



CHICAGO TITLE INSURANCE COMPANY

TOPIC: Construction Loans – A Review of Problem Areas
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Construction loans present a unique set of circumstances requiring special consideration when procuring title insurance. The loans are typically for the limited purpose of constructing improvements upon real property, and are generally of a very limited duration (usually two years or less). What makes a construction loan unique is that it will involve disbursements post-closing - matters typically not covered by a title policy because the policy is limited to matters as of its effective date - and a property that at least in theory will increase in value with each disbursement. Legal counsel to the lender must structure and document the loan in accordance with North Carolina law to ensure the priority of those advances made post-closing, and procure title insurance which insures the priority of those advances and provides increasing coverage for each advance. Counsel must also be aware of the increasing likelihood of mechanic's lien risks in the context of a construction loan. Legal counsel to the owner must give special consideration to the transaction underlying the loan in order to procure the appropriate amount of title insurance coverage for the owner. This manuscript highlights those special underwriting considerations along with others that are involved with structuring and insuring construction loans.

Future Advances

Article 7 of Chapter 45 of the North Carolina General Statutes (NCGS) provides a framework for ensuring the priority of future advances. According to NCGS 45-70:

Any security instrument which conforms to the requirements of this Article shall, from the time and date of registration thereof, have the same priority to the extent of all future advances secured by it, as if all the advances had been made at the time of execution of the instrument.

NCGS 45-68 sets forth those requirements that must be met in an otherwise valid security instrument to ensure the priority of those future advances, namely that the deed of trust must show:

- (1) that it is given wholly or partly to secure future obligations which may be incurred thereunder;
- (2) the amount of the present obligations secured, and the maximum principal amount, including present and future obligations, which may be secured thereby at any one time; and

(3) the period within which such future obligations may be incurred, which period shall not extend more than 15 years beyond the date of the deed of trust.

In addition, it makes no difference that the outstanding principal balance secured by the instrument fluctuates so long as the obligation(s) has been incurred within the timeframe and the maximum amount authorized in the security instrument and allowed under Article 7 (NCGS 45-69). Note, however, that if the instrument secures a revolving line of credit, it must so provide.

Article 9 of Chapter 45 also provides a framework for ensuring the priority of future advances under an equity line of credit. According to NCGS 45-82:

A mortgage or deed of trust which shows on its face that it secures an equity line of credit governed by the provisions of [Article 9], shall, from the time of its registration, have the same priority to the extent of all advances secured by it as if the advances had been made at the time of the execution of the mortgage or deed of trust, notwithstanding the fact that from time to time during the term of the loan no balance is outstanding.

NCGS 45-81(a) defines an “equity line of credit” as “an agreement in writing between a lender and borrower for an extension of credit pursuant to which:

- (1) At any time within a specified period not to exceed 30 years the borrower may request and the ***lender is obligated to provide*** (emphasis added), by honoring negotiable instruments drawn by the borrower or otherwise, advances up to an agreed aggregate limit;
- (2) Any repayments of principal by the borrower within the specified period will reduce the amount of advances counted against the aggregate limit; and
- (3) The borrower’s obligation to the lender is secured by a mortgage or deed of trust relating to real property which mortgage or deed of trust shows on its face the maximum principal amount which may be secured at any one time and that it secures an equity line of credit governed by the provisions of this [Article 9].”

Unlike Article 7, in order to comply with Article 9, the advances by the lender must be obligatory or the lender bound to make them, rather than the advances being optional. NCGS 45-81(b) specifically defines “lender is obligated” in NCGS 45-81(a) to mean “that the lender is contractually bound to provide advances.” Since October 1, 1989, Article 7 has not contained such a requirement; rather, the advances made under an Article 7 security instrument may be optional to lender.

Neither Article 7 nor Article 9 provides a rule of priority for future advances absent compliance with its terms. While noncompliance in either case would not invalidate an otherwise valid deed of trust, future advances made thereunder would seemingly not be secured. To date, there is no case law or agency opinion clarifying this issue; and thus, a title insurer would likely treat

each post-closing advance as a new loan independent from the advance at closing pursuant to the noncompliant deed of trust.

