Title Insurance Underwriting Review

Prepared

November 17, 2010

The ALTA Commercial Endorsements

By

Robert S. Bozarth
Senior Vice President
National Underwriting Counsel
International Underwriting Counsel
Richmond, Virginia

THE ALTA COMMERCIAL ENDORSEMENTS

CONTENTS

A. An Overview of the ALTA Endorsements 4

B. Zoning 5
ALTA 3-06 (Vacant Land) and 3.1-06 (Completed Structure)

C. Variable Rate Mortgage 6
ALTA 6-06 (Variable Rate Mortgage) & 6.2-06 (Variable Rate Mortgage – Negative Amortization)

D. Environmental Protection Lien 7
ALTA 8.2-06 (Commercial Environmental Lien)

E. Restrictions, Encroachments, Minerals 8
ALTA 9-06 (Loan), 9.1-06 (Owners-Unimproved Land), 9.2-06 (Owners-Improved Land), 9.3-06 (Loan), 9.4-06 (Owners-Unimproved Land), 9.5-06 (Owners-Improved Land)

F. Aggregation 12
ALTA 12-06

G. Leaseholds 16
ALTA 13-06 (Owners) & 13.1-06 (Loan)

H. Future Advances 21
ALTA 14-06 (Priority), 14.1-06 (Knowledge), 14.2-06 (Letter of Credit) & 14.3-06 (Reverse Mortgage)

I. Non-imputation 32
ALTA 15-06 (Full Equity Transfer), 15.1-06 (Additional Insured) & 15.2-06 (Partial Equity Transfer)

J. Mezzanine Financing 37
ALTA 16-06

K. Access and Entry 39
ALTA 17-06 (Direct) , 17.1-06 (Indirect) & 17.2 (Utility Access)

L. Tax Parcel 43
ALTA 18-06 (Single) & 18.1-06 (Multiple)

M. Contiguity 44
ALTA 19-06 (Multiple Parcels) & 19.1-06 (SingleParcel)

N. First Loss 46
ALTA 20-06

O. Location 48
ALTA 22-06 (Location) & 22.1-06 (Location and Map)

P. Coinsurance 48
ALTA 23-06 (Me, Too)

Q. Doing Business 49
ALTA 24-06 (Doing Business)

R. Survey 50
ALTA 25-06 (Same as Survey) & 25.1 (Same as Portion of Survey)

S. Subdivision 51
ALTA 26-06 (Subdivision)

T. Usury 51
ALTA 27-06 (Usury)

U. Easement 52
ALTA 28-06 (Easement – Damage or Enforced Removal)

V. Interest Rate Swaps 53
ALTA 29-06 (Interest Rate Swap – Direct Obligation) & 29.1 (Interest Rate Swap – Additional Interest)

W. Shared Appreciation 55
ALTA 30-06 (One to Four Family Shared Appreciation Mortgage)

X. Boilerplate 55

APPENDICES

A. THE ALTA ENDORSEMENTS 57
(A list in numerical order)

THE ALTA COMMERCIAL ENDORSEMENTS

A. An Overview of the ALTA endorsements

The early American Land Title Association endorsements were primarily designed for residential risks. The evolving secondary market for residential mortgages in the 1970s pushed the development of those endorsements to address risks that troubled investors. Although we view the ALTA 3 and 3.1 zoning endorsements as commercial endorsements, all of the other endorsements from the ALTA 1 Street Assessment Endorsement to the ALTA 8.1 Environmental Protection Lien Endorsement were designed to protect residential mortgages.

Of course, simplicity is crucial to the volume residential mortgage market, and endorsements are a bulky fix for inadequate title insurance coverage. The recent enlargement of policy coverage, as exemplified by the ALTA Expanded Coverage Residential Loan Policy, is a more efficient solution for the residential market. Consequently, we are witnessing a shift from the emphasis on residential issues for ALTA endorsements to an emphasis on commercial issues.

The endorsements beginning with the ALTA 9 Restrictions, Encroachments, Minerals Endorsement to the ALTA 11 Mortgage Modification Endorsement made a good transition between residential and commercial, because they can be used comfortably in either market. The ALTA then began developing a series of commercial endorsements designed to meet the needs of the commercial securitization markets, beginning with the ALTA 12 Aggregation Endorsement.

With the turn of the twenty first century, this process kicked into gear as the ALTA has adopted twenty six new endorsements before turning to the development of the new basic loan policies. They were designated the ALTA 13 to ALTA 30, with many being a series of two or more endorsements addressing variations on an issue. There are more series in the pipeline.

After the 2006 policies were drafted, a new series, designated the “-06” endorsements, from the ALTA 1-06 to the ALTA 30-06 have been adapted to the new policies. The changes are modest. The new endorsements incorporate the defined terms used in the new policies, and any references to policy provisions will be changed, or eliminated (*e.g.,* the ALTA 13 leasehold endorsement drops Section 2 of the old endorsement that deletes the coinsurance provision because the 2006 Owners policy has no coinsurance provision).

The new endorsements are designated with a “-06” to avoid confusion with the existing endorsements. Thus, an ALTA 14.2 endorsement is designed for a 1992 or earlier policy, and an ALTA 14.2-06 is the equivalent adapted for the new policies.

So, what’s in the pipeline? Expect endorsements for wind farms as the ALTA 31 series, and for construction lending in the ALTA 32 series.

B. Zoning

ALTA 3-06 (Vacant Land) and 3.1-06 (Completed Structure)

The Zoning Endorsements were an anomaly when they appeared in 1973 as a pair of commercial endorsements in a population of residential endorsements. They are not new, but deserve recognition as commercial endorsements, and you deserve an explanation for their 1998 amendments.

The ALTA 3 Zoning – Vacant Land Endorsement is designed for insuring vacant land. It insures against loss if the zoning classification at the Date of Policy is not as shown on the endorsement and if the list of uses given in the endorsement are not allowed. However, it does not insure that the current use complies with the zoning because there are no improvements or structures to measure. As a result, it has not been very popular. Many buyers of vacant land order an ALTA 3.1 instead if there are immediate plans to develop the land. They seek insurance that improvements and structures shown on an identified plan will comply with the zoning regulations.

The ALTA 3.1 Zoning – Completed Structure Endorsement gives the same basic insurance that is found in the ALTA 3, but includes insurance against loss if the structures and improvements do not comply with the zoning with respect to

(i) Area, width or depth of the land as a building site for the structure;

(ii) Floor space area of the structure;

(iii) Setback of the structure from the property lines of the land; or

(iv) Height of the structure; or

(v) Number of parking spaces.

In 1998 the endorsements were amended as a result of a decision reached in in *Alliance Mortgage Company v. Rothwell*, 10 Cal. 4th 1226, 44 Cal. Rptr. 2d 352 (1995) that indicated that the prelude in the 1987 and earlier forms of the zoning endorsements were inappropriate to title insurance. The old endorsements began:

1. The Company insures the Insured against loss or damage sustained by reason of any incorrectness in the assurance that, at Date of Policy:

   (a) According to applicable zoning ordinances and amendments thereto, the land is classified Zone ________________.

   (b) The following use or uses are allowed under that classification subject to compliance with any conditions, restrictions, or requirements contained in the zoning ordinances and amendments thereto, including but not limited to the securing of necessary consents or authorizations as a prerequisite to the use or uses: _________________________.

An indemnity policy must insure against loss or damage if a specified event or fact is <u>not</u> as indicated in the policy. The turn of the twenty-first century witnessed a scramble by the ALTA and CLTA to revise all of their endorsements to fit the new model. The result made the ALTA 3 and 3.1, more than any other form, negative and rather awkward. They now begin:

The Company hereby insures the insured against loss or damage sustained in the event that, at Date of Policy:

1. According to applicable zoning ordinances and amendments thereto, the land is not classified Zone ________________________.
2. The following use or uses are not allowed under that classification: ___________________.

With the appearance of the new 2006 policy forms, we also saw two new ALTA zoning endorsements, the ALTA 3-06 and ALTA 3.1-06. In addition, the new policies are the first ALTA policies to include express coverage against loss if notice of violation or enforcement of a zoning ordinance is filed in the Public Records in Covered Risk 5. This coverage may have been implied in the 1970, rev. 1984 and later ALTA policies, but it is now express in the 2006 policies. It is not the equivalent of an ALTA 3 or 3.1 coverage, so you should not change your requirements for zoning endorsements just because your project is insured with a new policy.

C. Variable Rate Mortgage

ALTA 6-06 (Variable Rate Mortgage) and 6.2-06 (Variable Rate Mortgage – Negative Amortization)

The Variable Rate Mortgage Endorsements were crafted for residential transactions at the request of Fannie Mae and Freddie Mac, but any mortgage loan, residential or commercial, may have a variable interest rate feature. There is nothing in the ALTA 6 or 6.2 (the ALTA 6.1 was a form of limited ALTA 6 coverage that has become obsolete since the 1970s) that limits its use to residential mortgages, only. So, it is not unusual to encounter an endorsement request on a commercial loan that specifies one of these ALTA 6 endorsements.

Commercial lenders especially had one objection to the ALTA 6 and 6.2. The endorsements use the term "changes in the rate of interest" but the definition of "changes in the rate of interest" was limited to ". . . only those changes in the rate of interest calculated pursuant to the formula provided in the Insured Mortgage at Date of Policy." The parties to a mortgage, and especially commercial mortgages, do not want to reveal the negotiated interest rate in a document that will be recorded in the Public Records. Under the original form, a lender faced a Hobson's choice of either disclosing the confidential interest rate in the mortgage to get the coverage, or not disclosing the interest rate in the mortgage and risking losing its coverage. It was incongruous that the ALTA endorsement required a disclosure in the mortgage that nobody in the marketplace was willing to make. Title insurance protects the lien of the Insured Mortgage, not the repayment of the indebtedness, so the ALTA composed the definition to refer to the mortgage.

Because the original approach was too rigid, the endorsements were amended by the ALTA on October 16, 2008 to correct that problem. The definition was changed to read:

> "Changes in the rate of interest", as used in this endorsement, shall mean only those changes in the rate of interest calculated pursuant to the formula provided in the loan documents secured by the Insured Mortgage at Date of Policy.

That's better. Now, the Insured decides on what disclosures to make in the recorded loan documents without jeopardizing its title insurance coverage.

D. Environmental Protection Lien

ALTA 8.2-06 (Commercial Environmental Protection Lien)

Fannie Mae required the ALTA 8.1 Environmental Protection Lien Endorsement as a condition to its acceptance of the 1987 ALTA Loan policies because environmental liens were the big issue in the mid 1980s. Several states had just enacted environmental cleanup statutes that not only gave the state a lien against land for the cost of cleanup, but also super-priority over any other lien on the land as well. Paragraph (a) of the endorsement indemnified the Insured against loss of priority to environmental protection liens filed on the Date of Policy in the Public records, and paragraph (b) insured against loss of priority to any state environmental liens even if the lien is filed after the Date of Policy. The endorsement was expressly limited to residential mortgages because virtually all super-priority lien statutes included a residential exemption. If Fannie Mae discovered a super priority environmental lien statute without a residential exemption, it would threaten to suspend purchases of mortgages in that state until the law was revised because it expected the title insurers to except to them following paragraph (b).

The ALTA 8.1 is unsuitable for commercial transactions because the exemptions in the super-priority lien statutes apply only to residential mortgages. The risk of loss to an environmental superlien on a commercial mortgage is unmanageable. A thorough phase I environmental survey report can be expected to list pages of chemical compounds identified on the property, and title insurers do not have the skill to determine if a state might require a cleanup of any of them.

To address the demand for a commercial variation of the environmental lien protection endorsement, the ALTA adopted the ALTA 8.2 Commercial Environmental Protection Lien Endorsement on October 16, 2008. It broadens the paragraph (a) coverage by eliminating the limitation of the coverage to "lack of priority of the lien of the insured mortgage." Instead the new endorsement "insures against loss or damage sustained by the Insured by reason of an environmental protection lien that, at Date of Policy, is recorded in the Public Records. . ." Consequently, it is suitable for owner's coverages as well as loan coverages.

Of course, neither of these environmental protection lien endorsements insures that the land is clean, or even suggests that it does. Title insurance is a "monoline" industry that is prohibited by law from insuring any other kind of risk. Environmental cleanup insurance is a property/casualty line of insurance, so title insurers may not accept that risk. The monoline restrictions are imposed on title insurance because an insurance line without deductibles, annual renewal premiums, and low statutory reserves cannot bear these risks.[1]

---

[1] *Chicago Title Insurance Co. v. Kumar*, 24 Mass. App. Ct. 53, 506 N.E.2d 154 (1987); *South Shore Bank v. Stewart Title Guaranty Co.*, 688 F. Supp. 803 (D. Mass. 1988); *Lick Mill Creek Apartments v. Chicago Title Insurance Company*, 231 Cal. App. 3d 1654, 283 Cal. Rptr 231 (1991), *appeal denied,* Aug. 29, 1991; and *Fleet Finance, Inc. of Georgia v Lawyers Title Insurance Corporation*, No 1:88-cv-1672-HTW (N.D. Ga. Dec. 29, 1989). Related decisions in *Manley v Cost Control Marketing and Management, Inc*., 583 A.2d 442 (Pa. Super. 1990), *Frimberger v. Anzellotti*, 594 A.2d 1029 (Conn. App. 1991) and *Bear Fritz Land Co. v. Kachmak Bay Title Agency, Inc*., 920 P.2d 759 (1996) held that latent physical environmental defects were not "encumbrances" on title. Where a party attempts to

E. Restrictions, Encroachments, Minerals
ALTA 9-06 (Loan), 9.1-06 (Owners-Unimproved Land), 9.2-06 (Owners-Improved Land), 9.3-06 (Loan), 9.4-06 (Owners-Unimproved Land), 9.5-06 (Owners-Improved Land)

The ALTA adopted the ALTA 9 Restrictions, Encroachments, Minerals (REM) Endorsement for Loan Policies in October 1988. Ten years later, the ALTA adopted two versions for owner's policies, the ALTA 9.1 for unimproved land, and the ALTA 9.2 for improved land. The ALTA 9 is a derivation of a California endorsement, the CLTA 100.

These endorsements are often referred to as the "comprehensive" endorsements, but the name is a misnomer and I discourage it. The endorsements deal only with discrete issues concerning restrictions, encroachments and mineral rights, as their official names suggest.

The most important issue is coverage over risks posed by covenants, conditions or restrictions. In the versions of the ALTA 9 from its inception to the 6-17-06 revision, it is spread throughout sections 1.a, 1.b, 2 and 5, and I have extracted those coverages in the following paragraphs:

> The Company insures the owner of the Indebtedness secured by the Insured Mortgage against loss or damage sustained by reason of:
>
> 1. The existence, at Date of Policy, of any of the following:
>   a. Covenants, conditions, or restrictions under which the lien of the Insured Mortgage can be divested, subordinated, or extinguished, or its validity, priority, or enforceability impaired.
>   b. Unless expressly excepted in Schedule B
>   (i) Present violations on the Land of any enforceable covenants, conditions, or restrictions, and any existing improvements on the land described in Schedule A that violate any building setback lines shown on a plat of subdivision recorded or filed in the Public Records.
>   (ii) Any instrument referred to in Schedule B as containing covenants, conditions, or restrictions on the Land that, in addition, (A) establishes an easement on the Land; (B) provides a lien for liquidated damages; (C) provides for a private charge or assessment; (D) provides for an option to purchase, a right of first refusal, or the prior approval of a future purchaser or occupant.. . .
>   (v) Any notices of violation of covenants, conditions, or restrictions relating to environmental protection recorded or filed in the Public Records.
> 2. Any future violation on the Land of any existing covenants, conditions, or restrictions occurring prior to the acquisition of title to the estate or interest in the Land by the Insured, provided the violation results in
>   a. the invalidity, loss of priority, or unenforceability of the lien of the Insured Mortgage; or

---

rescind a purchase of contaminated real estate, the Sixth Circuit held that "_environmental contaminants may diminish the value of the realty, but they do not constitute an encumbrance because they do not affect title." *Donehey v. Bogle*, 987 F.2d 1250 (6th Cir. 1993), reh'g denied, 1993 USApp LEXIS 14303 (1993).

b. the loss of Title if the Insured shall acquire Title in satisfaction of the Indebtedness secured by the Insured Mortgage. . .

5. Any final court order or judgment denying the right to maintain any existing improvements on the Land because of any violation of covenants, conditions, or restrictions, or building setback lines shown on a plat of subdivision recorded or filed in the Public Records.

Wherever in this endorsement the words "covenants, conditions, or restrictions" appear, they shall not be deemed to refer to or include the terms, covenants, conditions, or limitations contained in an instrument creating a lease.

As used in paragraphs 1.b(i) and 5, the words "covenants, conditions, or restrictions" do not include any covenants, conditions, or restrictions (a) relating to obligations of any type to perform maintenance, repair, or remediation on the Land, or (b) pertaining to environmental protection of any kind or nature, including hazardous or toxic matters, conditions, or substances, except to the extent that a notice of a violation or alleged violation affecting the Land has been recorded or filed in the Public Records at Date of Policy and is not excepted in Schedule B.

Coverage over encroachments is found in sections 1.b.iii, 1.b.iv, 3.a and 4. Those coverages are:

The Company insures the owner of the Indebtedness secured by the Insured Mortgage against loss or damage sustained by reason of:

1. The existence, at Date of Policy, of any of the following: . . .

   b. Unless expressly excepted in Schedule B . . .

      (iii) Any encroachment of existing improvements located on the Land onto adjoining land, or any encroachment onto the Land of existing improvements located on adjoining land.

      (iv) Any encroachment of existing improvements located on the Land onto that portion of the Land subject to any easement excepted in Schedule B. . .

3. Damage to existing improvements, including lawns, shrubbery, or trees

   a. that are located on or encroach upon that portion of the Land subject to any easement excepted in Schedule B, which damage results from the exercise of the right to maintain the easement for the purpose for which it was granted or reserved; . . .

4. Any final court order or judgment requiring the removal from any land adjoining the Land of any encroachment excepted in Schedule B.

Mineral coverage in the ALTA 9 is contained in Section 3.b. As we shall see, it changes in the ALTA 9.3. It reads:

3. Damage to existing improvements, including lawns, shrubbery, or trees . . .

   b. resulting from the future exercise of any right to use the surface of the Land for the extraction or development of minerals excepted from the description of the Land or excepted in Schedule B.

The coverage in the ALTA 9 and 9.3 (and their "-06" equivalents) for loan policies is more complete than you will find in the various endorsements for owners' policies. A title insurer may be willing to insure against damage to lawns, shrubbery and trees for a lender because the risk is so remote, but it would be unmanageable to protect an owner from damage to lawns, shrubbery and trees for the exercise of a right to service or maintain an easement. Consequently, the policies for owners do not indemnify the Insured for damage to lawns, shrubbery or trees.

