New York Title Policy Endorsements Change
Michael J. Berey

As noted in a prior article by this author,[1] due to changes in the ALTA 2006 policies, certain endorsements issued with the 1992 ALTA policies were withdrawn on May 1, 2007, the effective date of the ALTA 2006 policies in New York. Since then there have been modifications to the standard New York endorsements, the three variable rate endorsements, the Fannie Mae balloon endorsement and the mezzanine financing endorsement.

The New York Fairway endorsement has been withdrawn.

This article summarizes these later changes.[2]

The Standard Endorsements

The New York standard endorsements ("standard endorsements"), one each for the owner's policy and the loan policy, are required to be affixed to those policies, modifying them to account for New York-specific concerns.

The standard endorsements that accompanied the 1992 ALTA policies added an insuring provision providing coverage against mechanics' liens filed after the date of policy for work previously performed, and so-called "gap" coverage, insuring against intervening liens and encumbrances (except for real estate taxes, water charges and sewer rents) recorded between the date of policy and the date on which the insured instrument was recorded.

The loan standard endorsement issued with the 1992 ALTA loan policy also deleted a mechanics' liens carve out in the exclusions from coverage of that policy, which is not in the 2006 ALTA loan policy.

The New York standard endorsements have been amended for the 2006 ALTA policies. The endorsement for the owner's policy continues to afford mechanics' lien coverage. However, since coverage is afforded as to mechanics' liens by a covered risk in the 2006 ALTA loan policy, the endorsement for the loan policy no longer mentions mechanics' liens.

This does not mean, however, that mechanics' lien coverage is provided by default in New York in all instances. Under the Title Insurance Rate Service Association Inc. (TIRSA) rate manual, a loan policy insuring a mortgage securing future advances, collectively referred to in the rate manual as "construction loan(s)" but not limited to building or project loans, must include a so-called "pending disbursements clause." Under the pending disbursements clause, the policy "insures only to the extent of the amount actually disbursed plus interest thereon;" when advances are to be made a continuation search of title is conducted and any mechanics' liens filed since the last search need to be resolved so as not to be set forth as exceptions to coverage in the down-date of the policy.

Gap coverage is a covered risk in the 2006 ALTA owner's and loan policies.

Accordingly, the New York standard endorsements for those policies do not need to include this coverage. However, the standard endorsements amend the exclusion for coverage in the 2006 ALTA policies, carving out from gap coverage real estate taxes and assessments created or attaching between the date of policy and the date of recording to also except water charges or sewer rents.

The New York standard endorsement for the loan policy, as issued effective Dec. 1, 2008, also adds exclusion from coverage "8," excluding from coverage loss or damage resulting from "[a]ny consumer protection law, including without limitation, New York Banking Law Section 6-l ('High-Cost Home Loans') and 6-m ('Subprime Home Loans') relating to a mortgage on Land improved or to be improved by a structure or structures intended principally for occupancy by one-to-four families," discussed below.

Variable Rate Endorsements

The Variable Rate Mortgage, Variable Rate Mortgage-Negative Amortization, Variable Rate Mortgage-Fixed Rate Conversion, and the Fannie Mae Balloon Mortgage Endorsements (collectively the "variable rate endorsements"), as amended effective Dec. 1, 2008, state that the coverage of those endorsements is subject to "Section 8 of the Exclusions From Coverage, as added by the Standard New York Endorsement (Loan Policy)." These endorsements insure the holder of the indebtedness secured by the mortgage against loss or damage sustained if the insured mortgage is held to be invalid or unenforceable or the priority of the lien of the mortgage is impaired due to changes in the rate of interest and, in the case of the negative amortization endorsement, the addition of interest to principal.

The basis for the addition of exclusion from coverage 8 to the New York standard endorsement for the ALTA 2006 loan policy, and the corresponding amendments to the variable rate endorsements, was enactment of Chapter 472 of the Laws of 2008, New York State's "Subprime Lending Reform Act" (the act).

