

Title Insurance - Last Dollar Endorsements and Capping The New York Mortgage Tax

*By Michael J. Berey
Senior Underwriting Counsel and Vice-President
First American Title Insurance Company of New York*

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The form of lender's title policy endorsement known nationally as the Last Dollar Endorsement has been available for loan policies of title insurance insuring mortgages on New York property since January 31, 1995. Afforded for some time to lenders making loans secured by mortgages in other states, it should be of particular interest to lenders who take mortgages on property in New York.

The past few years the real estate market has taken on a more national focus and a single parcel of commercial or multi-family real estate will often be only one of a multiplicity of assets afforded as collateral for a loan. Since the amount of the indebtedness may dwarf the value of any single site in the borrower's realty portfolio, the securing of the entire obligation by one property in such a situation may be considered inequitable to the borrower, particularly in New York City with its high rate of mortgage recording tax on commercial and multi-family property of up to \$2.75 for each \$100.00 of principal debt or obligation secured.

The mortgage recording tax is also an important concern for both lender and borrower when a New York site is only intended to be minor security for a loan significantly greater than the value of that asset and other non real estate collateral is a more integral part of the lender's security.

Securing less than the entire obligation by the New York site has, however, not always been a viable option or has been done reluctantly due to a concern that a title insurer would reduce the amount of liability under the lender's policy insuring the New York mortgage dollar for dollar as payments are made on the total indebtedness even though the amount of indebtedness remaining outstanding would be in excess of the principal secured by the insured New York mortgage. Paragraph 9(b) of the Conditions and Stipulations of the now required 1992 ALTA Loan Policy (the form of policy issued in use in New York since September 1, 1993) under the heading "Reduction of Insurance; Reduction Or Termination of Liability", provides that "()ayment in part by any person of the principal of the indebtedness, or any other obligation secured by the insured mortgage...to the extent of the payment,...shall reduce the amount of insurance pro tanto...".

The Last Dollar endorsement, designed to address that concern was approved for filing with the New York State Department of Insurance for use in New York effective January 31, 1995. It modifies the terms of the title policy's Conditions and Stipulations by providing that "in calculating, for the purposes of the Policy, the amount of outstanding indebtedness secured by the mortgage and covered by the Policy, payments made to reduce the amount of said indebtedness (except payments



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made by the Company pursuant to provisions of the Policy) shall be deemed applied first to the portion of said indebtedness that is in excess of the Policy limit set forth in Schedule A of this Policy", the "Policy limit" being the amount of insurance which is the same as the principal sum secured by the New York mortgage.

For a Last Dollar endorsement to be issued the New York mortgage must include text to the effect that payments made to reduce the overall loan must be last applied to reduce the indebtedness which the mortgage secures. This approach will also serve to limit exposure for the payment of additional mortgage recording tax on secured commercial revolving credit and non-revolving loans as discussed below.

The charge for the Last Dollar endorsement is ten percent (10%) of the mortgage premium computed without adjustment for credits or discounts otherwise available under the Title Insurance Rate Service Association ("TIRSA") Rate Manual. For example, the additional charge for this endorsement when issued in connection with insuring a mortgage in New York City securing a principal amount of \$5,000,000 is \$1,392.00; for a mortgage securing the principal amount of \$10,000,000 the additional charge is \$2,572.00. Issuance of the endorsement by an agent of a title insurance company requires the prior approval of its underwriter.

As noted above, providing in a New York mortgage securing a commercial revolving line of credit that payments are to be last applied to reduce the indebtedness which the mortgage secures can also work to limit liability for mortgage recording tax.

Ordinarily, a lender in a multiple site transaction not involving revolving credit intending to secure the full amount of the loan by a New York mortgage can limit the mortgage recording tax payable in New York by merely placing a cap on the maximum amount secured. It does so by including in the mortgage a so called maximum amount clause reciting that notwithstanding anything contained in the mortgage to the contrary the maximum amount of principal indebtedness secured at the time of execution or which under any contingency may become secured at any time after execution of the mortgage is the specified capped amount of principal indebtedness. Section 648.2 of Subchapter N ("Mortgage Recording Taxes") of Chapter III of Title 20 of the Official Compilation of Codes, Rules and Regulations of the State of New York issued November 21, 1994 sets forth the following as being text acceptable to the New York State Department of Taxation and Finance:

"Notwithstanding anything contained herein to the contrary, the maximum amount of principal indebtedness secured by this Mortgage at the time of execution hereof or which under any contingency may become secured by this Mortgage at any time hereafter is \$_____, plus (a) taxes, charges or assessments which may be imposed by law upon the premises; (b) premiums on insurance policies covering the premises; (c) expenses incurred in upholding the lien of this Mortgage, including, but not limited to (1) the expenses of any litigation to prosecute or defend the rights and lien created by this Mortgage; (2) any amount, cost or charges to which the Mortgage becomes subrogated, upon payment, whether under recognized principles of law or equity, or under express statutory authority and (3) interest at the default rate (or regular interest rate)".



