



Covering the recording gap: How does title insurance protect a lender?

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Q. How does title insurance protect a Lender?

Covering the recording gap could well be the most important coverage afforded to the insured under the title policy in New York State.

Fundamentally, the lender's policy of title insurance protects the lender's lien priority. For example, a first mortgage is insured by the title underwriter as a first mortgage, and a second mortgage is firmly insured as a second mortgage, so on and so forth.

Potentially the most important coverage provided by a lender's title insurance policy is that which protects the lender from intervening liens being recorded during the recording gap. Although this coverage is not available in all jurisdictions, it is provided as a matter of course in New York State. Entities and/or individuals insured under a title insurance policy, regardless of jurisdiction, should know if recording gap coverage is provided prior to purchasing the title insurance policy. In this way the transaction can be structured to minimize any risks associated with the recording gap.

The 2006 ALTA (American Land Title Association) Loan policy specifically protects lenders against "Any defect in or lien or encumbrance on the Title or other matter that has been created or attached or has been filed or recorded in the public records subsequent to the date of policy and prior to the recording of the insured mortgage in the public records."

This is critical protection for the lender, particularly in a softening residential market. As foreclosure rates rise, the potential for intervening liens being recorded during the recording gap also increases. Different scenarios can come into play. The borrower may have committed fraud and executed several mortgages in a short time frame, all insured by different title underwriters as "first mortgage liens." The financially distressed borrower may have been hit with several judgments which attach to the property between the time of closing of the mortgage loan and the time of recording the mortgage in the county clerk's office. If not for the protection provided by the loan policy of title insurance, the lender would have to take subject to all of the intervening liens in a foreclosure proceeding and the value of mortgage could be diminished significantly.

The coverage provided in the 2006 ALTA policy is critical to protecting the lender's expectation interest in the transaction. Without such coverage, lenders would be unable to adequately minimize risk in the New York marketplace, given substantial delays in perfecting lien priority in several jurisdictions throughout the state. In my opinion, the gap coverage provided by title insurance underwriters is the most important coverage afforded to the insured under the title policy in New York State.

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