

ZONING LETTERS v. ZONING ENDORSEMENTS

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Lender's closing checklists sometimes include the requirement of a zoning letter or a zoning endorsement, and sometimes both.

Different lenders have different policies relating to these requirements. A CMBS lender or major life insurance company will usually require both. Banks and credit unions will sometimes require either only a zoning letter, or in some instances only a zoning endorsement. Sometimes, but not always, the size of the loan will govern.

A quick primer on these requirements and nuances relating to zoning letters and zoning endorsements follows:

- A zoning letter is issued by the zoning department (or sometimes planning department) of a municipality or other local governmental entity having jurisdiction over zoning matters. The zoning letter states that the use of the property (e.g., office building located in an area that is zoned for such existing use) is permitted. Thus, a lender obtains a level of assurance that the municipality or governing jurisdiction will not at any future time disallow the existing use of the property or require that it be modified.
- The ALTA 3 Form Endorsement (or CLTA 123) may be obtained for unimproved land. It is designed to inform the insured under a loan policy of the zoning classification under which the land falls and to insure against loss or damage by reason of inaccuracies in the information supplied or a final judicial determination invalidating the zoning ordinance establishing such classification and resulting in the prohibition of such uses.
- The ALTA Form 3.1 Endorsement (CLTA 123.2) zoning endorsement is for improved property and expands the coverage in the ALTA 3 (or CLTA 123). It specifies the zoning classification for a property and uses permitted under the classification, subject to compliance with applicable CC&Rs, including obtaining necessary permits. It also insures against loss or damage resulting from a final court order that either prohibits use of the land with the existing structure or requires alteration or removal of the existing structure based on ordinance violations in area, width, depth, floor space, setbacks, or height. This endorsement excludes any marketability claims arising from a refusal to perform under a contract to purchase, lease or lend. A lender may also request that this endorsement be modified to add ordinance violations relating to parking requirements.

- A lender that only requires a zoning letter is lowering the cost for closing a loan since the zoning endorsement for improved property generally costs approximately fifteen percent (15%) of the base rate of the ALTA policy, and for unimproved property approximately ten percent (10%) of the base rate of the ALTA policy.
- A loan may be positioned to close on a "fast track" without a zoning letter if a title company will issue its zoning endorsement without it also requiring a zoning letter as a condition of its issuing a zoning endorsement. Here, competition among title companies may dictate how a loan may close. The title company usually examines local zoning ordinances and zoning maps to ascertain allowable uses and classifications. It may request the insured (i.e., lender) obtain a zoning letter from the local governmental agency stating the zoning classification and permitted uses. Prior to issuing a zoning endorsement without a zoning letter, for an existing structure the title insurance company underwriter may also require an inspection of the property and a review of surveys and existing plans.
- In today's competitive environments, some title insurance companies will only request a zoning letter from a local governmental agency when it is unable to obtain enough information on its own -- and even in those situations, its proceeding to issue coverage without a zoning letter is simply based upon insurable risk-related issues.

Clearly the benefit of a zoning endorsement is that it will be relatively easier to pursue a title insurance claim as opposed to "fighting City Hall" on a zoning letter relied upon.

Both the zoning letter and zoning endorsement can be issues of controversy. The zoning letter may take several weeks to obtain. The zoning endorsement obviously results in cost to the borrower. Some lenders may negotiate what will be required. Some lenders may not negotiate at all. A lender's credit and underwriting culture will be determinative of the outcome of attempted negotiations on this issue.