

TITLE INSURANCE POLICY ENDORSEMENTS ADD VALUE

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Endorsements to a title insurance policy are designed to add to the coverage contained within the four corners of the pre-printed policy and, in some instances, to even override express policy provisions limiting coverage. Counsel handling real estate transactions involving property in New York will find that the endorsements available in this State will add value to the basic title policy coverage. This article will discuss certain of the more significant endorsements.

ENDORSEMENTS

The New York endorsements are set forth in the Rate Manual of the New York Title Insurance Rate Service Association Inc. ("TIRSA"), as reprinted October 21, 1998. All changes through that date by the State Superintendent of Insurance are included. Certain coverage not provided for in the filing can be drafted with the title insurance underwriter and set forth in the policy, either as affirmative insurance or on an otherwise "Blank Endorsement" form. However, it must be done within the Rate Manual's mandate that title insurance companies not afford affirmative coverage that contravenes the policy form unless there is a filed endorsement on point.

This requirement should not preclude insuring contiguity between multiple parcels. Similarly, insuring that there is an identity between the tax lot and the property insured by an affirmative statement in the title policy should be possible. Insuring that covenants and restrictions are not violated by existing improvements or that they contain no provision for the forfeiture or reversion of title, can also be afforded as a part of the title policy exception for the restrictive covenant in Schedule B of the policy. It is generally accepted by the title underwriter that such coverage is not in conflict with the filed policy.

It should be noted that not all endorsements available in other jurisdictions can be obtained for a title policy on New York property. Zoning, usury, subdivision, and usury coverage are, for example, not available in New York, and the creditors' rights exclusion from coverage cannot be deleted.

The creditor's rights exclusion in New York, referred to as the New York form of the exclusion, has become generally accepted outside of New York as striking an equitable balance between the interests of the insured and the title insurer. Instead of the former blanket exclusion in a number of states for any claim arising by reason of the operation of federal bankruptcy or state insolvency laws, the New York form limits the scope of the exclusion and excepts claims under bankruptcy or state insolvency laws arising out of the immediate, insured transaction being deemed fraudulent or a preference (and in the latter situation not disclaiming loss by reason of delays or errors in recording), or by reason of application of the doctrine of equitable subordination.

NON-IMPUTATION

Perhaps the most valuable endorsement is that affording Non-Imputation coverage. It overrides Exclusions From Coverage numbered 3 (a) and (b) in the Owner's form of title policy which otherwise would enable the title insurer to disclaim a loss by reason of title defects, liens and encumbrances that were either (a) created, suffered, assumed or agreed to by the insured claimant or (b) known to the insured prior to the date when the policy was issued, and neither disclosed to the title insurer nor otherwise notice to it by reason of the public record.

A Non-Imputation endorsement will apply when these conditions are met: (a) the insured is the purchaser of an interest in a corporation, partnership or limited liability company, (b) there are acts or knowledge of the person or persons from whom the interest is being obtained of matters adverse to title, and (c) those acts or knowledge would be imputed to the owning entity. In this situation, the exclusion alone would cause the title insurer to disclaim coverage.

This endorsement can be issued as part of the title policy insuring the acquisition of the interest in the entity owning the real property. The title insurer will require satisfactory affidavits and indemnities from the person or persons against whose acts and knowledge non-imputation protection is specifically required by the insured. The endorsement provides that notwithstanding policy Exclusions from Coverage 3(a) and (b), liability will not be denied on the ground that the insured "has knowledge of any matter imputed solely by reason of notice imputed to it through (a partner, shareholder or member, as the case may be) by operation of law".

The October 21, 1998 revision to the TIRSA Manual makes clear that this endorsement form is intended to be issued as part of an Owner's Policy of title insurance. The Rate Manual recites that the endorsement must be issued together with an Owner's policy of title insurance insuring an interest in an entity owning real property. Additionally, the policy must be in an amount not less than the value of the real property equivalent to the purchaser's percentage interest in the owning entity. This is not a lender's policy endorsement.

