RELYING (OR NOT) ON TITLE INSURANCE IN THE FORECLOSURE CASE – SOME PRACTICAL OBSERVATIONS FOR MORTGAGE LENDERS

By: Bruce J. Bergman

INTRODUCTION

Just as mortgage lending and mortgage foreclosures are specialized callings, so too are the substantial intricacies of title insurance. Although, of course, laws and interpretation relating to title insurance policies vary around the country, suffice it to say, predicting with certainty the outcome of all or many title claims is often close to an exercise in futility. (While we speak most often of title insurance generally, that actually means coverage applicable to fee ownership. As a lender, the insurance for the validity and superiority of the mortgage is mortgage insurance.)

That title claims exist and emerge from time to time is simply a fact of mortgage life. No title system, or the human aspects of it, can be foolproof. Consequently, sooner or later, of major consequence or not, it is reasonable to expect that a title claim is somewhere inevitable.

The message here — well worthy of the explanation which follows — is twofold. First, divining where your mortgage reposes in the chain of priorities is sometimes difficult, surprisingly complex and ultimately dangerous. (You may **think** you have a second mortgage, but it may not be so.) Second, relying upon the protection of the title company's mortgage insurance cannot (or should not) affect your zeal to protect your own rights.

Rarely does the title problem surface while the mortgage is current. Rather, unexpected senior interests are exposed when the borrower either defaults on some other obligation — or your second mortgage. Where it is now your mortgage proceeding to a foreclosure action, the foreclosure search may reveal the unanticipated encumbrance.

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THE PROBLEM

To explain, the moment a lender believes that a claim can be made to the title insurance carrier, it should be submitted. Delay, and certainly any undue detainment in presenting the claim, could be a waiver of rights. It might allow the title company to validly disclaim what would otherwise have been its obligation. In any event, it opens the door for a title insurer so inclined to **assert** a waiver, if only as a bargaining posture to push the insured to accept lesser proceeds. So, file the claim with dispatch. Once having done so, proceed with the pessimistic view that money will never be forthcoming from the insurer.[2]

There are two primary intertwined reasons for these recommendations:

(1) More recently inundated title insurers may not be able to address your claim very quickly. While they are contemplating, or investigating (or sometimes, unfortunately, being inefficient), the mortgage debt due you becomes ever larger. Allowing an obligation to escalate, which could either exceed the limits of the policy or which you might have to absorb in the end, portends only peril.

(2) During the period of the carrier's ruminations, what you believed to be an impediment may evaporate. Then there would be no need for the title company to respond in damages. Again, delay served no good purpose for you.

Thinking about the issue should make the point obvious, but perhaps an example may highlight the concept. To underscore the dilemma, suppose this scenario:

In 1988, a property is encumbered by a $200,000 first mortgage. Because its appraised value was $400,000, Sage lender loaned $100,000 and became a second mortgagee. When default ensued in early 1990, Sage ordered a search to confirm its position — or more likely obtained the search as an incident of instituting a foreclosure.

[2]*None of this is mentioned by way of criticizing title insurers in general or any carrier in particular. But there can be no assurance that every incident is covered by the policy and there can always be unusual factual issues.*

The search disclosed a $150,000 judgment entered **prior** to Sage's mortgage (athough Sage's mortgage was executed and delivered before the judgment was entered.) Someone on Sage's staff concluded — or perhaps was counseled — that the intervening judgment meant that no equity remained to cover its mortgage. Believing there was not much point in expending legal fees for a fruitless foreclosure, Sage refrained from pursuing the foreclosure and chose to rely upon a claim to its title carrier.

It took about a year before the title company responded with its final position, which was that Sage's mortgage was actually **senior** to what **looked** like an intervening judgment. The title company was correct! In New York for example, a mortgage first executed is superior to a later judgment even though the judgment may be first filed of record.

Armed with this new information, Sage now began its own foreclosure, woefully behind the first mortgage. Delays in the foreclosure were encountered. Worse still, the real estate market collapsed so that by the time the senior came to sale, the equity really **was** gone and there was no sense in Sage even bidding at the senior sale.

CONCLUSION

Granted, the noted hypothetical — which is **not,** by the way, a hypothetical — is a confluence of unusual events. Nevertheless, it makes the point.

The law relating to priorities and title insurance and title claims can be quite arcane. A labyrinthine path of obscure legal traps is hardly a stage upon which to venture when your money is a stake.

In the end, you do not know what the status of your title claim will be. There may or may not be compensible damages. Even if you will ultimately have a valid claim, you cannot know whether the title company will offer to pay in full, or how long it will take to get an answer, negotiate a settlement with the carrier, or sue them if necessary.

None of this is to suggest that every title claim situation is a nightmare. It is to urge, though, seriously protecting your rights even though a title claim apparently exists. Make the claim, but take care of yourself all the while.