CHICAGO TITLE INSURANCE COMPANY

TOPIC: Loan Modifications – Watch Out for the Fix that Fails

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INTRODUCTION

The current weak economy has created a significant increase in the number of loan modifications being entered by borrowers and lenders and insured by title insurers. As a result of decreasing property values and borrowers with diminishing incomes, lenders are often faced with the choice of foreclosing on property that is no longer worth the amount owed or negotiating a modification agreement. In addition, the flood of foreclosures has resulted in lenders purchasing more and more properties at foreclosure. The crisis started with residential borrowers but has since moved to commercial borrowers. A number of commercial borrowers have had to agree to principal reductions in order to obtain a modification. While loan modifications help avoid foreclosures, allow borrowers to stay in their homes and businesses to continue operating, there are a number factors to consider prior to entering into a modification. The effect of a modification on the priority of the lien of a deed of trust is perhaps the greatest factor that lenders, borrowers, their counsel, and title insurers need to consider. Unfortunately, that effect is often the hardest to predict under North Carolina law. This paper will focus on the various modifications and their affect on priority.

BASIC LAW AND PRIORITY ISSUES

a. Contract Requirements

As loan agreements and deeds of trust are contracts between borrowers and lenders, modifications of these documents must satisfy the requirements of a valid contract. Daniel Boone Complex, Inc. v. Furst, 43 N.C. App. 95, 258 S.E. 2d 379 (1979). The modification must comply with the Statute of Frauds, be in writing, recite consideration (can be forbearance or extension), be signed by the parties, and be delivered and accepted. NCGS Section 22-2. In addition, a modification should identify the loan agreement and deed of trust, the parties, and include a statement that the original agreement is continued, rather than terminated and replaced. In order to be effective notice against third parties, a modification must be placed of record in the county where the secured property is located. As a result, the modification must comply with recording requirements, such as proper execution and acknowledgment.

In some cases, the modification of the loan agreement may be so minor that modification and recordation of the deed of trust is not required. In these cases, the deed of trust must contain a clause that it covers any modifications to the loan agreement. Whether or not an endorsement to an existing title policy addressing an unrecorded modification should or can be obtained must be discussed with counsel of the title insurer.

b. Novation

From a priority standpoint, a lender's greatest fear is a modification that is deemed a novation. A novation occurs when the original debt of a loan is considered discharged and is replaced by a new debt. North Carolina case law defines a novation as "a substitution of a new contract or obligation for an old one which is thereby extinguished … novation implies the extinguishment of one obligation by the substitution of another." Tomberlin v. Long, 250 N.C. 640 at 644, 109 S.E. 2d 365 at 368 (1959). "The essential requisites of a novation are a previous valid obligation, the agreement of all parties to a new contract, the extinguishment of an old contract, and the validity of a new contract." Anthony Marani Co. v. Jones, 165 NC App. 266 at 269, 598 S.E. 2d 393 at 395 (2004) (quoting Tomberlin, 250 N.C. at 644, 109 S.E. 2d at 367-68).

In Anthony Marano Co., a year after executing a first note to his lender, the defendant executed a second "demand note" to the same lender, which changed the terms of the original debt by reducing the interest rate. The court held the change was only a modification, and did not extinguish and replace the original obligation. Anthony Marano Co., 165 N.C. App. at 269, 598 S.E. 2d at 395. It is generally accepted that the advancement of new funds not covered by the original note/deed of trust, will result in a new priority for only those new funds.

The result of a novation is that the original lien priority is lost as to the entire debt. The recordation of the modification establishes a new priority for the "new" debt. If there are any intervening matters (even potential intervening matters), then the modification must be considered to determine whether or not it creates a novation of the original loan agreement. The courts will consider the intent of the parties in determining whether or not a novation occurred. Lowe v. Jackson, 263 N.C. 634, 140 S.E. 2d 1 (1965).

c. Continuation

In most cases, a properly drafted loan modification will create a continuation of the original loan agreement and debt. To help assure this status, the modification should include a statement that it continues the original agreement and debt and does not extinguish or replace said agreement or debt. This is particularly important when the entire agreement is being "Restated." As mentioned above, the courts will consider the intent of the parties in determining whether a modification is a novation or continuation. Lowe, 263 N.C. 634, 140 S.E. 2d 1 (1965). A statement of intent is only a consideration and not determinative.

