

Show Me the Money

Alternative Financing

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| [http://www.alta.org/images/wppics/1180180.jpg](http://meetings.alta.org/commercial/speakers/jim-costello/) | [http://www.alta.org/images/wppics/1099877.jpg](http://meetings.alta.org/commercial/speakers/greg-chaparro/) | [http://www.alta.org/images/wppics/1022612.jpg](http://meetings.alta.org/commercial/speakers/alan-fields/) |
| **Jim Costello**  Economist  **Real Capital Analytics**  [jcostello@rcanalytics.com](mailto:jcostello@rcanalytics.com) | **Gregory J. Chapparo**  Senior VP  **Old Republic National Title Insurance Company** [gchaparro@oldrepublictitle.com](mailto:gchaparro@oldrepublictitle.com) | **Alan Fields**  Director of Underwriting  **WFG National Title**  **Insurance Company**  [afields@wfgnationaltitle.com](mailto:afields@wfgnationaltitle.com) |

**Mezzanine Financing**

Mezzanine financing is usually described as a hybrid of debt and equity financing that gives the lender the right to convert to an equity interest in the company in case of default. For title purposes, we can think of it as a loan to the parent company, secured by the equity/membership interests in the company that owns a real estate project.

In real estate financing, the use of a mezzanine structure is often driven by banking regulations; such as Dodd-Frank’s imposition of greater capital requirements on loans meeting the definition of High Volatility Commercial Real Estate (HVCRE) loan. Rating agencies have long placed restrictions on subordinate financing and second mortgages if a mortgage is to be bundled into a CMBS package.

Mezzanine debt is one of the highest-risk forms of debt – having a priority behind the first mortgage and construction lien rights. Accordingly it carries higher interest returns when compared to other debt types, often between 12% and 20% per year.

But for CMBS and HVCRE purposes, the mezzanine loan is considered as “equity” in the project entity.

Upon default, the theory is that the mezzanine lender is in a position to quickly take over the ownership of the project and control the workout process. This may or may not work out in practice.

**From a Title Perspective**

From a title perspective, focus on the parts of the transaction we are insuring. We’re insuring the ownership of the fee interest, and a first mortgage. Both very traditional. As always, the instruments must be examined carefully to confirm that they properly grant the interests, and that those interests ultimately have the priority, which we are to insure.

Some companies offer a type of “UCC Insurance” that is suitable for directly insuring a mezz loan is secured by the ownership interest in the project entity. This is separate and distinct from the ALTA 16-06 Mezzanine Financing endorsement.

**ALTA 16-06 – Mezzanine Financing**

The ALTA 16-06 includes an absolute assignment of the policy to the Mezz Lender, and non-imputation language which parallels that contained in the ALTA 15 series.

Extra caution is merited if:

* + The party pledging the equity interest as collateral doesn’t own 100% of the Project Entity. Other equity holders in the transaction are also expecting to be protected by the title policy, and the assignment under the Mezz endorsement would place the Mezz lender ahead of their interests.
  + An ALTA 40-06 Tax Credit endorsement is being issued to the tax credit investor, as that endorsement assigns conflicting rights in the Owner’s Policy; or
  + Non-imputation endorsements are issued naming other participants in the transaction.

The Mezz endorsement also includes an agreement that no amendment of or endorsement to the policy can be made without the written consent of the Mezzanine Lender.

**“Typical” Mezzanine Financing Structure**



**Opportunity Zones**

This is the current sexy topic, because it is new. Opportunity Zones were a concept created in the 2017 Tax Cuts and Jobs Act. Its goal was to revitalize economically distressed communities using private investments rather than taxpayer dollars. There are three parts to the tax treatment in an Opportunity Zone.

1. If a taxpayer has recognized a taxable capital gain, they could Defer paying tax on that gain, potentially until April 2027, by investing the proceeds in a qualified Opportunity Fund within 180 days.

2. The Taxpayer could eliminate a portion of the already recognized capital gain (never pay taxes on it).

* If held for 5 years by 12/31/26, previously recognized (but deferred) Cap Gain liability is reduced by 10%
* If held for 7 years by 12/31/26, previously recognized Cap Gain liability is reduced by 15%.

3. Any gains on the appreciation of the qualified Opportunity Fund are permanently excluded from taxable income, if the Opportunity Fund investment is held at least 10 years.

Each state’s governor could designate up to 25% of the census tracts in their state as Opportunity Zones if they met certain criteria. The zones then had to be approved by the IRS. It was estimated that 57% of all census tracts could meet these standards.

To be a qualified Opportunity Fund, the entity must intend to invest at least 90% of holdings in one or more Opportunity Zones. An individual can be the sole investor in an Opportunity Fund. The investment can be in:

* Partnership interests in businesses that operate in a qualified Opportunity Zone
* Stock ownership in businesses that conduct most or all of their operations within a qualified Opportunity Zone.
* Property such as real estate located within a qualified Opportunity Zone, including:
  + construction of new buildings
  + substantial improvement of existing unused buildings. If existing building, it must invest more in the improvement of the building than it paid to buy the building.
  + Improvements must be completed within 30 months of purchase.

