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MEMORANDUM

(Amended)

TO: Clients and Friends of the Firm
FROM: Mike Patterson
DATE: October 27, 2005
SUBJECT: Texas Interim Construction Binder Changes Effective November 1, 2005- Procedural Rule P-16 (Amending 10-25-2005 P&P Memo)

Texas Department of Insurance Commissioner Mike Geeslin has by order officially adopted amendments that were considered during the rulemaking phase of the 2004 Texas Title Insurance Biennial Hearing. These changes are effective November 1, 2005. Link: http://www.tlta.com/Final%20Adoption%20Handout.pdf

In the order, Item 2004-20 amends existing Title Insurance Procedural P-16. Before the amendment P-16 provided:

> **P-16.** Mortgagee Title Policy Binder on Interim Construction Loan (Interim Binder) - The Mortgagee Title Policy Binder on Interim Construction Loan (Interim Binder) shall be used only with respect to interim construction loans in which it is contemplated in good faith that the Company issuing the Interim Binder shall be asked to issue its Mortgagee Policy or Policies; issued simultaneously with Owner Policy or Policies of Title Insurance or at the basic rate, on a permanent loan or loans covering the identical property (in one or more parcels) when improvements are completed, but which permanent loan or loans may be made by a mortgagee or mortgagees other than the mortgagee named in the Interim Binder. The use of such Interim Binder shall be limited to interim construction loans and pledges of the interim construction notes and liens. Construction loans may include sums advanced for acquisition of land and/or to take up, renew or satisfy prior existing liens on land upon which construction is to occur. Interim Binder shall not be issued on vacant lots or tracts, except in connection with the immediate construction of improvements thereon, nor shall such Interim Binder be issued after completion of improvements to which it relates, but this does not prohibit the issuance of Extensions after completion of improvements. In all cases not specifically enumerated in this rule, a Mortgagee Policy shall be used. The Company shall be required to show all subordinate liens in Schedule B-Part 2 of the Interim Binder, but a statement may be made therein that such lien(s) is subordinate.

Effective November 1, 2005, P-16 will provide (new changes underlined):

> **P-16.** Mortgagee Title Policy Binder on Interim Construction Loan (Interim Binder) - The Mortgagee Title Policy Binder on Interim Construction Loan (Interim Binder) shall be used only with respect to interim construction loans in which it is contemplated in good faith that the Company issuing the Interim binder shall be asked to issue its Mortgagee Policy or Policies; issued simultaneously with Owner Policy or Policies of Title Insurance or at the basic rate, on a permanent loan or loans covering the identical property (in one or more parcels) when improvements are completed, but which permanent loan or loans may be made by a mortgagee or mortgagees other than the mortgagee named in the Interim binder. The use of such Interim Binder shall be limited <u>solely</u> to interim construction loans and pledges of the interim construction notes and liens <u>wherein: (i) the obligor on the indebtedness is an original contractor who is also the record owner of the land upon which improvements are to be constructed; and, (ii) the security document for the</u>

indebtedness is not the form of a Mechanic's Lien Contract. Construction loans may include sums advanced for acquisition of land and/or to take up, renew or satisfy prior existing liens on land upon which construction is to occur. Interim Binder shall not be issued on vacant lots or tracts, except in connection with the immediate construction of improvements thereon, nor shall such Interim Binder be issued after completion of improvements to which it relates, but this does not prohibit the issuance of Extensions after completions of improvements. In all cases not specifically enumerated in this rule, a Mortgagee Policy shall be used. The Company shall be required to show all subordinate liens in Schedule B-Part 2 of the Interim Binder, but a statement may be therein that such lien(s) is subordinate.

The effect of this new language is to require a mortgage title policy instead of an interim construction binder (cost of binder presently only $237, the amount equal to the current minimum Basic Premium Rate) when papering a Texas construction loan mechanic lien contract transaction. This is the normal procedure now when doing true one time closes before the rule change. P-8 provides the procedure to issue the mortgagee title policy at the closing of the construction loan with "pending disbursement" and "mechanic lien" coverage exceptions:

P-8. Issuance of Policies Prior to Completion of Improvements
(b.) Mortgagee Policy
(1) When a Mortgagee Policy is issued prior to completion of improvements made under a mortgage given in whole, or in part, for the cost of improvements, the policy must contain the following exception under Schedule B: "Any and all liens arising by reason of unpaid bills or claims for work performed or materials furnished in connection with improvements placed, or to be placed, upon the subject land. However, the Company does insure the Insured against loss, if any, sustained by the Insured under this Policy if such liens have been filed with the County Clerk of ________________ County, Texas, prior to the date hereof." AND THE FOLLOWING "PENDING DISBURSEMENT" PARAGRAPH: "Pending disbursement of the full proceeds of the loan secured by the lien instrument set forth under Schedule A hereof, this policy insures only to the extent of the amount actually disbursed, but increases as each disbursement is made in good faith and without knowledge of any defects in, or objections to, the title up to the face amount of the policy. Nothing contained in this paragraph shall be construed as limiting any exception under Schedule B, or any printed provision of this policy." In the event the premium for the Mortgagee Policy is paid in installments pursuant to Rate Rule R-2(a), the following shall be added to the "Pending Disbursement" paragraph: "Notwithstanding the foregoing, liability hereunder shall only increase as down-date endorsements are issued pursuant to construction advances and as the corresponding fractional premium for the policy and the full premium for the down-date endorsement are paid."