d. Priority

As mentioned above, a novation will replace the original priority of the lien with the priority established by the recordation of the modification. The effect of a modification that is considered a continuation may be controlled by whether or not the modified terms materially prejudice the interests of junior lienholders. If the modification does not materially prejudice the interests of junior lienholders, then the original priority should remain completely intact. North Carolina case law is not entirely clear on what happens if material prejudice exists. Two theories do exist.

First, the portion of the debt that results under the modified terms only has priority as of the recordation of the modification. The debt created under the original terms maintains its original priority. This theory has not been expressly adopted in NC, but the reasoning has been followed in some cases, such as McNeary's Arborists, Inc. v. Carley Capital Group. In that case, the time period for making future advances under a deed of trust was extended by a modification after the expiration of the original date for advancements. An intervening lienholder successfully challenged the priority of those advances made after the expiration of the original date to make advances. The Court found that only those obligations incurred during the original term related back to the recordation date. Those obligations incurred under the extended term were junior to the intervening lienholder's rights. McNeary's Arborists, Inc. v. Carley Capital Group, 103 N.C. App. 650, 406 S.E. 2d 644 (1991).

Under the second theory, the existence of a provision in the original loan agreement and deed of trust which reserves the right to modify allows modifications to maintain the original priority for all debt, whether created by the terms of original agreement or by the modification. This theory is discussed in The Restatement (Third) of Property: Mortgages Section 7.3. The Restatement provides:

> (b) If a senior mortgage or the obligation it secures is modified by the parties, the mortgage as modified retains priority as against junior interests in the real estate, except to the extent that the modification is materially prejudicial to the holders of such interests and is not within the scope of a reservation of right to modify as provided in Subsection (c).
>
> (c) If the mortgagor and mortgagee reserve the right in a mortgage to modify the mortgage or the obligation it secures, the mortgage as modified retains priority even if the modification is materially prejudicial to the holders of junior interests in the real estate, except as provided in Subsection (d).

Subsection (d) allows the mortgagor to issue to the mortgagee a notice terminating the right to modify. Once terminated, prejudicial modifications will no longer retain the original priority.

Case law from NC and other jurisdictions has yet to take a definitive position on the Restatement approach, particularly Section 7.3 (c).

e. Prejudice

Due to the lack of a definitive approach under NC law, lenders and title insurers must consider prejudicial matters to create new priority for the new terms. The most common modifications involve one or a combination of a maturity date extension, additional funds, interest rate change, principal reduction, or additional property as security. Each item below should be considered for potential prejudicial effect.

i. Maturity Date Extension – Many current modifications are negotiated during a forbearance period and contain an extension of the maturity date. Generally, the extension alone is not considered to be prejudicial to the interests of a junior lienholder. They do not create an additional burden on the borrower. The extension often prevents and reduces the likelihood of foreclosure which would extinguish the lien interest of the junior lienholder.

ii. Additional Funds – Extending additional funds to the borrower places an additional burden on the borrower and will decrease the potential equity of the secured property. As a result, less equity may be available following the foreclosure of the first lien. This is prejudicial to a junior lienholder and will result in the additional funds only having priority from the date of recordation of the modification that creates the new debt.

    It is important to note that additional funds advanced pursuant to a note and deed of trust which satisfy the future advance requirements of NCGS Section 45-68, et seq., retain the priority of the deed of trust as recorded. Other "future advance" issues are discussed below.

iii. Interest Rate Change – Whether an interest rate is increased or decreased will determine whether or not it is prejudicial to the interest of a junior lienholder. In the <u>Anthony Marano Co</u>. case, the interest rate was decreased and the court found no novation, nor did it indicate any prejudicial affect on the intervening lienholder. It is generally accepted that a decrease in the interest rate will not cause additional burden on the borrower.