Policy liability under the Non-Imputation endorsement is expressly limited to the lesser of the following: (a) the specified percentage of the actual loss sustained by the entity attributable to the interest of the insured at the date of policy (or such lesser interest held by the insured at the time of loss), (b) the insured percentage interest, as in (a), of the difference between the value of the insured estate and its value subject to the title defect, lien or encumbrance in question, or (c) the

policy amount. The charge for this endorsement is twenty percent of the straight owner's premium. It can be the most valuable addition to the title policy when an interest is being acquired in an entity owning the fee of, or a leasehold interest in, real property.

LAST DOLLAR

An important form of policy endorsement applicable to a lender's policy is the Last Dollar endorsement. This endorsement overrides Section 9(b) of the Conditions and Stipulations of the Policy which provides that "(p)ayment in part by any person of the principal of the indebtedness . . . to the extent of the payment...shall reduce the amount of insurance pro tanto...". This endorsement is applicable when the total loan indebtedness is in excess of the amount secured by the mortgage and insured under the policy. The intention is to not have the policy amount reduced as payments are made under the loan that are intended to reduce indebtedness other than the amount secured.

In order to obtain this endorsement when the total loan exceeds the title policy amount, (and coincidentally avoid additional mortgage tax exposure in New York), the mortgage and other loan documents need to provide that payments will be applied first to the portion of the loan not secured by the mortgage. Text needs to be inserted in the mortgage substantially as follows:

"The Secured Amount shall be reduced only by the last and final sums that the Borrower repays with respect to the Loan and shall not be reduced by any intervening repayments of the Loan by Borrower. So long as the balance of the Loan exceeds the Secured Amount, any payments and repayments of the Loan by Borrower shall not be deemed to be applied against or to reduce, the portion of the Secured Obligations secured by this Mortgage. Such payments shall instead be deemed to reduce only such portions of the Obligations as are not secured by this mortgage".

With multisite mortgages in various states, the last sentence would instead end with "only such portions of the Obligations which are secured by mortgages encumbering property located outside of the State of New York".

The endorsement provides as follows:

" . . (N)otwithstanding Section 9(b) of the Conditions and Stipulations of the policy, in calculating, for the purposes of the policy, the amount of outstanding indebtedness secured by the Insured Mortgage and covered by this policy, payments made to reduce the amount of the indebtedness (except payments made by the Company pursuant to the provisions of the policy) shall be deemed applied first to the portion of the indebtedness that is in excess of the Amount of Insurance set forth in Schedule A of the policy".

The charge for the Last Dollar Endorsement is ten percent of the mortgage premium computed without any reduction for prior insurance.

FIRST LOSS, CLUSTER

The First Loss and Cluster Endorsements are lender's policy endorsements that are usually issued in tandem, and usually when insuring a transaction involving property in more than one state.

Given that a title policy is a contract of indemnity, the title insurer can withhold payment to the lender, in the event of a loss, until all collateral of whatever nature securing the indebtedness is first enforced. There is then a determination whether there is an actual loss under the Policy. The First Loss Endorsement overrides these policy provisions. Absent the First Loss endorsement, no loss is suffered if the loan can be recovered out of other collateral.

The First Loss Endorsement provides that in the event of a loss or losses under the Policy exceeding ten percent of the amount of insurance, the title insurer is liable to pay the loss without requiring the lender to either accelerate the indebtedness or pursue remedies against other collateral securing the indebtedness. The charge for this Endorsement is also ten percent of the mortgage premium, computed without any reduction for prior insurance.

The Cluster Endorsement, referred to alternatively in other jurisdictions as a Tie - In or Aggregation endorsement, is issued by a title insurer in connection with policies insuring mortgages on property in different states securing a single indebtedness. It overrides Section 7(a)(i) of the Conditions and Stipulation of the lender's policy which provides that the liability of the title insurer under the policy will not be greater than the Amount of Insurance stated in the Schedule A of the policy.

