New England Regional Midweek Update
3/8/2023

Dear Stewart Partners,

In this week's Mid-Week Update, we are including an overview of leasehold policies and some key takeaways when working on transactions involving ground leases. We are also highlighting a case summary of a recent decision from the United States Bankruptcy Court for the District of New Hampshire involving mechanic's lien priority vs. construction mortgage. Wrapping up this week's update, we are answering some common bankruptcy questions. Also, be sure to check out the two upcoming webinars on commitment and policy preparation. We've included registration links again this week, and hope you can join us!

Two Upcoming Stewart Webinars

Stewart is pleased to invite you to register for two March webinars presented by our New England Underwriting Team. The first webinar will focus on Title Commitment Preparation and the second will focus on Title Policy Preparation. While this is intended to be a two-part series, you may sign up for one or both of these webinars. These webinars are open to all levels of title insurance professionals, so whether you're a seasoned pro or just starting out, you're sure to take away valuable insights and information that you can put into practice right away.

Topic: Commitment Preparation

Date: March 9, 2023

Time: 10:00 a.m.

Location: Live online webinar. You will receive a "You're Registered" email from Microsoft Teams which will include a link to join the event.

Register: Click here to register

CLE credit is available for the above webinar in NH, CT, RI and VT. We are applying for approval in ME and will let our Maine registrants know as soon as it is received.

Topic: Policy Preparation

Date: March 23, 2023

Time: 10:00 a.m.

Location: Live online webinar. You will receive a "You're Registered" email from Microsoft Teams which will include a link to join the event.

Register: Click here to register

CLE credit is available for the above webinar in NH, CT, RI and VT. We are applying for approval in ME and will let our Maine registrants know as soon as it is received

Leasehold Policies

In the commercial real estate market, title insurance is routinely purchased by buyers or lenders as part of the transaction. Owners of real property and their lenders typically would not invest time and money into a real property without purchasing a title insurance policy. But what about tenants of a long-term lease (often referred to as a ground lease)? Should they be concerned about their leasehold estate (the interest in the real property which is created by the ground lease)? Potential title issues not only affect the owner of real property but can also affect the tenant and its leasehold estate. Tenants will often sign a ground lease of a long-term duration and make expensive leasehold improvements (and be required to pay real estate taxes) without examining the underlying title to the real estate or purchasing title insurance with respect to their leasehold estate. Luckily, tenants and their lenders have the option to purchase title insurance insuring their leasehold estate in the property.

A leasehold estate (or leasehold interest) is the right to possess real property as created by a ground lease, which right exists for a designated period of time. In order for a leasehold estate to be insurable, either the full ground lease agreement or a notice of lease must be recorded. More commonly, a notice of lease is recorded, which notice contains the parties to the ground lease, identification of the subject property and the duration of the ground lease, along with various other requirements depending on the state where the property is located. When insuring a leasehold estate, establishing the value is typically a concern as it can be difficult to determine. The proposed insured's attorney should determine the appropriate coverage amount, which amount is subject to underwriting approval.

Lenders are often asked to provide financing secured by a mortgage encumbering the leasehold estate evidenced by a ground lease. When a lender forecloses on a leasehold estate, the lender or any party taking title through the lender, has the right to become the tenant under the ground lease. In such case, a leasehold loan policy can be issued to the underlying lender. A leasehold loan policy must be issued for the full amount of the leasehold mortgage.

Leasehold owner's policies are issued with the ALTA 13-06 Endorsement and leasehold loan policies are issued with the ALTA 13.1-06 Endorsement. Each respective endorsement effectively amends the coverage in the standard title insurance policy to reflect coverage for a leasehold transaction. Additional items of loss covered by a

leasehold policy include payment to landlord and costs to move the insured's personal property in case of an eviction, rent payable to persons having superior title to the landlord, fair market value of tenant's leasehold improvements, and costs to obtain a replacement premises. It is important (and necessary) to raise a special exception in every leasehold policy for the "terms, conditions and provisions" of the ground lease.

Prior to issuing a leasehold policy, it is important to carefully review the terms of the ground lease to determine if additional special exceptions or commitment requirements should be raised, with consideration given to issues such as easement rights, access, options to renew or purchase, prohibition of assignments, subleases or mortgages, or other limitations contained in the ground lease. Stewart's Virtual Underwriter's Underwriting Manual has a section on Leases and Insuring Leaseholds which provides additional information. To view, follow these links: https://www.virtualunderwriter.com/en/underwriting-manuals/2005-11/UM00000264.html and https://www.virtualunderwriter.com/en/underwriting-manuals/2014-1/UM00000208.html#SubTopics_2. If you are asked to insure a ground lease or a mortgage encumbering a ground lease and have questions about the underwriting guidelines, please reach out to your local underwriting counsel or account representative. We are always happy to answer questions and/or provide assistance.

United States Bankruptcy Court for the District of New Hampshire rules in favor of a construction contractor's mechanics lien as having priority over a construction lender's mortgage

In re Prospect-Woodward Home, 2023 BNH 001 issued Jan. 6, 2023 (Harwood, C.J.) (unpublished) the Court found that RSA 447:12-a did not govern a priority dispute between a construction contractor's mechanic's lien and a construction lender's mortgage and held that the construction contractor's mechanic's lien had priority over the construction lender's mortgage under the general race-notice doctrine.

The court analyzed New Hampshire's "race-notice" rule of priority, under which the first to record its interest at the registry of deeds is first in line unless it had notice of another's unrecorded prior interest.