The ALTA 9, 9.1 and 9.2 were revised on June 17, 2006 to add two provisions. First, the revision added a new part (v) to section 1.b. Second, the ALTA added the definition at the end of the covenants, conditions and restrictions provisions in the endorsement. It reflects the inability of a title insurer to determine if an environmental covenant has been violated by a release of toxic or hazardous material on the land.

In addition to these changes to the existing ALTA 9, 9.1 and 9.2, the ALTA adopted three more endorsements, and then adopted -06 variations of those, so this family of endorsements now consists of twelve new endorsements. The new ALTA endorsements correspond to the first set of three REM endorsements as follows:

New endorsement:	Corresponds to:
ALTA 9.3	ALTA 9
ALTA 9.4	ALTA 9.1
ALTA 9.5	ALTA 9.2

They extend the mining coverage, formerly in paragraph 3(b) of the ALTA 9 or paragraph 2 of the ALTA 9.1 or 9.1 to include buildings constructed after the Date of Policy as well as those existing on the Date of Policy. The new provision reads:

4. Damage to improvements, including lawns, shrubbery, or trees, located on the land on or after Date of Policy resulting from the future exercise of any right to use the surface of the land for the extraction or development of minerals excepted from the description of the land or excepted in Schedule B.

Compare this mineral coverage in the ALTA 9.3 to the coverage in the ALTA 9 on the preceding page. Unless there is a significant difference in premium, it would be difficult to justify ordering, say, an ALTA 9 if the ALTA 9.3 is available.

In 2005, the Federal District Court for the Western District of Pennsylvania misinterpreted paragraph 1.b.ii (D)[2] of the ALTA 9, and its misinterpretation appears to erase the coverage.[3] To summarize the facts of the case, Liberty Mills L/P deeded some land to PMI Associates with some restrictions. PMI obtained a mortgage loan form Nationwide Life Insurance. Nationwide's loan policy included an ALTA 9. PMI defaulted and gave Nationwide a deed in lieu of foreclosure. Nationwide asked Liberty Mills' successor, Franklin Mills, to waive a right to approve a purchaser of the property contained in the restrictions imposed by Liberty. Franklin Mills refused.

Nationwide tendered a claim against its title insurer; Commonwealth Land Title Insurance Company, asserting that paragraph 1.b.2 of the ALTA covered this loss. Commonwealth moved to dismiss because the policy included an exception for the restrictions. Paragraph 1 of the ALTA 9 states:

---

[2] I have cited the official ALTA designation for the paragraph. The variant quoted in the decision, and many on the market, use slightly different numbering systems.

[3] *Nationwide Life Insurance Company v. Commonwealth Land Title Insurance Company*, 2005 WL 2716492 (E.D. Pa. 2005 unpublished).

The Company insures the owner of the indebtedness secured by the insured mortgage against loss or damage sustained by reason of:

1. The existence at Date of Policy of any of the following: **. . .**

   b. *Unless expressly excepted in Schedule B:* **. . .**

      ii. Any instrument *referred to in Schedule B* as containing covenants, conditions or restrictions on the land which, in addition, (A) establish an easement on the land; (B) provides a lien for liquidated damages; (C) provide for a private charge or assessment; *(D) provides for* an option to purchase, a right of first refusal or *the prior approval of a future purchaser or occupant.* (Emphasis added).

The court granted Commonwealth's motion to dismiss because there was an exception to the restrictions in Schedule B of the policy, but read paragraph 1.b.ii.

It's plain that 1.b.ii. applies only to instruments referred to in the exceptions in Schedule B, so it makes no sense that an exception to the restrictions also excuses the title insurer of liability. An exception to the restrictions alone should not be enough. The exception must also expressly inform the policyholder that the restrictions include, in this case, a right of Liberty Mills, or its successor, to approve a future purchaser.

How does an insured now get the benefit of paragraph 1.b. of the ALTA 9 with this as a precedent? I suppose you could ask for another endorsement to state that no exception in Schedule B limits the coverage in the ALTA 9. It is clear that the ALTA 9s should be revised so this error will not be repeated. That process is underway.

Nationwide appealed to the Third Circuit and secured a reversal of the trial court decision in a precedential opinion of the court handed down on August 31, 2009.[4] Commonwealth argued that the ALTA 9 did not cover Nationwide's loss because "it was [Nationwide]'s duty to exercise proper diligence before issuing the subject mortgage." It said Schedule B Part II of the loan policy contained a "prioritization of liens" instead of exceptions so the language of the endorsement merely meant that "exceptions" in Part I excluded items from coverage under the ALTA 9, but entries in Part II did not. It was a silly argument. The ALTA 9.2 has the same conditions, but it applies to owners policies that have no Schedule B, Part II. The Third Circuit agreed with Nationwide that "it (1) is covered for loss arising from the rights of refusal contained in the Declaration, and (2) did not bear the burden of diligence to ensure that its title to the Property was free from harmful rights or restrictions."

In reaction to the misinterpretation of the endorsement by the district court, the ALTA decided to revise the ALTA 9 series to clarify the coverage and organize it so it will be easier to understand. Instead of the confusing "Unless expressly excepted in Schedule B" approach, the new endorsements insure against a risk, like a covenant, condition or restriction providing for:

> "an option to purchase, a right of first refusal, or the prior approval of a future purchaser or occupant, unless the exceptions in Schedule B of the policy identify the document or instrument containing the covenants, conditions, or restrictions,

---

4 579 F.3rd 304 (3rd Cir. 2009), *amended* 586 F.3rd 1001 (3rd Cir. 2009).

and, in addition, state that the document or instrument includes . . . the private charge or assessment or (d) the option to purchase, right of first refusal, or the prior approval of a future purchaser or occupant, that caused the loss."

This improves on the older versions because the older versions only applied the coverage to covenants, conditions and restrictions if there was an exception to them in Schedule B of the policy. The coverage for missed covenants, conditions and restrictions was the policy coverage only, and it was not as specific as in the endorsements. In the new endorsements, the coverages apply to covenants, conditions or restrictions unless there is an exception that identifies the document creating them, and in addition, specific identification of the violation or feature in the covenants, conditions or restrictions.

The endorsements were reorganized so that all of the coverages relating to covenants conditions and restrictions are listed in paragraph 1.a. of the endorsement. Paragraph 1.b. contains those exceptions that were at the end of the earlier endorsements. Paragraph 2.a. contains the encroachment and mineral coverages, and paragraph 2.b. contains an exception for damage resulting from contamination, fire, explosion or subsidence as to the minerals coverage in Paragraph 2.a.iii.(2).

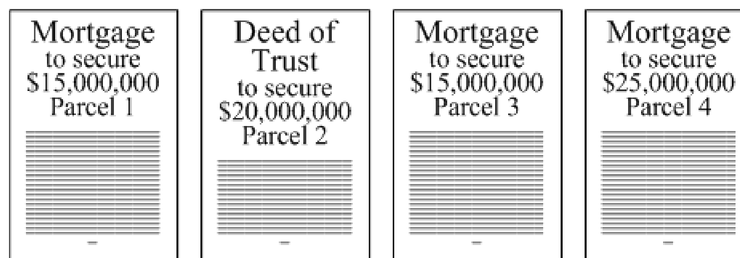
F. Aggregation
ALTA 12-06

1. Mortgage lien types

A group of liens in a financing may be created as a group of separate liens, or a group of aggregate liens. For illustration, let's imagine that we have a $75,000,000 financing that will be secured by four properties, each located in a different state.

a. Separate Liens.

Using separate liens, we could encumber our parcels 1 through four with mortgages limited to the value of a discrete note for each mortgage. Although the total of these liens is $75,000,000, the lender is limited to allocation on each site, as illustrated by these security instruments.

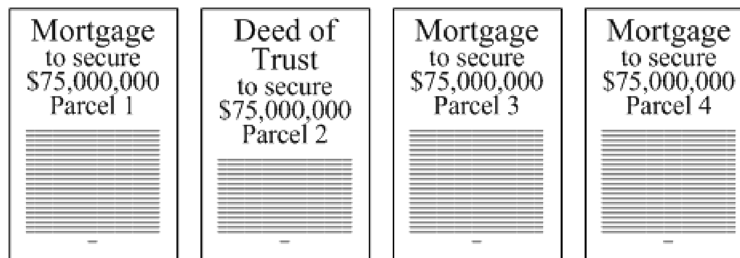


A competing creditor that examines the title to Parcel 1 will conclude that it is encumbered by a lien in the amount of $15,000,000. If Parcel 1 is worth more, say $25,000,000 the competing creditor expects equity in the amount of $10,000,000 to secure its extension of credit to the same borrower. Upon foreclosure of the first loan, the holder of this mortgage will be limited to the first $15,000,000 of proceeds. The mortgages do not each secure the aggregate loan amount of $75,000,000.

If these liens are "cross-defaulted" and "cross-collateralized, does that convert the liens to an aggregate lien? No. The mortgages are still limited to the amount they state that they secure. "Cross-default" simply means that a default on one mortgage is a default on all of them. That has no effect on the amount secured. If the mortgages are cross-collateralized, the lien may secure all four notes, but it is still limited by the amount the mortgage states that it secures. For example, if our lender accelerates the indebtedness on these loans and is partially paid, it may apply the payment to retire the notes on Parcels 1 & 2, and keep its liens on those parcels to secure the payment of the notes on Parcels 3 & 4. However, the lien on Parcel 1 remains at $15,000,000, not $40,000,000. The lien on Parcel 2 is still $20,000,000. By adding cross-default and cross-collateralization features, the lender has a more flexible security package, but it is not as flexible as an aggregate lien.

b. Aggregate Liens.

The lender can also structure its security instruments as "blanket mortgages" to give competing creditors notice that each stands as security for a total indebtedness of $75,000,000 by showing that amount in the mortgage, instead of discrete values allocated to each site.



Each "blanket mortgage" must state the entire indebtedness that the lender seeks to secure with all four parcels. An aggregate lien is cross-defaulted and cross-collateralized by its very nature since it is a single loan secured by four mortgages. A default on the single obligation is a default on all four mortgages, and all four mortgages secure the same obligation.

Structuring with an aggregate lien does have some weaknesses. It may take some persuasion to convince the clerk or registrar that any mortgage tax that may be due, is just due on an allocated amount when the mortgage shows an aggregate amount. It may take some extra effort, but we are usually successful. In addition, a blanket mortgage can defeat the isolation sought when a borrower is structured with Special Purpose Vehicles to hold title to the security. In many transactions this is overcome with an allocated first mortgage and a blanket second mortgage.

c. Requiring an Aggregate Lien for Aggregate Title Insurance.

Does it make any sense to increase the Amount of Insurance on Parcel 1 to $75,000,000 if the lender limited its own lien to $15,000,000? If we increase the Amount of Insurance to $75,000,000 on a separate lien for Parcel 1, are we misleading the insured into thinking that it successfully created an aggregate lien on all four properties? What happens if the lender, having separate liens, tries to recover substantially more than $15,000,000 on Parcel 1 after suffering a total failure of title on that site? Isn't the risk substantially greater once the lender seeks a recovery above its stated lien? Have you noticed that there are no answers, only questions, in this section?

d. Are There any Aggregate Ownership Interests?

There are few parallels in ownership or leasehold interest to an aggregate lien. Each parcel has its own discrete value. Of course, if a group of parcels are assembled into one parcel in a single site, you can argue that the values are now an aggregate, and may bear no relation to the values of the individual lots. Also, its conceivable that a group of unconnected sites might have an independent value as a group. A cell tower net might be an example. If one site is lost, it could create a hole in cell coverage, reducing the value of the network.

2. Aggregation in title insurance

a. Owner's Policies.

We have observed that aggregation exists in only very limited circumstances when we consider ownership and leasehold interests. Section 8 of the ALTA 1992 and earlier ALTA owner's policies is an "Apportionment" provision. It prevents aggregation in owner's coverages. Section 8 of a 1992 ALTA Owner's policy states:

> If the land described in Schedule A consists of two or more parcels which are not used as a single site, and a loss is established affecting one or more of the parcels but not all, the loss shall be computed and settled on a pro rata basis as if the amount of insurance under this policy was divided pro rata as to the value on Date of Policy of each separate parcel to the whole, exclusive of any improvements made subsequent to Date of Policy, unless a liability or value has otherwise been agreed upon as to each parcel by the Company and the insured at the time of the issuance of this policy and shown by an express statement or by an endorsement [attached to this policy].

In a multi-site transaction, this Apportionment clause limits recovery under an owner's policy to the pro rata allocation or value of the affected property on the date of the policy and prevents shifting of coverage from an unaffected property to the affected property. It applies automatically, even if there is no express allocation of property values in the policy or at the closing.

If a multi-property transaction assembles the properties into a "single site" the apportionment provision does not apply to the assemblage. The individual values for the assembled lots become irrelevant to the insurance. Otherwise, aggregation in owner's policies has been quite rare.

The 2006 ALTA Owner's Policies dropped the Apportionment provision. It opens the door for aggregation of owner's coverages. It is too early to see how title insurance companies and consumers will react to this development.

b. Loan Policies.

The ALTA Loan policies contain no apportionment provision. As a result, the insured is not restricted from "shifting" coverage from an unaffected property to a property affected by a defect, lien or encumbrance insured against by the same policy to realize any appreciation in value of the affected property as an offset for a diminution in value of unaffected properties. By this form of aggregation of the coverage amounts, lenders can reduce their risk of loss due to inflation and fluctuations in real property values.

In our second illustration, if the title insurer issues a single policy for all four sites in the aggregate amount, the insured can shift the coverage from one site unaffected by title problems

to another suffering a title loss. The aggregation of the title insurance coverage matches the aggregation of the lien of the mortgages.

Aggregation in a single loan policy works, but this form of aggregation often creates some problems. The policy forms used in some states may not be available in others, making this solution unavailable in some transactions. In addition, reviewing large policies with numerous properties can be tedious. It may be a manageable solution for transactions with a limited number of properties, but it can be unmanageable for larger transactions. Many states require a licensed resident to countersign a title insurance policy, so in multi-state transactions, delivery of the loan policy can be delayed while the policy is passed from one office to the next for review and execution.

Issuing separate policies, each in the aggregate amount exposes the title insurer to questions about the premium and premium tax due. In a claim, the insured may expect a limit of $75,000,000 for each site, an aggregate of $300,000,000. This approach can be very confusing and expensive for all parties.

Of course, one might buy more insurance. For example, if the borrower is restricted to a loan not to exceed 80% of the value of the real estate, a loan policy issued for the full value of the property may provide enough cushion. Where the borrower is buying owner's policies as well as loan policies, this technique would cost no more than ordering loan policies at the allocated amount because the simultaneous premium rate would apply to both. Some lenders initially ask their borrowers to buy a policy on each property in the full amount of the aggregate loan, but this requirement is unnecessarily extravagant.

c. Regulation of Aggregation.

Do any states impose restrictions on the use of aggregation in title insurance? There are a few restrictions and they are detailed in the following table.

FL	Aggregation is restricted to properties within Florida. Properties outside the state cannot be aggregated with properties in Florida.
PA	Aggregation is restricted to properties within Pennsylvania. Properties outside the state cannot be aggregated with properties in Pennsylvania.
DE	Aggregation is restricted to properties within Delaware. (As in PA).
NC	Aggregation is restricted to properties within North Carolina. Properties outside the state cannot be aggregated with properties in North Carolina.
TX	Texas allows interstate aggregation. All policies, however, must be issued simultaneously.

d. The ALTA 12-06 Aggregation Endorsement.

In October 1996, the American Land Title Association adopted the ALTA 12 Aggregation Endorsement. It solves several problems. First it allows each policy to state an allocated value for each property, making the process of defending allocated recording costs and taxes, and title insurance premiums much easier. It overrides that value for the Amount of

Insurance, so the Amount of Insurance on each mortgage is the aggregate amount, but the payment of a claim on any property reduces the aggregate amount. It makes local countersignatures easy and efficient.

When the parcels are scattered in different areas it has been the custom to open the title order for individual policies for each parcel with an office in that parcel's locality. Instead of a single policy, individual policies are generally issued. It's easier on everybody and using the ALTA 12 gives the same result as using a single policy.

As we have seen, individual policies for each parcel can be produced more quickly and accurately and the coverages can be reviewed more easily than a single policy, but the amount of coverage suffers by losing the ability to aggregate amounts. Adding an ALTA 12 aggregation endorsement to each single policy for all parcels or individual policies restores the ability to shift coverage among the properties, but without sacrificing the effect of using a single policy. Review is simplified because the exceptions for a particular property are the only exceptions that will appear in the policy for that property.

G. Leaseholds

ALTA 13-06 (Owners) & 13.1-06(Loan)

The original 1975 Leasehold policies were designed with a simple operating lease in mind. If the holder of leased space was dispossessed as a result of a defect in either the landlord's title or the lease itself, the title policy would indemnify the holder for the increased cost of leasing an alternate space, and give some "Miscellaneous Items of Loss" as well. The ALTA may have seen the market in 1975 as the market for simple operating leases of offices and store bays in shopping centers, but leaseholders in those markets did not sense enough coverage in the leasehold policy to make it a worthwhile hedge to the risks they faced. Consequently, the ALTA leasehold policy was never popular. The policy missed the developing markets in real estate leasing.

Leases have been used as a financing tool for decades. Sale-leaseback transactions have been commonplace at least since the 1960's in my own experience. In the last two decades of the twentieth century, leasing transactions have become even more significant in financing real estate transactions. We see leveraged leasing of build to suit projects, ground leases with tenant build to suit projects, and synthetic leases, just to name some of the recent applications.

1. Definitions.

The ALTA 13 begins by adding seven definitions to the policy. Here is a look at Section 1 of the ALTA 13:

1. As used in this endorsement, the following terms shall mean:
    a. "Evicted" or "Eviction": (a) the lawful deprivation, in whole or in part, of the right of possession insured by this policy, contrary to the terms of the Lease or (b) the lawful prevention of the use of the land or the Tenant Leasehold Improvements for the purposes permitted by the Lease, in either case, as a result of a matter covered by this policy.
    b. "Lease": the lease agreement described in Schedule A.
    c. "Leasehold Estate": the right of possession for the Lease Term.

d. "Lease Term": the duration of the Leasehold Estate, including any renewal or extended term if a valid option to renew or extend is contained in the Lease.

e. "Personal Property": chattels located on the land and property which, because of their character and manner of affixation to the land, can be severed from the land without causing appreciable damage to themselves or to the land to which they are affixed.

f. "Remaining Lease Term": the portion of the Lease Term remaining after the insured has been Evicted as a result of a matter covered by this policy.

g. "Tenant Leasehold Improvements": Those improvements, including landscaping, required or permitted to be built on the land by the Lease that have been built at the insured's expense or in which the insured has an interest greater than the right to possession during the Lease Term.

