

Distressed Properties and Title Insurance – Part 1: A Primer for a Down Market

Presented by

Dena Cruz

Senior Underwriting Counsel

Gediminas Rusteika

Commercial Underwriter

Stephen Sanders

Senior Vice President, Operations Director

TITLE TENETS Webinar Series



Downside In Commercial Real Estate Cycle Is Here! As bad as “08-09”?

Commercial real estate in SF grapples with 350 California's expected price drop of over 80% May 3, 2023 Hoodline

The World's Empty Office Buildings Have Become a Debt Time Bomb From San Francisco to Hong Kong, higher interest rates and falling property values are bringing the commercial real estate market to a perilous precipice. Bloomberg June 23, 2023

Commercial real estate gets even bleaker with \$64 billion in property now classified as distressed. Fortune June 22, 2023

The next big threat hovering over the U.S. economy \$1.5 trillion in mortgages will come due in the next two years, a potential time bomb as higher interest rates push down property values. Politico June 5, 2023

Remote work could spark an \$800 billion crash in office prices around the world. Market Insider July 13, 2023

Depressed NYC real estate prices yield bonanza for savvy investors. MPA April 10, 2023

Blackstone's New \$30B Real Estate Fund April 7, 2023, Bisnow

Typical Investment Capital Stack



5 – 20%

Sponsor Equity (unsecured)

15 – 30%

Preferred Equity (unsecured)

15 – 30%

Mezzanine Debt (secured against personality)

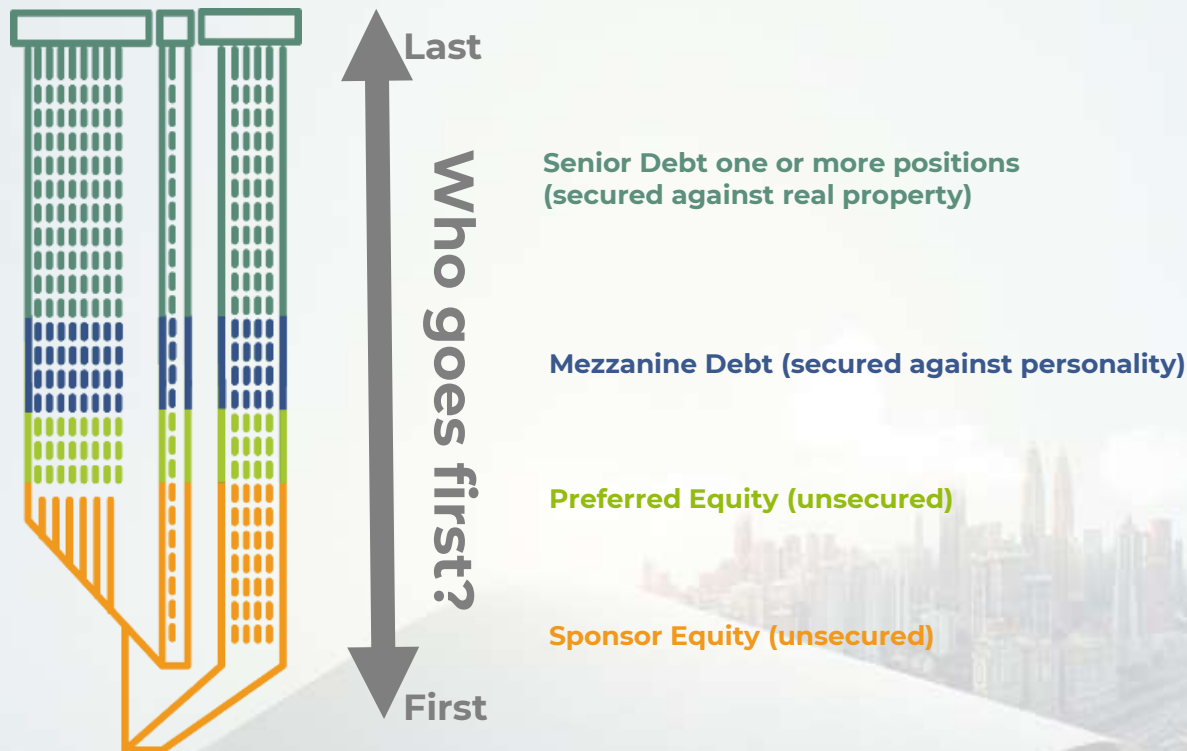
40 – 65%

Senior Debt one or more positions
(secured against real property)