Opportunity Fund investments are not limited to real property investments. Any kind of property can qualify.

**Comparison to 1031**

Title Insurance does not insure the tax treatment of transactions, nor as title professionals should we advise on taxes – unless you are also a tax lawyer or accountant. This discussion is included because the goal of these ALTA presentations is to understand the “big picture” economic issues driving the structuring of our transactions.

For a taxpayer who has not already triggered capital gains recognition, the Opportunity Fund may not be as favorable as a 1031 exchange -- especially if the taxpayer keeps rolling the gains until death.

Under the 1031, gain can be deferred beyond 2027. Under the Opportunity Fund, there is always payment of the gain recognized in 2027. Under a 1031, the basis in the property is stepped up to fair market value upon death – so if a property is held long enough (or rolled forward in a continuous string of 1031 exchanges) there is no taxable gain ever paid.

Under the opportunity fund, the taxable gain is already recognized, just deferred. So dying doesn’t qualify for a step-up in basis.

**From a Title Perspective**

An Opportunity Zone investment is a cash or financed purchase with the Opportunity Fund entity as the buyer. In contrast to a 1031, there is no qualified intermediary, or third parties to deal with, no special escrows.

**EB-5 Immigrant Investor Visa Program**

Like tax credit programs, the economic advantage to EB-5 financing (*employment-based fifth preference category)* is that the funding source is willing to accept less than a fair market return or a lesser security position because they are getting something else of value in return – becoming a lawful permanent residents of the United States.

The EB-5 program was created under the Immigration Act of 1990, and allows up to 10,000 visas to be granted each year allowing an eligible Immigrant Investor to become a lawful permanent resident — a "green card" holder — by investing at least $1,000,000 to finance a "new commercial enterprise” that will employ at least 10 American workers.

The required investment is lowered to $500,000 if the business is within a targeted employment area (TEA) — a rural area or area with an unemployment rate at least 150% of the national average. States were delegated authority to designate the TEAs. There have been allegations gerrymandering of the TEA boundaries to qualify EB-5 projects in better neighborhoods.

Spouses and unmarried children under 21 are admitted with the investment, but do count against the 10,000 cap.

Initially this program required a direct investment into the Job Creating Entity, and investment choices had a more entrepreneurial feel. In 1993, the law was amended to allow investments to be aggregated through approved “regional centers.” The regional centers allowed aggregation of much larger pools of funding for projects and a loosening of the employment standards.

The EB-5 program requires that the immigrant investor’s capital be placed “at risk” and meet certain requirements, including being continuously invested until the immigration petition is granted. Most types of debt payable to the Immigrant Investor are prohibited.

A direct investment required a showing of direct employees of the Job Creating Entity (generally full time W-2 employees). In contrast, a regional center is allowed to count direct and indirect employees for these purposes. Indirect jobs include the steel mill workers, wherever located, that create steel beams for a project; factory worker manufacturing bath tubs for a hotel project, workers who supply linens to a hotel after it opens and providers of professional services including accountants and lawyers.

Many EB-5 investments are centered around commercial real estate projects, because those projects result in significant job creation -- through construction work at first (which qualify if the jobs last 2 years or longer) and later in the service industry, for example in hotels, restaurants, resorts and/or stadium development.

The regional centers, which aggregate the EB-5 investors, may be “for-profit” entities. The great majority of EB-5 investors (about 93%) come through regional centers. About 97% of EB-5 investors are investing in Targeted Employment Areas so get the benefit of the $500,000 investment floor.

Many large commercial projects have utilized EB-5 funding in their capital structures. The largest reported to date was the $600 million raise for the Hudson Yards project by the Related Companies.

**Securities Law Issues**

When a developer or third party solicits EB-5 investors to contribute capital it typically constitutes a “security” for purposes of federal securities laws. So will generally be carefully structured to fall within the Reg. D. private offering exemption (limited to accredited investors) or a safe harbor under Reg. S. for “offerings made outside the United States.” Well done EB-5 offerings include formal securities offering documents, including a private placement memorandum and subscription agreement.

**How Developers Use the Funds.**

EB-5 capital is extremely flexible and can fill any space in the capital stack. EB-5 capital can take the form of debt (secured or unsecured) or equity. The limiting factor for EB-5 funding is the number of documentable jobs that can be proven. Few projects will generate enough jobs to fund a majority of the cost with EB-5 funding. So the EB-5 position is limited by the parameters imposed by other funding sources.

Traditional mortgage financing (post crash) will generally fund 50-70% of total project costs. Those lenders require the developer to have some “skin in the game” so expect the developer to have 5-10% or more in hard capital. That leaves a 20-40% gap that can be potentially be filled by EB-5 funds or other alternative structures.

CMBS rating requirements and internal lender standards often restrict second mortgages on projects. So a common structures for EB-5 funding is for the Immigrant Investor to pay funds into a New Commercial Enterprise (NCE) created by the regional center. Those funds come in as an “at risk” investment in common stock or preferred stock in the NCE. The NCE will then fund the Job Creating Entity (JCE) most often in the form of mezzanine loans or preferred equity.

