



Underwriting Commercial Transactions



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AGENDA

- Surveys
- Defeasance
- Recharacterization
- Fairway Endorsement
- Asset Sales vs. Equity Sales
- Non-Imputation Coverage
- Mezzanine Financing
- UCC Policies
- Alternative Financing
- Authority
- Energy Projects



SURVEYS

- Generic “catch all” survey exception rarely accepted in commercial transactions.
- Proposed Insureds will expect you to complete a survey read and call out anything you want excluded from policy coverage.



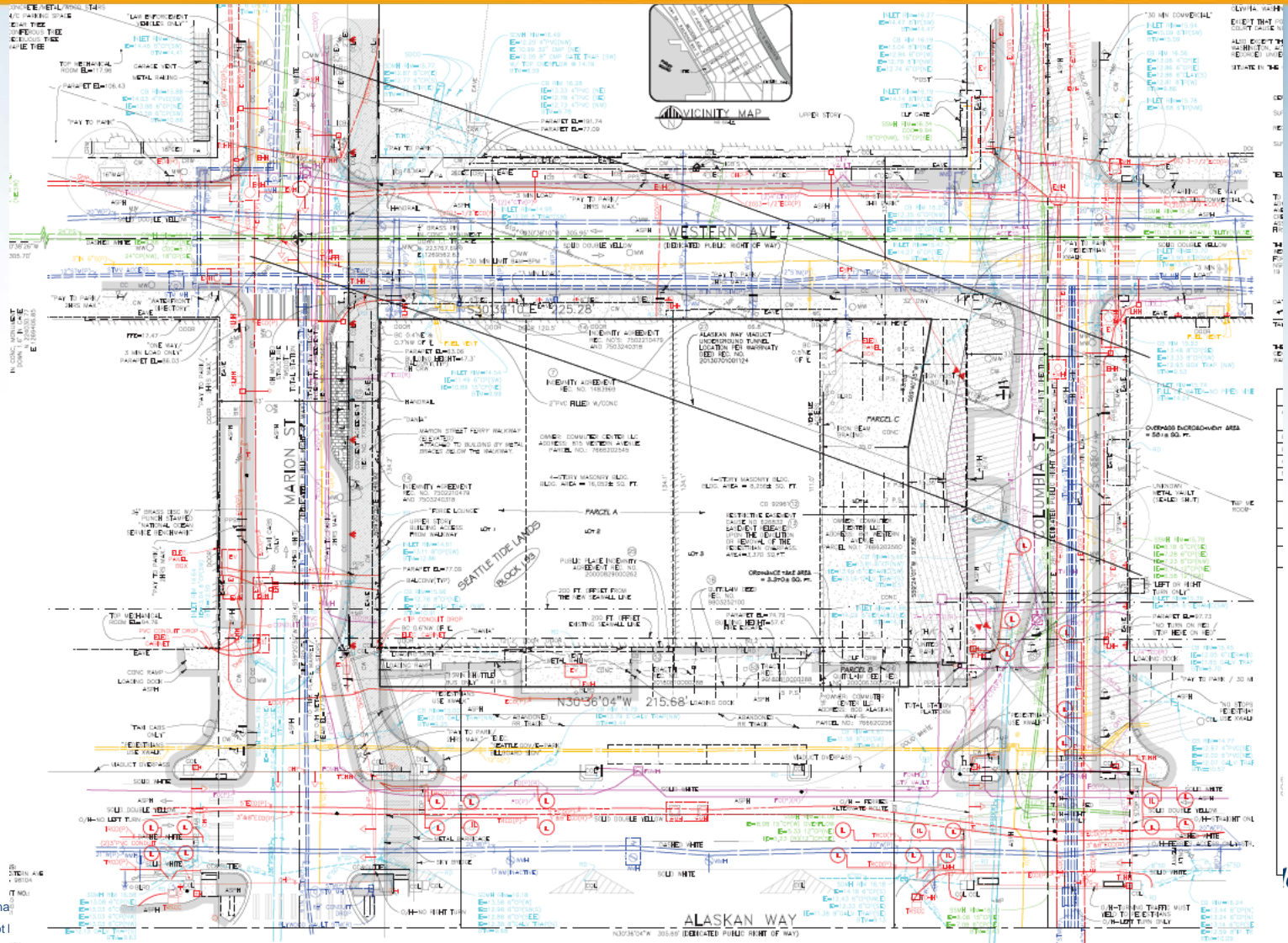
SURVEY DEPICTIONS

- Some customers will request that you add language to policy exceptions stating that the item described, such as an easement, is “as shown on survey”.
 - Lawyers Title v. Doubletree Partners, L.P.
- Suggested alternate language:

“Said easement is depicted on plat of survey made by _____, dated _____, bearing job number _____. The Company does not insure against loss or damage sustained by reason of any inaccuracy of or in such description”.