The Leasehold policy limited its definition of “Lease” as “subject to any provisions contained in the Lease which limits the right of possession.” The limitation was dropped because it received so much resistance from customer groups consulted in the drafting process. Although title insurers do not intend to protect policyholders from the consequences of their own agreements, the limitation in policy definition of “Lease” was not the only provision giving the title insurer this protection in the policy. The insurer is also protected by the “acts of the insured” Exclusion 3(a).

2. Valuation.

Although the valuation provision of the ALTA 13 does not appear until Section 3 of the endorsement, it is the most significant change in the ALTA leasehold coverages.

3. Valuation of Estate or Interest Insured

If, in computing loss or damage, it becomes necessary to value the estates or interests of the insured as the result of a covered matter that results in an Eviction, then that value shall consist of the value for the Remaining Lease Term of the Leasehold Estate and any Tenant Leasehold Improvements existing on the date of the Eviction. The insured claimant shall have the right to have the Leasehold Estate and the Tenant Leasehold Improvements valued either as a whole or separately. In either event, this determination of value shall take into account rent no longer required to be paid for the Remaining Lease Term.

There is no method specified for valuing either the Leasehold Estate or the Tenant Leasehold Improvements. It does recognize that the Leasehold Estate and the Tenant Leasehold Improvements can be valued independently. In short, the methods for valuing a loss and its deductions under this new endorsement are left to negotiation between the insured and title insurer when adjusting a claim.

3. Coinsurance.

Most leasehold interests are shorter than 99 years; so applying the coinsurance provisions of Section 7(b) makes little sense in the leasehold endorsement. The values we must use for insuring most leasehold estates are imprecise, at best. We don’t have a convenient, arms length purchase price as we do in most real estate conveyances. In the development of the ALTA 13, the Forms Committee made the coinsurance provision inapplicable to Leasehold Estates. It provides:

2. The provisions of subsection (b) of Section 7 of the Conditions and Stipulations shall not apply to any Leasehold Estate covered by this policy.

However, Section 2 of the ALTA 13 may mislead the incautious insured. It does provides that the coinsurance limitations on coverage contained in Section 7(b) of the policy do not apply to the Leasehold Estate, but does not make Section 7(b) inapplicable to Tenant Leasehold Improvements. If Leasehold Estates and Tenant Leasehold improvements are independent primary items of loss, then Section 7(b) still must apply to the Tenant Leasehold Improvements. This shouldn't be too alarming. If the insured owns or builds Tenant Leasehold Improvements at the outset of the leasehold estate, it should have an investment or purchase value for those assets. It has not bargained to rent them for the term of the leasehold estate.

You will not find a provision corresponding to Section 2 of the ALTA 13 in the ALTA 13.1, but leaving it out was no oversight. ALTA Loan policies do not have coinsurance provisions. Consequently, there is no need to include a corresponding coinsurance section in the ALTA 13.1. The coinsurance provision is also missing from both the ALTA 13-06 and 13.1-06 because the 2006 ALTA policies have no coinsurance provisions. We have come full circle to the position of the 1970 ALTA Policies on coinsurance.

4. Tenant Leasehold Improvements.

As we have seen, Section 1(g) of the ALTA 13 added a definition of Tenant Leasehold Improvements to protect the insured's investment in these assets. The definition encompasses any improvements, including landscaping, taking a lead from the ALTA 9 Endorsement that protects interests in "lawns, shrubbery or trees" in several sections. Recognizing landscaping as "improvements" is not unique, but certainly a new development for leasehold coverages.

Of course, as we saw on page 17, Section 3 of the ALTA 13 brought a recognition of damage or loss to the Tenant Leasehold Improvements to leasehold title insurance. In addition, supporting the conclusion that loss to Tenant Leasehold Improvements is a primary coverage, Section 3 empowers the insured to elect whether to have the Leasehold Estate and Tenant Leasehold Improvements valued together or separately. However, there is one other provision for valuation of Leasehold Tenant Improvements that was added in the ALTA 13.

Determining the value of Tenant Leasehold Improvements becomes really difficult if the tenant is in the process of building a significant structure on its leasehold when its right to possession is challenged. This isn't just a case of bad luck. The risk of a challenge to title is greatest during the construction of improvements because the evidence of the construction announces the tenant's claim to the land to any who see it.

An appraiser will not give a high value to incomplete improvements. Indeed, many times an incomplete project may actually reduce the appraised value of land. If the incomplete structure must be demolished as useless, the cost of removal must be deducted from the market value of the raw land. Even if the construction is only interrupted, it often costs substantially more to resume and finish the construction than it would if the construction had progressed without the interruption. If a leasehold was insured with either a leasehold or owner's policy, the title insurer might reduce or deny a claim for the value of the tenant's investment in the leasehold improvements by asserting that the incomplete project had little or no value.

This problem with valuation of improvements under construction is not confined to leasehold estates. It applies to any project under construction. Title insurance had never

addressed this problem in a standard policy or endorsement coverage until the ALTA 13 addressed it in Section 4(g) of the Additional Items of Loss:

> 4. Additional items of loss covered by this endorsement:
>
> If the insured is Evicted, the following items of loss, if applicable, shall be included in computing loss or damage incurred by the insured, but not to the extent that the same are included in the valuation of the estates or interests insured by this policy. . . .
>
> g. If Tenant Leasehold Improvements are not substantially completed at the time of Eviction, the actual cost incurred by the insured, less the salvage value, for the Tenant Leasehold Improvements up to the time of Eviction. Those costs include costs incurred to obtain land use, zoning, building and occupancy permits, architectural and engineering fees, construction management fees, costs of environmental testing and reviews, landscaping costs and fees, costs and interest on loans for the acquisition and construction.

Section 4(g) allows the insured to recover its investment in the construction, as well as those "soft costs" it expressly lists. It significantly expands the measure of damages under a title insurance policy, and the only reason for confining this coverage to leasehold estates is the greater difficulty that title insurers have experienced in breaking into the leasehold title market. We should expect pressure to migrate this type of coverage into fee ownership development transactions as well.

5. The "Eviction" Trigger.

In the process of drafting this endorsement, several of those involved questioned the use of the terms "Evicted" and "Eviction" as the trigger for coverage under the ALTA 13. It was criticized as sounding too rigid and might suggest that loss under the endorsement required a judicial eviction. The word "ouster was also considered, but rejected because the definitions of "ouster" included denial of possession to a rightful owner. It didn't fit. To resolve this concern, the definition was crafted to avoid a rigid construction for the term.

Section 15 of the old leasehold Policy also used the terms "evict" and "eviction," though it did not define them. The definition added to the ALTA 13 in Section 1(a) of the endorsement should allay any concerns that the words imply a requirement for a judicial proceeding:

> a. "Evicted" or "Eviction": (a) the lawful deprivation, in whole or in part, of the right of possession insured by this policy, contrary to the terms of the Lease or (b) the lawful prevention of the use of the land or the Tenant Leasehold Improvements for the purposes permitted by the Lease, in either case, as a result of a matter covered by this policy.

Under this definition "Eviction" may be either a lawful deprivation of the right of possession under the lease or the lawful prevention of the use of the land "for the purposes permitted by the lease." That's an additional nugget for the insured. Title insurance policies do not usually insure land use issues without an endorsement like the ALTA 3.1, but the ALTA 13 requires a prudent title insurance underwriter to compare the uses specified in a lease with the land use regulations that apply to the land to avoid losses under this definition.

The definition does create a coverage trigger. You must have an eviction before you can show a loss under this policy. It is important to recognize that this is no mere definition, even though it is included in Section 1 of the endorsement.

6. Additional Items of Loss.

When the first Leasehold policies were adopted in 1975, their best feature was a set of unusual consequential damage provisions in Section 15 that were entitled “Miscellaneous Items of Loss” On reflection, the Forms Committee twenty five years later decided that it could improve the title. The old caption in the policy suggests that these provisions are “miscellaneous,” almost an afterthought. However, they were revolutionary for their time, at least, they were revolutionary for the realm of title insurance. Title insurers avoid recognizing consequential damages as “loss” because consequential damages are so open ended. The new title is just a revision of the old, but it does invite the policyholder to read Section 4 of the ALTA 13 to find those ‘additional’ coverages.

It should be no surprise that these consequential damage provisions were kept in the ALTA 13. They were edited for some minor grammatical changes, to reflect the new definitions of terms in Section 1 of the ALTA 13, and to include the addition of Leasehold Tenant Improvements into the coverage. The grammatical changes were fairly harmless, like the substitution of “that” for “which” in Sections 4(c) & (e). With the addition of new definitions in Section 1, it makes sense that they would be incorporated wherever they would fit in the leasehold coverage. The definition of “personal property” formerly found in Section 15(a) of the Leasehold Policy was edited and moved to Section 1(e) of the ALTA 13.

Section 15(a) of the old “Miscellaneous Items of Loss” allowed payment of the costs of relocating personal property removed from the insured land to a replacement leasehold, but the title insurer would only pay for cost of transportation for the initial twenty-five miles. The idea was to limit the insured to relocations in the same area as the insured land. Title insurers did not want to be caught paying for transportation over long distances. I think this meant that the title insurer would pay for all the removing and relocating operations that take place at the origin and destination, but if the distance between the two exceeds twenty-five miles, the insurer would pay for the first twenty five miles of travel and the insured must pay for any additional travel.

Section 15(a) expanded the radius from twenty-five to one hundred miles. There are perhaps two reasons for this wider radius. First, title insurers have experienced very little, if any, losses based on Section 15(a), so the Forms Committee saw little risk in expanding the range to one hundred miles. Secondly, a one hundered mile radius is more attractive to title insurance consumers than a twenty-five mile radius, and the Forms Committee saw an opportunity to make the ALTA 13 more appealing than its predecessor.

Expanding from a twenty-five mile radius to a one hundred mile radius is a substantive change, but not very material. If our experience with Section 15(a) of the Leasehold Policy is any measure, few, if any, policyholders will realize a benefit from the change. Of course, all policyholders are better off for the change because we cannot identify that few at the outset. Some customers in the past have asked for changes to old Section 15(a) because it didn’t meet their needs. A jet engine rework facility located at a south Florida airport many years ago asked for a change because the business required a location on the ramp at an airport. The customer was concerned that no suitable site might be located within twenty-five miles. We agreed to modify Section 15(a) to encompass a move anywhere within the state.

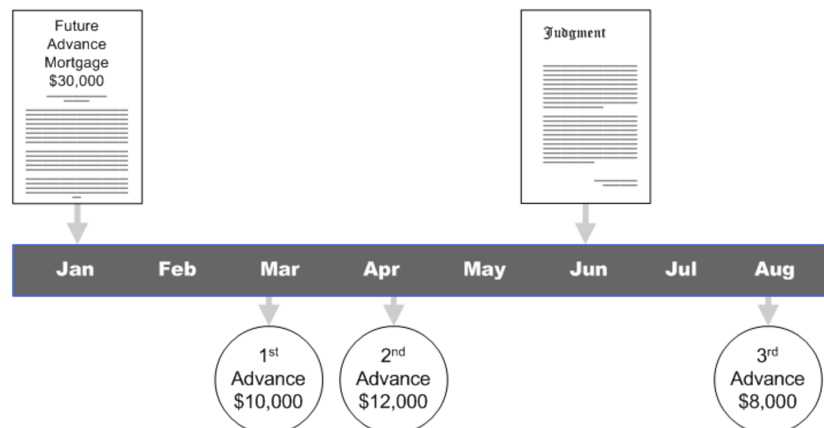
For title insurance customers with bond leases with "hell or high water" provisions that require the lessee to continue paying its 'rent' even after it has been evicted from the premises, Section 4(c) provides protection against that risk. I am mildly astonished that so few of these customers raise this issue and seek this coverage. Many, in recent years, have demanded ALTA Owner's Policies instead of leasehold policies, and have let the coverage slide in making the requirement. It should not be necessary with the ALTA 13.

The ALTA also added two new provisions to the Additional Items of Loss in the ALTA 13. We examined the valuation provisions for a new project under construction in new Section 4(g) in the discussion of Leasehold Tenant Improvements on page 19. Section 4(f) is also new, and reimburses the policyholder for the expenses to get a replacement Leasehold Estate. Like Section 4(g), Section 4(f) introduces the prospect of including "soft costs" into the computation of an insured's damages.

H. Future Advances

ALTA 14-06 (Priority), 14.1-06 (Knowledge), 14.2-06 (Letter of Credit) & 14.3-06 (Reverse Mortgage)

Let's begin by illustrating the future advance issue with a simple example. A borrower gives its lender a future advance mortgage to secure $30,000 in January. The lender advances $10,000 in March and another $12,000 in April. A competing judgment lien is perfected against the borrower in June. The lender makes a final advance of $8000 in August. What are the issues created by this structure? Advances 1 & 2 should be safe in any state. That third advance might have priority over the judgment lien, or not.



With an ALTA loan policy, the future advance lender has no protection for the lien of the mortgage as security for these future advances. The loan policy was designed to insure mortgages securing conventional term loans, so it does not insure that the lien of the mortgage either:

a. secures future advances made to or on behalf of the borrower; or

b. has priority over matters intervening in the records between the recording of the mortgage and the date of a future advance.

It might seem that these are deficiencies in the policy itself that would be better addressed by amending the policy, but many states impose requirements on the mortgage form if it is expected to secure future advances. An underwriter must first decide if the mortgage meets state requirements before it is appropriate to insure future advances

In addition, the priority rules for future advances vary from state to state. A title insurance underwriter must also satisfy itself that the coverage matches the state priority rule before insuring advances. Before we address the ALTA future advance endorsements, let's take a brief look at the risks and those policy provisions that apply to future advances, so we will understand why we must have at least three forms of endorsement.

1. Protective Advances.

If the third advance in the illustration on page 21 was not made to the borrower, but was used to pay real estate taxes, or to prevent or repair waste to the security, the title policy does insure that the mortgage secures it. These protective advances are not made to or on behalf of the borrower, but are made by the lender to preserve the value of the security where the borrower is in distress.

If the lender fails to make a protective advance, it might lose its security to a tax foreclosure, or witness a decline in value as the improvements fall into disrepair. Also, if the lender fails to police its security, its neglect may harm junior creditors and the borrower, as well. So most states allow these advances, even if the mortgage itself gives no notice that the lender might advance funds in the future.

The 1992 ALTA Loan policy recognized the preferred status of a protective advance. As we shall see on page 24, the policy expressly covered protective advances in Section 8(d) of the policy Conditions and Stipulations. They are also included in the amount of insurance defined in Section 2(c)(ii):

(c) Amount of Insurance. The amount of insurance after the acquisition or after the conveyance shall in neither event exceed the least of:

(i) the Amount of Insurance stated in Schedule A;

(ii) the amount of the principal of the indebtedness secured by the insured mortgage as of Date of Policy, interest thereon, expenses of foreclosure, *amounts advanced pursuant to the insured mortgage to assure compliance with laws or to protect the lien of the insured mortgage prior to the time of acquisition of the estate or interest in the land and secured thereby and reasonable amounts expended to prevent deterioration of improvements, but reduced by the amount of all payments made*; or

(iii) the amount paid by any governmental agency or governmental instrumentality, if the agency or instrumentality is the insured claimant, in the acquisition of the estate or interest in satisfaction of its insurance contract or guaranty. [Emphasis added]

The 2006 ALTA Loan policy recognizes protective advances in its definition of the term "Indebtedness" in Condition 1(d).

2. Does the policy insure that the mortgage secures advances to or on behalf of the borrower?

A mortgage may be silent about the potential for future advances, contain a future advances provision or contain a 'dragnet' provision. However, it would be imprudent to insure any but protective advances if the mortgage gives no notice that it secures future advances.

We can distinguish between future advance provisions and 'dragnet' provisions. A future advance provision indicates that the note or loan agreement establishes the potential for advances in the future that will be secured by the mortgage. A revolving credit line or home equity loan is a familiar example of a future advance loan.

A 'dragnet' provision may appear in a mortgage with or without a future advance provision. It may indicate that the mortgage secures all debts, past, present and future that the borrower may owe the lender. It is named for its ambitious scope. Courts tend to be more critical of mortgages with dragnet provisions than mortgages with typical future advance features because of the potential overreach. *Home Federal Bank FSB of Middlesboro v. First National Bank of Lafollette*, 2002 TN 1392 (TNCA 2002); *see*, *Uransky v. First Federal Savings and Loan Association of Fort Meyers*, 684 F2.d 750 (11th Cir. 1982).

Even if the mortgage includes a 'dragnet' provision, it can only secure advances that are of the same kind and nature as the loan secured. It usually cannot secure both the outstanding balance of the loan and liability for unrelated tortious conduct.

a. The risk that the mortgage does not secure advances to the borrower.

So, at a minimum, a mortgage must give other creditors notice that it secures future advances and it must state the maximum indebtedness it secures. These requirements may be set by statute or expressed in case decisions addressing future advances or dragnet provisions. If a mortgage fails to indicate that it will secure future advances and set a maximum amount, a court is unlikely to extend its protection for subsequent advances to or on behalf of the borrower. In addition, some state statutes require additional provisions in the mortgage or deed of trust form before it will secure future advances. These may be simple captions at the top of the mortgage. In most states the mortgage should also specify that it secures a 'credit line' or 'readvances' if the loan is a revolving credit line.

Even if a mortgage meets all state requirements for future advances, the lender cannot proceed with advances after a petition in bankruptcy has been filed by or on behalf of the borrower. The automatic stay under 11 U.S.C. 362 will bar the mortgage from securing post-petition advances, unless the bankruptcy court authorizes them. There is an exception to this rule for payments made under a letter of credit, but I will address it separately on page 26.

There are some other obstacles to future advances. Mortgage recording taxes can make revolving credit lines unworkable if the tax is due on the aggregate amount disbursed. In New York, one can pay mortgage tax on the maximum balance to be secured by a commercial mortgage for more than $3,000,000, and record the mortgage. The state will not seek any more tax unless the mortgage is modified or foreclosed. If the parties modify the mortgage, they must disclose the aggregate amount disbursed in the 255 affidavit, and pay tax for the aggregate in excess of the maximum amount stated in the mortgage. *See*, N.Y. TAX LAW §255. If the lender forecloses, it must also pay tax on the excess of the aggregate over the maximum balance on

which the original tax was paid. However, New York will not seek extra tax just to record a satisfaction of the mortgage, even if the aggregate amount disbursed exceeded the maximum balance on which the original tax was paid. That potential mortgage tax liability for mortgage modifications and foreclosures chills the market for commercial future advance mortgages in New York.

