LAST WORD

Saving on Title Insurance

Investor-owned title agencies slash transaction costs, but compliance is critical. **By Stephen Crawford**

In an effort to reduce the cost of title insurance by 30% or more, commercial real estate developers, investors, and lenders are increasingly forming partially or wholly owned title insurance agencies to service their own real estate acquisition, disposition, and refinancing activity. These ventures, or "affiliated business arrangements," are licensed title insurance agencies whose business is primarily supplied or controlled by one or more of the agency owners.

The cost savings can be significant for REITs, pension funds, life insurance companies, and other institutional real estate investors that spend millions of dollars annually for title insurance. For banks and other lenders, owning a title insurance agency can generate significant new fee income from mortgage loan transactions financed by the institution.

To illustrate the potential savings, assume a hospitality industry investor is acquiring a hotel in Orlando for $250 million. The investor orders a title insurance commitment from a title insurance agency in which it is a 50% partner. The premium for an owner's title insurance policy in the amount of the purchase price is over $500,000. The portion of the premium remaining after paying title search and exam fees, an underwriting remittance, operating expenses and payroll, would be distributable net income to the title agency's partners, often resulting in a 30% or higher net savings to the investor on the pretax cost of the title policy.

The entity taking title to the real estate, usually an affiliate of the investor, will be the principal insured party on the owner's policy of title insurance issued by the agency. The investor's mortgage lender will be the principal insured party on the lender's policy of title insurance.

Emergence of joint ventures

Title insurance joint ventures have existed since 1974 in residential real estate. Formation of these joint ventures in the commercial sector is accelerating. While no data exists on the number of these ventures, the growth in the commercial sector of the affiliated title insurance market is part of a trend toward "captive insurance" for other commercial real estate risks, such as property and casualty hazards and public liability exposure. Captive insurance is a form of self-insurance, and captive insurers are formed to insure the risks of their parent company.

A title insurance joint venture is often structured as a 50-50 partnership between a real estate investor and a title insurance agency or underwriter. Capital contributions are usually nominal but should be equal to the fair market value of the equity issued by the joint venture. To avoid conflicts of interest, the title industry partner should be responsible for all underwriting decisions and the investor partner should hold a purely economic interest in the venture.

Why are title insurance underwriters and agents willing to share profits? According to A.M. Best, the leading insurance industry rating agency, underwriting commercial transactions represents the highest profit margin activity for title insurers. The guaranteed premium volume generated by joint ventures also helps offset the industry's high expense ratio and susceptibility to real estate market volatility.

Do your homework first

Choosing the right industry partner is a big consideration in forming a title insurance joint venture. A partner must be capable of delivering accurate and responsive service. Real estate investors should also be aware of the strengths and weaknesses of underwriters and independent agents as joint-venture partners.

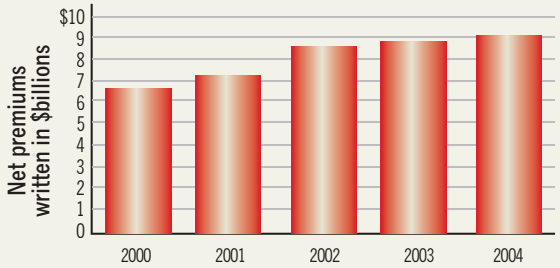
Title insurance underwriters can deliver financial strength to a joint venture, but may have financial and underwriting conflicts of interest. Agents can create competition among underwriters to maximize operating profits, but may lack sophisticated in-house title expertise.

State law governs ownership of title insurance agencies. A joint venture title agency should be organized in a state with a friendly regulatory environment, and that offers licensing reciprocity with states where the investor is doing business. Having the agency licensed in each state where the investor does business makes the venture less dependent on local service providers, and leads to higher profits.

Investigations into the title insurance industry have primarily focused on practices in the residential market. Recent settlements with New York's regulators have, however, brought certain practices in the commercial title insurance market into question. Compliance with state and federal insurance laws is critical. Experienced legal counsel should be retained early in the planning process.

BURGEONING CAPTIVE INSURANCE MARKET

A form of self-insurance, captive insurance is gaining momentum. The volume of net property and casualty premiums written by U.S. captive insurers has been steadily rising in recent years.



Source: A.M. Best Co.

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