Commercial Mortgage Insight
THE MAGAZINE FOR COMMERCIAL MORTGAGE FINANCE
Vol. 14. No. 2 – First Quarter 2010

As Featured Vol. 14, No. 2 - First Quarter 2010

PRODUCTS & SERVICES

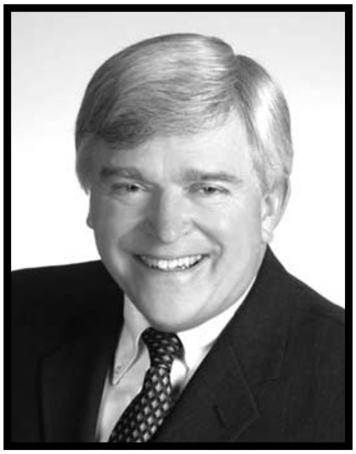
Nonperforming Loans Introduce Title Risks

When borrowers stop making payments on their mortgages, it is likely that they have also stopped paying other obligations. When those other obligations include real estate taxes or commercial condominium association dues, there is a risk to lenders that the priority of the lien of their mortgages may be in jeopardy.

This is because state laws often give real estate tax and association liens precedence over mortgage liens. In addition, the non-payment of state and federal income taxes and/or the non-payment of contractors' bills for improvements may also result in the filing of liens against the mortgaged property.

In some cases, the failure of a business, or other major changes in a borrower's financial health, may prompt borrowers to transfer ownership of their property to another person or entity without notifying its lender. For example, a corporate borrower may transfer its ownership interest to a parent company or other related entity.

Because of the risk of liens that may affect the priority of a mortgage and the possibility that a borrower may have transferred its ownership interest in the mortgaged property, it is important that lenders order a title report as soon as they begin to process a nonperforming mortgage loan.


Bruce E. Hawley

The liens of most mortgages are insured by a title insurance policy, so many lenders usually order the title report from the same title company that issued that policy. That company should already be familiar with the status of the title up to the exact time that the insured mortgage was recorded in the public land records and can quickly bring the title to the present time by examining those records for liens (including other mortgages), easements, assessments, covenants, agreements and changes in ownership.

The title company can also check with county and municipal tax collectors as to the status of current taxes to determine if those taxes are delinquent and may become a lien in the near future. To be thorough, the lender should also ask the title company to check state and federal court records to determine whether there are any judgment liens against the borrower, whether the borrower has been named as a party in active litigation and whether it has filed bankruptcy.

After it has completed its review of the land, court and tax records, the title insurance company will issue either a title report or a title insurance commitment. Armed with that updated title report or commitment, a lender is in a much better position to make informed decisions on how to process the nonperforming mortgage loan.

If a decision is made to modify the note and the mortgage, the lender should also consult with its attorney to make sure that the mortgage modification agreement complies with state laws and regulations and is in recordable form.

Depending upon the nature of the modification and state law, a mortgage modification may cause a loss of priority of the lien of the mortgage to a junior creditor whose rights might be prejudiced by the change. To avoid that situation, a lender's counsel may require the borrower to obtain a release or subordination of lien from the junior creditor.

In addition to ordering a title update from the title insurance company, a lender may also want the title insurance company to endorse the policy in cases where a mortgage modification agreement is recorded.

The standard form of endorsement used by the title insurance industry in most states to insure mortgage modifications is the American Land Title Association (ALTA) Endorsement 11-06 (Mortgage Modification).

That endorsement insures the lender against loss or damage that it may sustain by reason of the invalidity or unenforceability of the lien of the insured mortgage upon the title at the date of the endorsement as a result of the recording of the mortgage modification.

It also protects against losses or damages associated with the lack of priority of the lien of the insured mortgage, at the date of the endorsement, over defects in or liens or encumbrances on the title. Exceptions are for those shown in the original policy, or any prior endorsements, and those which may have arisen between the date of the recording of the original mortgage and the date of the recording of the mortgage modification which have not been released or subordinated to the lien of the mortgage as modified.

In states where the ALTA Endorsement 11-06 is not available, title companies usually issue a new policy that is dated as of the recording of the mortgage modification agreement and insures the title to the mortgage as modified.

Because it takes time to conduct an updated title search and to obtain releases or subordinations from other parties that may have mortgages or other liens that were recorded after the original mortgage was recorded, it is suggested that lenders, or their attorneys, involved in mortgage modifications contact their title insurance company as soon as the decision is made to modify the loan.

In cases where the lender decides to foreclose rather than modify the mortgage, it should send the updated title report or title commitment, along with a copy of the original title insurance policy to the foreclosure department or the attorney who will be handling the foreclosure. The information contained in those reports, commitments and policies can be used to prepare the foreclosure notices and, in the case of a judicial foreclosure, the court pleadings.

In summary, in order to fully protect its interests in cases where a borrower stops making payments, lenders should always order an updated title report or title commitment from their title insurance company at the beginning of the workout process.

The information contained in that report or commitment will give the lender a more complete picture of the financial condition of its borrower and help guide the lender in the exercise of its legal remedies and options.

In cases where the lender decides to modify the mortgage, lenders should also obtain a mortgage modification endorsement to its existing title insurance policy or order a new title insurance policy to insure the validity, enforceability and priority of the lien of its mortgage as modified.

– Bruce E. Hawley

Bruce E. Hawley is senior vice president, senior underwriting counsel and multinational title services group manager at Stewart Title Guaranty Co. – National Title Services. He can be contacted at (203) 368-9919 or bhawley@stewart.com