North Carolina on or after March 25, 2009.

For a list of all NC Department of Insurance approved ALTA forms, please visit the FAQs page on our web site at: <http://www.nclta.org/faq.html>. The approved ALTA forms are under question 10.

Legislative Initiatives Are Subject of February Executive Committee Meeting

A good deal of the discussion during the February 10, 2009, NCLTA Executive Committee meeting centered around the extraordinary expenditures the association was facing for the time spent by its lobbyist on the Railroad Corridor Rights of Way as well additional lobbying expenditures that would be necessary as the NCLTA Loss Prevention Committee was recommending that NCLTA again attempt to amend the Mechanics Lien law. NCLTA planned to take the least controversial of three options: essentially, the amendment would require informing an underwriter about any liens before closing. Opposition to any amendment was initially expected to be expressed by home builders, the Construction Law Section, credit managers, lenders, realtors, general contractors, subcontractors, and various building materials supply firms.

Forms Committee Chair Taby Cruden presented three proposed lien waiver forms that were adopted with some minor changes. These forms were mounted on NCLTA's web site and copyright permission granted for inclusion in the forthcoming edition of *North Carolina Real Estate with Forms*. The Executive Committee discussed developing potential training events around use of the forms. (Editor's Note: The 2009 NCLTA annual convention will have a panel presentation on this topic.)

The North Carolina State Bar's Ethics Committee had considered the issue of attorney trust account audits but had referred the issue back to subcommittee for further discussion. (Editor's Note: The Ethics Committee did pass the FEO for re-publication at its April 23 meeting.)

The Executive Committee discussed whether it would support filing another amicus brief in the case of *Johnson v. Schultz* if the case was appealed to the NC Supreme Court. (See related article on page 2.)

Authorization was given to staff to order an exhibit booth table cloth with the NCLTA logo and a set of ballpoint pens for distribution from the NCLTA booth at the Real Property Section Convention.

The Executive Committee approved donations in memory of former Insurance Commissioner Jim Long and staff member Nicole Shore's father, John Shore.

On March 20, the Executive Committee held a follow-up conference call meeting to a) revise the budget for the sponsorship of the Real Property Section Convention cocktail reception to match with the funds collected from title company members, b) determine how to fund the Mechanics Lien lobbying expenditures, and c) approve copyright permission for SoftPro Corporation to incorporate NCLTA's new lien waivers in its software programs.



IMPORTANT MESSAGE

Did You Know?

The new Real Estate Settlement Procedures Act (RESPA) requirements, issued by the U.S. Department of Housing and Urban Development, became effective as of January 16, 2009. As a result of this new rule, lenders may begin using the new Good Faith Estimate as determined by the U.S. Department of Housing and Urban Development. This means closings may be done using either the new or old HUD-1 and HUD-1A settlement statements, as dictated by the lender. If a lender is using a new GFE, agents MUST use the new 2009 HUD-1 and HUD-1A to be compliant with the new rules.

SoftPro is Here to Help.

It is critical that your closing and title software is compatible with both the old and new 2009 HUD-1 settlement statements during this transitional time. If your current closing software provider isn't up to speed with the new changes, contact SoftPro today. We are more than ready for this important transition and can help you stay up to date.

To learn more about this important new transition and how SoftPro can help, please visit <http://www.softprocorp.com/RESPA>

BE PREPARED.

Don't lose business because you're not ready for this transition!

Contact SoftPro today at **800.848.0143**