A few states have laws that automatically release the lien of the mortgage if the outstanding principal balance of the loan reaches zero. A lender can usually defeat these statutes by adding a provision for securing advances following a zero balance of principal indebtedness. *Martin v. Fairburn Banking Company*, 463 S.E. 2d 507 (Ga. App. 1995).

Some states impose a time limitation for making secured advances. For example, Florida and New York set a limit of twenty years. North Carolina limits the protection of the lien of the mortgage to advances made within fifteen years from the date of the mortgage. South Dakota sets a maximum of five years.[5]

b. Section 8(d) of the loan policy Conditions and Stipulations.

Most future advance lenders expect, as a minimum, that their title insurance policy would insure that their mortgage or deed of trust would *secure* advances made after the date of the policy. Although all states recognize that mortgages or deeds of trust can *secure* future advances or obligations, as we have seen, there are some circumstances where security may be lost. So, as basic as security for future advances may appear, a lender with an unmodified ALTA loan policy will not have coverage for any advances except protective advances because of Section 8(d) of the Conditions and Stipulations:

> (d) The Company shall not be liable for: (i) *any indebtedness created subsequent to Date of Policy* except for advances made to protect the lien of the insured mortgage and secured thereby and reasonable amounts expended to prevent deterioration of the improvements: or (ii) construction loan advances made subsequent to Date of Policy, except construction loan advances made subsequent to Date of Policy for the purpose of financing in whole or in part the construction of an improvement to the land which at Date of Policy were secured by the insured mortgage and which the insured was and continued to be obligated to advance at and after Date of Policy. [Emphasis added].

A title insurer can overcome Section 8(d) and insure that advances are secured by the lien of the insured mortgage, but it should first review the mortgage or deed of trust to assure itself that the mortgage contains those provisions required by state law to secure future advances. We will examine how to alter the policy for future advances after we look at priority.

There is no equivalent for Section 8(d) in the 2006 ALTA Loan Policy. However, the Covered Risks do not include future advances, so there is no express coverage for the validity and enforceability of the lien of the Insured Mortgage as to advances.

4. Priority of advances.

It's not enough to insure that an advance is secured by the mortgage, a prudent lender also wants insurance of the priority that advance will enjoy against liens junior to the mortgage.

---

[5] FLA. STAT. §697.04; N.Y. REAL PROPERTY LAW §281; N.C. GEN. STAT. §45-68; S.D. CODIFIED LAWS §44-8-26.

If we refer back to our example on page 21, assuming that we have a future advance mortgage, the advances in March and April are pretty safe. Its that August advance that might be subordinate to the judgment lien. To evaluate its priority, we must know the answers to two questions:

a. Are the advances optional or obligatory?

b. If the advances are optional, what priority rule applies?

a. Optional or obligatory?

To be an obligatory advance, the lender must have a duty to make the advance, even if it would prefer to decline advancing the disbursement. If an advance is optional, the lender has a choice. It may advance or not.

If the borrower is financially healthy, the lender will readily advance because it is in the business of making loans. If it thinks the borrower is in distress, it may decline a request for an advance, if it can. These distinctions may look clear, but there are problem areas. Although a lender may characterize its advances as obligatory, few will 'obligate' themselves to advance funds without also requiring the borrower to meet certain financial tests before each advance. If the borrower must pass a test before each advance, is the advance really obligatory or is it optional? Just when the lender needs the priority of obligatory advances, it may lose them where the borrower fails the tests set up in the loan documents.[6]

b. Priority

Many states have statutes or case law that apply the priority of the mortgage itself to any advance, whether obligatory or optional and whether or not the future advance lender has received notice of an intervening lien. In some cases, it appears that a statute was intended to create this result, but it might be poorly worded, so there is some risk that a court may construe it as creating notice priority. However, where this rule applies, it is unnecessary to distinguish between optional advances and obligatory advances.

'Priority' is a bit of a misnomer. The advances don't have priority over everything, but they are superior to advances made under notice priority rules. A priority advance may still be subject to certain risks:

- Real estate taxes and assessments. This should be no surprise because any amount secured by the mortgage is subject to taxes and assessments.
- A federal tax lien under 26 U. S. C. §6321 filed more than 45 days before the advance.
- Federal or state environmental protection liens.
- In some states, specified risks like judgments or mechanic's liens may take priority over full priority advances.[7]

---

[6] *See*, Colavito: *Credit Line Mortgages – Problems and Challenges*, Lawyers Supplement to the GUARANTOR (Chicago Title Insurance Company, January/February 1985).

[7] *See*, D.C. CODE ANN. §42-2303; S.C. CODE ANN. §29-3-50; VT. STAT. ANN. tit. 27 §410; VA. CODE ANN. §55-58.2; W. VA. CODE §38-1-14.

c. Notice priority

The distinction between ‘priority’ and ‘notice priority’ is quite simple. An advance in a notice priority state may be subject to all of the risks that it would be subject to in a full priority state, but it is also subject to a lien perfected after the mortgage if the intervening lienor gives either actual or written notice of the intervening lien to the future advance lender. If we look at our simple future advance example on page 21, the third advance would take priority over the intervening judgment lien in a full priority state, but it would be subject to the judgment lien in a notice priority state if the judgment creditor gives the lender notice of its judgment. The first two advances would take priority over the judgment in both cases. Lenders see the ‘full priority’ risks listed above as unpleasant but manageable. However, losing priority to a competing creditor is especially galling.

The real problem here is determining if notice is effective. When the notice rule evolved, most mortgage lenders were local, so a competing creditor could take its notice to the bank building, and leave confident that it had upset the priority of any subsequent advances. With national lenders, it is conceivable that some director, officer employee or agent might learn of facts that could upset the priority of an advance, but not know anything about the significance of those facts to a future advance loan.

d. Exclusion 3(d)

In addition to insurance that advances are *secured* by the insured mortgage, a lender will request coverage insuring that the *priority* of each advance will relate back to the mortgage and be superior to any matter intervening between the time the mortgage was recorded and the time the advance is made. Exclusion 3(d) of the Exclusions from coverage expressly excludes priority coverage for advances from the ALTA policy forms. If it remains unmodified in the policy, there will be no coverage against loss of priority of future advances as a result of matters that attach or are created after the policy date (which should be the date the mortgage is recorded).

ALTA loan policies - Paragraph 3(d) of the Exclusions:

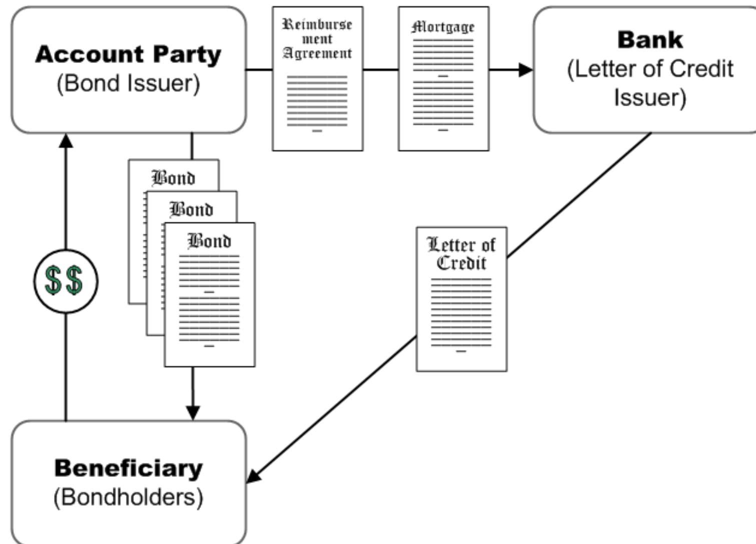
> The following matters are expressly excluded from the coverage of this policy and the Company will not pay loss or damage, costs, attorneys' fees or expenses which arise by reason of: ...
>
> 3. Defects, liens, encumbrances, adverse claims or other matters: ...
>
>   (d) attaching to or created subsequent to Date of Policy (except to the extent that this policy insures the priority of the lien of the insured mortgage over any statutory lien for services, labor or material) ...

5. Letters of credit and surety bonds.

Some disbursements enjoy general recognition as obligatory, but, as we have seen, others may be in doubt. The disbursements universally recognized as obligatory beyond question arise from standby letters of credit and surety bonds. They play by rules not generally applicable to future advances.

A letter of credit transaction involves three parties, the letter of credit issuer, its customer who asks for the letter of credit and a third party contracting with that bank customer who will not accept the customer’s credit for a transaction. It wants the bank’s credit instead. Let’s

imagine a simple bond transaction, where the bondholders are unwilling to accept the bond issuer's credit, and don't want the trouble of foreclosing as a remedy if the bond issuer defaults. The bank will issue its letter of credit and take a mortgage to secure its customer's reimbursement obligation. The transaction will diagram like this:



If the Account Party defaults in its obligation to the bondholders, the advance, if you want to call it that, will be paid to the bondholders when they present the letter of credit to the bank. No money will be disbursed to the Account Party, although it is the real borrower. This structure gets favored treatment in bankruptcy and for federal tax liens because the bank has an absolute obligation to pay if the letter of credit is duly presented to it.

a. Bankruptcy

Disbursing after presentment of a letter of credit is not a violation of the automatic stay in bankruptcy when the account party is in bankruptcy. The letter of credit is an obligation of the bank, not an obligation of the account party. After all, that was the point when the beneficiary or principal insisted on the letter of credit in the first place. That means the draw is not stayed, even if the reimbursement obligation securing the letter of credit or surety bond is secured by a lien on property in the bankrupt's estate.

> It is well established that a letter of credit and the proceeds therefrom are not the property of the debtor's estate under 11 U.S.C. § 541. [*citations omitted*] When the issuer honors a proper draft under a letter of credit, it does so from its own assets and not from the assets of its customer who caused the letter of credit to be issued. As a result, a bankruptcy trustee is not entitled to enjoin a post petition payment of funds under a letter of credit from the issuer to the beneficiary, because such a payment is not a transfer of debtor's property (a threshold requirement under 11 U.S.C. § 547(b)). *Kellogg v. Blue Quail Energy, Inc.* (*In re Compton Corp.*), 831 F.2d 586 at 589 (5th Cir. 1987); *See also*, *Willis v. Celotex Corp.*, 970 F.2d 1292, *modified*, 978 F.2d 146 (4th Cir. 1992).

b. Federal tax liens

Federal tax liens, established under the INTERNAL REVENUE CODE, 26 U. S. C. § 6321, do not take priority over an "obligatory disbursement agreement" 26 U. S. C. § 6323(c)(1)(A)(3). An 'obligatory disbursement agreement' is defined in 26 U.S.C 6323(c)(4)(A) as:

> The term "obligatory disbursement agreement" means an agreement (entered into by a person in the course of his trade or business) to make disbursements, but such an agreement shall be treated as coming within the term only to the extent of disbursements which are required to be made *by reason of the intervention of the rights of a person other than the taxpayer. (Emphasis added).*

The demand for payment by a beneficiary or principal under a standby letter of credit or surety bond constitutes the 'intervention of the rights of a person other than the taxpayer', so disbursement of the funds keeps its priority over a federal tax lien. A state definition of 'obligatory advance' or rule that optional advances are treated as if they were obligatory advances has no effect on §6323. Only advances satisfying §6323(c) take priority over previous federal tax liens.

Since a letter of credit mortgage is valid, enforceable and loses no priority even if the account party is bankrupt, or the IRS has filed a tax lien against its property, the title insurance for letters of credit will be substantially cleaner than for an obligatory advance of funds to the borrower.

If an advance does not meet the standards expressed in 26 U.S.C 6323(c), they are considered optional. 26 U. S. C. § 6323(d) gives optional advances a 45-day grace period after a federal tax lien is filed. After 45 days have elapsed after filing a lien, any optional advance is subordinate to the tax lien.

3. Insuring future advances.

Caveat: If there is *any* chance of future advances in a secured loan facility, you must counteract Section 8(b) and Exclusion 3(b) if you expect your title insurance to protect those advances. Lenders often order title insurance for a loan that includes some future advance features, but they never disclose those features. They trust the title policy to protect the advances without realizing that it must be modified to protect them. This can occur in loans where the future advance features are included in the "boilerplate" of the loan documents, but were never a significant concern in the loan as it was originally conceived. Five years later, the borrower and lender decide to take advantage of the mortgage's capability to secure future advances, but the title policy was set up to insure the loan as it was originally conceived. If the policy had been structured to insure future advances from the start, the borrower and lender could proceed with the advance without getting a modification of the title policy. There are two ways to adapt a policy to future advances.

a. Datedown endorsements

The date of the policy can be changed by a 'datedown' endorsement each time a disbursement is made. Advancing the date of the policy does not modify Exclusion 3(d) or Section 8(d); instead, it complies with them. The original policy is usually prepared for

datedowns with a 'pending disbursement' provision that announces that the date of the policy will be advanced. A typical 'pending disbursement' exception reads:

> Pending disbursement of the full proceeds of the loan secured by the mortgage (deed of trust) set forth under Schedule A, this Policy insures only to the extent of the amount actually disbursed but increases as each disbursement is made in good faith and without knowledge of any defects in, or objections to, the title, up to the face amount of the policy. At the time of each disbursement of the proceeds of the loan, the title must be continued down to such time for possible liens or objections intervening between the Date of Policy and the date of such disbursement.

This method is practical only in cases where there will be sufficient notice before each disbursement to schedule the supplemental examination (but it is usually necessary for construction loans in states where mechanics' liens can take priority over the construction loan).

Some lenders object to a "pending disbursements" exception in Schedule B of a policy insuring a construction loan. However, as we have seen, a policy without any provision for the construction advances will not cover them. A typical notice revolving credit endorsement takes exception to the lender's actual knowledge of liens intervening between the recording of the mortgage and the future advance. Construction lenders know that contractors, materialmen and laborers are providing services, material and labor on a project, so, if the local law grants them an inchoate lien for payment, the revolving credit endorsement does not protect the construction advances. The procedures established in a "pending disbursements" exception may be cumbersome, but they protect the lender. *See, Lincoln Federal Savings and Loan Assoc. v. Platt Homes, Inc*., 185 N.J. Super 457, 449 A.2d 553 (1982).

You don't need a pending disbursements provision in your policy as a condition for bringing the date forward. A title insurer can agree to bring the policy date forward in most states, but it may charge a premium if it did not initially agree to datedown endorsements in the policy with a pending disbursements provision. If you plan on policy updates, it makes sense to set a procedure and the cost for it at the outset.

b. Section 9(b) and the "last dollar" issue

The 'last dollar' issue was recognized by some title insurance customers upon reading Section 9(b) of the Conditions and Stipulations after it was added to the 1987 ALTA Loan Policies (it has been continued through the 1990 and 1992 loan policy forms). Section 9(b) was intended to reassure customers that accrued interest and protective advances would be covered if the aggregate loss was less than the Amount of Insurance in Schedule A. Instead, it became an apt example of the law of unintended consequences because it left observers with the impression that its purpose was to reduce the Amount of Insurance by each payment of principal indebtedness. It provides:

> *Payment in part by any person of the principal of the indebtedness,* or any other obligation secured by the insured mortgage, or any voluntary partial satisfaction or release of the insured mortgage, to the extent of the payment, satisfaction or release, *shall reduce the amount of insurance* pro tanto. The amount of insurance may thereafter be increased by accruing interest and advances made to protect the lien of the insured mortgage ad secured thereby, with interest thereon, provided in no event shall the amount of insurance be greater than the Amount of Insurance stated in Schedule A. [Emphasis added].

The idea of reducing the *amount of insurance* makes very little sense when the policy also limits the *liability* of the title insurer under section 7 of the policy. This subsection appears wholly unnecessary, and it can have some pernicious effects. Its operation in a revolving credit loan could destroy the insurance coverage as the borrower draws on the credit line, pays it down and draws readvances during the term of the loan. The payments would reduce the amount of insurance, but a series of optional advances made to the borrower would not restore the coverage under a strict reading of Section 9(b).

It also threatens loans where the value of the insured property is only a fraction of the loan amount. If the title policy was issued in the amount of $10 million (the value of the property), but the loan was made in the amount of $100 million and was also secured on other assets, the lender would be dismayed to learn that the title insurance was gone as soon as the borrower repaid the outstanding balance below $90 million.

The 2006 ALTA Loan policy dropped Section 9(b) to eliminate the last dollar issue. There is no equivalent provision in the new policies.

c. Future advance or revolving credit endorsements

Until now, the ALTA had no endorsement for future advances, so the industry has used CLTA endorsements or proprietary endorsements instead. There are so many forms that it would overwhelm us to consider all of them, but that should end shortly. Future advance endorsements don't bring the transaction into compliance with Exclusion 3(d) and Section 8(d) of the policy as a datedown does. Instead they override Exclusion 3(d) and Section 8(b) so the policy will expressly insure the enforceability, validity and priority of the lien of the insured mortgage as to future advances, with exceptions for real estate taxes, bankruptcy, tax liens, etc.

3. The ALTA future advance endorsements

a. The ALTA 14.0 Future Advance – Priority Endorsement

The ALTA 14 is designed for use in states that have future advance statutes giving *optional advances* either:

i. the same priority as obligatory advances or

ii. priority as of the date the mortgage was filed.

The statute must not include exceptions where the lender has received actual or written notice of any form of lien. So, does a Tennessee "open end mortgage" meet that standard? Certainly, the "open-end mortgages" in Tennessee under TENN. CODE ANN. §47-28-103(1) meets the standard. However, under §47-28-103(3)(c) mortgages with optional advances that don't meet the open-end standard (which appears to include all optional advances under commercial mortgages) are subject to a notice standard so the ALTA 14.1 would apply instead.

The ALTA 14 begins by listing the policy sections that it modifies, including Exclusion 3(d) and Sections 8(d) and 9(b) of the Conditions and Stipulations. It thus modifies those sections discussed above that make a bare policy inappropriate for insuring mortgages that are intended to secure advances.

Section 1 defines what an advance is and ties the endorsement to the note or loan agreement. The definition does not distinguish between obligatory and optional advances

because it was intended to cover both equally. It does expressly include 'protective' advances, even though the basic policy includes some coverage for them. With the endorsement, the insured is given the freedom to make a protective advance without checking to see if its advance matches the description for 'protective advances' in Section 2(c) of the policy.