    Conversely, an increase in interest rate will place additional burden on the borrower. As a result, the increase is theoretically prejudicial to the interests of a junior lienholder. Other jurisdictions have held that any interest accrued pursuant to the amount of the increase will have a priority from the date of the recordation of the modification while the principal and interest accrued under the original agreement will remain the same. <u>Bank of Searcy v. Kroh, 114 S.W.2d 26 (Ark.1938);</u> <u>Fleet Bank of New York v. County of Monroe Industrial Development Agency, 637 N.Y.S.2d 870 (N.Y.App.Div.1996);</u> It is not clear whether or not NC will follow these precedents.

iv. Principal Reduction – Numerous builders/developers have agreed to a reduction in the maximum amounts allowed under an equity line in order to obtain an extension of the maturity date. As the reduction lessens the potential burden upon the borrower, it is not prejudicial on the interests of a junior lienholder.

v. Additional Property as Security - Borrowers are often agreeing to add additional real property as security under a note and deed of trust. The property may be added to obtain an extension of a maturity date, obtain additional funds, be included as a purchase of separate real property, or obtain a modification of other terms. While the requirement of additional security may be a burden on the borrower (See Additional Property as Security/Preferences below), it may reduce the overall burden on the originally secured property. From the standpoint of a lienholder with only an interested in the original property, this may not be prejudicial. That said, many lienholders have an interest in the overall financial status of a borrower as the interests can be reduced to judgments which potentially attach to all of the borrower's real property.

vi. Combinations of Changes – Most modifications involve a combination of the changes discussed above. The most common modification during 2009 for this author involved an extension of maturity date, reduction of principal, and an increase in the interest rate. This is often referred to as the "No cash out refinance." How a court will weigh the existence of both a prejudicial change (increased interest rate) and beneficial change (extension) is unclear. The safest approach for lenders and title insurers is to treat any modification as creating a new priority for any new amounts resulting from the change. Additional funds will always have a new priority, unless advanced pursuant to a valid future advance deed of trust.

f. Content of Modification

In order to avoid a novation, partial loss of priority resulting from a prejudicial change, or loss of liability of guarantors, some specific provisions should be included in a modification. While not an exhaustive list, some such provisions include:

i. Not a Novation – A statement that the parties do not intend the modification to be a novation and that the original debt, liens and security continue as modified.

ii. Consent – A statement that all parties, including obligors, guarantors, endorsers … consent to the modification. If possible, the consent of a junior lienholder should be obtained.

iii. Original Loan Documents – Should be identified and their effectiveness as modified acknowledged. In addition, any default under the current loan agreements should be described and remedies reserved.

iv. Consideration – The consideration for the modification must be stated. Forbearance may be valid consideration

v. Existing Debt – The current amount of outstanding debt should be stated.

vi. Future Modifications – A statement that authorizes future modifications to the loan agreement and deed of trust.

g. Subordinated Lienholders

In many cases, an initial lender has subordinated their interest in the real property to that of a later lender and thus become a junior lienholder. A later modification of the first priority deed of trust may be limited by the terms of the subordination agreement. This type of subordination occurs most often when a seller takes back a purchase money mortgage but subordinates to a construction loan. Problems can arise when the parties attempt to modify the construction loan, perhaps into a permanent loan, and the seller/purchase money lender refuses to consent to the modification.

In MCB Limited v. McGowan, 86 N.C. App. 607; 359 S.E. 2d 50 (1987), a seller took back a purchase money mortgage that included provisions requiring the lender to subordinate the lien to future construction or permanent financing. The seller later refused to subordinate to a construction deed of trust. The buyer/borrower filed suit to force the subordination and recover damages. The deed of trust at issue stated that seller would subordinate its position upon the borrower's request "in such amount as may be reasonably requested by borrower." MCB Limited, at 612. The court found "this clause void for indefiniteness as a matter of law." Id. Note – The MCB Limited case was decided prior to the adoption of NCGS Section 39-6.6, which established statutory parameters for a valid subordination agreement.