**From a Title Perspective**

Since the EB-5 funding usually comes in as a mezzanine loan or preferred equity, it rarely affects the title insuring portion of the transaction other than the possible request for a Mezzanine Financing Endorsement. The land sales and mortgage financing forms tend to look like traditional CMBS forms but still must be reviewed carefully to determine insurability.

The title agent or insurer will sometimes be asked to perform escrow functions in connection with the EB-5 portions of the transaction. The more experienced regional centers are equipped to handle those functions. Because EB-5 investments are securities, great caution should be exercised before agreeing to handle such funds and experienced counsel consulted.

**Endorsements to Consider**

* + **ALTA 16-06 – Mezzanine Financing**

The EB-5 financings is often structured as Mezzanine Financing model and can generate a request for the ALTA 16-06 endorsement.

The ALTA 16-06 includes an absolute assignment of the policy to the Mezz Lender, and non-imputation language which parallels that contained in the ALTA 15 series.

As discussed in the NMTC section, the Mezz endorsement’s absolute assignment of the policy can present issues in more complex structures – but those issues are not usually implicated in a straight EB-5 backed Mezz loan.

As always, the best practice is to discuss the endorsements to be issued in detail with your underwriter.

**EB-5 Immigrant Investor Visa Program**



**EB-5 Visas Granted 2017 & 2018**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | FY 2017 | | FY 2018 | |
| China Mainland Born | 7,567 | 75.0% | 4,642 | 48.3% |
| Vietnam | 471 | 4.7% | 693 | 7.2% |
| Brazil | 282 | 2.8% | 388 | 4.0% |
| South Korea | 195 | 1.9% | 531 | 5.5% |
| China Taiwan Born | 188 | 1.9% | 452 | 4.7% |
| India | 174 | 1.7% | 585 | 6.1% |
| Russia | 115 | 1.1% | 134 | 1.4% |
| Venezuela | 108 | 1.1% | 237 | 2.5% |
| Nigeria | 89 | 0.9% | 113 | 1.2% |
| Mexico | 85 | 0.8% | 174 | 1.8% |
| Great Britain & Territories | 82 | 0.8% | 84 | 0.9% |
| Hong Kong S.A.R. | 81 | 0.8% | 200 | 2.1% |
| Canada | 55 | 0.5% | 109 | 1.1% |
| South Africa | 53 | 0.5% | 91 | 0.9% |
| Iran | 40 | 0.4% | 59 | 0.6% |
| Japan | 37 | 0.4% | 66 | 0.7% |
| France & Territories | 35 | 0.3% | 74 | 0.8% |
| Turkey | 27 | 0.3% | 69 | 0.7% |
| Germany | 26 | 0.3% | 28 | 0.3% |
| Syria | 24 | 0.2% | 32 | 0.3% |
| Pakistan | 22 | 0.2% | 103 | 1.1% |
| Colombia | 21 | 0.2% | 56 | 0.6% |
| All Other Countries | 313 | 3.1% | 682 | 7.1% |
| Total | 10,090 |  | 9,602 |  |

Data US State Department Report of the Visa Office, Table V (Part 3)

https://travel.state.gov/content/travel/en/legal/visa-law0/visa-statistics/annual-reports.html

**New Market Tax Credits**

Like most tax credits, Congress’ goal in creating the New Market Tax Credit (NMTC) program in 2000 was to encourage private investment in societally desirable directions. In this case, the NMTC program sought to stimulate investment and economic growth in low income urban neighborhoods and rural communities that lack access to the patient capital needed to support and grow businesses, create jobs, and sustain healthy local economies.

Tax credits change the economics of the transaction, reducing the cost of funding a project or increasing the rate of return or some combination. The effective economic subsidy under the NMTC program usually works out to between 15% and 20% of the total project cost, depending on the tax credit investors’ required yield and the complexity of the project structure. Transaction costs and legal fees can be substantial.

**The Buzzwords and Tax Stuff.**

Under the NMTC program, Congress authorizes an amount of tax credits that is to be made available annually, which the Treasury then allocates. The total approved has been running about $3.5 Billion per year. The NMTC program is created and governed under the IRS Code and IRS regulations – so there are very complex rules and convoluted terminology around the NMTC program.

The **Treasury’s Community Development Financial Institutions** Fund (CDFI) “allocates” portions of the Congressional authorization to qualified **Community Development Entities** (CDEs). Those CDEs are the intermediaries that make the loans or investments and “sell” the tax credits. The NMTC process is technically described in terms of a CDE being allocated the authority to raise a certain amount of capital in the form of “**Qualified Equity Investments**”. The CDE designates the investment as a Qualified Equity Investment, which allows the investor to take New Market Tax Credit dollar for dollar against amounts owed in Federal Income Tax.

Many enterprises, including banks, developers, and local governments can qualify to create CDEs. The CDE takes the proceeds of the **Qualified Equity Investments** allocated to it by the CDFI Fund and makes a **Qualified Low Income Community Investment** in a **Qualified Active Low-Income Community Business** (QALICB). The qualifying business can be just about any business which operates or plans to operate in a qualified low income area, including commercial real estate projects or renewable energy projects.

