

Why Title Insurance Is Important to Mortgage Bankers

Mortgage bankers have found that title insurance is a valuable tool in the lending industry, allowing faster and easier making of mortgages and deeds of trust. Originators and purchasers of loans obviously are very interested in the financial ability of borrowers to repay debt secured by a mortgage. But, should there be a problem with the title to the property securing the mortgage, there must be in place a security device - title insurance - which assures that the lender will be able to sell the real estate serving as collateral in the process of seeking recovery of the money that has been loaned.

The ability to sell real estate and recover the full balance of the loan depends not only on the market value of the property, but also on whether the lien of the mortgage is on good title to the property. Naturally, if there are parties other than the lender who own an interest in the land or there are unpaid taxes, judgement liens or other mortgages that have to be satisfied first, the lender will not receive full value for the property at foreclosure sale. Therefore, both the originator of the loan and anyone interested in purchasing the loan must be able to determine in advance whether there is a valid mortgage lien on a good title.

Determining that the owner/borrower has good title to real estate is more difficult than checking on the status of title to personal property. Because of the permanency of land, the title to real estate - as it is used by successive owners - often becomes burdened with defects, liens and encumbrances that can reduce its value. Therefore, it is important to examine - before closing - the history of title to real property to determine whether there are any outstanding matters of this nature.

This examination of the history of title to land, commonly called a title search, may be done at the clerk or register of deeds office, or in the offices of other public officials in county or municipal buildings. The search may be performed by an employee in a title company's own title information containing historical records of titles to land. Or, the search may be done by an abstractor, by an attorney or by an employee of a title company searching the public records. Methods of title search and examination vary from state to state.

Historically, lenders including banks, savings and loans, and mortgage bankers relied on searches and the opinions of attorneys and other examiners for assurance that a borrower/owner had acceptable title to real estate, and that the mortgage lien - if foreclosed - would enable them to sell good title to purchasers at a foreclosure sale.

Originators of loans for sale were equally interested in good title, since they needed to satisfy purchasers that a loan was secured by a good mortgage on good title, especially since they often warrant such matters and could face taking a loan back if a

lien and title were unacceptable. Relying on such professionals seemed generally satisfactory back when loans were locally made and lenders knew their borrowers, and lenders did not intend to sell their mortgages in the secondary market. After loan originators began to sell mortgages nation wide and had to satisfy the requirements of diversely located purchasers as well as such insurers of loans as the Federal Housing Administration and Veterans Administration, it became clear that better security was necessary.

The idea of title insurance is to insure the lender against loss or damage in the event the owner/borrower's title, or the validity and priority of the lien on that title, is not as described in the title insurance policy. If the lender cannot foreclose its mortgage lien and recoup the unpaid balance on the loan because there are defects, liens and encumbrances on the title or problems with the lien of the mortgage arising from matters not revealed in the title policy, the lender has the basis for a claim against the title insurance company.

In issuing its policies, the title insurance company relies on an examination of the history of the title, as previously mentioned, and produces a policy that reveals the status of the title to the property - including any defects, liens or encumbrances. Based on this information and insurance provisions in the policy, the lender is able to advance the proceeds of its loan or purchase a loan knowing that, if loss is suffered because the title is other than as revealed by the policy, there is a basis for a claim against the title insurance company.

Aside from the insuring provisions, lenders know that in preparing the title policy there has been an examination of title by a competent examiner, as well as review of the status of title by a title insurance expert who has knowledge of the lender's requirements. This is especially important when the originator of the loan is a mortgage banker and intends to sell the loan - because the title insurance company can speed up the process of closing and help make certain the status of title and coverage in the title policy will be acceptable to the mortgage banker's loan purchaser.

Lenders consider the title policy to be an important addition to the opinion of the history of the title as ordinarily furnished by a professional. For example, when compared with an attorney's certificate of title, the attorney can give an opinion only - while the title company *insures* that the title is as indicated. The attorney is liable only for his lack of skill, and the responsibility for any error dies with him.

Because of these reasons and others, mortgage bankers and other originators of loans have standard requirements for furnishing title insurance commitments and policies on their loans. Title insurance is considered an important part of their portfolio when mortgages are offered for sale in the secondary market.