Courts tend to favor purchase money lenders, particularly if the modification of the first priority loan is prejudicial. Whenever possible or practical, consent of the purchase money lender to the modification should be obtained. In addition, the subordination agreement should include provisions that the purchase money lender is subordinated not only to the original loan, but also any extensions, modifications or renewal of said loan.

h. Future Advances

As noted above, any funds advanced post closing pursuant to a note and deed of trust which satisfy the future advance requirements of NCGS Section 45-68, et seq., are not considered new funds. Priority of these advanced funds is as of the date and time of recording of the deed of trust. Problems do exist for a modification to the future advance terms of such a deed of trust. As noted above in the discussion of the McNeary's Arborists, Inc., case, modifications to the future advance terms can create a prejudicial effect and cause funds advanced pursuant to said modification to have a priority as of the date of recordation of the modification.

Also problematic are advances or new loans made outside the terms of the future advance provisions. Almost all deeds of trust include a clause that it secures any extensions, modifications, and renewals of the subject note. The effectiveness of such a clause likely turns on the nature of the modification in relation to NC statutory requirements for a future advance deed of trust. If a later modification changes the terms in such a manner that they do not comply with the statutory requirements, then it is likely that new priority is created for any advances made pursuant to the modification.

Some deeds of trust include clauses that any future obligation incurred by the borrower to the lender is secured by the deed of trust. The effectiveness in securing future obligations has been questionable and point of contention among title insurers. In 2009, NCGS Section 45-68 was modified to address this issue among others. Subsection (1b) now states:

> Future advances and future obligations that may from time to time be made from time to time be made or incurred under the security instrument, but only if the security instrument shows all of the following:
>
> a. That the security instrument is given wholly or partly to secure future advance and/or future obligations that may be made or incurred under the security instrument.
> b. The maximum principal amount that may be secured by the security instrument at one time.
> c. The period within which future advances may be made and future obligations may be incurred, which period shall not extend more than 30 years beyond the date of the security instrument or, if the security instrument is not dated, the date the security instrument is registered.

An argument can be made that any future obligation which falls within the three requirements above complies with the statute. A deed of trust to be used for future obligations would create issues with identifying valid debt to be paid off at later closings. Also, lenders may accidently cancel all debts of a borrower by marking a deed of trust satisfied. Unfortunately, these issues have not been considered by NC courts.

i. Additional Property as Security/Preference

A lender may require additional real property of the borrower be added as security under a loan modification. If this is done without additional funds being advanced or if the funds advanced are significantly less than the value of the new property, then the modification may be deemed a preferential transfer under Section 547 of the Bankruptcy Code. As a result, a bankruptcy trustee could set aside the conveyance if the borrower files for bankruptcy within 90 days.

A modification which cross-collateralizes existing loans may also create a potential preferential transfer. As part of a modification to parent entity's loan agreement, loans to subsidiary or related special purpose entities are often required to be cross-collateralized with the parent's loan agreement. The result is the subsidiary has pledged its property for additional debt without receiving consideration. This creates potential to be set aside if bankruptcy is filed. The General Growth Properties bankruptcy case has further complicated this case by allowing subsidiaries to be rolled up into a parent's bankruptcy case. On August 11, 2009, the United States Bankruptcy Court for the Southern District of New York issued a decision denying several motions to dismiss numerous special purpose entities (subsidiaries) in the bankruptcy of General Growth Properties and its various subsidiaries.

As a result of the threat of preferential transfers, title insurers have to use extreme caution with regard to creditors' rights coverage and modifications. Creditors' rights coverage in these situations is extremely risky, has potential for large claims, and requires extra investigation prior to agreeing to provide the coverage. Modifications will be reviewed to determine whether a creditors' rights scenario exists and whether coverage should be issued or specifically excepted. (See discussion of ALTA 11 below.)

j. Bankruptcy

It is important to note that various cram down and lien stripping provisions do exist in the Bankruptcy Code and their effect is a modification of the loan agreement. Their existence is often the reason for a lender's willingness to enter a workout. An in depth discussion of these provisions is beyond the focus of this paper.

k. Guarantees and Assumptions

A modification to a loan agreement may release the obligations of a guarantor to the extent that guarantor is prejudiced by the modification if the guarantor is not given notice or does not consents to said modification. The general rule in North Carolina is that a material alteration of a contract between a principal debtor and creditor without the guarantor's consent will discharge the guarantor from its obligation. Kirkhart v. Saieed, 98 N.C. App. 49, 54, 389 S.E.2d 837, 840 (1990). The facts of each case will determine whether or not guarantors are released from their obligations. Lenders should include a waiver of notice of modifications in the loan agreement, obtain consent or at least give notice to the guarantor of a modification.