A few types of business are expressly excluded: Rental residential property (presumably because there is another tax credit program for that); commercial golf courses, country clubs, massage parlors, hot tub facilities, suntan facilities, race tracks or gambling facilities, liquor stores, and most farms (again subsidized through other programs).

The resulting tax credits are equal to 39% of the Qualified Equity Investment. The taxpayer gets the benefit of the 39% tax credit over a period of 7 years (5% each year for first 3 years, 6% per year for the next 4 years). An investor interested only in the tax credit is not going to pay $100 to receive $39 of tax credits over a 7 year period. So many NMTC transactions are leveraged so that the investor receives tax credits in excess of their cash invested.

Once placed, the QEI needs to remain outstanding for the full 7 years or tax credits will be lost. At any given time, 85% of each QEI must be in qualifying investments. Some projects refinance or repay funding in less time, in which case the CDE must make another qualified investment in another QALICB to keep the funds substantially placed for the full 7 year term of the tax credits.

Failure to follow the rules can result in a disallowance or recapture of the tax credits.

**The Money Flows**

The chart below shows a simplified depiction of a NMTC transaction.

Because there are multiple programs, public and private, which incentivize similar public policy goals, it is not uncommon to see NMTC projects structured to also take advantage of grants, charitable contributions, other tax credits (but not low income housing), funding from tax increment financings and other sources. Those combinations can make the structures in actual transactions much more convoluted than the “Simplified Structure” shown in the diagram.

Parties benefitting from the transaction, such as a planned tenant of the project, sometimes act as Sources of Funds for different parts of the transaction resulting in a certain circularity in the diagram.

**From a Title Perspective**

From a title perspective, the tax structure driving the transaction doesn’t much affect us. Our focus is on the parts of the transaction we are insuring, which are pretty traditional. The documents used, however, are usually carefully drafted non-standard forms. The forms can be an integrated package in which critical definitions from other documents are incorporated in the mortgages, leases and subordinations that we are asked to insure. So one of the title challenges is to review the documents carefully enough to confirm that the ultimate instruments properly grant the interests, and that those interests ultimately have the priority, which we are to insure. Be cautious of requests to add additional insureds or to insure contingent or springing interests. The core test is whether party asking to be named really has an insurable interest in real estate.

The title agent or insurer will sometimes be asked to perform escrow functions in connection with a New Market Tax Credit transaction. The usual caveats apply. Read and understand the escrow instructions and be cautious of indemnity language. Although the transactions and money flows can be complex, NMTC transactions are usually well and thoroughly “lawyered” with well drafted escrow instructions.

**Endorsements to Consider**

* **ALTA 40-06 – Tax Credit Owner’s Policy**

This endorsement specifically names the Tax Credit Investor, and insures against a reduction in the tax credit caused by a defect, lien, or other matter covered by the policy. Like the ALTA 16 Mezz Financing endorsement, the Tax Credit endorsement is joined by the named insured to assign a partial interest in the policy to the Tax Credit Investor.

The Tax Credit endorsement does NOT include non-imputation language.

* **ALTA 15 Series -- Nonimputation**

Sometimes there is a request to provide nonimputation coverage for the Sub-CDE or others involved in the transaction. This takes the form of an endorsement to the Owner’s Policy in favor of the Project Entity (QALICB).

The ALTA 15.2-06 -- Nonimputation-Partial Equity Transfer is generally the most appropriate for naming the Sub-CDE when it acquires an equity interest in the Project Entity. The non-imputation endorsements provide that the insurer will not assert any of three listed exceptions from coverage as to the named non-imputed party. ((3)(a) “created, suffered, assumed or agreed to” (3)(b) unrecorded matter known to named insured but not disclosed in writing; and (3)(e) the insured didn’t pay value for the insured interest).

* + **ALTA 16-06 – Mezzanine Financing**

Some parts of an NMTC financing can fit the Mezzanine Financing model and generate a request for the ALTA 16-06 endorsement. For example, you sometimes see a pledge of the equity interests in the Project Entity by the Developer as collateral for additional funding.

The ALTA 16-06 includes an absolute assignment of the policy to the Mezz Lender, and non-imputation language which parallels that contained in the ALTA 15 series.

The Mezz endorsement’s absolute assignment of the policy and other provisions are generally going to be inappropriate (at least absent some very carefully modification of the endorsement or side agreements and acknowledgements) if:

* + The party pledging the equity interest as collateral doesn’t own 100% of the Project Entity (rare in an NMTC model). Other equity holders in the NMTC transaction (e.g. the Sub-CDE and the Tax Credit Investors) are also expecting to be protected by the title policy, and the assignment under the Mezz endorsement would place the Mezz lender ahead of their interests.
  + An ALTA 40-06 Tax Credit endorsement is being issued to the tax credit investor, as that endorsement assigns conflicting rights in the Owner’s Policy; or
  + Non-imputation endorsements are issued naming other participants in the transaction.

The Mezz endorsement also includes an agreement that no amendment of or endorsement to the policy can be made without the written consent of the Mezzanine Lender. That also presents issues.

* + **Property & Lien Related Endorsements**

Most of the ALTA endorsements cover something related to the property or the lien of a mortgage, and an assortment of these will routinely be requested in connection with a New Market Tax Credit transaction, or in any commercial transaction.