Section 2 of the endorsement gives the basic coverages against loss caused by the unenforceability, invalidity or loss of priority of the lien of the insured mortgage as it secures advances. On the day before the endorsements were adopted, a comment raised the concern that the original language of paragraph 2(b) might not protect a lender if a competing creditor was given equal priority to the advance, although it was clear that the lender was protected if it lost priority to the competing creditor. The provision was changed so it should protect against loss caused by 'equal priority' as well as 'lost priority.'

Section 2 also insures that the lender can re-advance funds and the lien will not fail if the outstanding balance of the loan equals zero. Section 3 gives the lender ALTA 6 variable rate mortgage coverage in addition to future advance coverage.

Section 4 contains the exceptions from coverage for advances made after the borrower's bankruptcy, loss of priority to real estate taxes and assessments, federal tax liens; environmental liens or usury. It has an optional exception for mechanic's liens if the lender fails to achieve statutory priority over unfiled liens.

The ALTA 14 should not be used in states that impose a loss of priority if the lender has actual knowledge of a competing lien even if lender's counsel argues that the advances are 'obligatory' because only letter of credit advances are obligatory if the borrower is in default when the advance is made. A title insurer cannot determine if the borrower will be in compliance at the time of an advance simply by reading the loan agreement.

b. The ALTA 14.1 Future Advance – Knowledge Endorsement

The ALTA 14.1 has all of the provisions in the ALTA 14, but adds paragraph 4(d) excluding coverage if the insured had actual knowledge of an intervening lien. Let's take a closer look at paragraph 4(d):

4. This endorsement does not insure against loss or damage (and the Company will not pay costs, attorneys' fees or expenses) resulting from: . . .

   d. The loss of priority of any Advance made after the insured has knowledge of the existence of liens, encumbrances or other matters affecting the land intervening between the Date of Policy and the Advance, as to the intervening lien, encumbrance or other matter.

The ALTA 14.1 was designed for states that have "knowledge" priority rules. If a lender argues that it should have full priority coverage because the loan agreement makes advances 'obligatory', your title insurer can add a second sentence to paragraph 4(d) to the effect that "Paragraph 4(d) does not apply if the advance is obligatory." By adding that sentence, the policy does not insure that the advance is obligatory, but if a court determines that it was obligatory, the endorsement will then insure that it had priority.

c. The ALTA 14.2 Future Advance – Letter of Credit

The last endorsement, the ALTA 14.2 should be used where the mortgage secures a reimbursement obligation for a letter of credit or surety bond. With the ALTA 14 the distinction

between obligatory and optional advances made no difference. With the ALTA 14.1, optional advances are subject to notice of an intervening lien. The ALTA 14.2 insures 'advances' that are given special protection in bankruptcy and against federal tax liens.

This endorsement was adopted without the ALTA 6 coverage because it was not considered necessary for letters of credit. Eliminating the ALTA 6 coverage puts the endorsement exceptions in Section 3 instead of 4, and it only has exceptions for real estate taxes and environmental liens. There is no exception for advances made after the borrower's bankruptcy or loss of priority to a federal tax lien created under 26 U. S. C. § 6321, as you would find in the ALTA 14 and 14.1. There is an optional exception for mechanic's liens for use if the mortgage did not achieve statutory priority over the inchoate rights of providers of services labor or materials.

As a result of the decision in *In re Mayan Networks*, 306 B.R. 295 (9th Cir, BAP 2004), in 2009 the ALTA Forms Committee added an exception for:

> "Limitations, if any, imposed under the Bankruptcy Code on the amount that may be recovered from the mortgagor's estate."

c. The ALTA 14.3 Future Advance – Reverse Mortgage

On June 17, 2006, the Forms Committee passed a reverse mortgage endorsement to be added to the ALTA 14 series as the ALTA 14.3. It is designed to insure residential reverse mortgages that fall under the Fannie Mae and Freddie Mac reverse mortgage programs.

I. Non-imputation
ALTA 15-06 (Full Equity Transfer), 15.1-06 (Additional Insured) & 15.2-06 (Partial Equity Transfer)

1. Imputation of knowledge.

We have been asked to include some form of non-imputation coverage in many of the policies we issue in larger commercial transactions. Purchasers of partnership interests, joint venture interests, memberships in limited liability companies or shares in a corporation seek to shift the risk to the title insurer that notice or knowledge of existing or departing partners, venturers, members or shareholders might affect the title (and reduce the value) of real property owned by the entity. These purchasers fear that the notice or knowledge of the unrecorded matter might be imposed on them by imputation.

The rules for imputation of knowledge are found in agency law, although we frequently think of them in the context of corporation or partnership law. The general rule is that a principal is bound by the knowledge of its agent. So a principal-agency relationship must exist between the parties before knowledge of one (the agent) can be imputed to the other (the principal). Both the 1914 and 1997 Uniform Partnership Acts provide that notice to a partner (the agent) operates as notice to the partnership (the principal).[8] Corporations and banks are

---

[8] UPA (1914) § 12:

Partnership Charged with Knowledge of or Notice to Partner

Notice to any partner of any matter relating to partnership affairs, and the knowledge of the partner acting in the particular matter, acquired while a partner or then present to his mind, and the knowledge of any other partner who reasonably could and should have communicated it to the acting partner, operate as notice to or knowledge

bound by the knowledge of or notice to their officers, agents and employees.[9] Notice is crucial in real estate transactions, because, in most states, a purchaser without actual or constructive notice of a prior conveyance or encumbrance on title is protected against the prior matter.

2. Recording Acts.

When a party in interest conveys an interest in property by deed, mortgage or deed of trust, recording the document to another party in the United States, the recording acts of the state where the property lies will govern which of competing interests will prevail. In all states, *a recorded instrument* creating an interest in a property *is constructive notice* of the interest, and any subsequent purchaser or encumbrancer takes subject to the recorded interest. Constructive notice means a purchaser is charged with notice of the recorded instruments, whether or not the purchaser orders a title examination to discover those recorded interests. Title insurers manage the risk of constructive notice of outstanding interests with an examination of title to reveal the interests of record.

However, where there is an *unrecorded interest* outstanding when the property is either conveyed or encumbered, one of three rules may be applied to determine priority of the competing interests, depending on the recording act of the state where the property is located. Of the three distinct types of recording acts in effect among the states, the two most common, Notice and Race-Notice type acts, require a purchaser to have no notice, either actual or constructive, of prior matters to establish priority. The three types of recording acts are:[10]

a. “Notice” type acts

Under the notice type act, found in most states, an unrecorded instrument is invalid as against a subsequent purchaser without notice, whether or not the subsequent purchaser records before the first purchaser.[11] If Jones takes an interest in real estate, but has no constructive or actual notice of Brown's prior unrecorded interest, Jones will take free of Brown's interest. Even if Brown records *before* Jones records the instrument creating his interest (but *after* Jones' interest is created), Brown's interest will be subject to Jones' interest.

---

of the partnership, except in the case of a fraud on the partnership committed by or with the consent of that partner.

RUPA (1997) § 102(f):

Knowledge and Notice …

(f) A partner's knowledge, notice or receipt of notification of a fact relating to the partnership is effective immediately as knowledge by, notice to, or receipt of notification by the partnership, except in the case of a fraud on the partnership committed by or with the consent of that partner.

[9] *See,* 10 AM. JUR.. 2d, *Banks* §163; 18B AM. JUR.. 2d *Corporations* § 1671; and 58 AM. JUR.. 2d *Notice.*

[10] These definitions are from Sweat, *Race, Race-Notice and Notice Statutes: The American Recording System*, PROBATE AND PROPERTY, May/June 1989 p.27. This excellent article also contains a list of the states identifying the type of recording act and its citation for each state.

[11] Alabama, Arizona, Arkansas [other than mortgages], Connecticut, Florida, Illinois, Iowa, Kansas, Kentucky, Maine, Massachusetts, Missouri, New Mexico, Oklahoma, Rhode Island, South Carolina, Tennessee, Texas, Vermont, Virginia and West Virginia. Derived from Sweat, *supra*, p.31.

b. “Race-notice” type acts

The race-notice type statute contains the same provisions except that if the subsequent purchaser records before the earlier purchaser records and the subsequent purchaser takes without actual knowledge of the earlier conveyance, the subsequent purchaser has priority.[12] If Jones takes an interest in real estate, but has no constructive or actual notice of Brown's prior unrecorded interest, Jones can take free of Brown's interest if Jones records *before* Brown. If Brown records *before* Jones records the instrument creating his interest (but *after* Jones' interest is created), Jones' interest will be subject to Brown's interest.

c. “Race” type acts

The race statutes place a premium on the "race" to the courthouse. The subsequent purchaser must record before the earlier purchaser, but is protected even though aware of the earlier conveyance.[13] If Jones takes an interest in real estate, it won't matter if he has actual notice of Brown's prior unrecorded interest. Jones can take free of Brown's interest if Jones records *before* Brown. If Brown records *before* Jones records the instrument creating his interest (but *after* Jones' interest is created), Jones' interest will be subject to Brown's interest.

3. Exclusion 3d and imputed knowledge.

The ALTA policies are designed to protect the lien of a real estate interest with a "notice" standard, giving the title insurer a defense against policy liability if the policyholder knew of the unrecorded matter that caused the loss at the time of closing, but failed to disclose it to the insurer. This limitation on coverage is contained in paragraph 3b of the Exclusions from Coverage. Exclusion 3 also cancels coverage for acts of the insured, incidents allowed by the insured and incidents resulting in loss or damage that would not have been endured if the insured had paid value for the insured mortgage. Exclusion 3 provides:

> The following matters are expressly excluded from the coverage of this policy and the Company will not pay loss or damage, costs, attorney's fees or expenses which arise by reason of: ...
>
> 3. Defects, liens, encumbrances, adverse claims or other matters:
>
> (a) created, suffered, assumed or agreed to by the insured claimant;
>
> (b) not known to the Company, not recorded in the public records at Date of Policy, but known to the insured claimant and not disclosed in writing to the Company by the insured claimant prior to the date the insured claimant became an insured under this policy;
>
> (c) resulting in no loss to the insured claimant;

---

[12] Alaska, California, Colorado, District of Columbia, Georgia, Hawaii, Idaho, Indiana, Maryland, Michigan, Minnesota, Mississippi, Montana, Nebraska, Nevada, New Hampshire [Sweat lists N.H. REV. STAT. ANN. §477:3-a(1983) as a Notice statute, but the recent decision in *Amoskeag Bank v. Chagnon*, 572 A.2d 1153 (N.H. 1990) interprets it as a Race-Notice Act], New Jersey, New York, North Dakota, Ohio, Oregon, Pennsylvania [other than mortgages], South Dakota, Utah, Washington, Wisconsin and Wyoming. Derived from Sweat, *supra*, p.31, except as noted.

[13] Arkansas [mortgages only], Delaware, Louisiana, North Carolina, and Pennsylvania [mortgages only]. Derived from Sweat, *supra*, p.31.

(d) attaching to or created subsequent to Date of Policy(except to the extent that this policy insures the priority of the lien of the insured mortgage over statutory lien for services, labor or material); or

(e) resulting in loss or damage which would not have been sustained if the insured claimant had paid value for the insured mortgage.

In the beginning, the non-imputation risk focused solely on Exclusion 3(d), but recently investors have broadened the focus to include concerns about Exclusions 3(a) and 3(e) as well. It could be argued that a title insurer could not apply the acts of the others, incidents allowed by others and incidents resulting in loss or damage that would not have been endured if others had paid value for the insured mortgage because the exclusion only applies to acts and knowledge of the 'insured claimant.' Acts and knowledge of anyone else, even if an insured, should not affect the coverage. However, the argument is still enough of a stretch to make ordering a non-imputation endorsement a prudent decision.

4. Managing the non-imputation risk.

A title insurer is without a means of managing the risk of unrecorded documents, the existence of which are known to the insured, so it protects itself with Exclusion 3(b) if no non-imputation coverage is requested. This position is consistent with the stance of other insurance lines. Even casualty lines of insurance take exception to such risks, e.g., life and health insurers do not accept liability for pre-existing health conditions of the insured that are not communicated to the insurer on the application.

Can the title insurer manage the risk of a loss due to an unrecorded matter not known to the insured (or an incoming owner of an interest in an insured entity) when notice of it is imputed to the insured or insured entity? Protection against such a risk appears similar to other protections against "hidden risks" afforded by a title policy. The insured has clean hands in such a case, unless a thorough "due diligence" investigation would reveal the unrecorded transfer or encumbrance. Under limited circumstances, title companies began to underwrite these risks.

At the beginning of the 1980's, certain life insurance companies began to invest in partnerships or joint ventures holding or developing real property. In most cases, the insurance company would convert a construction loan into an equity position after the developer completed construction and began the rent-up phase. By purchasing a partner's or joint venturer's share, there was no conveyance of title to the real estate. Thus, the life insurer's interest was not protected by the recording acts, so any unrecorded matter affecting title would be unaffected. By purchasing a share in the partnership or joint venture, the life insurance company also accepted its developer partner as the agent of the venture, so the law imputes to it any knowledge of or notice given to the developer.

The life insurers were not satisfied with this risk of loss through imputation, so they demanded that the partnership's title policy contain affirmative coverage against the imposition of Exclusion 3(b) as a defense to a claim under the policy by the partnership. Title insurers agreed to give this coverage limited to knowledge of the owner or developer at the Date of Policy, if satisfied that the risk of loss was eliminated by:

a. receipt of a written description of the complete structure of the transaction,

b. receipt and review of satisfactory current financial statements of any party or entity required as indemnitor (*i.e.*, all withdrawing partners, or all existing and remaining partners in a partnership, or current and former officers and directors of the acquired corporation),

c. receipt of satisfactory affidavits from individuals, partners or partnerships, officers, and directors of the acquired corporation. Copies of specimen affidavits are included in Appendix B together with copies of basic non-imputation endorsements.

d. receipt of satisfactory indemnity bonds from individuals, partners or partnerships, officers, and directors of the acquired corporation, and

e. receipt of a written request for the non-imputation endorsement.

This coverage applies to situations where a party buys an interest in an insured property, but acquires the interest through the purchase of shares of stock, a partnership share or membership in an LLC. Virtually all of the circumstances requiring non-imputation coverages involve these ownership interests. Lenders rarely need non-imputation coverage.

5. Automatic non-imputation for mortgage assignees

Most transfers of loan indebtedness are made by assignment. The loan policy protects assignees of the indebtedness in its definition of the term "insured" in paragraph 1(a) of the Conditions and Stipulations.[14] Thus an assignee for value should not be troubled by potential defenses of the title insurer based upon matters known to the original named insured in the policy if it has no notice of that matter.

6. Non-imputation endorsements

For years title insurers have issued proprietary non-imputation endorsements. Most have been limited to protecting a new owner from the impact of Exclusion 3(b) only. The ALTA Forms Committee reported three non-imputation endorsements to the ALTA. They broaden the coverage to protect the party from the operation of Exclusions 3(a), 3(b) and 3(e) as they apply to existing or former participants in the entity owning the insured land.

I have one important caution about non-imputation endorsements. A prudent title insurer must manage the risk that the selling party has not created any off-record matter that might emerge at a later time to cause a loss. It does this first by limiting the coverage to matters that occurred before the Date of Policy. Limiting the risk to past events permits the title insurer to manage the risk by requiring the existing party to affirm that there is no off record matter that might affect title. Although limiting the coverage to the past is necessary, as we shall see with the ALTA 15.1, it might create a coverage gap if you aren't paying attention to the details.

---

[14] (a) "insured": the insured named in Schedule A. The term "insured" also includes

(i) the owner of the indebtedness secured by the insured mortgage and each successor in ownership of the indebtedness except a successor who is an obligor under the provisions of Section 12(c) of these Conditions and Stipulations (reserving, however, all rights and defenses as to any successor that the Company would have had against any predecessor insured, *unless the successor acquired the indebtedness as a purchaser for value without knowledge of the asserted defect, lien, encumbrance, adverse claim or other matter insured against by this policy as affecting title to the estate or interest in the land.* (Emphasis added).

a. The ALTA 15 Non-Imputation – Full Equity Transfer Endorsement

The ALTA 15 was designed for situations where the entire ownership of the entity owning the land has changed hands. It protects the incoming partners against defenses that the title insurer may have had against the outgoing owners of the landholding entity under Exclusions 3(a), 3(b) or 3(e). It is intended for a new policy issued to protect the incoming owners.

b. The ALTA 15.1 Non-Imputation - Additional Insured Endorsement

The ALTA 15.1 is similar to the ALTA 15 but is formatted for situations where the existing entity is the named insured in the policy and landholder to protect an incoming partner, member, or shareholder.

I think this endorsement continues a flaw that began with the earliest non-imputation endorsements. It does not bring the Date of Policy forward, so it either misses the period of greatest risk to the additional insured, or, if it is construed as insuring the period from the Date of Policy to the date of the endorsement, it may lull an issuing office or agent into issuing it without conducting a fresh title rundown. I would caution its use only after careful examination and amendment so its meaning is clear.

c. The ALTA 15.2 Non-Imputation – Partial Equity Transfer Endorsement

Finally, the ALTA 15.2 is also similar to the ALTA 15, but is formatted for an incoming partner, member, or shareholder, as the named insured in its own policy, where the landholder is a partnership, limited liability company or corporation.

J. Mezzanine Financing
ALTA 16-06

1. Structured Financings.

Many commercial borrowers divide their borrowings into tiers or 'tranches' to optimize the cost of borrowing. For a very simple illustration, let's imagine that ABC, LLC seeks to borrow $100,000,000 and discovered that it would cost LIBOR + 3% to borrow the full amount in one slug. However, if it structures the financing into tiers, having two levels of debt secured by mortgages, one level secured by a pledge of the memberships in the LLC,

Total Loan Facility	Tranche
Total Loan Facility $100,000,000 To ABC, LLC	Tier 1 Senior Real Estate Financing Secured by a 1st Mortgage $20,000,000 Rate: LIBOR + 1
	Tier 2 Junior Real Estate Financing Secured by a 2nd Mortgage $30,000,000 Rate: LIBOR + 2
	Tier 3 Mezzanine Financing Secured by pledge of ABC, LLC memberships $30,000,000 Rate: LIBOR + 3
	Tier 4 "First Loss Piece" Financing Unsecured $20,000,000 Rate: LIBOR + 5

and the last an unsecured level as shown in this diagram, the effective interest rate in this simple example is LIBOR + 2.7%

Until recently, title insurers limited their participation in these structured transactions to those top two tiers that were secured by mortgages on the real estate. The bottom tiers were not a part of the title insurance market. However, those subordinate lenders recognized the critical role that real estate plays in so many of these transactions, and if there is a major title loss, it may exceed the title insurer's liability on the two loan policies. If the lenders in the bottom two tiers, the mezzanine and the unsecured 'first loss piece[15]' financing, can require the borrower to buy an owner's policy, and capture the title insurer's liability to it, they will gain some protection against that title risk.