Similarly, where a loan agreement has been assumed and the original borrower has not been released from their obligations under the loan agreement, a modification may be entered by either the original borrower or their transferee. If entered into by the transferee who assumed the debt, the majority of jurisdictions find that the original borrower is released (at least to the extent they would incur damage), if the lender has knowledge of the assumption and does not obtain consent for the modification. If the original borrower enters into the modifications, then the transferee is bound by the terms of the modification.

l. Proper Parties

As a result of assignments of loans pursuant to loan securitization and purchases of failed banks, determining the proper party to execute a modification for the lender can be difficult. This problem is further complicated, since assignments do not have to be recorded. Care should be given to confirming the party executing the modification is authorized to act on behalf the lender that owns the note.

Failed banks are placed in the receivership of the FDIC. The FDIC will sell the assets, including beneficial loan agreements, to other banks pursuant to the terms of a standard FDIC Purchase and Assumption Agreement. Some purchasing banks have sought to treat the Purchase and Sale Agreement as conveying them title to real property interests of the failed bank. They refer to section 3.1 of the Purchase and Sale Agreement which states:

> **3.1** Assets Purchased by Assuming Bank, Subject to sections 3.5 and 3.6[which describe assets not purchased, such as Bank premises as well as properties deemed essential to the Receiver], the Assuming Bank hereby purchases from the Receiver, and the Receiver hereby sells, assigns, transfers, conveys, and delivers to the Assuming Bank, all right, title, and interest of the Receiver in and to all of the assets (real, personal and mixed, wherever located and however acquired) of the Failed Bank whether or not reflected on the books of the Failed Bank as of Bank Closing, as set forth in Schedule 3.1 attached hereto and incorporated herein. Schedule 3.1 sets forth

> certain categories of Assets. Such schedule is based upon the best information available to the Receiver and may be adjusted as provided in Article VIII. Assets purchased hereunder by the Assuming Bank subject to all liabilities for indebtedness collateralized by Liens affecting such Assets to the extent provided in Section 2.1.

The problem is other provisions of the Purchase and Sale Agreement clearly describe the need for documents of conveyance.

> 3.3 Manner of Conveyance; Limited Warranty; Nonrecourse; Etc. The conveyance of all assets, including real and personal property interests, purchased by the assuming bank under this agreement shall be made, as necessary, by receiver's deed or receiver's bill of sale, "as is", "where is", without recourse, and, except as otherwise specifically provided in this agreement, without any warranties whatsoever with respect to such assets, express or implied, with respect to title, enforceability, collectibility, documentation or freedom from liens or encumbrances (in whole or in part), or any other matters

> 9.2 Additional Title Documents The Receiver, the Corporation [the FDIC] and the Assuming Bank each agree, at any time, and from time to time, upon the request of any party hereto, to execute and deliver such additional instruments and documents of conveyance as shall be reasonably necessary to vest in the appropriate party its full legal or equitable title in and to the property transferred pursuant to this Agreement or to be transferred in accordance herewith. The Assuming Bank shall prepare such instruments and documents of conveyance (in form and substance satisfactory to the Receiver) as shall be necessary to vest title to the Assets in the Assuming Bank. The Assuming Bank shall be responsible for recording such instruments and documents of conveyance at its own expense.

The Purchase and Sale Agreement does not act as a conveyance of real property interests or satisfy any state laws regarding conveyances of real property. With regard to real property interests, title insurers will not accept the new bank as a successor-in-interest without documentation, such as a power of attorney, from the FDIC.

m. Home Affordable Modification Program (HAMP)

Part of the Obama's Administration's Financial Stability Plan includes the Home Affordable Modification Program. For qualifying borrowers, monthly mortgage payments are reduced in an effort to keep them in their homes.