The "clustered" amount of insurance set forth in the endorsement, which may cover a loss payable under any of the policies listed in the endorsement, is the amount of the entire principal indebtedness intended to be secured by the individual mortgages. In the event that there is a policy loss on any of the properties in the "cluster" exceeding the policy amount for that property, and the market value of that property at the time of loss exceeds that amount, payment can be made under that policy up to that property's then market value not to exceed the "clustered" amount. There is a pro tanto reduction in the insurance remaining available to pay a title claim under any of the other policies in the cluster.

The endorsement provides as follows:

"Notwithstanding the provisions of Section 7(a)(i) of the Conditions and Stipulations of this policy, the Amount of Insurance available to cover the Company's liability for loss or damage under this policy at the time of Payment of Loss hereunder shall be the aggregate of the Amount of Insurance under this policy and the other policies identified above. At no time shall the Amount of Insurance under this policy and the other policies identified above exceed in the aggregate \$ _____."

This endorsement is often considered as inflation protection endorsement and it useful when there may be a rising market in property values. In general, policies issued in all states other than Florida (which allows tie - in endorsements only on policies issued intra-state), New Mexico, Pennsylvania, and Texas can be included in the Cluster endorsement.

CLUSTER REQUIREMENTS

For the Cluster endorsement to be issued, a number of requirements must be met. Each mortgage insured by or on behalf of a title company by its authorized agent under a policy in the Cluster must, absent mortgage recording tax considerations, secure the entire indebtedness and be cross-defaulted. They should also be cross-collateralized with the other mortgages insured under the Cluster except, perhaps, in those high mortgage recording tax jurisdictions, such as New York, in which the amount secured by the mortgage is less than the entire indebtedness elsewhere secured. This will limit the amount of recording tax due.

In addition, to avoid so-called "rate discrimination", each policy in the cluster should be for an amount which, unless impacted by high mortgage recording tax considerations, either reflects the property's fair market value or is in an amount computed based on a loan to value ratio applied uniformly to each property. Rate discrimination is the situation where a greater amount of policy coverage is paid for in the lower title premium rate jurisdictions and the coverage in higher premium rate jurisdictions is limited. While the Cluster endorsement itself has a minimal cost one should early on consult with the title insurer on pricing issues arising from the cluster pertaining to each policy, and to any required reinsurance.

A Cluster endorsement may also be issued when all policies are issued by or on behalf of a title company on property within a single state. However, a single, blanket policy including all of the properties may in such instances be an administratively preferable alternative.

The Cluster endorsement is not available for an Owner's Policy due to the Apportionment Clause. That clause limits recovery under the owner's policy to the pro rata allocation or value of the affected property on the date of policy, and prevents the shifting of coverage between properties. Section 8 of the Conditions and Stipulations of the Owner's Policy reads as follows:

"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 of 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".

REVOLVING CREDIT

The lender's policy endorsements for insuring the priority of the lien of a revolving credit mortgage were reissued and expanded effective October 21, 1997. They are now identified as the RCE-1 ("Residential Revolving Credit") endorsement, RCE-2 ("Commercial Revolving Credit Endorsement for Commercial Credit Line Mortgages Which Secure a Maximum Principal Indebtedness of Less Than \$3,000,000"), RCE-3 ("Commercial Revolving Credit Endorsement (Limited Term Coverage) for Commercial Credit Line Mortgages Which Secure a Maximum

Principal Indebtedness of Less Than \$3,000,000")) and RCE-4 ("Commercial Revolving Credit Endorsement For Commercial Credit Line Mortgages Which Secure a Maximum Principal indebtedness of \$3,00,000 or More").

These endorsements provide insurance that a credit line mortgage will not lose lien priority to post-policy filed liens and encumbrances as loan proceeds are advanced and re-advanced, so long as (a) the insured lender does not have actual knowledge of either the sale or transfer of the Insured Premises, or (b) there is no event of default.

The endorsements do not insure against loss or damage based on federal tax liens or bankruptcies appearing in the public records prior to the time of an advance, or post-policy real estate taxes and related charges. RCE-2, RCE-3 and RCE-4 do not insure against loss or damage based on statutory liens arising after the Date of Policy which, by virtue of federal, state or local laws, are entitled to priority over advances under the mortgage.

