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What title insurance products are available to protect a foreclosing mezzanine lender?

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A mezzanine loan is a type of commercial loan that is being used more and more frequently in supplementing the financing of commercial properties. Typically it is a large-scale loan subordinate to first mortgages. Mezzanine loans differ from secondary mortgages in that they are secured by the stock of the organization owning the property rather than the property itself. So when a lender makes a loan structured as a mezzanine loan, it secures a pledge of the borrower's ownership.

The pledged interest is generally in the form of a membership interest in a limited liability company. The mezzanine lender generally perfects the security interest by having the borrower execute a security agreement and filing the appropriate UCC-1 filing statements in the proper jurisdiction for recording. Simultaneously with the closing of the mezzanine loan, prudent lenders generally require borrowers to purchase UCC lenders insurance policies which insure the priority of the lender's lien on the membership interests, that the UCC-1 filing statements are in the proper form for recording and that the filing statements will be recorded in the appropriate jurisdictions (Secretary of State, County, etc.).

In a distressed commercial marketplace, we are naturally seeing a rise in the default rate on these types of loans structured in the mezzanine format. Clearly, upon deciding to foreclose, the lender should be aware that title insurance products exist to protect the foreclosing lender's interest in the collateral. UCC Owners Policies for Foreclosure are offered by several prominent title insurance underwriters. Fundamentally, these products protect against impairment of the collateral due to improper notice being given under the foreclosure proceeding, the existence of a prior security interest and lack of priority of the lender's security interest. It is crucial for mezzanine lenders and their counsel to realize that these types of title insurance products exist to protect the foreclosing lender's property interest. Additionally, purchasing these types of insurance policies ultimately increases the marketability for the inevitable sale to the new purchaser.

As the coverage provided can be slightly different depending on the title insurance underwriter and the pricing of the policy is deal specific, I highly suggest speaking to specialists dealing in these types of policies. If faced with a mezzanine foreclosure transaction, a knowledgeable title insurance agent or title insurance underwriter can be of great assistance in helping guide lenders and their counsel with these types of products.

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