In mezzanine financing, it's not the landowner that transfers a security interest in the collateral to the Mezzanine Lender. The landowner owns the land. Its owners pledge their interests in the landowner itself for the Mezzanine Lender's security. Thus the pledging entities may be shareholders, partners or members of the landholding entity, or even shareholders, partners or members of an entity that owns the entity that owns the land. Although some earlier mezzanine financing endorsements required the Mezzanine Lender to take title to the pledged ownership interests in the landowner as a condition to its right to payment for a loss, there is no real rationale for making that requirement.

2. Insuring a mezzanine financing.

The mezzanine lender usually has a security interest in the ownership interests of the entity that holds title to the land. It can seek UCC insurance for this security interest, and most title insurers can either issue or obtain the UCC policy for it. However, the UCC policy is another policy to buy, and it is an additional expense for a junior loan. There is a title insurance solution that has become popular in recent years.

If a Mezzanine Lender or first loss piece lender has no ownership interest, or mortgage, does it have any insurable interest in land at all? Well, we can't insure its interest with a loan title insurance policy because there is no lien to insure. These lenders will not have an ownership interest in the land unless the Mezzanine Lender realizes upon its pledges of the ownership interests, and even then the interest is indirect, so it appears that these lenders have no traditional insurable interest in the land or in a mortgage on the land.

However, these lenders have recently sought title insurance coverage in the owner's policy with a 'loss payable' provision similar to those found in a typical property/casualty homeowner's policy. The borrower does have an insurable interest because it is the landowner. If it gets an owner's policy, the mezzanine lender can bargain for the right to receive any title insurance proceeds that the borrower might receive from the title insurer.

So a lender that is not secured by a mortgage lien on the land can nevertheless find some protection from title risks to the borrower in a Mezzanine Financing Endorsement. New York

[15] Its unfortunate that the endorsement allowing a claim before requiring foreclosure on all the collateral in a multi-site mortgage transaction has also been named "first loss." The different usages for this term in a transaction may cause some confusion.

had a Mezzanine Financing Endorsement that served as a model for the ALTA 16 Mezzanine Financing Endorsement.

The New York endorsement limits its liability to a lender that has taken possession of ownership interests in the entity holding title to the land. The ALTA endorsement rejects that restriction, so although it is named a Mezzanine Financing Endorsement, it will serve an unsecured lender, as well. Perhaps the endorsement is misnamed, but it is convenient to continue a name recognized by our customers and it gives the loss payable beneficiary a convenient name, Mezzanine Lender.

The insured in the Owner's Policy must be the landowner, because it has the only insurable interest. To assign its rights to receive payments from the title insurer in the 'loss payable' provision, the landowner must also execute the endorsement. Consequently, the process of executing this endorsement is more cumbersome than our ordinary experience with endorsements. The Mezzanine Financing Endorsement can be issued with a new owner's policy when the loan is closed, or issued to amend an existing owner's policy held by the borrower.

In addition to recognizing the Mezzanine Lender as a loss payee, the title insurer agrees in paragraph 5 of the endorsement that Exclusions 3(a), 3(b) and 3(e) will not be applied against the borrower to defeat a recovery by the Mezzanine Lender

The ALTA 16 removes the requirement for the insured's consent before a Mezzanine Lender can participate in claims negotiations. The Forms Committee decided that a Mezzanine Lender has too much at stake to be denied a place at the table, as it is in the New York endorsement.

The Mezzanine Lender must consent to any later change in the policy coverage. Paragraph 8 of the revised draft includes a 'standstill' provision with respect to the title insurer's right of subrogation against the insured, the borrower or a guarantor of the Mezzanine Loan.

Paragraph 6 is a "Fairway" provision protecting the Mezzanine Lender in case it acquires the ownership interests pledged to it. It may be the only '*Fairway*' provision ever to be adopted by the ALTA. That's not because the ALTA wants to preserve the *Fairway* issue, but because it never applied to ALTA policies in the first place, and the new policy revisions should put this issue to rest, at last.

K. Access and Entry
ALTA 17-06 (Direct), 17.1-06 (Indirect) & 17.2-06 (Utility Access)

1. Access in the policy forms.

Both the ALTA owner's and loan policies insure access to the insured land. It is insuring provision 4, and it states, succinctly that the Company insures against loss or damage cause by a, "Lack of a right of access to the land."

Access should be a simple concept. To insure 'access' to the land, a title insurer must only show that the insured can go to and from at least one public street and some point on the boundary to the land without the interference of the rights of another party. An owner can establish a right to access if the land abuts a public road, or if there is an appurtenant easement of right of way or a private road to the land.

To illustrate, imagine two lots numbered 1 & 2. At some time in the past (before subdivision control laws), an owner of Lot 2 sold its road frontage to the owner of Lot 1. Lot 1 has apparent access to the street, but Lot 2 is "landlocked" by Lot 1 and the other surrounding lots. It has no access to the street because the rights of the owner of Lot 1 block it.

Lot 2 does not have insurable access in this illustration, so a title insurer will take an express exception to access in its title insurance policy to override insuring provision 4. However, if a right of way easement to the street had been reserved for Lot 2 when the frontage was sold, it would still have insurable access. It would also have insurable access if the title to both lots were vested in one owner.

2. Insurable access in court decisions.

The insured has access even if the way between the street and the boundary is long and dangerous. *Gates v. Chicago Title Insurance Company*, 813 S.W.2d 10 (Mo. App. 1991). A 2½ foot barrier in a parking lot might make it impractical to travel from one lot to another, but it is not a lack of a right of access. *Magna Enterprises, Inc. v. Fidelity National Title Insurance Company*, 104 Cal. App.4th 122, 127 Cal. Rptr. 681 (2002). These cases apply the conventional standard - if the insured has the right to get to its land, it has access.

The opinions in both *Gates* and *Magna Enterprises* distinguished the earlier decision in *Marriott Financial Services, Inc. v. Capitol Funds, Inc.,* 288 N.C. 122, 217 S.E.2d 551 (1975). Marriott Financial bought a parcel of land, from Capitol Funds, along Wake Forest Road in Raleigh for development of a Roy Rogers fast food restaurant. Its purchase was insured by Lawyers Title. The City of Raleigh denied Marriott's application for driveway permits. The lot's frontage along Wake Forest Road was within 150 feet of a bridge over Crabtree Creek. The city would not allow driveway permits closer than 200 feet to the bridge because the road had such heavy traffic. Earlier, Capitol sold an adjacent parcel to an automobile dealer, and the city placed a notation on the dealership lot's plat that the parcel later sold to Marriott was "not an approved lot." Marriott sued capitol for rescission, or alternatively for recovery under its title insurance policy

The Supreme Court of North Carolina reversed an order dismissing an access claim against Lawyers Title because it found the insured had 'pedestrian' access only to Wake Forest Road. Marriott's access was described as 'pedestrian only' because the city had refused to grant it the driveway permit to the road. The *Marriott* court confused a permit for a driveway with access, and applied a right of way classification to an access right. It ignored the terms in paragraph 4 of the Lawyers Title policy by holding that mere 'pedestrian' access was not 'reasonable' access when the insured sought 'vehicular' access for development of the fast food restaurant. I suspect that the Supreme Court thought that the city's notation on the auto dealer's plat that the adjacent parcel later sold to Marriott was "not an approved lot" was warning enough to the title insurer. It could have ruled that the title insurer had a duty under the policy to disclose the limitation stated on the auto dealer's plat to reach the same outcome without confusing the issues.

The *Marriott* decision is unrealistic because it suggests that the policy insured 'reasonable' access for Marriott's planned use, even though land was undeveloped. Of course, access has nothing to do with permits to build or use driveways and parking areas inside the

boundaries of the land. The process of securing development permits often requires some concessions. Changing the facts slightly, if Marriott's optimal design had included two curb cuts on Wake Forest Road and two on an adjacent side street that empties onto Wake Forest, would it have had a title claim if Raleigh had limited it to one curb cut on Wake Forest and one on the side street, if that plan would still work for the business? Title insurers have no means for managing the risk of insuring the outcome of a future development permit process. Insuring the existing permitting may seem reasonable for most cases, but it would not have helped Marriott.

It would seem that the *Marriott* decision, having misstated the concept of access, and suffered criticism in subsequent access cases, should simply melt away into obscurity. Unfortunately, the court coined the terms "pedestrian and vehicular access." Afterwards, title insurers agreed to those terms in affirmative access coverage endorsements. The ALTA followed suit by including them in the Homeowner's and Expanded Coverage Residential Policies.

3. "Pedestrian and vehicular".

The law recognizes pedestrian ways (foot paths) and vehicular ways (streets and highways), so a right of way can be described as a pedestrian or vehicular way. Access may involve either kind of way or both, but the *Marriott* case is the only decision that I can find that transfers the concept of a "pedestrian and vehicular way" to access. The Marriott interpretation has been rejected in subsequent cases, but the term lingers on, so what does it mean? If it means anything, it must be that the public street or way to a public street needed as an element of access must allow both foot and vehicular traffic.

Others have suggested that it means that the owner can drive up to and on the insured land. That means there is no 'pedestrian and vehicular access' to many urban residential and commercial properties built on lots on city blocks because the sidewalk keeps a vehicle away. That rules out a large set of real estate from coverage eligibility. It also raises some other questions. If the boundary between the land and the street is the edge of the actual roadbed, but there are no curb cuts, does the owner have 'pedestrian and vehicular access?' What if the frontage is a 'no parking' zone?

If we return to *Gates*, the policyholder asserted a claim after being denied access to his land over an "east road." Chicago Title said the lot had access by a "west road" as well. However, Gates testified that the "west road" was a "goat path." He once traveled the 'west road' in a four-wheel drive vehicle with the 'passengers' walking alongside "watching that we didn't fall over the side of the mountain." Perhaps a mountain bike would easily make that journey. Mountain bikes are vehicles. What if the road easily accommodates automobiles, but is too narrow for heavy earth moving trucks? Does the insured have reasonable access? Where do we now draw the lines? 'Pedestrian and vehicular access' may confuse a concept that was reasonably settled before.

4. Utility Access.

Many lists of requested endorsements include a "utility facility endorsement" or a "utility availability endorsement." Until 2008, these were not standard endorsements, and often they were drafted by people outside the industry who were taking a stab at the coverage. Recognizing that some discipline was necessary, the ALTA considered several of the endorsements in

circulation to determine how to craft a title insurance coverage to meet our customer's needs. Insurance must be specific so each party understands the insurer's liability to the insured. Insuring against loss if specified services are not "available" to the Land is ambiguous.

Certainly, nobody expected the title insurer to pay all of the utility bills for the specified services during the period that the Insured occupies the Land. So, does it mean that these utilities are actually connected? Should a policyholder have a claim in a power outage because the "availability" of electrical power has been interrupted? Should the title insurer race around on the day of closing to transfer all of the utility billing accounts to the buyer? If it is a loan policy, does the insurer have this obligation if the Insured forecloses on its mortgage? No, that doesn't make much sense either, and few customers want the title insurer to be that involved in their affairs in any event.

Are we being asked to insure that connection fees are paid? I am sure that many would like that coverage, but it has nothing to do with title. Why stop here? Why not ask for coverage against loss if any improvement on the land was not built to code with a building permit? Better yet, insurance against loss if the local jurisdiction refuses to permit development of the Land as the buyer envisions? This spins out of control so quickly. If we view the issue from a title perspective, what do we have? It is an access issue.

5. Insuring Access

a. ALTA 17 Access and Entry Endorsement

The ALTA has adopted the ALTA 17 Access and Entry Endorsement to insure that the land abuts a public street; the insured has actual "vehicular and pedestrian access" and has the right to use existing curb cuts or entries. The express wording of the endorsement limits the insurance to the state of facts existing at the Date of Policy, so it should not be construed as insuring against interruption or obstruction of access for a later cause like street repairs or street widening. It does not insure the policyholder's first choice for a development plan for the land, either.

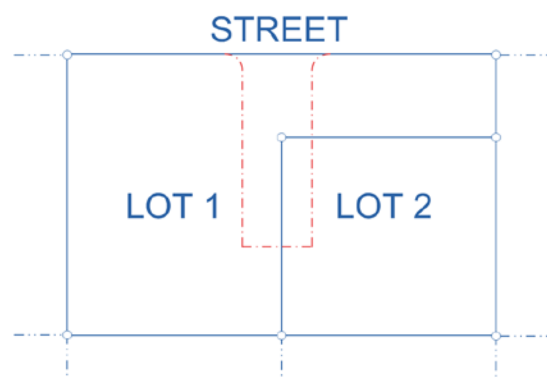
b. ALTA 17.1 Indirect Access and Entry Endorsement

Upon considering this endorsement, the ALTA forms Committee decided that it should also propose an ALTA 17.1 for land not abutting a public street. It insures when the policyholder has access to the public streets over an easement. The Commercial Endorsements Subcommittee drafted the proposed ALTA 17.1 endorsement, in December 2003 and the ALTA Board of Governors swiftly adopted it just a little more than a month later on January 17, 2004.

The coverages in the ALTA 17.1 are substantially the same as in the ALTA 17, but access and entry are insured over an easement identified in the endorsement. The endorsement indemnifies the insured if it cannot use "curb cuts and entries along that portion of the street abutting the easement."

c. Selecting the correct endorsement.

It should be easy to select the correct endorsement. The facts will dictate. Let's take our original example, and add a common driveway and easement to serve both Lots 1 & 2 (designated by the



broken lines). We can use an ALTA 17 to insure access and entry for Lot 1, but an ALTA 17.1 must be used to insure access and entry for Lot 2

c. ALTA 17.2 Utility Access Endorsement

If the words "available" and "availability" are too vague to define this interest in real estate, "access" should do nicely. The endorsement insures against loss if there is no access for the specified services through an abutting street or an easement. Connecting to the service is the policyholder's responsibility. We can designate which services by check boxes on the endorsement, or add other services on the blank lines on the form.

The endorsement actually goes farther than most "utility facility" or "utility availability" endorsements because it expressly insures that there are no gaps between the boundary of the land and the right of way, or gaps in the right of way itself, or a termination of the right of way. It's not unheard of to receive a request to search the title to all utility right of way back to the water plant, power substation, gas plant, etc. That coverage against gaps in the right of way even addresses that issue.

L. Tax parcel
ALTA 18-06 (Single) & 18.1-06 (Multiple)

1. Tax parcel issues.

A buyer of a single lot or parcel has concerns about how that parcel is taxed by the local jurisdiction. If taxes are unpaid, all of the property in the tax parcel can be sold so the taxing jurisdiction can recover the unpaid taxes, penalties, interest and expenses of sale. A landowner controls the payment of taxes for land it owns if the 'tax parcel' is congruent with land described in the transaction. If not, the landowner may be paying somebody else's taxes as well, or might lose all or a portion of its land if the property is sold to satisfy unpaid taxes for a larger tax parcel. It's important to be sure that no mistakes were made in describing the tax parcel for the land, and in properly designating the landowner, or its mortgagee, to receive the tax bills.

The owner of a single lot wants insurance against loss caused by the tax parcel including more land than is described in the title insurance policy because the taxing jurisdiction did not post the subdivision of the insured land from the larger parcel. It also wants protection against the possibility that the insured land includes land in two tax parcels. If the land is dependent on another parcel for access, parking, etc., the owner may want assurance that a tax sale of that easement parcel will not unseat its rights in that parcel.

2. Insuring tax parcel risks

a. ALTA 18 Single Tax Parcel Endorsement

The ALTA 18 is a conventional tax parcel endorsement that insures against loss if the tax parcel includes more land than is described in Schedule A, or does not include all of the land described in Schedule A. If there are no easements critical to access or any other purpose to the land, the ALTA 18 is a suitable choice.

b. ALTA 18.1 Multiple Tax Parcel Endorsement

The ALTA 18.1 adds indemnification against loss where "the easements, if any, described in Schedule A being cut off or disturbed by the non-payment of real estate taxes assessed against the servient estate." A comment indicated some concern about the affect of an assessment lien as well as real estate taxes. The Forms Committee added assessments imposed by a governmental authority to the coverage. It is designed for properties, like shopping center outlots, that depend on easement rights for vital service like access and entry. .

M. Contiguity

ALTA 19-06 (Multiple Parcels) & 19.1-06 (SingleParcel)

I see a proper 'contiguity' coverage as eliminating *all* outside interests that may come between two parcels. However, simply stating that two parcels are 'contiguous' doesn't eliminate the possibility that the rights of another may separate the two parcels at some point.

1. Assemblages

Let's imagine a very simple assemblage of two parcels of real estate into one larger parcel that the buyer intends to use as a single large parcel. In the diagram, Lots 1 & 2 have been assembled into a single parcel defined by corners 1, 2, 3 & 4.

The buyer expects the two lots, Lot 1 & Lot 2, to be contiguous along lines AB and BC so nobody else will have any rights to interfere with its abilities to build a structure straddling lots 1 & 2, and since both lots front on the street along line ①-②, the buyer expects no impediment to unfettered access between the lots.

That is the expectation, but let's change the facts slightly. After buying the two lots, the owner discovers a problem. The lots are contiguous along the line BC, but a gore appears along the line AB, and it widens as we get closer to the street at A. So, if a title insurer insures that Lots 1 & 2 are contiguous, can it defend on the basis that they are indeed contiguous along BC? Will it lose because the lots are *not* contiguous along AB?

Why should AB make such a difference? It is plain that Lot 1 has four other lines that are not contiguous with any other line (A-①, ①-④, ④-③ & ③-C), and Lot 2 has two such lines (A-② & ②-C). Nobody expects a contiguity endorsement to insure that any of those lines are contiguous to a line in the other lot because they are so plainly not contiguous.

BC makes the two lots contiguous, so isn't that enough?

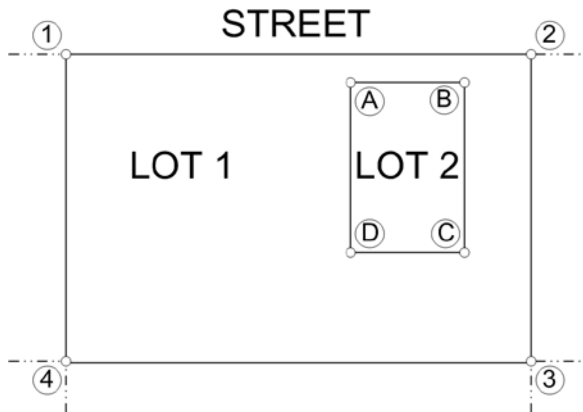
I doubt if the policyholder would be satisfied with this minimal contiguity if its goal was to construct a building straddling the two assembled lots, or to have unfettered access from one to another across AB. It seems to me that our conventional contiguity coverage is ambiguous and insufficient.

