

COVID-19 Update: Recording Issues and Title Insurance

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While the long-term effects of the COVID-19 pandemic on commercial real estate transactions are not yet known, lenders and their counsel must consider the title insurance company's ability to record mortgages and take immediate action to ensure a safe path to closing transactions with adequate title insurance coverage. Clear and early communication with each title company on each transaction is imperative, as requirements vary by county and laws vary by state. Policies will even vary by title company and, most notably, some recording offices throughout the country have already closed.

In order to understand issues related to recording real property instruments, a basic understanding of the types of recording acts is necessary. Every state has adopted a recording act, which generally falls into one of three categories of recording acts: (1) a notice act, (2) a race act, and (3) a race-notice act, which is a combination of the race and notice acts. A notice act, which is almost as common as the race-notice act, provides that a subsequent interest will be valid against a prior interest so long as the holder of the subsequent interest did not have notice of the prior interest. The act of recording provides the whole world with constructive notice. A race act, the least common recording act, provides that a prior interest will be void against a subsequent interest if the subsequent interest is recorded first, regardless of whether the subsequent interest holder had notice of the prior interest. A race-notice act, the most common recording act, protects a subsequent interest against prior interests if the subsequent interest holder both recorded first and did not have notice of the prior interest.

All 50 states, with the exception of Vermont, and the District of Columbia have authorized electronic recording of mortgages. At the county level, approximately 2,054 of the 3,141 U.S. counties and county equivalents allow electronic recording, which figure represents approximately 85% of the U.S. population. In those counties, the title company may be willing to close, record and issue title insurance in the ordinary course of business. However, even if the mortgage can be recorded electronically, if the county's electronic indexing system cannot be updated, the title company will not have the ability to "update title" immediately prior to closing, which prevents the title company from ensuring that no other instruments have been recorded (or are in line to be recorded) prior to the related mortgage. In addition, even if a mortgage can be electronically recorded, certain states may require other real property instruments (e.g., mechanics liens) to be filed by attorneys or other specific parties in courts or other government offices, which may be closed. Accordingly, title companies will then either be forced to take one or more exceptions for such shortcomings or make a decision on whether they can insure the "gap" on a deal-by-deal basis.

The "gap" is the time period between the closing date of the transaction (or the last search of the record which pre-dates closing) and the date the mortgage is recorded. As the effective date of the title insurance policy is the date the mortgage is recorded, the title company assumes the risk that no other instruments will be recorded or matters will arise during the gap. The title company minimizes its risk by sending documents for recording as soon as practicable, performing a title update immediately prior to closing, as previously discussed, and obtaining an indemnity from either the borrower/sponsor/buyer or seller. Pursuant to such a gap indemnity, the borrower/sponsor/buyer or seller will indemnify the title company against any defects, liens, encumbrances, adverse claims or other matters which may arise during the gap. In these uncertain times, more careful consideration will be given to the financial viability and reputation of the borrower/sponsor/buyer providing such gap indemnity. Some title companies may just decline to insure the gap altogether.

It is likely that transactions in counties that require in-person recording will not be able to close given the inability to record at all if the local recording office is closed. If the title company cannot update their title search and the mortgage cannot be accepted for recording, it is unlikely that the title company will insure the gap. Without title insurance coverage, closing would need to be delayed because the title company would only be able to issue their policy based on a title update that happens at some point after closing. Recording offices in New York City, for example, are currently only accepting electronic mortgage filings. Additionally, specifically related to New York City transactions,

absent a special arrangement with the title company, if a transaction includes a “building loan agreement” and related “building loan mortgage,” that transaction cannot close until the recorder’s office re-opens, as these documents must be recorded in person. “Building loan agreements” are required by statute to be recorded within ten days of closing, and the related “building loan mortgage” cannot be recorded until the “building loan agreement” has been recorded. Therefore, given the inability to record, the transaction will likely not be able to close with title insurance because title companies may not take on this risk.

On the other hand, certain title companies have indicated that if the recording office cannot both provide a title update and record, closings may nevertheless proceed, provided that certain conditions are met. Such conditions may include additional exceptions to coverage and broader gap indemnities. Title companies are also limiting the amount of insurance for such transactions, such limits ranging from \$10 million to as low as \$3 million. In addition, construction mortgages are being especially impacted as at least one title company has refused to close any construction mortgages, or mortgages where work has been recently performed, without direct contact with such title company’s internal legal counsel. Generally, if these types of transactions do not satisfy the title company’s conditions, the parties are being directed to contact the title company’s internal legal counsel.

In some cities and counties, although the offices may be closed to the public, there may be personnel working to process delivered recording packages. In this instance, if the jurisdiction is able to process the recording package and the related index is being reliably updated, transactions will be able to close with appropriate title insurance in the ordinary course.

There are a number of scenarios that could unfold, especially given the variation in city, county and state closures in addition to the related state’s title insurance regulations. Given the circumstances surrounding COVID-19, conditions and guidelines issued by title companies are constantly changing. Therefore, lenders and their counsel must initiate early discussion with the title company on each transaction in process during the COVID-19 pandemic and take into consideration the various obstacles created in its wake.

While some jurisdictions, such as New York, have enacted emergency executive orders which permit virtual notarization to facilitate closings, there will be a need in the days ahead to address a myriad of issues in order to facilitate the transaction of business in the current new normal. We will continue to provide periodic updates regarding issues of interest to our industry through this venue and other means. Most importantly, stay safe.