Keep in mind that a title insurance policy generally excludes coverage for post-policy matters and covered risks are based on date and time of initial closing, not post-policy actions. Thus, despite having a deed of trust compliant with the requirements of one of the future advance statutes above, counsel should request the appropriate ALTA Endorsement Form 14 (Future Advance - Priority) (hereinafter ALTA 14) in order to confirm lender coverage for such post-policy matters.

Mechanics' Liens

The circumstances involved in making any proposed construction loan must be reviewed with special attention paid to potential mechanics' liens. NCGS 44A-8 provides that any person who performs or furnishes labor or professional design or surveying services or furnishes materials or rental equipment pursuant to a contract with the owner of real property for the making of any improvement thereon shall have a right to file a claim of lien against the real property to secure payment for such services and materials. Such a person is defined as a "contractor" in NCGS 44A-17. To perfect such a lien, the lien must be filed in the county where the property is located within 120 days from the contractor's last furnishing of labor, services, or materials (NCGS 44A-12). An action to enforce the lien must then be commenced within 180 days of the last furnishing of materials or labor by the contractor (NCGS 44A-13). The priority of the lien relates back to the date of the contractor's first furnishing of labor, services, or materials at the site of the improvement, and thus may be prior in right to a lien, judgment, or deed of trust filed or recorded before the recording of such a claim of lien – including future advances made purportedly under a construction loan but for which the deed of trust does not comply with Article 7 or Article 9 (NCGS 44A-10).

It is the possibility of the priority of such a "non-record" lien relating back before the recording of the proposed deed of trust that causes concern to a lender and its title insurer with any loan, but in particular with construction loans. In the typical construction loan situation, some work on the property has likely already begun (e.g., clearing trees, grading, etc.), and / or some building material has likely already been delivered to the property prior to closing. In such circumstances, a determination must be made as to who ordered the work and materials, and then proper lien waivers or subordinations must be secured.

For instance, if the prospective owner of the real property contracted with each of the suppliers or contractors; then each such person with whom the prospective owner dealt has a potential lien on the real property, and must provide no less than a lien subordination in order to protect the priority of the deed of trust. (See Carolina Builders vs. Howard-Veasey Homes, Inc., 72 N.C. App. 224, 324 S.E.2d 626 [1985] holding that a party's equitable interest in real property through execution of a purchase contract followed by the party's subsequently attaining a legal interest satisfies the ownership requirement under NCGS 44A-8.) If the owner, however, has not contracted individually with the contractors and suppliers, but rather has worked through what is commonly referred to as a "general contractor," then only such general contractor needs to provide no less than a lien subordination at the time the construction loan deed of trust is

recorded. In many construction loan situations, however, the owner has a “general contractor” and other contractors with whom he has contracted and thus from whom also must be obtained proper lien affidavits and subordinations. Chapter 44A does not recognize the term “general contractor;” rather, it provides as stated above, that any person who contracts with the owner of real property to provide services or materials for the construction of improvements thereon is entitled to a lien on such real property to secure payment for such services and materials.

The contractor’s lien waiver or subordination will also affect those lien rights of any of its subcontractors – persons contracting with the contractor and not the owner. NCGS 44A-23 provides subcontractors in the first three tiers of the construction hierarchy with a method for obtaining an enforceable claim of lien upon the owner’s real property by virtue of subrogation to the contractor’s right to file and enforce its claim of lien, if any, against the real property. In sum, according to NCGS 44A-23, if the subcontractor gives notice of a claim of lien upon funds as provided in NCGS 44A-18 to the owner and the other subcontractors, if any, above it in the construction hierarchy, the subcontractor may, to the extent of its claim, enforce the claim of lien upon the real property of the contractor. The filing period (120 days from last furnishing) and enforcement period (180 days from last furnishing) are based on the contractor’s last furnishing, and the subcontractor’s claim of lien itself will relate back to the contractor’s first furnishing.