The act amended Banking Law §6-l ("High-cost home loans") and added new §6-m ("Subprime home loans"), addressing "home loans" "consummated" on and after Sept. 1, 2008, and also amended sections of the Real Property Actions and Proceedings Law (RPAPL). A "home loan," in the context of high-cost and subprime home loans, is a loan made to a natural person (other than a reverse mortgage transaction) in which "the principal balance of the loan does not exceed the conforming loan size limit for a comparable dwelling as established from time to time by the federal national mortgage association," secured by a mortgage on real property improved or to be improved by a structure occupied by one-to-four families, including by the borrower as his or her principal dwelling.[3]

The act contains numerous restrictions on high-cost and subprime home loans. For example, such loans may not include "an abusive yield spread premium," a "teaser rate," negative amortization, or a provision to increase the interest rate after default, and balloon payments and points and fees chargeable are limited. "Loan flipping," as defined in Banking Law §§6-l.2(i) and 6-m.2(h), is prohibited.

Determining whether a home loan is a high-cost home loan or a subprime home loan and, if it is, whether the loan complies with the relevant requirements of the act, is within the usual scope of the business of the lending community but outside the title underwriter's customary knowledge and experience. For example, a subprime home loan is defined in Banking Law §6-m(1)(c) as:

…a home loan in which the fully indexed annual percentage rate exceeds by more than one and three-quarter percentage points for a first-lien loan, or by more than three and three-quarter points for a subordinate lien loan, the average commitment rate for loans in the northeast region with a comparable rate for loans in the northeast region with a comparable duration to the duration of such home loan, as published by [Freddie Mac] in its weekly Primary Mortgage Market Survey (PMMS) as posted in the week prior to the week prior to the week when the lender received a completed application.

Violations of Banking Law §§6-l and 6-m may result in rescission of the loan transaction and may be raised as affirmative defenses in mortgage foreclosures.[4] RPAPL §1302.2 ("Foreclosure of high-cost home loans and subprime home loans"), as amended by the act, provides that "[i]t shall be a defense to an action to foreclose a mortgage for a high-cost home loan or subprime home loan that the terms of the home loan or the actions of the lender violate any provision of section 6-l or 6-m of the banking law or Section 1304 of this Article."

The New York State Insurance Department (NYSID) agreed with TIRSA that it was appropriate, by amending these endorsements, to clarify that the loan policy does not cover the consequences of violations of such consumer protection laws.

Fairway Endorsement

The New York Fairway Endorsement ("Fairway") for an owner's policy was first issued in 1993 in response to customers' concerns that title insurers would apply the holding in Fairway Development Company v. Title Insurance Company of Minnesota[5] to owner's policies issued in New York.

In Fairway, a federal district court in Ohio, applying that state's uniform partnership law, held that the assignment of partnership interests from two partners to the remaining partner and a new, third-party purchaser resulted in the termination of the title insured partnership and the creation of a "new" partnership, which "new" partnership lacked the standing to bring an action under the title policy issued to the original partnership. The endorsement provided, in effect, that the transfer of an interest in an Insured under an owner's policy would not be deemed to create a new entity, not entitled to the benefits of the policy.

TIRSA deemed the Fairway endorsement unnecessary under the 2006 ALTA owner's policy due to the policy's expansion of the definition of the "Insured" to include successors by "reorganization." An "Insured" is defined, in part, to include "successors to an Insured by dissolution, merger, consolidation, distribution, or reorganization." The Fairway endorsement was withdrawn on July 31, 2009; it may not accompany a policy issued on or after that date.

Mezzanine Financing Endorsement

A mezzanine loan is a loan made to the partners or members of an entity, typically a limited liability company, secured by a pledge of their interests in the entity under the Uniform Commercial Code. UCC-based title insurance policies are available to insure the interest of the mezzanine lender.[6] The interest of the lender may also be secured by a title insured mortgage on the entity's real property.