The target monthly payment is an amount equal to 31% of Front–End Debt-to-Income (DTI) ratio. The US Treasury guidelines define Front-End DTI as the ratio of PITIA to monthly income. PITIA includes principal, interest, taxes, insurance, and homeowner association and/or condominium fees. The lender is initially asked to reduce payments to match a 38% Front-End DTI ratio. The US Treasury will match the further reductions to reach the 31% Front-End DTI ratio target. To be eligible a loan must have been originated prior to January 1, 2009. In order to qualify a borrower must meet the following requirements:

1. The home must be owner-occupied, single family 1 to 4 unit property (including condominium, cooperative, and manufactured home affixed to a foundation and treated as real property under current state law).
2. The home must be the primary residence (verified by tax return, credit report, and other documentation such as utility bills).
3. The home may not be investor-owned.
4. The home may not be vacant or condemned.
5. Borrowers in a current bankruptcy case are not automatically eliminated from consideration for HAMP.
6. Borrowers in active litigation regarding the mortgage loan can qualify for a modification without waiving any legal rights.
7. First lien loans must have an unpaid principal balance (prior to capitalization of the arrears) equal to less than:
   a. 1 Unit—$729,750
   b. 2 Units–$934,200
   c. 3 Units–$1,129,250
   d. 4 Units–$1,403,400

The program follows three steps, in the following order, to reach the target of 31% Front-End DTI ratio:

1. Interest rates are reduced, subject to a 2% floor. The reduced rate will remain in place for the remainder of the loan term, unless the rate is reduced below the floor. Rates reduced below the floor will remain in place for five years and then be increased by 1% per year until the cap is reached, at which point the rate is fixed.
2. Mortgage term may be extended up to 40 years.
3. Forbearance of principal may occur, if the above two options do not reach the target. The principal would become due upon maturity or other determination of the loan.

Once the modification is determined, the borrower engages in a 90 day (three payments) trial period. If current at the end of the trial period, the modification is then effective.

In addition to matching a portion of the reduction as described above, lenders may also receive a $1,500 bonus incentive will modified loans stay current.

More information regarding HAMP can be found at the following websites:

http://www.freddiemac.com/sell/single/news/newsletter/2009/04/bulletin_2009_6.html

http://www.ustreas.gov/press/releases/reports/modification_program_guidelines.pdf

https://www.efanniemae.com/sf/servicing/pdf/loanworkoutfactsheet.pdf

TITLE INSURANCE

a. Original Policy

Most deeds of trust that are the subject of loan modifications are already insured by an existing loan policy of title insurance. In order to have the modification included as part of the coverage, the existing policy must be endorsed or a new policy must be issued. The existing policy does not provide coverage as the modification would be a post policy matter. In addition, Condition 9 (c) of the 2006 ALTA Loan Policy states:

> *The Company shall not be liable for loss or damage to the Insured for liability voluntarily assumed by the Insured in settling any claims or suit without prior written consent of the Company.*

If the modification creates defects in the insured title interest, then the title company may have a defense to a later claim under the policy. If the title company consents to the modifications, for example by issuing an endorsement, then they would not have a defense based on this Condition.

b. ALTA Form 11 Endorsement

The ALTA 11 (Attached as Exhibit A) provides lenders coverage for mortgage modifications. The ALTA 11 does not change the effective Date of Policy on the original policy, but rather links certain coverages to a Date of Endorsement. These coverages insure against loss or damage resulting from the lien of the mortgage:

i. Being Invalid or unenforceable upon the title at the Date of Endorsement as a result of the modification; and
ii. Lacking priority at the Date of Endorsement over defects in, or liens or encumbrances on the title, except those shown in the policy, prior endorsements, and specified on the ALTA 11 (These could include mechanic lien or survey matters).

As discussed above in “Additional Property as Security/Preferences” section, creditors’ rights coverage is a significant concern for title insurers. The modification may be considered a new transfer that is subject to treatment as a preferential transfer. As a result, the ALTA 11 contains language which excepts coverage from loss or damage resulting from the modification being deemed a fraudulent conveyance, a fraudulent transfer, or a preferential transfer under federal bankruptcy, state insolvency, or other creditors' rights laws.