(2) Upon the completion of the improvements on said property, the owner's acceptance thereof, and satisfactory evidence to the Company that all bills for labor and materials have been paid in full, the exception plus the "Pending Disbursement" paragraph in "b(1)" above may be eliminated from the policy and mechanic's and materialmen's lien coverage amended by issuance of the promulgated Endorsement form containing the applicable promulgated language covering said elimination and amendment. In addition to the above elimination, if a satisfactory survey made after the completion of improvements is furnished to the Company, survey coverage may be provided as set out in Rules R-16 and P-2, using the promulgated Endorsement form and containing the applicable promulgated language. (3) In the event a Mortgagee Policy is issued subsequent to the issuance of a Mortgagee Title Policy Binder on Interim Construction Loan, but prior to the improvements having been completed and accepted by the owner, and before satisfactory evidence that all outstanding bills have been paid or satisfied has been furnished to the Company issuing said Mortgagee Policy, said Mortgagee Policy must contain the following exception under Schedule B: "Any and all liens arising by reason of unpaid bills or claims for work performed or materials furnished in connection with improvements placed, or to be placed, upon the subject land. However, the Company does insure the Insured against loss, if any, sustained by the Insured under this Policy if such liens have been filed with the County Clerk of _____________ County, Texas, prior to the date hereof, except the following." (Here insert any exception necessary by reason of matters arising since the date of the Binder or delete the immediately preceding words "except the following".) AND THE FOLLOWING "PENDING DISBURSEMENT" PARAGRAPH: (if applicable) Pending disbursement of the full proceeds of the loan secured by the lien instrument set forth under Schedule A hereof, this policy insures only to the extent of the amount actually disbursed, but increases as each disbursement is made in good faith and without knowledge of any defects in, or objections to, the title up to the face amount of the

policy. Nothing contained in this paragraph shall be construed as limiting any exception under Schedule B, or any printed provision of this policy.

P-19 allows lenders to get the "pending disbursement" exception removed when the loan is fully funded:

> **P-19.** When a Mortgagee Policy is to be issued and the full proceeds of the loan have not been disbursed by the insured therein, the "Pending Disbursement" clause in Paragraph "P-8.b.(1)" must be inserted as an exception to said policy. When the full proceeds of the loan have been disbursed by the insured, the exception provided for above may be eliminated by the issuance of the promulgated endorsement form containing the appropriate language to effect such elimination.

R-16 is the applicable rate rule for getting the survey insured if not gotten by the owner simultaneously with the issue of the owner's title policy:

> **R-16.** Amendment of Exception as to Area, Boundaries, etc. - Applicable only as provided in Rules P-2 and P-8a.(2) - the Exception as to area and boundaries, etc., may be amended in an Owner or Mortgagee Policy upon the payment of an additional premium (in the case only of an Owner Policy) therefore equivalent to (1) 15% of the Basic Rate in an Owner Policy (T-1), or (2) 5% of the Basic Rate in a Residential Owner Policy of Title Insurance - One-To-Four Family Residences (Form T-1R), with a minimum premium of $20.00.

If not a "one time close" wherein the permanent mortgage note is executed as part of the closing a borrower must again pay for a new mortgagee title policy at the time of the permanent loan is closed (i.e. if a new note is made). However, according to rate rule R-8 the borrower can purchase a new mortgagee title policy for an amount equal to the then current minimum Basic Premium Rate, presently $237 (the cost of a binder) plus the cost for any additional coverage amount:

> **R-18. Creation of New Loan Contemplated by Construction Lender -** When a Mortgagee Policy has been issued insuring the lien of a construction loan to be fully taken up, renewed, extended or satisfied by a new loan, the premium on the Mortgagee Policy insuring the lien of the new loan shall be at the currently promulgated minimum policy Basic Premium Rate; provided however, if the Mortgagee Policy insuring the lien of the new loan is in an amount in excess of the amount of the Mortgagee Policy insuring the lien of the construction loan, the premium shall be equal to the greater of (i) the currently promulgated minimum policy Basic Premium Rate, or (ii) the excess of the currently promulgated Basic Premium Rate on the amount of the Mortgagee Policy insuring the lien of the new loan less the currently promulgated Basic Premium Rate on the amount of the Mortgagee Policy insuring the lien of the construction loan.