2. Perimeter descriptions

We can easily correct this problem by using a perimeter description of the assembled parcel within lines ①-②, ②-③, ③-④ & ④-①. If we use this perimeter description, we are insuring that nobody else has any rights inside that perimeter, unless we take exception to specific rights in Schedule B. This solution neatly resolves the contiguity issue, and makes any endorsement unnecessary. Unfortunately, it is not always possible to apply this tidy solution.

Often custom, practice or the title insurance customer prevents creating a new description for the assembled lots. In some other cases, the two estates may not be the same, so we can't use a new perimeter description. If Lot 1 is a fee estate, and Lot 2 is a leasehold a perimeter description will not work.

Also we might have an outlot in a shopping center, owned in fee, but the insured may want its easement rights in the center insured as well, so the policy will insure title to a fee parcel surrounded by an easement parcel.



Most shopping centers have reciprocal easement agreements or operating agreements that give the tenants rights to the common areas, including the parking lots. Those easements are crucial to fee owners of anchor outlots because the shopping center landlocks the outlot. The outlot owner may also demand insurance that the lot lines for outlot are contiguous to the adjacent lines of the center so nobody else has the right to interrupt access to the outlot. A perimeter description will not work here, because the two parcels are not being assembled in this transaction.

3. Contiguity endorsements

I see three basic ways to construct a contiguity endorsement. Let's return to our first illustration (with no gore at AB).

First, the endorsement may insure that Lot 1 is contiguous to Lot 2. I hope the weaknesses of this approach are obvious from the previous discussion.

Second, the endorsement could insure that nobody else has any rights between Lot 1 & Lot 2. I actually favor this form of coverage because it avoids vague concepts like 'contiguity' and goes to the heart of the matter. If the company insures that no other has rights between Lots 1 & 2, the coverage protects against any gore that would separate the two lots. We avoid the

problems of saying Lots 1 & 2 are contiguous to each other along lines AB and BC (if that was true).

The third approach is to insure that the lots are contiguous along specified lines. This approach avoids the ambiguity. Now this form of endorsement would specify that lines AB & BC in both lots are contiguous to one another. This is perhaps the most precise of the contiguity endorsement forms, but it is a bit clumsy, especially if the assemblage involves multiple parcels or a large number of calls between parcels. Like our first endorsement form, this form speaks of 'contiguity' and makes the reader infer that 'contiguity' eliminates the rights of anyone else to interfere with the insured's rights across the lines. After all, isn't that the insured's goal?

4. Contiguity risks

a. ALTA 19 Contiguity – Multiple Parcels

The ALTA Forms Committee combined insuring specified lines with coverage for, "the presence of any gaps, strips or gores separating any of the contiguous boundary lines described above" for the ALTA 19 and 19.1. It's a hybrid form of coverage.

The ALTA 19 is a conventional contiguity endorsement for insuring the contiguity of two or more parcels described in Schedule A. It meets the conventional role for contiguity coverages where a number of separate lots or tracts are assembled into one larger tract.

b. ALTA 19.1 Contiguity – Single Parcel

The ALTA 19.1 is designed for insuring that the land described in the policy is contiguous to adjacent land not insured by the policy. Although it may seem marginal compared to the demand for the assemblage coverage, it can be used for that shopping center outlot. In addition, it might be useful if a landowner buys adjacent land and wants insurance that the new lot is contiguous to the old lot. By using an ALTA 19.1, the buyer could insure contiguity without disturbing the title insurance for the original lot.

N. First Loss
ALTA 20-06

A "first loss" endorsement` is requested by lenders in some multi-property transactions to accelerate the payment of a loss under a loan policy if the value of one of the properties is diminished by a matter covered by the title insurance. Several forms of first loss coverage have been in circulation since the 1980s, but the endorsements are vague.

When the ALTA Forms Committee began exploring the value of a standard form, many legal commentators remarked that they did not know what the endorsements meant, or what they would do. Many real estate lawyers were skeptical that the ALTA Forms Committee could ever fashion a workable endorsement. Of course, it was obvious that a new standard endorsement must do at least as much as the general perception of the existing endorsements, or the new endorsement would not replace them. It has taken the Forms Committee longer to produce this endorsement than the others because the concept is both elusive and controversial.

1. The early first loss endorsements.

The general perception is that first loss coverage should entitle the lender to a payment on a loss without requiring foreclosure of all of its security (subject to certain limitations). Lenders

seeking first loss think it gives them the same protection in a title insurance claim as if the loan was secured by a single property, but in practice first loss coverage probably goes beyond that.

If a loan is secured by one property and that property is affected by a title defect that substantially reduces its value, the lender can declare a default, accelerate the indebtedness and foreclose (unless foreclosure is futile). It may then seek indemnity from its title insurer to the extent its security is inadequate to repay the loan, interest and costs as a result of a defect in title covered by the title insurance. The decision to foreclose and realize upon the collateral is rarely complicated by the problem of whether the borrower could survive without the property; because in most cases it can't.

In multi-property transactions, however, lenders are concerned about the consequences of potential title defects affecting just one of the properties that may cause a substantial loss of value to that property and impair the security for the loan. The lender's choice either to accelerate the indebtedness to protect itself or to allow the loan to continue to protect the borrower becomes complicated if the lender has an otherwise financially healthy borrower capable of surviving the loss of the affected property. If the lender accelerates and forecloses against all of its security to protect itself, it will destroy its borrower; if it doesn't accelerate, it may be undersecured and runs the risk that it may suffer a greater loss later. Under a loan policy of title insurance, however, such a lender has suffered no loss requiring indemnity, because: (i) the coverage will continue to protect the lender from loss as a result of the defect, in effect replacing the value lost in the property securing the loan; (ii) most loan security packages include more value in the collateral than is loaned and (iii) the other unaffected properties may adequately secure the loan.

2. The ALTA 20-06 First Loss Endorsement – Multiple Parcel Endorsement

The ALTA Forms Committee played with several concepts for this endorsement before landing on the current form. If title insurance is an indemnification line of insurance, it seems inconsistent to create a coverage that will compensate an insured when it determines its collateral has been impaired, but has not exhausted its collateral to establish a monetary loss. If the borrower and insured lender proceed with the loan after the title insurer makes a payment under the endorsement, the one of them may realize a windfall at the end of the transaction.

Liability is triggered under the endorsement when a loss insured against by the policy materially impairs the insured’s security under the insured mortgage. The endorsement begins by defining “Indebtedness”, “Collateral” and “Material Impairment Amount.” The “Material Impairment Amount” is the difference between the value of the insured’s Collateral and the value of the Indebtedness after a loss caused by a title defect lien, encumbrance or other matter. If the loss does not reduce the value of the Collateral below the value of the Indebtedness, there is no Material Impairment Amount and no liability under the endorsement. When the value of the Collateral is less than the Indebtedness because of a loss, the company is liable to pay the insured the Material Impairment Amount, not to exceed the limits of Sections 2 and 7 of the Conditions and Stipulations.

The liability is triggered even if the insured has not accelerated the payment of the debt, pursued its remedies against any of the Collateral, whether real or personal, or pursued any remedies under guaranties, bonds or insurance policies. The title insurer agrees to a ‘standstill’

against remedies against the borrower until the insured lender has been paid in full. The Title insurer does reserve its rights of subrogation against the borrower or a guarantor after the insured lender has been paid, and has the right to recoup from the insured lender any money received in excess of the amount it is due.

O. Location
ALTA 22-06 (Location) & 22.1-06 (Location and Map)

The ALTA acknowledged the pressure for a location endorsement modeled on the form of the CLTA 116.1 by passing new location endorsements on June 17, 2006. The ALTA 22 insures that a described improvement with an identified address is located on the land at the Date of Policy. The ALTA 22.1 adds coverage that a map attached to the policy correctly shows the location and dimensions of the land according to the public records.

P. Coinsurance
ALTA 23-06 (Me, Too)

In some jurisdictions, notably, New York, transactions are frequently insured by several title insurers, ostensibly to spread risk, although reinsurance does that more efficiently from the Insured's point of view. The Coinsurance Endorsement contemplates one of the insurers as the "Issuing Insurer" that will do all of the work of searching, examining and issuing the policy, and the other coinsurers simply issue the ALTA 23-06 to ratify the policy of the Issuing Coinsurer. Many years ago, each coinsurer did its own work, but it's manifest that having several different forms of coverage on the same property causes more work for the insured who generally negotiated a single form of coverage among the coinsurers. The "Me, Too" form of endorsement was devised to relieve the Insured of the burden of negotiating separate agreements with each insurer to follow a single model, and then to review each policy to verify that they are all congruent.. Of course, if there is a need for modifying the title insurance coverage after the policy has been issued, all coinsurers must agree to the modification, so the insured has not escaped entirely by using the endorsement. In addition, one company can't endorse the policy of another, so each company's execution of the Coinsurance Endorsement is actually a separate, but identical policy. Finally, regulators do not permit joint and several liability among companies because that would make reserving for losses almost impossibly difficult, so the insured must make a claim against each coinsurer if it has suffered a covered loss.

Now that the ALTA facultative[16] reinsurance agreements used by the title insurance industry include "Direct Access" provisions that empower an insured to seek recovery against

---

[16] "Facultative reinsurance" is reinsurance negotiated and purchased on individual transactions. If a title insurer is required or decides to reinsure a risk, it will use a facultative reinsurance agreement to make its arrangement with its reinsurers. Reinsurers for title insurance in the United States must be qualified as title insurance companies, so the reinsurers on most transactions are usually the large national title insurance companies. Some small regional title insurers may not have the capital that will allow them to insure all but the smallest risk because of state statutory retention formulas. To increase their capacity, they can enter into a "treaty" with a larger insured that will cover all risks above

the reinsurers of its transaction, despite not having privity with the reinsurers, reinsurance is much cleaner than coinsurance. All reinsurers must accept the issued policy, and a claim against the reinsured company is a claim against all. Making a claim under the "Direct Access" provision is very rare, and only necessary if the reinsured company can't respond to the claim, but it is a necessary backup.

Q. Doing Business
ALTA 24-06 (Doing Business)

All ALTA Loan Policies since, at least 1970, have included an exclusion to a state's doing business laws as Exclusion 4. Exclusion 4 in the 2006 ALTA Loan Policy says:

> 4. Unenforceability of the lien of the Insured Mortgage because of the inability or failure of an Insured to comply with applicable doing business laws of the state where the Land is situated.

If there is no exclusion for the insured loan in the state doing business law, this exclusion protects the insured from claims that a mortgage is unenforceable if the lender fails to comply with the law. The exclusion is a carve out from Covered Risk 9 of the 2006 ALTA Loan Policy that insures against loss caused by the invalidity or unenforceability of the lien of the Insured Mortgage.

However, most states do not require a lender to comply with their doing business laws if the lender only makes a mortgage loan on land located in the state without actually conducting business operations in the state. If there is an exemption, Lender's counsel may ask the title insurer to override Exclusion 4 with a "doing business" endorsement. For Example, Virginia exempts mortgage lenders from its requirement to obtain a certificate of authority from the State Corporation Commission in §13.1-757 of the Code of Virginia.[17]

---

a stated amount without the necessity of entering into a facultative agreement for each one.

[17] **§13.1-757. Authority to transact business required.** - A. A foreign corporation may not transact business in the Commonwealth until it obtains a certificate of authority from the Commission.

B. The following activities, among others, do not constitute transacting business within the meaning of subsection A:

1. Maintaining, defending, or settling any proceeding;
2. Holding meetings of the board of directors or shareholders or carrying on other activities concerning internal corporate affairs;
3. Maintaining bank accounts;
4. Maintaining offices or agencies for the transfer, exchange, and registration of the corporation's own securities or maintaining trustees or depositories with respect to those securities;
5. Selling through independent contractors;
6. Soliciting or obtaining orders, whether by mail or through employees or agents or otherwise, if the orders require acceptance outside this Commonwealth before they become contracts;

However, the endorsement does not protect a lender if it conducts other activities that are not exempt under §13.1-757(B), even if making the loan itself is exempt. It only protects a lender if its making these loans is its only activity in the state. Policyholders with owners' policies don't need this endorsement because there is no "doing business" exclusion in the ALTA Owners Policy.

R. Survey

ALTA 25-06 (Same as Survey) & 25.1-06 (Same as Portion of Survey)

Basic title evidence comes from two places, the recorder's office and surveys of the land. A search of the records in the recorder's office is common to every title insured, but not all title examinations include an examination of a current survey of the Land. If the buyer or borrower orders a current survey, or if there is an acceptable existing survey, the policyholder may have some concerns that the Land described in the recorder's documents is the same land shown on the survey. The insured can tie these two sources together by asking for a "same as survey" endorsement.

Property descriptions can change from one survey to the next because the surveyors may use different base points, and, of course, technology has greatly improved the accuracy of surveys. In many cases, the documents will use a historical description and the survey will show the results of the surveyor's own measurements. That can make the policyholder uneasy.

The ALTA 25 Same as Survey Endorsement can be used where the title insurer is confident that the property description in Schedule A of the policy is the same land as that shown in the survey, even if the calls for the metes and bounds differ in the two documents. The ALTA 25.1 Same as Portion of Survey Endorsement is used where the survey shows more land than the Land insured in the policy. For example, if a buyer is purchasing an outlot in a shopping center and doesn't want to pay for a survey of just the outlot because it is adequately depicted in a

---

7. Creating or acquiring indebtedness, deeds of trust, and security interests in real or personal property;

8. Securing or collecting debts or enforcing deeds of trust and security interests in property securing the debts;

9. Owning, without more, real or personal property;

10. Conducting an isolated transaction that is completed within 30 days and that is not one in the course of repeated transactions of a like nature;

11. For a period of less than 90 consecutive days, producing, directing, filming, crewing or acting in motion picture feature films, television series or commercials, or promotional films which are sent outside of the Commonwealth for processing, editing, marketing and distribution. The term "transacting business" as used in this subsection shall have no effect on personal jurisdiction under § 8.01-328.1; or

12. Serving, without more, as a general partner of, or as a partner in a partnership which is a general partner of, a domestic or foreign limited partnership that does not otherwise transact business in the Commonwealth.

C. The list of activities in subsection B is not exhaustive. [*Emphasis added*].

survey of the entire shopping center, the title insurer can accept the shopping center survey and issue an ALTA 25.1 designating the outlot as the Land.

S. Subdivision

ALTA 26-06 (Subdivision)

Until the 2006 ALTA policies, Exclusion 1 of the policies provided:

> The following matters are expressly excluded from the coverage of this policy:
>
> Any law, ordinance or governmental regulation (including but not limited to building and zoning ordinances) restricting or regulating or prohibiting the occupancy, use or enjoyment of the land, or regulating the character, dimensions or location of any improvement now or hereafter erected on the land, or prohibiting a separation in ownership or a change in the dimensions or area of the land, or any parcel of which the land is or was a part. [*Emphasis added*].

That last clause in the exclusion (this is the 1984 revision language that continued through the 1992 policies) was intended to describe subdivisions of the land. Many policyholders failed to grasp what the clause addressed, until they had a claim about an improper subdivision. Others recognized the exclusion and asked for an endorsement to cover subdivision risks. The California Land Title Association developed a CLTA 116.7 Subdivision Map Act Compliance endorsement decades ago, but it had to be altered for use outside the state because it insured compliance with the Subdivision Map Act, §66410, et seq., of the California Government Code.

The language "Any law, ordinance or governmental regulation . . . restricting or regulating or prohibiting . . . prohibiting a separation in ownership or a change in the dimensions or area of the land, or any parcel of which the land is or was a part ." lasted until 2006. With the new policies, the ALTA dropped the obscure reference to subdivision and substituted the word itself in both Covered Risk 5(c) and Exclusion 1(a)(iii). Covered Risk 5 now insures against

> 5. The violation or enforcement of any law, ordinance, permit, or governmental regulation (including those relating to building and zoning) restricting, regulating, prohibiting, or relating to . . .
>
>   (c) the subdivision of land; or
>
>   if a notice, describing any part of the Land, is recorded in the Public Records setting forth the violation or intention to enforce, but only to the extent of the violation or enforcement referred to in that notice.

So a subdivision endorsement is unnecessary if the title insurer misses a notice in the Public Records. If there is no notice the title insurer would not be liable under the policy. The ALTA 26 has no requirement that there be notice in the Public Records, so it extends the policy coverage by an assumption of the risk of loss by the title insurer due to a subdivision violation not noticed in the Public Records.

T. Usury

ALTA 27-06 (Usury)

Title insurance policies insure against title and lien risks, so a usury endorsement insures against:

> loss or damage sustained by the Insured by reason of the invalidity or unenforceability of the lien of the Insured Mortgage as security for the Indebtedness

> because the loan secured by the Insured Mortgage violates the usury law of the state where the Land is located.

The endorsement does not insure against a loss caused by a judgment that the debt is unenforceable, or against penalties assessed against the insured because the loan is usurious. Title insurers are restricted to insuring the title or the lien of the mortgage, and cannot insure the validity or enforceability of the debt itself.

A title insurer will generally require that the loan fit into a statutory exemption before it will offer a usury endorsement. In Virginia, §6.1-330.61 provides the following exemption:

> No person shall, by way of defense or otherwise, avail himself of the provisions of this chapter or any other section relating to usury to avoid or defeat the payment of interest, or any other sum, upon a loan made to a person by a bank, savings institution, industrial loan association or credit union, provided the initial principal amount of the loan is $5,000 or more.

At first, the coverage sounds disappointing, but lenders us the coverage to determine if their loans meet a statutory exemption. If the title insurer gives the coverage, the loan should be exempt. If the title insurer must calculate the interest rate to determine if the loan is usurious, most companies will not issue the endorsement. So the lender can take comfort from the endorsement even if the coverage is not everything it would like to have.

U. Easements

ALTA 28-06 (Easement – Damage or Enforced Removal)

Occasionally review of a survey will show a building that encroaches on an easement. Buyers of policies who see an exception for such an encroachment will often ask for some "affirmative" coverage over the risks posed by the encroachment. The title insurer cannot insure that the encroachment does not exist, because it does. We often receive requests for coverage against loss caused by "any exercise or attempted exercise of the right of use or maintenance of the easement referred to in exception ___." Of course, if the survey shows an active pole line or manholes in the right of way, it would be imprudent to insure an owner against the right to use or maintain the easement. A title insurer who did that would create a claim merely by issuing the policy.