A title insurance commitment or binder provides a preliminary report as to condition of title based on evidence from the public records, and serves as a preliminary commitment to issue a policy subject to certain stipulations. The value of the policy assures the lender of the protection indicated in the commitment, meaning there will be a title policy in the lender's portfolio that is acceptable in the secondary mortgage market.

Why Marketable Title Is Important

Whether the involvement is ownership of real property or making a mortgage loan on the security of real estate, it is important that the title to the property be *marketable*. This has a meaning different from making certain the property is saleable from the standpoint of its physical value. Marketable title means the status of title is such that the ordinary purchaser, with knowledge of the title, should be willing to purchase the real estate.

This does not necessarily mean the title is free of defects, liens and encumbrances. But if they exist with a marketable title, the problems are not serious enough to keep a willing purchaser from taking title.

The reason for this is that if one contracts to buy property or make a loan on it and later discovers there is a defect that was not contemplated by the contract or loan commitment, the buyer may not cancel the purchase contract or loan commitment if, in spite of the defect that exists, the title is considered to be marketable.

For example, if a loan commitment is issued and it is later discovered that a former owner back in the chain of title did not cause his or her spouse to join in a deed, resulting in an outstanding dower (right of surviving spouse in property at death of the other), a court might require the lender to make the loan. In this example, the court ruling would take into account the remote chance that the spouse would return after a long period with a claim against the property. Thus, the title would be deemed marketable in spite of this imperfection.

Marketability insurance under a title policy is of great importance to a lender. Marketability insurance assures that, if a lender is unable to sell the loan or property at a foreclosure sale because the title is held to be unmarketable, the title insurance company will either have to bring a law suit to have the title declared marketable, attempt to find another purchaser who will accept the title, or pay damages to the insured lender to the extent that it is unable to market the loan or property.

Insuring Mortgage Lien Validity and Priority

The ALTA Loan Policy insures against loss or damage sustained by the lender because of the invalidity or unenforceability of the insured mortgage upon the title, or the priority of any lien or encumbrance over the lien of the insured mortgage that is not excepted to under Schedule B of the policy (see the analysis of the ALTA Loan Policy - 1992 in the following section). Insuring validity and enforceability is important to the lender because the owner of a mortgage may have to go to court to defend against an attempt by the owner/borrower or a third party to stop foreclosure on the grounds that the mortgage is invalid or unenforceable.

In making a mortgage loan, a lender usually requires that its mortgage be first in priority against other liens. Many lenders make only first mortgages, which generally are the type of loan sold by mortgage bankers in the secondary market. It is therefore important for the lender to determine there are no other liens, such as judgement liens and mortgage liens, shown as exceptions from coverage under Schedule B of the title policy. This would mean there are no other liens with priority over the insured mortgage. If there were any liens that are *subordinate* to the insured mortgage, they would be shown under Part 2 of Schedule B, meaning the title company is insuring they are subordinate.

The Far Reaching Secondary Market Role

Nearly all conventional mortgages traded in the secondary market are protected by lender's title insurance. As suggested earlier, furnishing the loan purchaser with a title policy is the best way to assure the mortgage is valid and enforceable, and is lien on good and marketable title.

Conventional mortgages may carry private mortgage insurance, which covers a portion of the amount of the loan. This type of mortgage is widely sold to various investors including banks, savings and loans, life insurance companies, investment bankers and quasi-governmental entities such as Freddie Mac and Fannie Mae.

A more recent arrival among types of mortgage investment is the formation of pools of mortgages by an investor, who sells certificates of ownership in the pool to numerous investors, much in the same way stocks and bonds are sold. These are generally known as *collateralized mortgage obligations* or *CMOs* - some types of which are insured by Ginnie Mae. In almost every instance, originators of conventional mortgages for sale in the secondary market will make certain - early on - that they obtain title policies which meet the purchaser's requirements.

Besides conventional mortgages, government insured mortgages are the other type of loan sold in the secondary market. Under the government insurance programs, the Federal Housing Administration and the Veterans Administration provide assurance that, if a loan goes into default, they will take the property off the lender's hands through payment of a mortgage insurance claim.

Although FHA and VA do not require title insurance, they stipulate that the status of title comply with their own written requirements before they will pay a claim. By obtaining a title policy that conforms to these standards when a loan is made, the lender can be assured that, should it become necessary to turn the title over to one of the federal agencies, the policy will be acceptable evidence of title at the time.