Owners should get their owner's title policy also at time of closing of the construction loan. Under Rate Rule R-5 there is only an additional $100 charge when an owner's and mortgagee title policy is issued simultaneously:

> **R-5.** Simultaneous Issuance of Owner and Mortgagee Policies
>
> A. Except as otherwise provided in this rule, when an Owner Policy and Mortgagee Policy(ies) are issued simultaneously, bearing the same date, and covering the same land, or a portion thereof, covered by the Owner Policy and covering no other land, the Owner Policy showing the lien(s) as an exception therein, the Owner Policy shall be issued at the Basic Rate, and the premium for the Mortgagee Policy(ies) shall be $100.00 each. Should the amount of the Mortgagee Policy(ies) exceed the amount of the Owner Policy, the Basic Rate shall be charged for the Owner Policy, and the premium for the Mortgagee Policy(ies) shall be at the Basic Rate plus $100.00 for each Mortgagee Policy, less the Basic Rate for the Owner Policy. (In the application of this rule, if an Owner Policy has been previously issued covering the identical property to be covered by the Owner Policy to be issued and provided that the Owner Policy is to be issued in accordance with P-8.a and within four (4) years after the date of the previously issued Owner Policy and that there has

been no change in ownership of such property, credit shall be given against the premium of the Owner Policy to be issued for the amount of the premium paid by any party for said previously issued Owner Policy. In no event shall the premium collected for such Owner Policy be less than the regular minimum promulgated rate for an Owner Policy.)

THIS RULE MAY NOT BE APPLIED in connection with the issuance of a series of Mortgagee Policies issued by reason of notes being apportioned to individual units in connection with a master policy covering the aggregate indebtedness, including improvements. Individual Mortgagee Policies must be issued at the Basic Rate.

B. When an Owner Policy meeting the requirements of Rule R-2(b) is issued in the manner provided in Rule P-8.a., and is issued simultaneously with a Mortgagee Policy described in Rule R-2(a), bearing the same date, and covering the same land covered by the Mortgagee Policy, or a portion thereof, and covering no other land, the premium for the Owner Policy shall be $100.00. Should the amount of the Owner Policy exceed the amount of the Mortgagee Policy, the premium for the Owner Policy shall be at the Basic Rate plus $100.00 less the Basic Rate (to be paid as provided in Rule R-2(a)) for the Mortgagee Policy. In the application of this rule, if an Owner Policy has been previously issued covering the identical property to be covered by the Owner Policy to be issued and provided there has been no change in ownership of such property, credit shall be given against the premium for the Mortgagee Policy to be issued for the amount of the premium paid for said previously issued Owner Policy.

C. An insured under an existing Owner Policy not issued containing P-8 exceptions may, after completion of improvements on the property insured, turn in the existing Owner Policy and receive credit for the premium previously paid when purchasing a new Owner Policy in an amount greater than the existing Owner Policy. A Mortgagee Policy may be simultaneously issued for the premium established in R-5.A. In no event may the Owner Policy be issued for less than the minimum promulgated basic premium rate. This subsection applies only if (1) the land is residential property, (2) the existing Owner Policy covered the identical land to be covered by the new Owner Policy to be issued, (3) the new Owner Policy is to be issued within four (4) years after the date of the existing Owner Policy, and (4) there has been no change in ownership of such land.

Survey coverage (5% addition to the Basic Rate for One-To-Four Family Residences) can be paid only once if paid for in the owner's title policy under a simultaneously issued owner and mortgagee title policy:

R-16. Amendment of Exception as to Area, Boundaries, etc. - Applicable only as provided in Rules P-2 and P-8a.(2) - the Exception as to area and boundaries, etc., may be amended in an Owner or Mortgagee Policy upon the payment of an additional premium (in the case only of an Owner Policy) therefore equivalent to (1) 15% of the Basic Rate in an Owner Policy (T-1), or (2) 5% of the Basic Rate in a Residential Owner Policy of Title Insurance - One-To-Four Family Residences (Form T-1R), with a minimum premium of $20.00.

Summary

This amendment to this rule closes a "loophole" that had become the rule rather than the exception over the last 20+ years. If a mortgagee title policy is issued upfront simultaneously with the borrower's owner's title policy, the effect will be to only cause the borrower to pay more of their normally required lender title coverage upfront and less on the later permanent loan. The total should not be very different. If not issued simultaneously, it will cause substantially more for the owner's title policy and the required lender title insurance coverage.

Effective for loans closing on or after November 1, 2005, mortgagee title policies will be required instead of interim construction binders in those transactions using a Texas mechanic lien contract.