SAMPLE COMMERCIAL SURVEY



SAMPLE COMMERCIAL SURVEY

Survey Exception

20. SUCH MATTERS, INCLUDING BUT NOT LIMITED TO, COVENANTS, CONDITIONS, RESTRICTIONS, RESERVATIONS, EASEMENTS OR OTHER SERVITUDES, IF ANY, AS DISCLOSED BY ALTA/NSPS SURVEY PREPARED BY BUSH, ROED & HITCHINGS, INC., UNDER JOB NO. 2016087.06, BEARING A DATE OF 08/14/18, AND MORE PARTICULARLY DESCRIBED AS:
- A. THE SUBJECT BUILDING ENCROACHES OVER THE NORTH, NORTHWEST, AND SOUTHEAST PROPERTY LINES.
 - B. THE LOADING DOCK APPURTENANT TO THE SUBJECT BUILDING ENCROACHES ALONG THE SOUTHWEST PROPERTY LINE.
 - C. PARKING STALLS APPURTENANT TO THE SUBJECT PROPERTY ENCROACH ALONG THE SOUTHWEST PROPERTY LINE.
 - D. PARKING STALLS APPURTENANT TO THE SUBJECT PROPERTY ENCROACH ALONG THE SOUTHEAST PROPERTY LINE.
 - E. THE SUBJECT BUILDING ENCROACHES INTO THE EXISTING AND NEW SEAWALL OFFSET LINE.
 - F. THE SIGN APPURTENANT TO THE SUBJECT BUILDING TENANT "FORGE LOUNGE" ENCROACHES OVER THE NORTHWEST PROPERTY LINE.
 - G. BALCONIES APPURTENANT TO THE SUBJECT BUILDING ENCROACH OVER THE NORTHWEST PROPERTY LINE



DEFEASANCE

- When a loan is defeased, it is not paid off. The lender authorizes the substitution of new collateral instead of a payoff. The lender will then release the DOT.
- The new collateral is not real property, it is US government securities that are equivalent in value to the existing real estate collateral.



DEFEASANCE

- A defeasance will involve a Securities Intermediary who will be identified on the defeasance documents.
- The most important thing from a title perspective is to review the instructions and confirm that they provide that you are not instructed to disburse funds until you have confirmation that the Securities Intermediary has received the securities.



DEFEASANCE

- Why is this instruction language so important?
- If you have already disbursed and for some reason the securities are not received, you are at risk of the transaction being unwound (yet you have disbursed and obligated yourself to insure).



RECHARACTERIZATION

- A lease that contains terms and conditions that render it a financing vehicle may trigger a need for a recharacterization exception.
- The exception would prevent the Insurer from being responsible for loss or damage should the lease be characterized as something else (due to the structure of the transaction).



RECHARACTERIZATION

- Examples of scenarios where recharacterization risk is common.
- Endorsement:
 - Can insure that in the event the lease is recharacterized as a mortgage, the owner's policy insuring the leasehold interest will convert to a loan policy.
 - Still need to include Sch B exception.



RECHARACTERIZATION

Sample Exception: Owner's Policy

Owner's Policy:

Any defect in, or lien or encumbrance on the title to the estate or interest referred to in Schedule A, including any claim of unmarketability, **resulting from an allegation or determination that the interest of the Insured in the land is other than a lessee's interest** including, but not limited to, any defect, lien or encumbrance imposed by a court as part of its determination that the interest of the Insured in the land is other than a lessee's interest.



RECHARACTERIZATION

Sample Endorsement Language

Notwithstanding exception _____ of Schedule B, the Company hereby assures the Insured that, in the event of a final determination by a court of competent jurisdiction that the deed dated _____ and recorded _____ as Instrument No. _____ and the lease shown as exception ____ of Schedule B, create a mortgage as of Date of Policy from the lessee in favor of the lessor under the lease with a priority date as of Date of Policy, the Insured shall have (in place of and instead of the rights and obligations under this policy) all of the rights and obligations of an Insured under an ALTA Loan Policy (6-17-06), insuring said mortgage as a lien encumbering the title to the Land as of Date of Policy with an amount of insurance of \$ _____, subject to no exceptions other than those set forth in Schedule B and any statutory lien or right to a lien for services, labor or material heretofore or hereafter furnished for an improvement or work related to the Land.