That affirmative coverage is even broader than the lender's coverage in an ALTA 9.3 endorsement. It provides in paragraph 3:

> 3. Damage to existing improvements, including lawns, shrubbery, or trees, located or encroaching on that portion of the Land subject to any easement excepted in Schedule B, which damage results from the exercise of the right to maintain the easement for the purpose for which it was granted or reserved.

That language originated in California where lawns shrubbery and trees are coaxed out of desert soil and conditions. In the eastern U.S., it is unthinkable to give coverage against damage to trees to an owner because our utility companies try to prevent power outages by trimming back trees, with painful results. With a little more editing, we can craft an endorsement that makes sense.

> The Company insures against loss or damage sustained by the Insured by reason of:
>
> (1) damage to an existing building located on the Land, or

(2) enforced removal or alteration of an existing building located on the Land,

as a result of the exercise of the right of use or maintenance of the easement referred to in Exception ___ of Schedule B for the purpose for which it was granted or reserved.

V. Interest Rate Swaps

ALTA 29-06 (Interest Rate Swap-Direct Obligation)& ALTA 29.1 (Interest Rate Swap-Additional Interest)

1. Interest Rate Swap Transactions

Interest rate swaps are "derivative" transactions, so they intimidate title insurance employees who haven't done that much work with them. Actually, the title insurance role is quite simple, even though derivatives can be complex. Borrowers enter into interest rate swaps to fix all or a part of the cost of borrowing. So how does a swap work?

It's easiest to begin with an illustration. Mooch, LLC borrows $20,000,000 from National Bank with the loan to be secured by a mortgage from Mooch. National Bank is only willing to lend with a variable rate, let's say LIBOR plus two points, even though Mooch had applied for a fixed rate loan expecting inflation in the future. To simplify matters, let's say that the loan provides for one payment at the end of each year of its ten year life.

To fix the rate (a goal that National Bank agrees with) National Bank offers Mooch an interest rate swap. The swap has a "notional amount" of $20,000,000 to match it to the principal indebtedness of the mortgage loan. The notional amount could be less if the parties decided to hedge only a portion of the loan. Using this notional amount, Mooch and National Bank agree to pay each other at year end (i) at a fixed rate of 6% of the notional amount from Mooch to the bank and (ii) at a variable rate of LIBOR plus two points from the bank to Mooch. Of course, to simplify matters, the parties will net out their obligations so the party that owes more will pay that excess to the other.

With the swap, Mooch will owe National Bank a payment of 6% of the $20,000,000 notional amount on the swap and another payment of LIBOR plus two points on the $20,000,000 mortgage indebtedness. At the same time, National Bank will owe Mooch a payment of LIBOR plus two points on the $20,000,000 notional amount of the swap. The result after netting everything out, is that Mooch will pay National Bank 6% on $20,000,000, or $120,000.

Let's imagine, at the end of the first year, that LIBOR is 3%. In the swap, Mooch is obligated to National Bank for $120,000 and National Bank is obligated to Mooch in the amount of $100,000, so Mooch pays the bank $20,000. In addition, Mooch must pay the bank interest on its loan of LIBOR plus two, or $100,000. It pays a total of $120,000 to National Bank. Looking at the swap, it appears that the bank "wins" this round because Mooch lost the advantage of the low variable rates.

The next year that dreaded inflation kicks in, so by the end of the year, LIBOR is now 6%. In the swap, Mooch is obligated to National Bank for its $120,000, but this time National Bank is obligated to Mooch in the amount of $160,000 (8% of $20,000,000), so National Bank pays Mooch $40,000. Mooch must also pay the bank $160,000, so at the end of the day Mooch has paid $120,000 for its loan and swap. This time Mooch "wins" in the swap.

When Mooch borrowed the $20,000,000, National Bank was unwilling to accept the risk of interest rate fluctuations, but after they entered into the swap agreement, Mooch transferred that risk back to the bank. Why was the bank willing to accept a risk in a swap that it was unwilling to accept in the mortgage loan? When the bank set up the swap to hedge Mooch's interest rate risk, it also rehedged that risk with another swap. In the swap agreement, Mooch agreed not only to net payments, but also to pay the expense of rehedging the banks's hedging swap if Mooch defaulted on the swap. The damages for a default are often called "breakage."

If the bank must seek indemnification for the breakage from Mooch after a default on the swap, the bank should be concerned about Mooch's ability to pay. If Mooch defaults on its mortgage loan, the bank can recover its loss by foreclosing on the mortgage (at least that's the theory), so if the bank secures Mooch's reimbursement obligation for the breakage with the mortgage, it can be a secured creditor as to both.

2. Master Interest Rate Swap Agreements

The typical swap agreement is an International Swap dealer's Association (ISDA) Interest Rate Swap Agreement. It provides for the details of an interest rate swap and when complete, the swap is in effect.

In some cases, the borrower and swap provider enter into an ISDA "Master Interest Rate Swap Agreement" that provides that the parties may confirm an actual interest rate swap in the future. There may be no swap in place at the loan closing, even if the master agreement has been fully executed. There is no law that supports viewing an interest rate confirmation in the future as creating a breakage reimbursement obligation that relates back to the date of the mortgage securing it, as often happens with future advances of indebtedness.

3. Securing Direct Obligations

The simple way to secure a swap obligation is to identify it as a an obligation secured by the mortgage, just as a note is secured. If the mortgage secures such a direct obligation, then a title insurer can insure that the mortgage secures the obligation with an ALTA 29 Interest Rate Swap – Direct Obligation endorsement. That sounds easy, but the swap must be in place when the endorsement is issued, and swaps are not always confirmed when the borrower closes the loan. The ALTA 29 only insures swap obligations in existence on the date the endorsement is issued, so if the parties confirm a swap after the endorsement was issued, it will not be insured. To insure a later confirmation, the swap provider must seek an endorsement to its loan policy.

One problem with the direct obligation method is that it requires the lender to increase the amount secured by the mortgage by the estimated amount that a rehedging swap will cost. Usually that estimate is ten percent of the notional amount. So in the case of the Mooch mortgage, the amount secured should be $20,000,000 plus $2,000,000 or $22,000,000. In a state having no mortgage tax, that isn't a barrier. In a state with a significant mortgage tax, that extra 10% for a contingent obligation can be a material amount.

4. Securing Additional Interest

If the mortgage secures the breakage as "additional interest" and the mortgage loan contains an additional interest provision that will be triggered by a swap default to fund the breakage, the mortgage can secure the principle amount of $20,000,000 in our illustration, and

still secure the amount needed to rehedge the swap. It's more complex, but in some states the mortgage tax savings may make this method worth the effort. Of course, if the mortgage secures the indebtedness and additional interest to fund the breakage, it should be insured with an ALTA 29.1 Interest Rate Exchange – Additional Interest endorsement. Like the ALTA 29, the ALTA 29.1 only insures breakage if the swap exists at the date of Endorsement.

In Maryland, a mortgage tax state, the same savings can be achieved with a direct obligation that is secured by an Indemnity Deed of Trust without using the additional interest structure; however, if the indebtedness is secured by a conventional Deed of Trust it may be difficult to decide whether using (i) additional interest in one Deed of Trust or (ii) a Deed of Trust and an Indemnity Deed of Trust, creates the best savings.

W. Shared Appreciation

In the 1980's the ALTA Forms Committee drafted a shared appreciation mortgage endorsement using the ALTA 6 Variable Rate Mortgage Endorsement as a model, but did not adopt the form as an ALTA form. It circulated as a model to use in the rare occasions that such an endorsement was needed. The Forms Committee decided not to adopt it as an ALTA form because there was not sufficient demand for such an endorsement.

In 2010, the Forms Committee reconsidered and updated the old model so it could adopt it as an ALTA form. Although there is only one endorsement in the series, the Forms Committee is considering adding some commercial endorsements. The ALTA 30 One-to-Four Family Shared Appreciation Mortgage endorsement is designed only for residential mortgages where the additional interest is based on the appreciation in value of the home. The Forms Committee expects shared appreciation to become more popular in some of the residential workouts now underway. If a refinancing or modified mortgage contains a shared appreciation feature, the endorsement insures that the feature is secured by the mortgage.

X. Boilerplate

The ALTA Forms Committee decided that even the boilerplate should be brought up to date with the new endorsements. It has applied it to all ALTA endorsements.

The old boilerplate read:

> This endorsement is made a part of the policy and is subject to all of the terms and provisions thereof and of any prior endorsements thereto. Except to the extent expressly stated, it neither modifies any of the terms and provisions of the policy and any prior endorsements, nor does it extend the effective date of the policy and any prior endorsements, nor does it increase the face amount thereof.

The new boilerplate sheds some archaic usage, and adds a second sentence to declare that the endorsement controls over any inconsistency in the policy or a previous endorsement. That would be implied under the general rules of construction, but now the endorsements say so.

> This endorsement is issued as part of the policy. Except as it expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsements, (iii) extend the Date of Policy or (iv) increase the Amount of Insurance. To the extent a provision of the policy or a previous endorsement is inconsistent with an express provision of this endorsement, this endorsement controls. Otherwise, this endorsement is subject to all of the terms and provisions of the policy and of any prior endorsements.

On January 17, 2004, the ALTA Board of Governors adopted the recommendation of the ALTA Forms Committee to substitute the new boilerplate into all of the ALTA endorsement forms. It now applies to all ALTA endorsements. In addition the ALTA included a complementary provision in subsection (d) of Conditions 14 and 15 of the 2006 Loan and Owner's policies respectively. If a title insurer inadvertently leaves off the boilerplate from an endorsement, these policy provisions will incorporate the endorsement into the policy without it. It's belts and suspenders.

In the revisions to the 2006 policies, it became evident that nothing in the policies addressed the effect of endorsements, and so Section 14(d) was added to the 2006 Loan Policy and section 15(d) was added to the 2006 Owners Policy to correct that deficiency. They say:

> (d) Each endorsement to this policy issued at any time is made a part of this policy and is subject to all of its terms and provisions. Except as the endorsement expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsement, (iii) extend the Date of Policy, or (iv) increase the Amount of Insurance.

II
The ALTA Endorsements
(In numerical order)

Form	Name	Introduced	Current Revision
ALTA 1	Street Assessments	4/2/70	6/1/87
ALTA 1-06	Street Assessments	6/17/06	6/17/06
ALTA 2	Truth-in-Lending	4/2/70	6/1/87
ALTA 2-06	Truth-in-Lending	6/17/06	6/17/06
ALTA 3	Zoning – Vacant Land	10/3/73	10/17/98
ALTA 3-06	Zoning – Vacant Land	6/17/06	6/17/06
ALTA 3.1	Zoning – Completed Structure	10/3/73	10/17/98
ALTA 3.1-06	Zoning – Completed Structure	6/17/06	6/17/06
ALTA 4	Condominium	9/27/78	3/27/92
ALTA 4-06	Condominium	6/17/06	10/16/08
ALTA 4.1	Condominium	10/17/92	10/17/92
ALTA 4.1-06	Condominium	6/17/06	10/16/08
ALTA 5	Planned Unit Development	10/17/79	3/27/92
ALTA 5-06	Planned Unit Development	6/17/06	10/16/08
ALTA 5.1	Planned Unit Development	10/17/92	10/17/92
ALTA 5.1-06	Planned Unit Development	6/17/06	10/16/08
ALTA 6	Variable Rate Mortgage	10/17/80	6/1/87
ALTA 6-06	Variable rate Mortgage	6/17/06	10/16/08
ALTA 6.1	Variable Rate Mortgage	10/17/80	6/1/87
ALTA 6.2	Variable Rate Mortgage – Negative Amortization	1982	6/1/87
ALTA 6.2-06	Variable Rate Mortgage – Negative Amortization	6/17/06	10/16/08
ALTA 7	Manufactured Housing	3/12/82	6/1/87
ALTA 7-06	Manufactured Housing	6/17/06	6/17/06
ALTA 7.1	Manufactured Housing- Conversion; Loan	6/17/06	6/17/06
ALTA 7.1-06	Manufactured Housing – Conversion; Loan	6/17/06	6/17/06
ALTA 7.2	Manufactured Housing -	6/17/06	6/17/06

Form	Name	Introduced	Current Revision
	Conversion; Owners		
ALTA 7.2-06	Manufactured Housing - Conversion; Owners	6/17/06	6/17/06
ALTA 8.1	Environmental Protection Lien	6/1/87	3/12/88
ALTA 8.1-06	Environmental Protection Lien	6/17/06	6/17/06
ALTA 8.2-06	Commercial Environmental Protection Lien	10/16/08	10/16/08
ALTA 9	Restrictions, Encroachments, Minerals	10/19/88	6/17/06
ALTA 9-06	Restrictions, Encroachments, Minerals	6/17/06	6/17/06
ALTA 9.1	Restrictions, Encroachments, Minerals – Owner's Policy: Unimproved Land	10/17/98	6/17/06
ALTA 9.1-06	Restrictions, Encroachments, Minerals – Owner's Policy: Unimproved Land	6/17/06	6/17/06
ALTA 9.2	Restrictions, Encroachments, Minerals – Owner's Policy: Improved Land	10/17/98	6/17/06
ALTA 9.2-06	Restrictions, Encroachments, Minerals – Owner's Policy: Improved Land	6/17/06	6/17/06
ALTA 9.3	Restrictions, Encroachments, Minerals	6/17/06	6/17/06
ALTA 9.3-06	Restrictions, Encroachments, Minerals	6/17/06	6/17/06
ALTA 9.4	Restrictions, Encroachments, Minerals – Owner's Policy: Unimproved Land	6/17/06	6/17/06
ALTA 9.4-06	Restrictions, Encroachments, Minerals – Owner's Policy: Unimproved Land	6/17/06	6/17/06
ALTA 9.5	Restrictions, Encroachments, Minerals – Owner's Policy: Improved Land	6/17/06	6/17/06
ALTA 9.5-06	Restrictions, Encroachments, Minerals – Owner's Policy:	6/17/06	6/17/06

Form	Name	Introduced	Current Revision
	Improved Land		
ALTA 10	Mortgage Assignment	10/21/95	10/21/95
ALTA 10-06	Mortgage Assignment	6/17/06	10/16/08
ALTA 10.1	Mortgage Assignment and Datedown	10/21/95	10/21/95
ALTA 10.1-06	Mortgage Assignment and Datedown	6/17/06	10/16/08
ALTA 11	Mortgage Modification	10/19/96	10/19/96
ALTA 11-06	Mortgage Modification	6/17/06	6/17/06
ALTA 12	Aggregation	10/19/96	10/19/96
ALTA 12-06	Aggregation	6/17/06	6/17/06
ALTA 13	Leasehold Owners	10/13/01	10/13/01
ALTA 13	Leasehold Owners	6/17/06	6/17/06
ALTA 13.1	Leasehold Loan	10/13/01	10/13/01
ALTA 13.1	Leasehold Loan	6/17/06	6/17/06
ALTA 14	Future Advances – Priority	10/22/03	10/22/03
ALTA 14-06	Future Advances – Priority	6/17/06	6/17/06
ALTA 14.1	Future Advances – Notice	10/22/03	10/22/03
ALTA 14.1-06	Future Advances – Notice	6/17/06	6/17/06
ALTA 14.2	Future Advances – Letter of Credit	10/22/03	10/22/03
ALTA 14.2-06	Future Advances – Letter of Credit	6/17/06	6/17/06
ALTA 14.3	Future Advances – Reverse Mortgage	6/17/06	6/17/06
ALTA 14.3-06	Future Advances – Reverse Mortgage	6/17/06	6/17/06
ALTA 15	Non-Imputation – Full Equity Transfer	10/22/03	10/22/03
ALTA 15-06	Non-Imputation – Full Equity Transfer	6/17/06	6/17/06
ALTA 15.1	Non-Imputation – Additional Insured	10/22/03	10/22/03
ALTA 15.1-06	Non-Imputation – Additional	6/17/06	6/17/06

Form	Name	Introduced	Current Revision
	Insured		
ALTA 15.2	Non-Imputation Partial Equity Transfer	10/22/03	10/22/03
ALTA 15.2-06	Non-Imputation Partial Equity Transfer	6/17/06	6/17/06
ALTA 16	Mezzanine Financing Endorsement	10/22/03	10/22/03
ALTA 16-06	Mezzanine Financing Endorsement	6/17/06	6/17/06
ALTA 17	Access and Entry	10/22/03	10/22/03
ALTA 17-06	Access and Entry	6/17/06	6/17/06
ALTA 17.1	Indirect Access and Entry	1/17/04	1/17/04
ALTA 17.1-06	Indirect Access and Entry	6/17/06	6/17/06
ALTA 17.2-06	Utility Access	10/16/08	10/16/08
ALTA 18	Single Tax Parcel	10/22/03	10/22/03
ALTA 18-06	Single Tax Parcel	6/17/06	6/17/06
ALTA 18.1	Multiple Tax Parcel	10/22/03	10/22/03
ALTA 18.1-06	Multiple Tax Parcel	6/17/06	6/17/06
ALTA 19	Contiguity – Multiple Parcels	10/22/03	10/22/03
ALTA 19-06	Contiguity – Multiple Parcels	6/17/06	6/17/06
ALTA 19.1	Contiguity – Single Parcels	10/22/03	10/22/03
ALTA 19.1-06	Contiguity – Single Parcels	6/17/06	6/17/06
ALTA 20	First Loss – Multiple Parcel Transactions	4/19/04	4/19/04
ALTA 20-06	First Loss – Multiple Parcel Transactions	6/17/06	6/17/06
~~ALTA 21~~	Creditors' Rights	4/19/04	Withdrawn 2/3/10
~~ALTA 21-06~~	Creditors' Rights	6/17/06	Withdrawn 2/3/10
ALTA 22	Location	6/17/06	6/17/06
ALTA 22-06	Location	6/17/06	6/17/06
ALTA 22.1	Location and Map	6/17/06	6/17/06
ALTA 22.1-06	Location and Map	6/17/06	6/17/06
ALTA 23	Coinsurance	1/1/08	1/1/08

Form	Name	Introduced	Current Revision
ALTA 23-06	Coinsurance	1/1/08	1/1/08
ALTA 24-06	Doing Business	10/16/08	10/16/08
ALTA 25-06	Same as Survey	10/16/08	10/16/08
ALTA 25.1-06	Same as Portion of Survey	10/16/08	10/16/08
ALTA 26-06	Subdivision	10/16/08	10/16/08
ALTA 27-06	Usury	10/16/08	10/16/08
ALTA 28	Easement – Damage or Enforced Removal	2/3/10	2/3/10
ALTA 29	Interest Rate Swap – Direct Obligation	2/3/10	2/3/10
ALTA 29.1	Interest Rate Swap – Additional Interest	2/3/10	2/3/10
ALTA 30	One-to-Four Family Shared Appreciation Mortgage	7/26/10	7/26/10