"New Hampshire is a race-notice jurisdiction regarding priority of interests in real property." In re McLaughlin, Bk. Nos. 09-11671-JMD, 09-11672-JMD, and 09-11673-JMD, 2011 WL 1706791, at *3 (Bankr. D.N.H. May 4, 2011). New Hampshire's recording statute "acknowledges by negative implication the rule that the first party to record without notice of a priority party's claim has priority." ROK Builders, LLC v. 2010-1 SFG Venture, LLC v. (In re Moultonborough Hotel Group, LLC), 726 F.3d 1, 5 (1st Cir. 2013) ("Moultonborough III") (citing RSA 477:3-a). In a race-notice jurisdiction, a purchaser or creditor has the senior claim if he or she records without notice of a prior unrecorded interest. The purpose then of the recording statutes … is to provide notice to the public of a conveyance of or encumbrance on real estate. The statutes serve to protect both those who already have interests in land and those who would like to acquire such interests. Id. In re Chase, 388 B.R. 462, 467 (Bankr. D.N.H. 2008) (quoting Amoskeag Bank v. Chagnon, 133 N.H. 11, 14 (1990)). Notice of a prior unrecorded interest may be (1) actual, (2) record (also referred to

as constructive), or (3) inquiry. Bilden Props., LLC v. Birin, 165 N.H. 253, 258 (2013). A party is deemed to have notice of an unrecorded interest "upon receipt of enough information … that would cause a reasonably prudent person" to make further inquiry. CF Invs., Inc. v. Option One Mortg. Corp., 163 N.H. 313, 316 (2012). "If a party is obligated to investigate, then the party is chargeable with actual notice of what the investigation will show." Amoskeag Bank v. Chagnon, 133 N.H. at 14.

Although the construction mortgage was recorded first, the mortgagee was aware at the time of that recording that the construction manager, had already commenced tree-clearing work, giving it an inchoate lien on the property from the time its work commenced. Accordingly, the contractor's later-recorded lien was held to have priority over the mortgage and the Court ruled that RSA 477:12-a is inapplicable.

Although not mentioned in the decision, this case raises an interesting issue from a title insurance perspective. Sophisticated lenders in large construction loans often require that the mechanic's lien exception be deleted from its loan policy during construction. This type of extra-hazardous coverage requires very special underwriting and is often conditioned upon receiving, among other things, indemnification from the owner and possibly its principals. Here, the project owner has filed Chapter 11 bankruptcy. As such, to the extent it indemnified the underwriter against policy losses arising from mechanics liens, that indemnification may be worthless. If the principals of the owner also indemnified the underwriter, they may be the actual parties in interest who stand to lose if the Bankruptcy Appellate Panel upholds the judgment. While this is just supposition, the fact remains that issuing title insurance policies in connection with construction loans requires important considerations that can have significant impact when construction projects don't go as planned. Your Stewart underwriters have expertise in these matters and are always here to assist you.

This case is presently on appeal. The US Bankruptcy Courts decision, which also includes a holding on the rights of subcontractors, can be found here: https://www.nhb.uscourts.gov/sites/nhb/files/opinions/2023-bnh-001.pdf

Common Bankruptcy Questions

Title search revealed a lien that was never discharged of record. The lien is against someone who filed bankruptcy. Bankruptcy action is now closed, and the debtor was discharged. Do I need to worry about the lien?

Yes. Discharging the debtor in bankruptcy is not the same as discharging the liens of record at the registry of deeds. A bankruptcy discharge releases the debtor from personal liability for certain specified types of debts.

Although a debtor is not personally liable for discharged debts, a valid lien on the other hand (i.e., a perfected attachment or judgment lien upon specific property to secure payment of a debt) that has not been avoided (i.e., made unenforceable) in the bankruptcy case will remain after the case. Essentially, this lien will remain against whatever property it is "attached" to on the date the bankruptcy case is filed even after the bankruptcy

discharge has been entered, unless it is specifically “avoided” (removed) in the bankruptcy case.

While a debtor’s discharge in bankruptcy may prevent a creditor from pursuing the debtor for the discharged debt, that creditor may still execute against the real estate subject to the lien. This is called an in rem proceeding.

Under 11 U.S.C. §522(f), a lien may be “avoided”. Check the bankruptcy filing and if you do not see an Order entered avoiding the lien, the lien recorded at the registry of deeds must be discharged of record. Stewart has issued an underwriting bulletin relative to this topic.

To view the bulletin, follow this link: https://www.virtualunderwriter.com/en/bulletins/2010-6/BL127687165800000008.html

Seller has informed us that she is currently in bankruptcy. May we continue with the sale of her real estate? Do we need to obtain anything from the Bankruptcy Court?

Selling property out of a bankruptcy estate is a complicated matter and generally a debtor must first obtain authorization from the Bankruptcy Court. The form of authorization will depend upon the type of bankruptcy filed and if the sale will be subject to liens or a sale free and clear of liens. It will be necessary to review the motions and orders granted by the Bankruptcy Court very carefully before proceeding with the sale. Furthermore, you should obtain a certified copy of the order authorizing disposition and record the certified copy at the registry of deeds in conjunction with your transaction. Title insurance may only be issued if the order is a final and non-appealable order. Stewart’s Virtual Underwriter has an extensive section on Bankruptcy in its underwriting manual, which can be accessed here: https://www.virtualunderwriter.com/en/underwriting-manuals.html

Given the nuances and risks involved when there is a sale of property and a title owner has an open bankruptcy, please contact a member of our underwriting team to discuss insurability and requirements for your particular transaction.

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