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Hidden Hazards for Lenders in Title Insurance Policies

For as long as commercial lenders have been securing loans with real estate collateral, title insurance has been a critical item in the transaction. Lenders and regulators can sleep better at night knowing that if a covered claim arises after the policy's purchase, the title company will either defend the claim or pay the owner of the policy for covered losses up to the policy's limits.

While all can agree that such comfort is essential for any real estate-based transaction, not everyone appreciates how a title policy works and what it does and does not cover. This article covers the essential fine print and how lenders can ensure they are adequately protected by title insurance policies.

What exactly does title insurance cover?

Like any other insurance policy, title insurance policies are very specific about the matters they do and do not cover. For example, covered matters generally include (i) liens arising due to a prior owner of the real estate's failure to pay a mortgage, judgment, taxes, or other charges that attach to the property (e.g., homeowners or condominium association assessments); (ii) liens for labor or materials provided by contractors performing work on the property; (iii) certain undisclosed restrictive covenants; and (iv) defects in deeds or other documents in the chain of ownership title.

On the other hand, matters that are not typically covered include (i) defects created by the lender or of which the lender otherwise had knowledge; (ii) defects created after the issuance date of the policy; (iii) fire, flood, theft or other types of property damage or loss; and (iv) problems arising from a failure to obey applicable laws or previously disclosed covenants. In addition, every title policy has certain exclusions, exceptions, conditions and stipulations that may be specific to the particular real estate.

Title commitments and title policies

Whereas the title policy goes into effect as of the date that title is transferred or the loan is closed, the title commitment acts as a placeholder between the

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About the Firm

In 2011 Shapiro Sher Guinot & Sandler was named the top medium-size law firm in Maryland for "Business & Transactions" by Super Lawyers, a division of Thomson Reuters. The firm represents clients in numerous practice areas, including banking, bankruptcy, corporate, real estate, tax, and commercial litigation.

The firm's banking lawyers provide experienced counsel in connection with all aspects of commercial loans. Co-chaired by **K. Lee Riley, Jr.** and **Scott W. Foley**, the firm's **Banking & Financial Services Group** represents regional and community banks, credit unions, finance companies, pension funds, and other financial institutions in Maryland and throughout the Mid Atlantic.

Mr. Riley advises financial institutions in commercial lending transactions; Mr. Foley advocates for financial institutions in commercial loan workouts, restructurings, and bankruptcy proceedings. Because the group has extensive experience in the origination of loans and in workout situations, it is prepared to provide efficient representation at every stage in the commercial lending process. With over thirty years of experience in the banking industry between them, Mr. Riley and Mr. Foley appreciate the potential hazards facing clients in the commercial loan process, and strive to protect lenders' interests throughout the lifecycle of the loan.

For more information about the Banking & Financial Services Group, contact Mr. Riley at LRiley@ShapiroSher.com or Mr. Foley at SWF@ShapiroSher.com.

time the commitment is issued and the date of closing, and generally expires a short period of time thereafter. While it may seem that a title commitment would not be of much use once the policy is issued, it is not uncommon for the final title policy to differ from the commitment in ways that prevent the lender from making a claim on the policy. Such discrepancies may limit or even invalidate the earlier commitment.

Therefore, a lender should follow up on the policy to ensure that it is properly and timely issued (usually 30 to 60 days after the settlement). Furthermore, the lender should maintain accurate records of the title commitment and review and compare it to the title policy promptly after issuance to ensure that the policy provides the coverage reflected in the earlier commitment. Otherwise, when an issue arises, the lender may discover: (i) the policy in place does not provide the necessary coverage and (ii) the only way to remedy may include litigation.

Exclusions, exceptions, conditions and stipulations

A basic title policy is limited by exclusions, exceptions, conditions and stipulations. These are often boilerplate parts of a policy, but must be reviewed for each individual commitment. As noted above, one of the standard exclusions in both owner's and lender's policies, for example, is an exclusion from coverage for matters actually known by the insured party or its agents that are not disclosed to the title insurer prior to the policy's issuance. Failure to disclose this information to the title insurer prior to the issuance can cause the lender to lose its potential claim on the policy.

Beware of boilerplate endorsements

The American Land Title Association ("ALTA") currently has 36 generic form or standard endorsements available for use in preparing title commitments and policies. Some lenders use standardized forms and/or instructions indicating the endorsements (ALTA or otherwise) that should be included in every deal.

While this practice can be effective, especially for a creditor that focuses on loans of the same general type and size, lenders should be wary of routine reliance on the "standard" list of endorsements. Often, a transaction calls for a "tailored" endorsement that, if not discovered in the early stages of structuring the loan, may result in dangerous gaps in coverage. Alternatively, having an over-inclusive set of standard policy endorsements can lead to unnecessary fees being added to the cost of the transaction.

Lenders that enter into multi-state loan transactions are encouraged to seek the guidance of counsel with knowledge and experience with laws and regulations specific to the state and local jurisdiction in which the property to be insured is located. An attorney with experience in dealing with title insurance policies and endorsements, after reviewing the loan structure and the results of a title and land records search, can help identify specific areas of concern that may not be in a lender's basic package of endorsements and/or tailor the general form endorsements to match the structure of the deal.

Why closing protection letters matter

Closing protection letters are a common means of protecting the lender from changes to or defects in title that occur before closing. A properly drafted closing protection letter provides sufficient and succinct instruction to the title agent regarding the documents to be obtained and actions to be taken prior to closing and disbursement of the lender's funds. On the other hand, if the letter is either too vague or onerous, the lender risks delays in closing and the possibility that the title agent and company will not accept the instructions.

Measures such as obtaining closing protection letters and reviewing endorsements do take time, but they are worth the effort. Title insurance offers valuable and cost-effective protection to lenders who accept real estate collateral to secure their loan transactions. The key is ensuring that you obtain the appropriate coverage for your transaction.

For further information about title insurance, please contact Scott Foley at swf@shapirosher.com.