To issue an ALTA 11, a title insurer will require that the following be satisfied:

> Receipt of (1) verification of recording of satisfactory modification of the deed of trust insured ("Modification") which Modification has been properly executed by (a) the current record owner(s) of the Land, and spouses, if any; (b) the current record owner(s) of the Indebtedness evidenced by the deed of trust insured; and (c) the current trustee or substitute trustee of the insured deed of trust; and (2) attorney's certification of Title to the Land through and including the date and time of recording of the Modification. If the Modification, attorney's certification or other information provided to Company reveals anything which, as of Date of Endorsement, may impair the validity, enforceability or priority of the deed of trust insured (including potential mechanics' and materialmen's liens or rights of tenants in possession), those matters will be shown in the endorsement unless (1) resolved to the satisfaction of Company; or (2) in the case of a superior interests, subordinated to the lien of the insured deed of trust as modified. If survey coverage is required through Date of Endorsement, Company must be provided with
> (1) a current and accurate survey of the Land if there have been improvements or alterations subsequent to Date of Policy; or
> (2) a Survey Affidavit if there have been no improvements or alterations since Date of Policy.

c. Date Downs

In some instances a modification can be insured as part of a date down endorsement. Date down endorsements change the effective Date of Policy. "Date of Policy" is a defined term under the 2006 ALTA Loan and Owner's policies. When the Date of Policy is to be changed, title insurers will give special consideration to endorsement coverages. ALTA endorsements reference Date of Policy: "The Company insures against loss or damage sustained in the event that, at Date of Policy …." Without proper underwriting, an unintentional extension of coverage granted by the policy or an endorsement, such as zoning, survey, or mechanics' liens, might occur. As a result, some existing coverages may be carved out of a date down endorsement (such as creditors' rights) or limited to a specified date such as the original effective date of the policy.

Requirements for a date down endorsement include an update of title and information, certifications, and/or documentation to extend endorsement coverages. Additional exceptions or subordinate matters may be added to the policy.

CONCLUSION

Much of the law in North Carolina regarding modifications of loan agreements and deeds of trust is unsettled. Law regarding novations, partial changes to priority, and prejudicial effects on junior lienholders is all very factually driven. The concept of first to the court house wins (establishes their priority and that priority cannot be changed by later actions of other lienholders) still appears to hold strong. However, the use of dragnet and other rights to modify in the original recorded documents is clearly gaining momentum. In order to protect the modifying lienholder's interest, consideration should always be given to whether or not a junior lienholder is being prejudiced. If so, extra caution should be employed to maintain the desired priority.

ALTA ENDORSEMENT 11-06

Attached to Loan Policy No.

Issued by

CHICAGO TITLE INSURANCE COMPANY

The Company insures against loss or damage sustained by the Insured by reason of:

1. The invalidity or unenforceability of the lien of the Insured Mortgage upon the Title at Date of Endorsement as a result of the agreement dated ___________________, recorded ______________________________ ("Modification"); and

2. The lack of priority of the lien of the Insured Mortgage, at Date of Endorsement, over defects in or liens or encumbrances on the Title, except for those shown in the policy or any prior endorsement and except:

   (a) ____
   (b) ____
   (c) ____

This endorsement does not insure against loss or damage, and the Company will not pay costs, attorneys' fees, or expenses, by reason of any claim that arises out of the transaction creating the Modification by reason of the operation of federal bankruptcy, state insolvency, or similar creditors' rights laws that is based on:

1. the Modification being deemed a fraudulent conveyance or fraudulent transfer; or

2. the Modification being deemed a preferential transfer except where the preferential transfer results from the failure

   a. to timely record the instrument of transfer; or

   b. of such recordation to impart notice to a purchaser for value or to a judgment or lien creditor.

DATE OF ENDORSEMENT: ________________________________

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.

CHICAGO TITLE INSURANCE COMPANY

____
Authorized Signatory

Note: This endorsement shall not be valid or binding until signed by an authorized signatory.

ALTA Endorsement - Form 11-06 (Mortgage Modification) (Adopted 6/17/06)