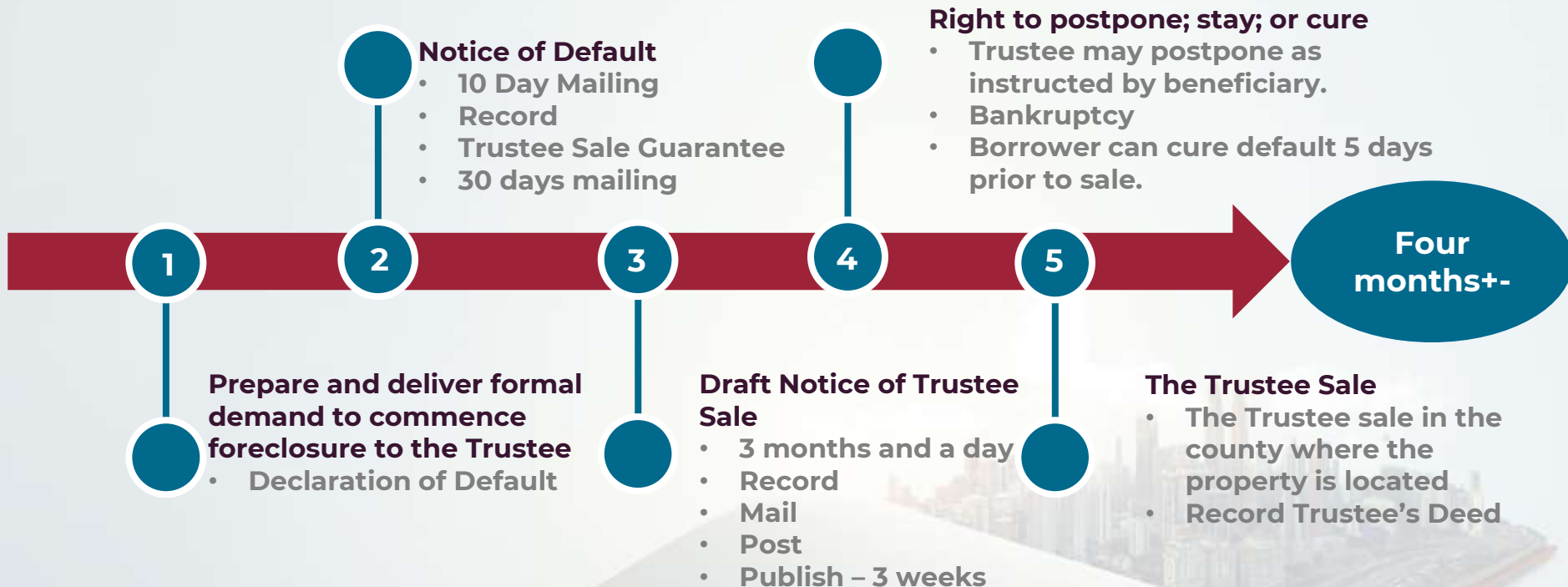
Inverse Interests – Return/Security – Title / UCC Insurance Policies



Capital Stack under distress



California Non-Judicial Foreclosure Process Overview (Commercial)



Non-Judicial Foreclosures (California) vs. Judicial

	Non-Judicial	Judicial
Timeline	Approximately 4 months	12-18 Months
Process	NOD, NOS, TD (record, post, publish, cry sale)	Litigation
Pursue Deficiency	No	Yes
Positive Reasons	Speed, less expensive (?), no redemption rights after sale	Allows for receiver to be appointed (protect and collect)
Additional Considerations	Limited by one action rule	Limited by one action rule Takes Longer, borrower right of redemption.
Cost	Legal Fees, TSG Costs, Trustee Fees (1%)	Typical litigation costs.
Dual Paths	Yes	Yes
Title Product	Trustee Sale Guarantee (TSG)	Litigation Guarantee

Commitment vs. Guarantee(s)

	Title Commitment	Trustee Sale Guarantee	Litigation Guarantee
Purpose	Title Policy(ies) issuance	Process Non-Judicial Foreclosure	Filing of Judicial Action
Assured	Proposed Insured(s)	Foreclosing Beneficiary	Plaintiff or Defendant Counsel
All record document exceptions shown	Yes	No	Yes
Schedule A	Plant Date, Assured, Estate, Legal,	Plant Date, Assured, Estate, Legal, Assurances, Required Notice Party(ies), Taxing Agency(ies), Judicial District, and general circulation publication	Plant Date, Assured, Estate, Legal, and Assurances,
Schedule B - BI	(BI) Closing Requirements	(B) Real Property Tax, <u>general exceptions</u> , DOT to be foreclosed on, any other liens, intervening matters since recording DOT, Bankruptcy, courtesy notices.	(B) Exceptions
Schedule BII	Exceptions to Title	None	None
Cost	Filed	Filed	Filed
Policy to be issued	Yes	No	No

Loan Modification Endorsements (ALTA 11 Series)

The ALTA 11 series endorsements are mortgage modification endorsements to be issued in those cases where a mortgage is modified after its original date by agreement of the parties.