As always, the best practice is to discuss the endorsements to be issued in detail with your underwriter.



**Synthetic Leases – Coming Back?**

Synthetic lease transactions are driven by the accounting and tax treatment. All discussions of accounting and tax issues in this summary are, at best, surface level only.

In the old days, a synthetic lease involved a special purpose entity established by a parent company which purchases an asset then leases it back to the parent company. The parent company treated the lease as an operating lease. With an operating lease, the lease payment is deducted as an expense on the income statement. By structuring the ownership of the “subsidiary” to avoid consolidation, neither the asset nor the debt appeared on the parent company balance sheet (even though the parent was ultimately liable for the debt). Synthetic leases were used to great effect by Enron prior to its collapse in 2002.

After Enron, the FASB implemented new guidance in FIN 46 “Consolidation of Variable Interest Entities” providing that if the lessee is the primary beneficiary of certain entities, including a single-asset lessor, then the lessor entity must be consolidated by the lessee on its financial statements. That effectively destroyed the off balance sheet benefits of a synthetic lease.

Today, the lessor is usually a bank or large finance company due to the 2003 FASB changes, and the synthetic lease is a financing technique. It is structured to be an operating lease for the lessee’s financial accounting purposes and an asset and loan for U.S. federal tax purposes. Variations of the financing lease are also seen used by governmental and other entities having charters or contractual provisions prohibiting debt.

Using a synthetic lease, a borrower/lessee with strong credit can often get 100% financing on headquarters or other real estate projects, corporate aircraft and large equipment. Since the leases can be structured as the lease equivalent of an “interest only” loan, with effective rates competitive with borrowing under credit facilities, the lessee reduces immediate cash outlays.

Since it appears as a financing for U.S. Federal Income tax purposes, the lessee still gets to depreciate the real estate assets for tax purposes. In a bankruptcy, a synthetic lease is treated as a secured loan from the lessor to the lessee.

The transaction is usually structured so that the lessee has the ability to purchase the property at the end of the lease term for an agreed upon amount, which permits the lessee to realize any appreciation on the property. However, the lessee can also be contractually responsible for shortfalls if the property declines in value. (Note: there are a whole set of accounting rules on when an operating lease gets reclassified as a capital lease that have to be met)

The financial reporting standards for Synthetic Leases are about to change in ways that may make a synthetic lease simultaneously more and less desirable. ASC 842 will commence with fiscal year 2019 for most public companies and the following year for private companies. Under ASC 842, there will be a Right-of-Use asset on the lessee’s balance sheet and a lease liability. The lease liability will be discounted to present value for reporting purposes.

Under ASC 842, the lessee accounting rules for determining whether a lease is an operating lease or a capital lease will be subject to additional interpretation since the bright-line tests with percentages will become guidelines. To allay concerns from these changes, at least one of the big 4 accounting firms has confirmed in their literature that they will not object to the use of the bright-line tests from ASC 840 to make this determination under the new lease standards of ASC 842.

The 2017 Tax Cuts and Jobs Act changed a number of key leasing/financing related provisions. The most significant in this context should be the introduction of 100% expensing for qualified tangible property with a recovery period of 20 years or less. This current year expensing applies to property placed in service after September 27, 2017 and before January 1, 2023, and for phased-down amounts (20% annual reduction of the percentage) generally through 2026. The recovery period for real estate assets exceeds 20 years, so real estate assets do not qualify for expensing, but other associated tangible personal property may qualify.

Tax lawyers at King & Spaulding has suggested that 100% expensing opportunity may spur some taxpayers to seek synthetic lease treatment for qualifying assets so that, as the tax owner, the lessee may claim the full expensing – but point out that the 100% expensing is subject to caps measured against “business interest income” and adjusted taxable income.

**Structuring Twists**

There tends to be concern that a synthetic lease may be recharacterized as a financing transaction or visa-versa in bankruptcy, by the courts or otherwise. So most transactions include a lease and a separate mortgage and UCC-1 financing statement as if the lessee is obtaining a loan from the SPE/lessor and/or holders of the SPE's debt.

Usually the lease documents will include a statement that the mortgage and security interest are granted in the event that the lease is characterized as a loan transaction. Sometimes the lease documents even recite that it is the intent of the parties that the transaction be characterized as an operating lease for financial accounting purposes but as a loan for tax, bankruptcy and other purposes. This language may be helpful in connection with the opinion of counsel for the sponsor/lessee, but may create problems with the auditors.

**From a Title Perspective**

From a title perspective, we do not insure the tax or accounting treatment of the transaction. The biggest title concern surrounds recharacterization of the transaction. Title will be asked to issue an Owner’s policy with ALTA 13 endorsement to the Lessee, and perhaps also a Loan title policy for the “back-up” mortgage and both can’t be correct.