Basically, NCGS 44A-23 provides a statutory scheme by which a subcontractor may step into the contractor’s shoes and administer the contractor’s lien rights against the real property to the extent of its lien rights. However, NCGS 44A-23 also provides that prior to filing its action to enforce its lien rights, the rights of any subcontractor (in any tier) claiming through the contractor shall be affected to the same extent as the rights of the contractor are affected through its acceptance of full payment, lien waiver. Urban and Whitney, North Carolina Real Estate, Section 21-54 (2007) (citing Electric Supply Co. of Durham, Inc., v. Swain Electrical Co., Inc., 328 N.C. 651, 403 S.E. 2d 291 (1991)). Thus, a contractor’s waiver or subordination will not only affect its lien rights relative to the proposed deed of trust but also those of any subcontractor that would potentially assert its rights through the contractor so long as such waiver or subordination is effected prior to that subcontractor instituting its action to enforce the claim of lien. Of course, if the contractor has been paid in full (at which time a complete waiver of liens should be obtained in exchange for such final payment), it has no lien rights against the real property through which any subcontractor may assert its lien rights.

NCGS 44A-20(d) also provides a statutory scheme by which a subcontractor may administer its lien rights against the real property. According to NCGS 44A-20(a):

Upon receipt of the notice of claim of lien upon funds provided for in this Article, the obligor shall be under a duty to retain any funds subject to the lien or liens upon funds under this Article up to the total amount of such liens upon funds as to which notices of claims of lien upon funds have been received.

NCGS 44A-20(b) provides that the obligor shall be personally liable to the extent that it makes further payments to a contractor or subcontractor against whose interest the lien upon funds is claimed. If the obligor in such instance is the owner of real property, the lien claimant may file a claim of lien against the real property to the extent of the owner’s personal liability with such

claim of lien being subject to the filing requirements, limitation periods, and “priorities” of the contractor (NCGS 44A-20(d)). Most importantly, however, unlike the subcontractor’s rights to subrogation pursuant to NCGS 44A-23, the subcontractor’s rights under a NCGS 44A-20(d) lien may not be affected by any waiver or subordination of lien rights by the contractor. Mace vs. Bryant Constr. Corp., 48 N.C. App. 297, 269 S.E.2d 191 (1980). A notice of claim of lien upon funds is not recorded except with a filed claim of lien or in order to discharge a filed claim of lien, so a “44A-20(d) claim of lien” poses the same “off record” problem that any mechanic’s lien poses – that it may have priority by relating back prior to the proposed deed of trust. In examining a proposed construction loan, the lender and title insurer in order to ensure the priority of the proposed deed of trust from a “44A-20(d) claim of lien” will require the owner to state under oath that construction has not commenced, or that the owner has not received any notice of claim of lien upon funds.

In the typical situation where the borrower is purchasing the property and obtaining the construction loan, there are at least two parties from whom proper affidavits, lien waivers, or subordinations are needed in order to insure the priority of the construction loan deed of trust:

- Seller / Seller’s Contractor(s): Must provide an affidavit and indemnity confirming no construction or deliveries of materials to the property within the past 120 days; and if to the contrary, obtain lien waivers or subordinations from each contractor dealing with the seller and an affidavit that it is not in receipt of any notice of claim of lien upon funds.
- Purchaser / Purchaser’s Contractor(s): Must provide an affidavit and indemnity confirming non-commencement of construction; and if to the contrary, obtain lien waivers or subordinations from each contractor dealing with the purchaser, and an affidavit that, among other things, purchaser is not in receipt of any notice of claim of lien upon funds. Lien waivers or subordinations should also be obtained from any contractors performing due diligence services for the purchaser prior to closing.

The contractor will typically refuse to waive its lien rights if it has not already been paid in full. In most cases, however, the lender and title insurer will be satisfied with the subordination of such lien rights to the proposed deed of trust. In fact, such a subordination request is generally anticipated by the owner, and required within the owner’s contract with the contractor. Please note, however, that a waiver of such rights (rather than a subordination) by the contractor in its original work contract is unenforceable by statute (NCGS 44A-12(f)).