This endorsement is issued as part of the policy. Except as it expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsements, (iii) extend the Date of Policy, or (iv) increase the Amount of Insurance. To the extent a provision of the policy or a previous endorsement is inconsistent with an express provision of this endorsement, this endorsement controls. Otherwise, this endorsement is subject to all of the terms and provisions of the policy and of any prior endorsements.

FAIRWAY ENDORSEMENT

- Recent uptick in requests for Fairway Endorsements.
- Endorsement created in response to *Fairway Dev. Co. v. Title Ins. Co. of Minn.*, 621 F. Supp 120 (N.D. Ohio 1985).
- This endorsement is obsolete and no longer necessary.



FAIRWAY CASE

- *Fairway* was decided under the old Uniform Partnership Act (as adopted in Ohio).
- In *Fairway*, the Insured was a general partnership, comprised of partners A, B and C. A and B sold their interest to D, leaving C and D as partners.
- A claim arose and the title insurer attempted to deny the claim by arguing that the insured general partnership had been dissolved and this no longer existed by reason of the sale of A & B's partnership interests to D. Thus there was no longer an Insured.



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FAIRWAY ENDORSEMENT

- The *Fairway* case involved a general partnership.
- General partnerships are rarely used in real estate any more. We see more LLCs and limited partnerships.
- Uniform Partnership Act revised in 1997 by stating “A partnership is an entity distinct from it’s partners” § 201(a).
- The comments as to this revised section openly state that this provision is intended to overturn the result in *Fairway*.



FAIRWAY ENDORSEMENT

- The *Fairway* case does not say what policy form was used, but given the date of the case it is easily presumed that it was a 1970 policy form.
- The definition of “Insured” in the 1970 policy form read “the insured named in Schedule A, and...those who succeed to the interest of such insured by operation of law...”.
- The court found that the “new partnership” created in *Fairway* did not succeed to the rights of the old partnership “by operation of law”.



FAIRWAY ENDORSEMENT

- The 2006 policy form modified the definition of “Insured” by adding “successors to and Insured by dissolution, merger, consolidation, distribution, or reorganization”.

Conclusion:

1. *Fairway* result has been overturned by the Revised Uniform Partnership Act.
2. General Partnerships are rarely used in real estate transactions.
3. Argument made by title insurer in *Fairway* is inapplicable under 2006 policy definition of “Insured”.



ASSET VS. EQUITY SALES

Asset Sale: Conveyance of **title** by the title-holding entity to the new purchaser.

Equity Sale: Conveyance of the **underlying equity interests** in the title-holding entity.

- Can be full or partial.



RISKS IN INSURING EQUITY TRANSFERS

- Insuring over off-record matters without the protection of a recording statute.
- Relying on Affidavits and Indemnities to mitigate risks.
- Identifying a suitable Indemnitor.



NON-IMPUTATION COVERAGE

Exclusions 3(a), (b) & (e) of the OP

The following matters are expressly excluded from the coverage of this policy, and the Company will not pay loss or damage, costs, attorneys' fees, or expenses that arise by reason of:

3. Defects, 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;
 - (e) Resulting in loss or damage that would not have been sustained if the Insured Claimant had paid value for the Title.



NON-IMPUTATION COVERAGE

- Coverage provided through the ALTA 15 Series of Endorsements and ALTA 16-06 Mezzanine Endorsement.
- Insurer agrees not to deny liability solely by reason of the action, inaction or knowledge of the outgoing parties.



NON-IMPUTATION COVERAGE

ALTA 15-06: Full Equity Transfer

- Applies when **100%** of the equity interests in the title-holding entity are being acquired.
- Attach to an owner's policy **insuring the title-holding entity.**
- A **new** owner's policy must be issued.



NON-IMPUTATION COVERAGE

ALTA 15.2-06 Partial Equity Transfer

- Applies when **less than 100%** of the equity interests in the title-holding entity is acquired by the buyer.
- Attached to an owner's policy **insuring the incoming parties**.
- A **new** owner's policy must be issued.



NON-IMPUTATION COVERAGE

ALTA 15.1-06 Additional Insured

- Attached to an owner's policy insuring the title-holding entity.
- "Up chain" equity acquisitions.
- A new owner's policy may not be required.