Synthetic leases are highly complex transactions and your underwriting counsel should be brought into the process early. Most underwriters will require every policy in the transaction (including the policy insuring the transfer of fee from the developer to the lessor) to take exception for the terms and conditions of the complete list of transaction documents AND have some sort of recharacterization exception:

**“Any claim, assertion or determination that (a) the lease referred to at item \_\_\_\_ is not a “true lease”; (b) the mortgage and security agreement referred to in item \_\_\_ are not providing a security interest for a loan or debt; or (c) the vesting of title in [the lessee] is part of a loan transaction, including the assertion that the deed to [the lessor] and the lease constitutes a mortgage or other security device.”**

Affirmative insurance should never be added to this type of exception.

Some underwriting counsel may conclude that it is not necessary to raise any exception because they have a defense under one of the following theories:

1.  *The “Act of the Insured” Defense:* the risk of recharacterization is excepted from coverage under the title policy exclusions because it is a matter “created, suffered, assumed, or agreed to” by the insured, or

2.  *The “Post Policy” Defense:* the risk of recharacterization is excepted from coverage because it is a “defect, lien, encumbrance, adverse claim, or other matter…attaching to or created subsequent to Date of Policy,” or

3. *The creditor’s rights exception* excludes bankruptcy coverage in the current transaction.

Here is a hypothetical (and simplified) diagram of how the synthetic lease transaction might be structured.



ENDORSEMENT

Attached to Policy No. \_\_\_\_\_\_\_\_\_\_

Issued by

BLANK TITLE INSURANCE COMPANY

1. This endorsement is subject to the exclusions in Section 4 of this endorsement; and the Exclusions from Coverage, the Exceptions from Coverage contained in Schedule B, and the Conditions in the policy.

2. For purposes of this endorsement only:

* 1. “Tax Credit Investor” means \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_.
  2. “Tax Credit” means a tax credit in effect at Date of Policy pertaining to the Land that is available to the Tax Credit Investor under an applicable section of the Internal Revenue Code or other applicable law.

3. The Company insures against loss or damage, not exceeding the Amount of Insurance, sustained by the Tax Credit Investor by a reduction in a Tax Credit that is caused solely by a defect, lien, encumbrance, or other matter insured against by the policy, subject to the limitations in Section 8(a) of the Conditions. The Company has no liability to the Tax Credit Investor under this endorsement until:

* 1. its liability and the extent of a loss insured against by the policy have been definitely fixed in accordance with the Conditions; and
  2. the Tax Credit Investor establishes the reduction in the amount of a Tax Credit.

4. This endorsement does not insure against loss or damage (and the Company will not pay costs, attorneys’ fees, or expenses) incurred in defending or establishing:

a. the eligibility of the Tax Credit Investor or the Land for a Tax Credit;

b. that the Tax Credit Investor or the Land is entitled to a Tax Credit; or

c. the existence, ownership, or amount of a Tax Credit.

5. The calculation of loss or damage under this endorsement shall be subject to Section 11 of the Conditions. In addition, the Company shall not be liable for duplicate recoveries of loss or damage to the Insured and Tax Credit Investor.

6. The Insured:

* 1. assigns to the Tax Credit Investor the right to receive any payment or portion of a payment for loss or damage otherwise payable to the Insured under Section 12 of the Conditions, but only to the extent of the reduction in the amount of a Tax Credit; and
  2. acknowledges that any payment made by the Company to the Tax Credit Investor under this endorsement shall reduce the Amount of Insurance as provided in Section 10 of the Conditions.

This endorsement is issued as part of the policy. Except to the extent expressly stated, 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.

[Witness clause optional]

**Agreed and Consented to:**

**\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

Insured

**\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

[Tax Credit Investor]

**BLANK TITLE INSURANCE COMPANY**

**By: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

Authorized Signatory

ENDORSEMENT

Attached to Policy No. \_\_\_\_\_\_\_\_\_\_

Issued by

BLANK TITLE INSURANCE COMPANY

1. The Mezzanine Lender is: ­­­­­­­­­­\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ and each successor in ownership of its loan (“Mezzanine Loan”) reserving, however, all rights and defenses as to any successor that the Company would have had against the Mezzanine Lender, unless the successor acquired the indebtedness as a purchaser for value without Knowledge of the asserted defect, lien, encumbrance, adverse claim, or other matter insured against by this policy as affecting Title.
2. The Insured
   1. assigns to the Mezzanine Lender the right to receive any amounts otherwise payable to the Insured under this policy, not to exceed the outstanding indebtedness under the Mezzanine Loan; and
   2. agrees that no amendment of or endorsement to this policy can be made without the written consent of the Mezzanine Lender.
3. The Company does not waive any defenses that it may have against the Insured, except as expressly stated in this endorsement.
4. In the event of a loss under the policy, the Company agrees that it will not assert the provisions of Exclusions from Coverage 3(a), (b) or (e) to refuse payment to the Mezzanine Lender solely by reason of the action or inaction or Knowledge, as of Date of Policy, of the Insured, provided
   1. the Mezzanine Lender had no Knowledge of the defect, lien, encumbrance or other matter creating or causing loss on Date of Policy.
   2. this limitation on the application of Exclusions from Coverage 3(a), (b) and (e) shall
      1. apply whether or not the Mezzanine Lender has acquired an interest (direct or indirect) in the Insured either on or after Date of Policy, and
      2. benefit the Mezzanine Lender only without benefiting any other individual or entity that holds an interest (direct or indirect) in the Insured or the Land.
5. In the event of a loss under the Policy, the Company also agrees that it will not deny liability to the Mezzanine Lender on the ground that any or all of the ownership interests (direct or indirect) in the Insured have been transferred to or acquired by the Mezzanine Lender, either on or after the Date of Policy.
6. The Mezzanine Lender acknowledges
   1. that the Amount of Insurance under this policy shall be reduced by any amount the Company may pay under any policy insuring a mortgage to which exception is taken in Schedule B or to which the Insured has agreed, assumed, or taken subject, or which is hereafter executed by an Insured and which is a charge or lien on the Title, and the amount so paid shall be deemed a payment under this policy; and
   2. that the Company shall have the right to insure mortgages or other conveyances of an interest in the Land, without the consent of the Mezzanine Lender.
7. If the Insured, the Mezzanine Lender or others have conflicting claims to all or part of the loss payable under the Policy, the Company may interplead the amount of the loss into Court. The Insured and the Mezzanine Lender shall be jointly and severally liable for the Company’s reasonable cost for the interpleader and subsequent proceedings, including attorneys’ fees. The Company shall be entitled to