The importance of examining the state of the property and obtaining lien waivers or subordinations from all contractors performing any work or delivering any materials prior to closing cannot be understated. Standard loan policy underwriting theories commonly relied upon may not provide enough coverage for a construction loan. For instance, in a purchase with construction lending the doctrine of instantaneous seisin would only protect the priority of the purchase money portion of the deed of trust against liens for labor or materials provided prior to closing with respect to those funds disbursed at closing for the purchase. In such case, future advances for construction would be subordinate to such liens. (Dalton Moran Shook v. Pitt Development Co., 113 N.C. App. 707, 440 S.E.2d 585 [1994] holding that a contractor’s lien

will acquire priority over the portion of proceeds reserved for construction). Thus, it is critical to understand the circumstances of the loan and obtain adequate lien waivers or subordinations beforehand.

If mechanic's liens are found of record before the recording of the proposed deed of trust, the lender of course will require the proposed deed of trust to be insured as having priority. There are three courses of action that the title insurer may consider. First, the title insurer may consider accepting an indemnity from the borrower if the claim of lien is for a small amount, and the title insurer is comfortable that the dispute is not part of a pattern and the borrower has enough liquid assets to cover the claim. Second, if the title insurer is not comfortable with accepting an unsecured indemnity from the borrower, it may consider having the borrower escrow approximately 125% of the claim amount with the title insurer with an agreement to otherwise indemnify the title insurer. In this situation, the escrow document must allow the title insurer to draw on the escrow in its discretion to cover any potential claim against the loan policy. Third, if the circumstances involved with the claim and the borrower are such that the title insurer cannot accept an unsecured indemnity and the borrower is not willing to escrow approximately 125% of the claim amount, the title insurer may require the borrower to bond the claim pursuant to NCGS 44A-16(6) which provides:

Whenever a corporate surety bond, in a sum equal to one and one-fourth times the amount of the claim or claims of lien on real property claimed and conditioned upon the payment of the amount finally determined to be due in satisfaction of said claim or claims of lien on real property, is deposited with the clerk of court, whereupon the clerk of superior court shall cancel the claim or claims or lien on real property of record.

In such case, the title insurer will add as a requirement that a discharge of the claim be recorded by the clerk of court.

Coverage

In administering a construction loan, the lender will issue an advance at closing and numerous advances post-closing as loan requirements are met and draws are made by the borrower pursuant to its loan documents. Of course, the lender is expecting coverage beyond the amount of the initial advance, and coverage insuring the priority of each advance. Assuming the construction loan deed of trust contains the requisite future advances language discussed above, the title insurer may issue a title policy insuring the priority of the future advances with coverage under the policy increasing with each advance made subject to the policy amount and its conditions. As simple as it sounds, it is important to obtain the correct loan policy and endorsement to insure the lender is receiving liability coverage and priority coverage with each advance.

With regard to whether the policy's coverage increases with each advance, the 1992 ALTA Loan Policy (the "Loan Policy") provides in Section 8(d) of its Conditions and Stipulations for increasing coverage only for "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). Thus, the current standard loan policy by its terms only provides increasing coverage if the advances are for construction and are secured by the insured mortgage, and if lender is bound to make the advances as of the Date of Policy. Note, however, that most construction loans in North Carolina are nonobligatory, so counsel should not rely upon this provision for coverage, but rather should request future advance coverage through ALTA 14 or at least a pending disbursement clause, as discussed below. (Please also note that the 2006 ALTA Loan Policy deletes Section 8(d) but now includes within its definition of “indebtedness” the amount of all advances disbursed after the policy date; thus, allowing such advances to be included in the measure of loss under the policy. However, the priority of the insured deed of trust with regard to such advances is insured only if the advances are included as a covered risk under the policy.) However, the revised policy generally does not include post-policy matters in its “Covered Risks”.) The 1992 ALTA Construction Loan Policy (the “Construction Loan Policy”) is different and provides increasing coverage in Section 7(a)(ii) of its Conditions and Stipulations for “each succeeding disbursement made in accordance with the terms of the insured mortgage until the aggregate of all disbursements is equal to the Amount of Insurance stated in Schedule A.” Thus, the standard construction loan policy does not condition its increasing coverage on the advances by the lender being obligatory.

