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Lenders Taking Title by Foreclosure or Deed in Lieu: The Advantages of Obtaining an Owner’s Title Insurance Policy

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Lenders who make loans secured by real estate routinely obtain a loan title insurance policy insuring their lien position. Owners of real estate routinely obtain an owner’s title insurance policy insuring their title to the property. But what about when a lender becomes an owner by foreclosure or deed in lieu of foreclosure of their insured deed of trust? Can a lender rely on its loan title policy to insure its title to the property? If so, then should a lender rely on its loan policy, or should it obtain an owner’s policy?

Generally, coverage under a loan policy does continue after a lender takes title to the property. However, certain actions can jeopardize continued coverage, and there are advantages to obtaining an owner’s policy. Lenders about to take title should therefore consider the following traps for the unwary and benefits of an owner’s policy.

Continuation of Coverage

Coverage under a loan policy continues after foreclosure or recordation of a deed in lieu*if* title to the property is taken by the same entity that is the named insured under the title policy. If a secured lender prefers, instead, to take title in the name of an affiliate OREO entity or a special-purpose entity, then the named insured lender should assign the secured debt to the entity that will take title, and have that entity bid at the sale or take the deed in lieu of foreclosure. Alternatively, the insured lender could take title and then convey the property by deed for no consideration to either: (i) the insured lender’s parent company, who must wholly-own the lender; or (ii) a wholly-owned subsidiary of the insured lender. If the transaction is not structured in one of these ways, the discrepancy between the named insured under the title policy and the new owner could be a basis for the insurer to deny continued coverage under a loan policy.

Improper Foreclosure Issues

Unlike a loan title insurance policy, an owner’s policy will insure that a foreclosure was done properly and title was successfully transferred without any outstanding adverse interests (unless expressly noted as exceptions). A loan policy may not protect the lender if there was a defect in the foreclosure process. A post-foreclosure owner’s policy also offers the benefit of insuring title during the time period between the issuance date of the existing loan policy and the date of foreclosure. It can only improve marketability of the property if the lender can present a prospective buyer with a clean title policy dated after the foreclosure that insures that there are no surprises.

Deeds in Lieu

By opting to take a deed in lieu of foreclosure rather than foreclosing, the lender foregoes the extinguishment of any junior interests in the property through foreclosure. In this situation, obtaining a title update and obtaining an owner's title policy is invaluable because the risks presented by most intervening junior interests will be identified before the deed is recorded. The lender then can condition its acceptance of a deed in lieu upon the borrower eliminating any intervening interests and obtaining clean title insurance for the lender.

Lenders should be aware that some title insurers refuse to give coverage for deed in lieu transactions without exception for contractor's liens. For this reason and others, the documents for a deed in lieu transaction should specify that the secured obligation is merely rendered non-recourse, rather than being discharged, and that the deed of trust will remain of record, in case the lender later discovers some intervening interest that must be extinguished by foreclosure.

Insured Value

An owner's policy can offer greater coverage value. An owner's policy insures the face amount of the policy. By comparison, a loan policy insures only the lesser of the face amount of the policy or the outstanding amount of the secured debt. This is because the terms of a loan policy give the title insurer the right to discharge their obligations at any time simply by purchasing the debt.

Triggering the Insurer's Obligation to Pay

An insurer's obligation to pay a loss under an owner's policy is triggered at "first loss." Under a loan policy, though, generally no loss is recognized until the collateral is fully liquidated and an actual loss is suffered. Therefore, an owner's policy may result in a more expedient resolution of a title claim than a loan policy would.

Conclusion

Arguably, it is penny-wise and pound-foolish for a lender to rely on its loan policy to insure title taken by foreclosure or deed in lieu. There are significant advantages to having an owner's policy. Moreover, obtaining an owner's policy should not be financially burdensome to the lender. Generally, the title work needed to obtain an owner's policy is for a relatively short period of time (between the date the insured deed of trust is recorded and the date the lender takes title), which drastically decreases the cost to obtain an owner's policy. Additionally, because the title insurer will already have insured the property, it should issue a new policy on the property at a "reissue" rate that is lower than the original premium. Finally, because an owner's policy increases the marketability of the real property, obtaining the owner's policy further benefits the lender by increasing the likelihood of selling the property quickly to a third party. In sum, lenders are encouraged to obtain an owner's policy in all foreclosure and deed in lieu of foreclosure transactions.

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