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Assume, however, the following state of facts. A borrower enters into a revolving credit line for \$40,000,000 all of which is or becomes fully advanced. The New York mortgage secures the credit line to a maximum amount of \$20,000,000 but it does not state that the amount secured thereby is repaid last. One half of the credit line is subsequently repaid and re-advanced. Since the New York mortgage secured one - half of the original principal amount, the mortgage may be deemed by the Department of Taxation and Finance to be reduced by one - half of the repayment and to secure a pro rata amount of the re-advance on which mortgage recording tax would be payable. In this example, mortgage tax on an advance of \$10,000,000 might be due.

This problem would be resolved by taking the same approach as that which would enable issuance of the Last Dollar Endorsement . A 1993 Advisory Opinion of the New York State's Taxpayer's Service Division of the Department of Taxation and Finance dealt with a \$50,000,000 commercial revolving line of credit secured only in part by a mortgage on New York property for \$1,400,000 (the "Secured Amount"). In addition to the usual maximum amount clause, the mortgage provided, in part, as follows:

"The Secured Amount shall be reduced only by the last and final sums that the Borrower repays with respect to the Loan and shall not be reduced by any intervening repayments of the Loan by Borrower....

"So long as the balance of the Loan exceeds the Secured Amount, any payments and repayments of the Loan by Borrower shall not be deemed to be applied against, or to reduce, the portion of the Secured Obligations secured by this Mortgage...Such payments shall instead be deemed to reduce only such portions of the Secured Obligations as are secured by mortgages encumbering property located outside of the State of New York..."

According to the Advisory Opinion, "all repayments and re-advances of the Overall Loan can be allocated to non-New York real property security...and such allocation will be respected and honored by the Department of Taxation and Finance for purposes of computing the mortgage recording taxes due".

The Advisory Opinion did include a cautionary note. Further mortgage recording tax would have been imposed on any re-advances made once the amount secured by the New York mortgage was reduced below the capped amount which in the case at hand was \$1,400,000.

What if the mortgage is intended to secure less than all of the advances to be made under a non - revolving loan? Assume a further state of facts. A borrower enters into a non - revolving loan for \$40,000,000, all of which is fully advanced prior to the making of any payments of principal. A mortgage on New York property is executed to secure this loan to a maximum amount at any time of \$20,000,000. The mortgage does not provide that the portion of the loan that it secures is to be considered reduced only after the loan indebtedness which it does not secure is fully paid. A principal payment of \$10,000,000 is made leaving a loan balance of \$30,000,000. Since the overall loan has been reduced by one-fourth, the mortgage might be deemed reduced by \$5,000,000 (one-quarter of the principal amount of the mortgage) to \$15,000,000. Mortgage tax might then be



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imposed on \$5,000,000 since the mortgage secures up to \$20,000,000 of the loan at any time outstanding. Payment of part of the loan could also result in a reduction of liability under the lender's title insurance policy absent a Last Dollar endorsement.

It is therefore necessary to limit exposure to the mortgage recording tax by structuring a revolving credit loan secured by a mortgage on property in New York, and even a non - revolving loan only partially secured by a New York mortgage, to ensure that the secured amount is not reduced until the outstanding loan balance is intended to finally become less than the secured amount. So structuring the mortgage and obtaining a Last Dollar endorsement will also ensure a lender that payments made to reduce the loan will not reduce the amount of coverage outstanding under the lender's title policy.

Structuring of the form of mortgage to be executed on New York property to limit mortgage tax consequences by carefully securing less than the entire loan amount and to enable issuance of the Last Dollar endorsement should be discussed with one's title insurer as a transaction develops. Although the mortgage tax may not be a concern for mortgages or deeds of trust encumbering property outside of New York, the Last Dollar endorsement should also be discussed with the title insurer to protect the interest of the lender under those title policies.



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