Nonetheless, faced with explaining the small print in the jackets for the Loan Policy and the Construction Loan Policy, most title insurers will provide their assurance of increased coverage for future advances through the addition to Schedule B of a “pending disbursement” clause such as stated below:

Pending disbursement of the full proceeds of the loan secured by the deed of trust insured, 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.

With regard to insuring the priority of each advance, the Loan Policy in Section 7(a) of its Insuring Provisions insures future advances against statutory liens arising from work contracted for or commenced prior to the policy date, and in 7(b) against statutory liens arising from work contracted or commenced after the policy date and which is financed in whole or in part by proceeds of the indebtedness secured by the insured mortgage which as of the policy date the insured was obligated to advance. In Section 3(d) of its Exclusions from Coverage, however, the Loan Policy excepts from its coverage defects, liens, encumbrances, adverse claims and other matters attaching or created subsequent to the policy date except for those statutory liens covered in 7(b) of the Insuring Provisions. The Construction Loan Policy in Section 6 of its Insuring Provisions insures future advances against the priority of any other lien or encumbrance, but in Section 3(d) of its Exclusions from Coverage excepts from its coverage defects, liens, encumbrances, adverse claims and other matters attaching or created subsequent to the policy date. In addition, in Section 7 of its Exclusions from Coverage, the Construction Loan Policy excepts from its coverage the priority of the lien of the insured mortgage relative to any other lien because the proceeds of the loan secured have not been fully disbursed at the policy date.

With these exceptions in mind, in order to clarify or confirm that it has coverage for the continued priority of its future advances, most lenders will require that the title insurer issue an ALTA 14 which specifically provides for the continued priority of such future advances subject to the following specific exceptions set forth under its Section 4:

- a) Advances made after the filing of a petition for bankruptcy regarding the mortgagor;
- b) Real estate taxes or assessments arising after the Date of Policy;
- c) Federal tax liens of record for more than 45 days after the Date of Policy;
- d) Federal or state environmental protection liens;
- e) Usury or any consumer credit protection or truth in lending law; and
- f) Mechanic's or materialmen's liens.

The mechanic's lien exception stated above is typically deleted by the title insurer upon presentation of satisfactory subordinations of potential mechanics liens from all persons or entities dealing directly with the owner or potential owner. In addition to insuring continued priority of the future advances, it also contains, among other things, variable rate coverage comparable to the coverage found in the ALTA Endorsement Form 6. The only requirement for issuance of the ALTA 14 (assuming the transaction's compliance with general underwriting standards) is verification that the deed of trust contains the proper future advances language discussed above. The ALTA 14 (unlike the ALTA Endorsement Form 14.1 [Future Advance-Knowledge]) does not preclude coverage in the instance where the insured has knowledge of an adverse interest and thus is used in North Carolina transactions because neither of the North Carolina future advances statutes discussed above require in order to sustain the priority of the advance require that the advance be made to the lender without knowledge of an adverse interest. A copy of the standard ALTA 14 is attached hereto.

Title insurers will not require an update to title or a new set of lien affidavits with each advance in order to insure its priority under the deed of trust. The future advances language within the deed of trust protects the priority of the disbursement. Of course, it is not atypical for a lender to require a title update and policy datedown endorsement with each advance. Many lenders use the title update for due diligence into the borrower's creditworthiness and the financial status of the project. For instance, the update may be used by the lender to verify no claims of lien or subordinate deeds of trust have been filed of which it is unaware, to include coverage regarding an updated survey, to confirm lots as yet unreleased of record, or to identify restrictions, easements, plats or other matters recorded by the developer but not shown on the policy.