payment of the sums for which the Insured and Mezzanine Lender are liable under the preceding sentence from the funds deposited into Court, and it may apply to the Court for their payment.

1. Whenever the Company has settled a claim and paid the Mezzanine Lender pursuant to this endorsement, the Company shall be subrogated and entitled to all rights and remedies that the Mezzanine Lender may have against any person or property arising from the Mezzanine Loan. However, the Company agrees with the Mezzanine Lender that it shall only exercise these rights, or any right of the Company to indemnification, against the Insured, the Mezzanine Loan borrower, or any guarantors of the Mezzanine Loan after the Mezzanine Lender has recovered its principal, interest, and costs of collection.

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.

AGREED AND CONSENTED TO:

(*Insert name of Insured*) (*Insert name of Mezzanine Lender*)

By:\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ By:\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

[Witness clause optional]

**BLANK TITLE INSURANCE COMPANY**

**By: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

**Authorized Signatory**

[Entity as the named Insured and vestee of the insured estate or interest identified in Schedule A]

ENDORSEMENT

Attached to Policy No. \_\_\_\_\_\_\_\_\_\_

Issued by

BLANK TITLE INSURANCE COMPANY

The Company agrees that it will not assert the provisions of Exclusions from Coverage 3(a), (b), or (e) to deny liability for loss or damage otherwise insured against under the terms of the policy solely by reason of the action or inaction or Knowledge, as of Date of Policy, of

**[identify exiting or contributing partner(s) of the insured partnership entity, member(s) or manager(s) of the insured limited liability company entity, or officer(s) and/or director(s) of the insured corporate entity]**

whether or not imputed to the Insured by operation of law, provided

**[identify the “incoming” partners, members, or shareholders]**

acquired the Insured as a purchaser for value without Knowledge of the asserted defect, lien, encumbrance, adverse claim, or other matter insured against by the policy.

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.

[Witness clause optional]

**BLANK TITLE INSURANCE COMPANY**

**By: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

**Authorized Signatory**

[Entity as the named Insured in the policy and vestee of the insured estate or interest identified in Schedule A]

ENDORSEMENT

Attached to Policy No. \_\_\_\_\_\_\_\_\_\_

Issued by

BLANK TITLE INSURANCE COMPANY

For purposes of the coverage provided by this endorsement,

**[identify the “incoming” partner, member or shareholder]**

(“Additional Insured”) is added as an Insured under the policy. By execution below, the Insured named in Schedule A acknowledges that any payment made under this endorsement shall reduce the Amount of Insurance as provided in Section 10 of the Conditions.

The Company agrees that it will not assert the provisions of Exclusions from Coverage 3(a), (b), or (e) to deny liability for loss or damage otherwise insured against under the terms of the policy solely by reason of the action or inaction or Knowledge, as of Date of Policy, of

**[identify, as applicable, the existing and/or exiting partner(s) of the insured partnership entity, member(s) or manager(s) of the insured limited liability company entity, or officer(s) and/or director(s) of the insured corporate entity]**

whether or not imputed to the Additional Insured by operation of law, to the extent of the percentage interest in the Insured acquired by Additional Insured as a purchaser for value without Knowledge of the asserted defect, lien, encumbrance, adverse claim, or other matter insured against by the policy.

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.

AGREED AND CONSENTED TO:

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

INSURED

[Witness clause optional]

**BLANK TITLE INSURANCE COMPANY**

**By: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

**Authorized Signatory**

[Incoming partner, member, or shareholder, as the named Insured in its own policy, where the vestee of the insured estate or interest identified in Schedule A is a partnership, limited liability company, or corporation]

ENDORSEMENT

Attached to Policy No. \_\_\_\_\_\_\_\_\_\_

Issued by

BLANK TITLE INSURANCE COMPANY

The Company agrees that it will not assert the provisions of Exclusions from Coverage 3(a), (b), or (e) to deny liability for loss or damage otherwise insured against under the terms of the policy solely by reason of the action or inaction or Knowledge, as of Date of Policy, of

**[identify, as applicable, the existing and/or exiting partner(s) of the vestee partnership entity, member(s) or manager(s) of the vestee limited liability company entity, or officer(s) and/or director(s) of the vestee corporate entity]**

whether or not imputed to the entity identified in paragraph 3 of Schedule A or to the Insured by operation of law, but only to the extent that the Insured acquired the Insured’s interest in the entity as a purchaser for value without Knowledge of the asserted defect, lien, encumbrance, adverse claim, or other matter insured against by the policy.