An endorsement to an ALTA owner's policy has been available in New York since 2001, affording to a mezzanine lender the benefits of the policy insuring the property-owning entity. The charge for the TIRSA mezzanine financing endorsement ("mezzanine endorsement") has been 30 percent of the owner's policy premium rate computed on the entire amount of the owner's policy, even if the amount of the mezzanine loan was less than the amount of the policy.

A revised mezzanine endorsement, based substantially on the recently adopted ALTA form, modified by TIRSA, was approved by the NYSID effective Aug. 15, 2009. The charge for the endorsement has been reduced to 20 percent of the owner's policy rate and is computed based on the amount of the mezzanine loan, which is typically a lesser number than the policy amount, the amount of the mezzanine loan being set forth in the endorsement. When a mezzanine loan is made after the owner's policy is issued to the entity in which the mezzanine borrowers have ownership interests, the revised form of mezzanine endorsement may be appended to the existing owner's policy, with no change in the date of policy.

The new mezzanine endorsement varies from the prior form in a number of other respects. First, under paragraph 2(b), the Insured under the owner's policy "agrees that no amendment or endorsement to this policy can be made without the written consent of the Mezzanine Lender." The endorsement is executed by the insured under the owner's policy and the mezzanine lender to agree and consent to the provisions contained therein.

Paragraph 4 of the revised endorsement provides that the insurer will not assert against the mezzanine lender exclusions from coverage 3(a), 3(b) and 3(e), provided that "the Mezzanine Lender had no Knowledge (actual or constructive) of the defect, lien, encumbrance or other matter creating or causing loss on [the] Date of Policy." The prior form of the mezzanine endorsement provided only that the insurer would not assert exclusion 3(b) against the mezzanine lender, provided that the mezzanine lender did not have knowledge of an unrecorded defect, lien, encumbrance or other matter at the date of policy.

Exclusions 3(a), (b) and (e) provide that the owner's policy does not insure against loss or damage arising by reason of "[d]efects, liens, encumbrances, adverse claims, or other matters (a) created, suffered, assumed, or agreed to by the Insured Claimant; (b) not Known to the Company, not recorded in the Public Records at Date of Policy, but Known to the Insured Claimant and not disclosed in writing to the Company by the Insured Claimant prior to the date the Insured Claimant became an Insured under this Policy…[or] (e) resulting in loss or damage that would not have been sustained if the Insured Claimant had paid value for the Title."

Under endorsement paragraph 6(a), the mezzanine lender acknowledges "that the Amount of Insurance under this policy shall be reduced by any amount the Company may pay under any policy insuring a mortgage to which exception is taken in Schedule B or to which the Insured has agreed, assumed, or taken subject, or which is hereafter executed by an Insured and which is a charge or lien on the Title, and the amount so paid shall be deemed a payment under this policy." This is substantially the same as the text in the liability noncumulative provision of the conditions and stipulations of the 1992 owner's policy and the conditions of the 2006 ALTA owner's policy.

Under revised endorsement paragraph 8, the insurer's subrogation rights are only exercisable after the mezzanine lender recovers its principal, interest and costs of collection.

Not included in the new form is paragraph 5 of the prior form of the endorsement providing that "the amount which the Company shall be liable to pay the Mezzanine Lender pursuant to this endorsement shall be paid without requiring the Mezzanine Lender to pursue its remedies against other collateral securing the Mezzanine Loan."

Further information on these endorsements can be obtained by contacting a title insurer or any of its agents.

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Endnotes:

1. Berey, "New Title Insurance Policies in New York," New York Law Journal, May 30, 2007.

2. A required form of co-insurance endorsement, to be executed by each coinsuring company, was also approved by the NYSID, effective Nov. 1, 2008.

3. Banking Law §§6-l (1)(e) and 6-m(1)(d).

4. Subsections 10 and 11 of Banking Law §6-l; subsections 3 and 11 of Banking Law §6-m.

5. 621 F.Supp. 120 (N.D. Ohio, 1985).

6. Berey, "Article 9 Products—Covering Mezzanine Loan Financing in New York," "Real Estate Update," New York Law Journal, June 13, 2001.

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