The update may also ensure that no encumbrance has occurred against the property since closing that threatens the priority of the advance and is excluded from coverage under the ALTA 14. For instance, the Internal Revenue Service takes the position that any advance made more than 45 days after the filing of a federal tax lien loses its priority to such federal tax lien. In another instance, though there are no specific provisions in the Bankruptcy Code addressing advances made pursuant to a deed of trust recorded prior to the commencement of a bankruptcy case, at the least the automatic stay provisions could be interpreted to prohibit the making of such an advance. In such a situation, the borrower is now in default under its loan documents; but if the lender wished to move forward and make the advance, it would be prudent to do so only with the permission of the Bankruptcy Court.

In order to issue a datedown endorsement or update the effective date of the underlying policy, a complete title update from the effective date of the original policy is required, and standard underwriting procedures must be followed. The issuance of a datedown endorsement would not effect the coverage granted under the ALTA 14.

Survey coverage in the construction loan context is initially based on the survey provided as of closing, assuming the survey is timely and accurate, or based on representations to the company that the land is vacant, no construction having commenced as of recording of the deed of trust. Such survey coverage will only cover those matters of survey as of the effective date of the policy, not post-policy construction. In order for the lender to ensure its coverage against encroachments, violations or other matters for construction done post-policy, a foundation or completed improvements survey must be submitted to the title insurer along with a request for affirmative coverage of the matters shown thereon.

Owner's Coverage

At the time of procuring the construction loan commitment, a question always arises concerning an owner's policy. Rarely, however, is the question whether to obtain a corresponding owners policy; rather, the question is typically in what amount. Title insurers recommend that the owner's policy be issued in an amount that covers the purchase price of the property and the value of the improvements when completed. Often, however, in order to save premium, the owner will not obtain any coverage because the lender only needs temporary construction coverage or the owner will only obtain coverage up to the loan amount, thus not covering any equity it has (or builds through improvements) in the real property.

In such cases of underinsurance, the owner's coverage procured may be even weaker than expected due to the coinsurance provisions contained in Section 7(b) of the Conditions and Stipulations in the standard 1992 ALTA Owner's policy. In sum, Section 7(b) requires that the property be insured for at least 80% of its actual value or current value plus contemplated improvements. If the property is not so insured as a result of a 20% increase in value to the property due to improvements made subsequent to the policy date, that portion of any loss exceeding 10% of the policy amount shall only be covered pro rata in the proportion that 120% of the policy amount bears to the sum of the policy amount plus the amount spent for the improvements. Thus, if the owner purchases land for \$200,000 with owner's coverage at that amount, and then adds improvements costing \$1,800,000 to the property; in the event of a loss of \$75,000, the owner may only receive \$26,600. The coinsurance provisions do not apply to costs, attorney's fees, and expenses for which the insurer is liable under the policy. (Note that Section 7(b) is deleted from the 2006 ALTA Owner's policy.)

In the event that the owner does not request coverage, and only a temporary construction loan policy is purchased, the owner would have no coverage for any title defects arising during the construction period.

On the other hand, in the event that the owner requests title coverage exceeding the purchase price of the property, the owner's policy will contain a pending improvements clause providing

that the policy coverage is equal to the actual value of the improvements at the time of any claim. A typical pending improvement clause provides the following:

Pending such time as the improvements contemplated upon insured premises shall commence, liability under this policy is limited to the purchase price paid for the land; but as and when the erection of such improvements shall commence, liability hereunder shall increase, as the improvements progress, in the amount of the cost thereof, up to the face amount of the policy.

As the language shows, should the owner suffer a loss, in order to recover under its policy, it must prove the actual value of the improvements under the above provision.

Of course, as with underwriting the construction loan policy, the underwriting of the owner's policy will involve the same survey coverage limitations (except that survey coverage without a survey is not available to owners) and require the same scrutiny of mechanics' liens issues. Note, however, that mechanics' liens incurred by the owner are not covered in the owner's policy because they would be considered to be liens "suffered, assumed or agreed to" by the insured under Section 3(a) of the Exclusions From Coverage of the 1992 ALTA Owner's Policy. In addition, if the owner wants coverage against mechanics' liens attributable to services and materials procured by its seller, the title insurer will require lien waivers from those contractors, not simply lien subordinations.