- **ALTA 11/11-06 (Mortgage Modification)**

- Insures against loss or damage due to invalidity or unenforceability of the mortgage as a result of the terms of the modification agreement. Simply – it insures the validity of the modification

- **ALTA 11.1/11.1-06 (Mortgage Modification with Subordination)**

- Provides the same coverage as provided by the ALTA 11 endorsement, but the ALTA 11.1 is issued when an intervening lien appears in the title search and is made subordinate by agreement to the insured mortgage as modified.

- **ALTA 11.2/11.2-06 (Mortgage Modification with Additional Amount of Insurance)**

- Provides the same coverage as the ALTA 11 and ALTA 11.1 endorsements, but the ALTA 11.2 allows for a new amount of insurance to be stated in the endorsement, hence allowing for the existing policy amount to be increased.

Other Distressed-Property Related Loan Endorsements

- **CLTA 107.11-06 – Non-Merger After Lender Acquires Title**
 - Used for the Deed-in-Lieu transactions. It insures against loss which may result because the insured Lender is also the owner of the encumbered estate.
- **ALTA 15-06 – Nonimputation – Full Equity Transfer**
 - Is designed for issuance with an Owner's Policy. It contemplates acquisition by the new investors of the full interest in the entity owning the land and named as the insured under the policy.



Continuation Coverage and measuring loss

Per Section 2 of Conditions of ALTA Loan Policy (both 2006 and 2021), the policy continues *as of the Date of Policy* in favor of an Insured after the Insured's acquisition of the Title as long as the Insured retains an estate or interest in the Land; and after Insured's conveyance of the Title, so long as the Insured has liability for warranties given by the Insured in any transfer or conveyance of the Insured's Title.

However, the Lender still should consider getting the Owner's Policy for the following reasons:

- **The Loan Policy retains the old effective date; and**
- **The Loan Policy remains a Loan Policy and is subject to the Conditions in the Loan Policy regarding Measure of Loss**

2006 /2021 ALTA Policies: Distressed Real Estate Issues

- **ALTA 2021:** Covered Risk 10
- **ALTA 2021 :** Definition of “Public Records”
- **Troubled Construction Loans: Mechanic Lien Issues:**
 - **Captivia Lake Investments, LLC v. Fidelity Nat’l Title** (8th Cir. 2018) 883 F.3d 1038; [Exclusion 3A: Failure to Fully Fund]
 - **Hall CA-NV, LLC v. Old Republic National Title Insurance Company** (Fifth Cir. 2021) 990 F 3d 933 [ALTA 32 replaces Risk 11; No coverage under Risk 2 or 10]
 - **Fidelity Nat’l Title v. Osborn II Partners LLC,** (Arizona 2021) 483 P.3d 237 [Exclusion 3A: Failure to Fully Fund]
 - **Claims: Hovannisian v. First American Title Insurance Company, 14** Cal.App.5th 420 (2017)



Measure ULA: City of Los Angeles Mansion Tax

- Effective **April 1, 2023**; modeled on tax rule 462.260 (change of ownership)
- Applies to all real estate transactions, when consideration or value of the real property conveyed exceeds a threshold of \$5 mil: residential, commercial, vacant land. Transferee must pay:
- City Rate prior to 4.1.23, (§ 21.9.2(a)) : \$4.50 (Per thousand) County Rate : \$1.10 per \$1000
- After 4.1.23, County Rate plus City Rate (§ 21.9.2 (a) & (b)): Additional amount owed:
 - 4% of consideration or value of the property: greater than 5,000,001 to \$10 mil
 - 5.5% of consideration or value of the property: greater than \$10,000,001
- Exemptions (Section 21.9.15 of the LAMC). **FEW** (501(c) 3 entity, government agencies)
 - **TRUSTEE'S DEEDS/ DEEDS IN LIEU: NO EXEMPTION**
- Resources:
 - https://clkrep.lacity.org/online/docs/2022/22-1100-S2_ord_187692_1-1-23.pdf

Stewart's National Offerings

NATIONAL SERVICES

- **Trustee Sale Guarantee (CA)**
- **Litigation Guarantee**
- **Title Insurance - Policies**
- **Escrow / Settlement**
- **Underwriting**
- **UCC Coverage**
- **1031 Exchange**

ONLINE ACCESS TOOLS

- **Virtual Underwriter**
- **Title Pro – real property information**
- **State Laws and Customs Toolkit**
- **Ernst Publishing**
- **FindLaw for Legal Professionals**



Thank You

Stewart Title Guaranty Company

100 Pine St Suite 450
San Francisco, CA 94111
dag@stewart.com
stewart.com/commercial



Stewart Title Guaranty Company National Commercial Services

Dena Cruz
Senior Underwriting
Counsel
dena.cruz@stewart.com



Stewart Title Guaranty Company National Commercial Services

Gediminas Rusteika
Commercial
Underwriter
gedis.rusteika@stewart.com



Stewart Title Guaranty Company National Commercial Services

Stephen Sanders
Senior Vice President,
Operations Director
stephen.sanders@stewart.com