The lender will need to consider whether, notwithstanding the endorsements, it will require limited bring down searches of title for such matters.

RCE-1 and RCE-3 afford protection against mechanics liens filed prior to a post - closing advance or re-advance. For commercial credit line mortgages securing a maximum outstanding principal indebtedness of less than \$3,000,000 with a term of three years or less other than construction loans, RCE-3 is an entirely new and valuable coverage.

Only RCE-4 (for commercial credit line mortgages securing a maximum principal indebtedness of \$3,000,000 or more) excludes from coverage the risk of mortgage recording tax being imposed on advances made after the aggregate amount of advances exceeds the face amount of the mortgage. Protection is afforded for RCE-1 based on the provisions of Tax Law, Section 253-b which exempts from the payment of mortgage recording taxes readvances on loans secured by mortgages on one to six family owner-occupied residential real property. This protection for RCE-2 and RCE-3 is also based on the provision of Section 253-b, which affords mortgage recording tax protection for readvances under credit line mortgages securing a maximum principal indebtedness of less than \$3,0000,000. (1)

The charge for the RCE-1, RCE-2 and RCE-4 endorsements is ten percent of the mortgage premium computed without any reduction for prior insurance. The charge for RCE-3 is a twenty percent of the straight mortgages premium.

OTHER ENDORSEMENTS

Other endorsements available in New York for either or both Owner's and Loan policies. often at minimal cost, may also add value to the coverage of the policy and should be discussed with the title underwriter. Certain underwriting requirements may need to be met in order for these endorsements to issue.

Owner's policy endorsements include the Fairway endorsement (insuring that the transfer of interests in an insured partnership will not create a new entity which is outside the policy coverage), an endorsement insuring the position of a Contract Vendee, the Market Value Policy Rider (for one-to-four family owner-occupied property) and a Limited Liability Company endorsement (extending the benefits of the policy to the entity which is a successor by operation of law).

Lender's policy endorsements include the Comprehensive (ATLA 9) endorsement (with extended coverage for restrictive covenants), Variable Rate endorsements (insuring against loss of lien priority either by reason of provisions for a change in interest rate or the addition of interest to principal, so-called "negative amortization"), Additional Interest and SWAP endorsements (insuring that the securing of certain amounts such as so-called breakage costs under an Interest Rate Exchange Agreement as Additional Interest will not impair lien priority), a Survey endorsement for one to four family residential property which affords coverage against matters that would be disclosed by a survey, ALTA 8.1 Environmental Protection endorsements (available on residential, including multifamily, property), Reverse Mortgage and, for an existing loan policy, Successor in Ownership of Indebtedness endorsements.

Also available for both Owner's and Lender's policies issued in New York, although sometimes in different forms, are endorsements for New York City Air Rights (insuring the validity and binding effect of the Zoning Lot Development Agreement and the easement of light and air and negative covenant not to build set forth therein), Land Same as Survey coverage, Waiver of the policy provision for Arbitration of Claims, and endorsements affording specific coverage for leaseholds, and for condominium and cooperative units.

A Joint and Several Liability endorsement is also available for transactions to afford joint and several liability on transactions insured ("coinsured") by more than one title insurer for a specific amount of policy liability on which an additional premium is payable.

Note should be made that the Cluster, First Loss, Last Dollar, RCE-3, SWAP and Additional Interest endorsements can only be issued after approval by the title insurer which is extending the coverage of its policy.

CONCLUSION

There is much value in the title policy endorsements available in New York. These endorsements and their applicability to the transaction at hand should be discussed with the title underwriter to ensure that the client gets the maximum benefit from the title policy being issued.

(1) Tax Law Section 253-b was amended by Chapters 489 and 490 of the Laws of 1996 to extend the treatment afforded residential credit line mortgages to all other credit line mortgages which secure a maximum principal indebtedness of less than \$3,000,000.

Published in the New York Law Journal, March 23, 1998