SAMPLE ENDORSEMENT
ALTA Endorsement Form 14 (Adopted 10/22/03)

ALTA ENDORSEMENT FORM 14
(Future Advance – Priority)

Attached to Loan Policy No. _____

Issued by
CHICAGO TITLE INSURANCE COMPANY

1. The insurance for Advances added by Sections 2 and 3 of this endorsement is subject to: the exclusions in Section 4 of this endorsement and the Exclusions from Coverage in the Policy, except Exclusion 3(d); the provisions of the Conditions and Stipulations, except Section 9(b); and the Exceptions contained in Schedule B.
 - a. "Agreement," as used in this endorsement, shall mean the note or loan agreement secured by the insured mortgage or the insured mortgage.
 - b. "Advances," as used in this endorsement, shall mean only those advances of principal indebtedness made after the Date of Policy as provided in the Agreement, including expenses of foreclosure, amounts advanced pursuant to the insured mortgage to pay taxes and insurance, assure compliance with laws or to protect the lien of the insured mortgage before the time of acquisition of the estate or interest in the land and reasonable amounts expended to prevent deterioration of improvements, together with interest on those advances.
2. The Company insures against loss or damage to the insured as a result of:
 - a. The invalidity or unenforceability of the lien of the insured mortgage as security for each Advance.
 - b. The lack of priority of the lien of the insured mortgage as security for each Advance over any lien or encumbrance on the title.
 - c. The invalidity or unenforceability or loss of priority of the lien of the insured mortgage as security for the unpaid indebtedness and Advances resulting from: (i) re-Advances and repayments of indebtedness; (ii) lack of outstanding indebtedness before an Advance; or (iii) failure to comply with the requirements of state law to secure Advances.
3. The Company also insures against loss or damage to the insured as a result of:
 - a. The invalidity or unenforceability of the lien of the insured mortgage resulting from any provisions of the Agreement that provide for: (i) interest on interest; (ii) changes in the rate of interest; or (iii) the addition of unpaid interest to the principal indebtedness.
 - b. Loss of priority of the lien of the insured mortgage as security for the principal indebtedness, including any unpaid interest which was added to principal in accordance with any provisions of the Agreement, interest on interest, or interest as changed in accordance with the provisions of the insured mortgage, which loss of priority is caused by (i) changes in the rate of interest; (ii) interest on interest; or (iii) increases in the unpaid principal indebtedness resulting from the addition of unpaid interest.

"Changes in the rate of interest," as used in this endorsement, shall mean only those changes in the rate of interest calculated pursuant to a formula provided in the insured mortgage at Date of Policy.
4. This endorsement does not insure against loss or damage (and the Company will not pay costs, attorneys' fees or expenses) resulting from:
 - a. Advances made after a Petition for Relief under the Bankruptcy Code (11 U.S.C.) has been filed by or on behalf of the mortgagor.
 - b. The loss of priority of Advances to real estate taxes or assessments imposed on the land by governmental authority arising after the Date of Policy.

- c. The loss of priority to a federal tax lien of any Advance made more than forty-five days after a notice of federal tax lien has been filed in the public records.
 - d. The loss of priority of Advances to any federal or state environmental protection lien.
 - e. Usury, or any consumer credit protection or truth-in-lending law.
 - f. [The loss of priority of an Advance to a mechanic's or materialmen's lien.]
5. The Amount of Insurance defined in Section 2(c)(ii) of the Conditions and Stipulations shall include Advances.
6. Section 8(d) of the Conditions and Stipulations shall not apply to Advances.

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.

CHICAGO TITLE INSURANCE COMPANY

S A M P L E

Authorized Signatory

Note: This endorsement shall not be valid or binding until signed by an authorized signatory.