MEZZANINE FINANCING

- A mezzanine lender makes a loan **secured by pledges of the ownership interest in the title-holding entity**, rather than a loan by the title-holding entity secured by a mortgage or deed of trust on real property.
- Generally, a non-mortgage form of subordinate financing (replaces the traditional 2nd mortgage concept).
- Upon foreclosure the mezzanine lender owns the entity borrower.
- Potential financing option when senior mortgage has prepayment penalty.



ALTA 16-06 Mezzanine Financing

- Applies when equity interests are pledged as security to the mezzanine lender.
- Not intended for scenarios where the mortgage lender is pledged the equity interests as additional security for the property loan.
- Attached to an owner's policy insuring the title-holding entity.
- The mezz lender is added as an "Additional Insured" and the Company agrees not to deny liability solely by reason of the action, inaction or knowledge of the Insured.



NON-IMPUTATION AFFIDAVIT

- Affidavit: A voluntary declaration of facts written down and sworn to by the declarant before an officer authorized to administer oaths, such as a notary public.
- The affiant must be a natural person because only natural persons can give sworn testimony. Artificial persons (entities such as LLCs or corporations) cannot give sworn testimony.
- Language can be inserted clarifying the extent of affiant's personal liability.



NON-IMPUTATION AFFIDAVIT

- The Affiant must have meaningful knowledge about the management of the property and the management of the entity.
- Beware of knowledge qualifiers:
 - To the affiant's present actual knowledge...
 - To the affiant's present actual knowledge without any duty of inquiry...
- Org charts are also extremely helpful.
 - "Before" and "After".



NON-IMPUTATION INDEMNITY

- Typically part of the Non-Imputation Affidavit.
- Unlike the Affiant, the Indemnitor may be an artificial person.
- Common Indemnitors:
 - Exiting or remaining equity holders.
 - Parent, upper-tier or affiliate entities.
- Indemnitor cannot be the Insured.



SUNSET PROVISIONS & INDEMNITY CAPS

- A sunset provision puts an “expiration date” on the indemnity, rendering it unenforceable after a certain date.
- An indemnity cap limits the indemnitors liability to a fixed dollar amount, which may be less than the amount of insurance under the policy.
- These provisions may be problematic because they are inconsistent with the nature of the coverage provided in the ALTA 15 series of Endorsements.



UCC POLICIES

- UCC Insurance Policies insure the attachment, perfection and priority of security interests (liens) in all Article 9 personal property.
- UCC Policies need to be separately underwritten, as they provide different types of coverage than the policy forms we are used to working with.



UCC POLIES

■ Example: UCC Insurance – Lender’s Policy

Insures:

- Lien priority.
- Insures that the Security Agreement has been duly authorized, executed and delivered.
- Insures that the Security Agreement is sufficient to create the security interest.
- Insures the description of the collateral matches the Financing Statement.
- Insures the capacity of the Debtor.
- Insures the accuracy of the Debtor’s name.
- Insures against mis-indexed filings.
- Insures the gap between Search Report and Date of Filing.
- Insures against unauthorized terminations.
- Insures filing in the appropriate jurisdiction.



SUMMARY:

NON-IMP, MEZZ LOANS & UCC POLICIES

- ALTA 15 Series: Non-Imp coverage for incoming investors purchasing real property; endorsement attached to OP.
- ALTA 16-06: Provides coverage to mezz lender in the event they have to foreclose the mezz loan and become an owner of the title holding entity (e.g. LLC Member, Partner, etc.). Endorsement attached to OP.
- UCC Policy: Provides coverage for a personal property security instrument.
- All three do not have to exist in the same transaction (although a UCC Policy is often purchased when there is mezz financing).



ALTERNATIVE FINANCING

- Examples: EB-5 financing, crowdfunding, multiple beneficiary mortgages, etc.
- This type of financing poses extra risk due to possible securities laws violations, inadequate loan underwriting and mechanic's lien risk assessment and potential fraud.
- Often involve unsophisticated parties and/or projects of questionable viability.
- More risk than traditional financing arrangement with experienced institutional lenders.



ENERGY PROJECTS

- High liability amounts – many projects valued over \$100 million.
- Energy project endorsements.
- Complex, labor intensive transactions.
- Assemblage of individual parcels.
- New construction.
- Equity Sales.
- Non-Imputation Coverage (investors).



Questions?

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