

## Avoiding Title Insurance Pitfalls in Portfolio Transactions

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In commercial real estate finance transactions involving a portfolio of properties located in multiple states, lenders must consider certain title insurance issues unique to such transactions. Lenders will need to request specific types of coverage and be cognizant of certain state-specific and timing issues that are often associated with large portfolio transactions.

In the context of a single property transaction, a lender would generally obtain a single loan policy for the full amount of the loan. In portfolio transactions, there are typically multiple mortgages which secure the full amount of the loan which raises an additional set of issues. First, it is unwieldy to include multiple properties on the same loan policy, especially as the number of sites increases. Second, while a mortgage might secure the full loan amount in jurisdictions where there is no mortgage tax, multiple policies cannot be issued with coverage equal to the full loan amount for each property since the premium would be excessive. Third, separate and distinct policies with coverage amounts equal to the individual allocated loan amount for such property would have to stand on their own, meaning that a loss at one property in excess of the insured amount for such property would leave the lender uninsured for the loss of such excess. While a mortgage in a non-mortgage tax state will usually secure the full loan amount which will exceed the value of the specific property, the amount of title insurance on such property will not.

The ALTA Endorsement 12-06 (Aggregation), often called a “Tie-In” endorsement, addresses the foregoing concerns and is therefore a necessary endorsement in any portfolio transaction. The “Tie-In” endorsement allows a title company to issue separate policies for each mortgaged property with insured amounts equal to a “grossed up” portion of the total loan amount allocated to such property (usually 125%), and then aggregates the insured amount of such policy together with the insured amounts of the policies listed in the “Tie-In” endorsement such that the total insured amount will be at least equal to the total loan amount. In essence, this produces the same result as the title company issuing a single policy covering the entire portfolio. It allows the lender to take advantage of any increases in the value of individual properties, since if there is a loss at a single property in excess of its allocated loan amount then the lender can then take advantage of the remaining portion of the insurance coverage to make itself whole. In addition, this type of insurance protects lenders against fluctuations in the value of individual properties in a portfolio.

The “Tie-In” endorsement is not available in all states, however. Title insurance is regulated by each state and therefore there are variations as to the availability and forms of endorsements from state to state. Specifically, Florida, Delaware, and Pennsylvania will only “tie-in” policies for properties that are located within their own states. For states that will only “tie-in” intrastate policies, the total coverage amount for those properties should be increased to account for the inability to “tie-in” with the remainder of the portfolio. In addition, lenders should be aware that certain states have capped liability amounts for aggregated policies. In that situation, the ALTA Endorsement 12.1-06 (Aggregation – State Limits) is used, which merely states that if the land is located in a restrictive state then the aggregate insured amount for that state is capped at such amount.

In addition to aggregation considerations, portfolio transactions also raise co-insurance concerns, especially those transactions with high loan amounts. Many banking institutions have maximum risk guidelines that require them to diversify the insurance risk among multiple title companies in the event the loan amount is over certain thresholds. These guidelines further depend on which title company is providing insurance. In a portfolio transaction, especially one closing on a tight timeline, it is best to bring the co-insurer into the deal as early as possible. This can be a lead time item that may prevent a timely closing due to the fact that a co-insuring title company may potentially need to take the time to perform their own due diligence before they agree to co-insure, essentially requiring them to start from the preliminary title commitment stage. Lenders providing financing for large loan portfolio transactions should ensure that the ALTA Endorsement 23-06 (Co-Insurance), also known as a “Me-Too” endorsement, is obtained and that it is requested early on in the transaction timeline.

Lenders should also consider reinsurance in order to further manage risk attributed to the creditworthiness of the title insurance company. Reinsurance is title insurance purchased by the original title company from third-party title companies to cover liabilities above a specific dollar amount. Reinsurance can be used in the same transaction as co-insurance, thus further diversifying credit risk. When reinsurance is obtained, Lenders should be sure that it is issued in a form which gives the insured "direct access" to the insurer in order that the coverage is not derivative.

Knowledge of the correct title insurance coverage, state-specific nuances and timing concerns will help move your portfolio financing through to a smooth closing, avoiding unnecessary time delays and potential pitfalls.