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LENDER BEWARE: WHEN REAL PROPERTY TITLE ISSUES ARISE, DON'T FORGET YOUR ESCROW CLAIM

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When a lender experiences real property title issues involving a secured loan, the first thought that normally comes to mind is: where is my title insurance policy? While this is a very good initial reaction—and one that cannot be forgotten—what is sometimes overlooked is that the lender may also have an escrow claim based on the instructions it provided to the escrow holder who closed the loan. Accordingly, when title issues arise with respect to loans secured by real property: don't forget your escrow claim!

In other words: welcome to the *escrow claim zone*. It is an area close to, and sometime overlaps, the *title claim zone*. Nevertheless, entrance into both zones always begins the same way. A would-be borrower fills out an application for a loan and compiles supporting documentation. This documentation is either submitted directly to the lender by the borrower or through a broker or a correspondent lender. The would-be lender then reviews the application and supporting documentation and obtains an appraisal to determine whether the value of the proposed real property security is sufficient to justify the proposed loan amount. If the information compiled by the lender satisfies its underwriting guidelines, the proposed loan is approved.

An escrow is then set-up and instructions are provided by the lender to the escrow holder. These instructions are normally in writing, although they do not have to be, and include a request for the issuance of a title insurance policy which insures that title to the real property securing the loan is vested in the borrower and that the deed of trust securing the loan is in a first lien position on the secured property. A closing date is set, the borrower signs the appropriate loan and security documents, and then the loan funds. The deed of trust securing the loan is then recorded with the applicable county recorder and the origination process is complete.

In a perfect world, shortly after the escrow closes the lender receives a title insurance policy with no exceptions that indicates that title to the real property security is vested in its borrower alone. The borrower then begins to make timely payments on the loan and does so until the entire loan balance is satisfied. The lender then happily reconveys its deed of trust and closes the books on what was a perfect loan.

But wait, we are not in a perfect world . . . we have traveled into the *escrow claim zone*! Here, borrowers do not always tell the truth or make payments on time. These borrowers sometimes fall on hard times and are willing to do things that honest people are not willing to do.

Similarly, in the *escrow claim zone*, escrow companies do not always follow the instructions that they are given. The escrow companies also cannot always be relied upon to make sure that the lender is fully apprised of all pertinent facts—of which they have actual knowledge at the most important time—prior to the funding of the loan.

For example, in the *escrow claim zone*, borrowers default on loans secured by properties that they misrepresented that they owned (but didn't) and the title insurance company who issued your policy did not catch this material issue or is part of the borrower's scheme to defraud. This same title insurance company, which gladly took the lender's money to issue a title policy, now refuses to issue the litigation guarantee that the lender needs to provide to the trustee under the deed of trust so that the foreclosure sale can proceed.

In this situation, the lender should of course tender a claim under its title insurance policy. In fact, it is always a best practice, subject to certain exceptions, to try and tender every possible claim that you may have to an insurer. However, title insurance is a policy of indemnity and not a guarantee. Practically speaking, this means that just because the title insurance company screwed up, it does not mean that the title insurer needs to pay the full amount of the policy, which is generally the cap on damages a lender will be able to obtain against a title insurer.

To keep all of the lender's options open, the lender should also consider an escrow claim. An escrow claim is based on the lender's instructions to the escrow holder in conjunction with the closing of the loan.

Since an escrow holder is the agent of all of the parties to the escrow, it has a fiduciary duty to the parties to the escrow. A fiduciary duty is the highest duty of care provided for in the law. As a result, the escrow holder is required to strictly comply with the instructions provided to it and is liable for damages to the lender when it does not do so. Accordingly, unlike a title claim,

which is solely contractual in nature, an escrow claim is not so limited.

For example, an escrow claim does form the basis for a breach of contract cause of action. But it can also form the basis for negligence, breach of fiduciary duty and fraud claims. This means that the damages a lender suffers from an escrow claim may not be limited solely to contract—benefit of the bargain principles—but may be governed by common law tort principles which include damages proximately caused as a result of the escrow company's breaches of duty. Under certain circumstances, tort principles can allow a lender to a recover an amount in excess of what is obtainable in indemnity under a title insurance policy.

Accordingly, when real property title issues arise: don't forget the escrow claim.

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