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.

[Witness clause optional]

**BLANK TITLE INSURANCE COMPANY**

**By: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

**Authorized Signatory**

ENDORSEMENT

Attached to Policy No. \_\_\_\_\_\_\_\_\_\_

Issued by

BLANK TITLE INSURANCE COMPANY

1. As used in this endorsement, the following terms shall mean:

a. "Evicted" or "Eviction": (a) the lawful deprivation, in whole or in part, of the right of possession insured by this policy, contrary to the terms of the Lease or (b) the lawful prevention of the use of the Land or the Tenant Leasehold Improvements for the purposes permitted by the Lease, in either case as a result of a matter covered by this policy.

b. "Lease": the lease described in Schedule A.

c. "Leasehold Estate": the right of possession granted in the Lease for the Lease Term.

d. "Lease Term": the duration of the Leasehold Estate, as set forth in the Lease, including any renewal or extended term if a valid option to renew or extend is contained in the Lease.

e. "Personal Property": property, in which and to the extent the Insured has rights, located on or affixed to the Land on or after Date of Policy that by law does not constitute real property because (i) of its character and manner of attachment to the Land and (ii) the property can be severed from the Land without causing material damage to the property or to the Land.

f. "Remaining Lease Term": the portion of the Lease Term remaining after the Insured has been Evicted.

g. "Tenant Leasehold Improvements": Those improvements, in which and to the extent the Insured has rights, including landscaping, required or permitted to be built on the Land by the Lease that have been built at the Insured's expense or in which the Insured has an interest greater than the right to possession during the Lease Term.

2. Valuation of Estate or Interest Insured:

If in computing loss or damage it becomes necessary to value the Title, or any portion of it, as the result of an Eviction of the Insured, then, as to that portion of the Land from which the Insured is Evicted, that value shall consist of the value for the Remaining Lease Term of the Leasehold Estate and any Tenant Leasehold Improvements existing on the date of the Eviction. The Insured Claimant shall have the right to have the Leasehold Estate and the Tenant Leasehold Improvements affected by a defect insured against by the policy valued either as a whole or separately. In either event, this determination of value shall take into account rent no longer required to be paid for the Remaining Lease Term.

3. Additional items of loss covered by this endorsement:

If the Insured is Evicted, the following items of loss, if applicable to that portion of the Land from which the Insured is Evicted shall be included, without duplication, in computing loss or damage incurred by the Insured, but not to the extent that the same are included in the valuation of the Title determined pursuant to Section 2 of this endorsement, any other endorsement to the policy, or Section 8(a)(ii) of the Conditions:

a. The reasonable cost of (i) removing and relocating any Personal Property that the Insured has the right to remove and relocate, situated on the Land at the time of Eviction, (ii) transportation of that Personal Property for the initial one hundred miles incurred in connection with the relocation, (iii) repairing the Personal Property damaged by reason of the removal and relocation, and (iv) restoring the Land to the extent damaged as a result of the removal and relocation of the Personal Property and required of the Insured solely because of the Eviction.

b. Rent or damages for use and occupancy of the Land prior to the Eviction that the Insured as owner of the Leasehold Estate may be obligated to pay to any person having paramount title to that of the lessor in the Lease.

c. The amount of rent that, by the terms of the Lease, the Insured must continue to pay to the lessor after Eviction with respect to the portion of the Leasehold Estate and Tenant Leasehold Improvements from which the Insured has been Evicted.

d. The fair market value, at the time of the Eviction, of the estate or interest of the Insured in any lease or sublease permitted by the Lease and made by the Insured as lessor of all or part of the Leasehold Estate or the Tenant Leasehold Improvements.

e. Damages caused by the Eviction that the Insured is obligated to pay to lessees or sublessees on account of the breach of any lease or sublease permitted by the Lease and made by the Insured as lessor of all or part of the Leasehold Estate or the Tenant Leasehold Improvements.

f. The reasonable cost to obtain land use, zoning, building and occupancy permits, architectural and engineering services and environmental testing and reviews for a replacement leasehold reasonably equivalent to the Leasehold Estate.

g. If Tenant Leasehold Improvements are not substantially completed at the time of Eviction, the actual cost incurred by the Insured, less the salvage value, for the Tenant Leasehold Improvements up to the time of Eviction. Those costs include costs incurred to obtain land use, zoning, building and occupancy permits, architectural and engineering services, construction management services, environmental testing and reviews, and landscaping.

4. This endorsement does not insure against loss, damage or costs of remediation (and the Company will not pay costs, attorneys’ fees or expenses) resulting from environmental damage or contamination.

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.

**BLANK TITLE INSURANCE COMPANY**

**By: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

**Authorized Signatory**