

Commercial Real Estate Financing: The Borrower's Perspective



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Tough times notwithstanding, there are ways for the commercial real estate borrower to use the lending process to its advantage.

WE ARE LIVING through difficult economic times, and every day there seems to be more bad news about the commercial real estate market. The numbers aren't encouraging. A recent newspaper article reported that: "Commercial property sales plunged 73% last year, according to Real Capital Analytics. Vacancy rates are rising, and hundreds of large properties are in default. The American Institute of Architects' billing index, a leading indicator of construction six months ahead, is at a record low. Unemployment in the construction industry is 15.3%, well above the average 7.2% jobless rate." See, Sue Kirchoff, *Economic downturn pounds commercial real estate market*, USA Today, updated Jan. 12, 2009, available at http://www.usatoday.com/money/economy/2009-01-11-commercial-real-estate_N.htm

But as bad as things might look for commercial real estate right now, an upturn will happen sooner or later. And despite all of the gloomy news, it is still possible to get a commercial real estate loan. The following outline is intended to help the borrower to make the best of the process by making the best use of the standard documents. Although there is no one-size-fits all solution for the borrower, there are fundamentals that can move the loan along or scuttle it. The practitioner should know as

much as possible about the client's project to get a clear picture of just how realistic the client's expectations are as a borrower.

I. COMMITMENT LETTER

A. A Commitment Letter Is A Binding Contract

A commitment letter is an important document in the loan negotiation process because it is a binding contractual commitment by the lender to loan money on the terms stated. In the commitment letter the lender will outline the terms upon which it is willing to make the loan and upon signing the commitment letter, the borrower is agreeing to borrow the funds subject to the stated terms. The commitment letter should contain all of the business terms and some of legal the terms for the loan.

B. Use The Commitment Letter Process To The Borrower's Advantage

1. Before the commitment letter is finalized is the borrower's best time to negotiate.
 - a. Unfortunately, borrowers often do not involve attorneys until after the commitment letter is executed, which can be too late because many of the loan terms are already locked in by the commitment letter.
 - b. Lenders are also less willing to negotiate terms of loan documents that were not included in a commitment letter.
2. Examples of items to negotiate at the commitment letter phase include:
 - a. In a multi-family apartment loan agreement, there is often a requirement that all leases be at least six months, no month-to-month leases are allowed. However, the borrower can negotiate a deviation from this standard language by asking for it in the commitment letter. This type of deviation would be much harder to get later.
 - b. Many loan documents preclude transfers of ownership interest in the borrower; but a borrower may want to have the right to transfer ownership for estate planning purposes in the future—most lenders have language which can be inserted into their forms, permitting such transfers without the application of transfer/assumption fees or prepayment “premiums”—but this alternative language needs to be negotiated for up front when the borrower has leverage.
 - c. The commitment letter negotiation phase is also a good time to try to get a reasonable cap on lender's legal fees, and other post-closing charges (such as escrow account fees) that are charged to the borrower.
3. The following standard terms appear in most commitment letters:

- Loan term;
- Interest rate (and if not locked, how and when to lock it);
- Amortization of payments;
- Whether a guaranty will be required;
- Prepayment premiums (if any);
- Commitment and loan fees; and
- Payment of lender's expenses.

4. The borrower should consider negotiating to have the following added to the terms outlined in the commitment letter:

a. Interest:

- How will it be calculated (actual days elapsed or 30-day months)?
- What is the mechanism to lock in an interest rate, if it is not already locked?
- Secondary financing: Does the borrower need or envision a second position deed of trust or mezzanine financing? If so, get it addressed in the commitment letter so it is excepted from the "due on sale" clause in the note or deed of trust. Also make sure the financing will be attractive. Will the second position lender have the ability to realize on its collateral?.
- Tax and insurance escrows: ask if they can be abated until there is an uncured monetary default.

b. Insurance Requirements:

- The borrower may want to get insurance requirements established and be able to satisfy them before executing the commitment and before paying the commitment fee;
- Is there is a form lease in place (or it is a single tenant property), and if so, can the lender agree that the lease's insurance section's description of coverage is sufficient?
- How much and what types of insurance are required?
- Can the lender change and increase the insurance requirements later?
- Can the borrower self insure, or include the property as part of larger (blanket) policy?

c. Recourse vs. Non-recourse Liability: spell out carve-outs in detail, rather than just state "standard carve-outs"—watch for carve-outs which create "full recourse" rather than just paying the lender for its damages caused by a particular breach.

d. Guarantor:

- Is the death of a guarantor is an event of default?
- Is there a restriction on transfer of guarantor's assets?
- Is there a limit on the guarantor's liability?

e. Expenses:

- Can you cap lender's legal fees?
- Can you cap charges for post closing escrow accounts?
- Can you use existing surveys?

f. Assignment/Assumption:

- Can there be at least one assumption by an acceptable borrower for a one percent fee?
- Will the assuming borrower assume based on the same interest rate?
- Will the original borrower and/or lender be released upon assignment?

g. Partial Releases and Partial Pre-payments:

- Are there multiple parcels of collateral being pledged? Does the borrower want some of them released as the loan balance gets paid down? If so, this should be spelled out in the commitment letter.
- Will the loan payment be re-amortized upon partial pre-payments (including application of insurance or condemnation proceeds)?

h. Extension, Late Charges, Default Interest, Cure Period:

- Extension: is there a provision to extend commitment date if needed?
- Consider asking for small late charges (flat dollar amount) and specific pre-determined default interest rates; ask for five to 10 days to cure (after notice if possible) for monetary defaults and 30 days for non-monetary (but with extended time if the default cannot be cured within 30 days).

i. Title Insurance:

- Are their oddities regarding title you need waived or endorsed around now? If so, the borrower should bring these up before paying non-refundable commitment fees.
- Ask for surveyor's certification early on as it is another long lead time item and the process should be started before the commitment letter is signed.

j. Opinion Letter:

- Can you get the lender to agree that any opinion letter required will be limited to borrower's authority and due organization?
- If a Delaware borrower entity, are you required to employ Delaware licensed counsel or will the lender let the attorney assume the laws of the jurisdiction where the property is located are the same as Delaware for opinion purposes (some lawyers may be willing to give Delaware authority opinions without being licensed in Delaware, this is risky and lenders may not be willing to accept it regardless).
- For large loans (\$20 million or more) the borrower may be required to obtain a bankruptcy remote opinion.

k. Confidentiality:

- Request confidentiality of financial information for both the borrower and guarantors;
- Try to have most confidential information contained in the loan documents and other unrecorded documents instead of in the deed of trust (e.g., release prices for parcels).

l. Other Lender Due Diligence. Be sure the commitment letter spells out what the lender will be spending borrower's money to get, including:

- Surveys;

- Appraisals;
- Environmental assessments;
- Review of entity documents, consents;
- Financial statements of borrower and guarantor; and
- UCC searches.

5. Timing: The limited time between finalizing the commitment letter and closing of the loan makes negotiating before the commitment is signed important. For instance, with a Fannie Mae loan, the time between execution of the commitment letter and actual closing on the loan is very short.

II. PROMISSORY NOTE

A. Initial Pointers

1. Enforceability Issues for Borrower's Opinion Letter

a. Statute of Frauds. Be aware that some states have specific language required with regard to the statute of frauds.

b. In Washington, for example, R.C.W. 19.36.140 requires that “[t]he creditor shall give notice to the other party on a separate document or incorporated into one or more of the documents relating to a credit agreement. The notice shall be in type that is bold face, capitalized, underlined, or otherwise set out from surrounding written materials so it is conspicuous. The notice shall state substantially the following:

ORAL AGREEMENTS OR ORAL COMMITMENTS TO LOAN MONEY, EXTEND CREDIT, OR TO FORBEAR FROM ENFORCING REPAYMENT OF A DEBT ARE NOT ENFORCEABLE UNDER WASHINGTON LAW.”

2. Recourse or Non-recourse

a. Distinction. The issue here is whether lender has a choice to sue on the Note and collect directly against the borrower (and perhaps the guarantor, with or without foreclosure), or whether the lender's only recourse will be to foreclose and take its collateral.

b. Carve-outs. In many instances you will encounter a non-recourse loan, but then the loan documents will have what the lender refers to as its “standard carve-outs.” There is a big difference from lender to lender as to what those carve-outs entail. Common carve outs lenders seek include:

- Full liability under the Note for actual fraud, violation of the “due on sale” transfer restrictions (including allowing junior liens or transfers of ownership interest in borrower);
- Partial liability to the extent lender was harmed for lesser issues—such as failure to apply insurance proceeds to rebuild, absconding with rent, etc.;

- Gray area—some lenders go to full liability, others to partial liability if there is a bankruptcy of a borrower or guarantor, or a violation of the single purpose entity (SPE) requirements.

B. Specific Note Terms

1. Parties

a. Are they jointly and severally liable on the Note? If there are multiple borrowers, this means the lender can elect to pursue any one of them and not sue the others.

• Practice pointers:

- If there are multiple borrowers, make sure there is an agreement between them as to what happens if one is called to pay on the Note; consider whether your client needs security for such an agreement;
- If there are multiple borrowers, make sure that notice addresses for ALL of them are included;
- The lender may want to require one payment from all borrowers, or not consider a payment made until the last dollar of the installment received, if it is coming in pieces from multiple borrowers (i.e. full interest accruing, default interest possible).

b. Lender's Participants. If the lender will later be acting as an agent for several participants, they will want to have language in the loan agreement or the note which states that one "lender" is designated as the agent, and only need to get approvals from that agent and only need to send notices to that agent.

2. Payment Schedule and Maturity Date.

a. No offset: point out to your borrower that it will not be permitted to offset against the Note payments any other sums which it claims the lender owes to the borrower.

b. Payment due at closing? Sometimes a lender requires the first payment at closing, even though interest has not yet accrued.

c. Principal or interest only? A lender may require periodic payments of the principal and interest.

d. Amortization? If the lender is requiring principal plus interest, find out if the amortization is the actual term of the loan or whether it is based on a 10, 15, or 30 year payment schedule—which means that you would have a "balloon payment" equal to the balance of the loan due at the end of the actual term.

e. Application of payments? If nothing is stated, then the lender has option to apply payments however it wants; if there is an understanding that certain payments should go certain places, the borrower will want to be sure to expressly state the understanding in the Note (for instance partial payments that will go to pay down principal to permit partial reconveyances).

3. References to “Security and Loan Documents” in the Note.

a. Deed of Trust (DOT). In Washington, for example, the DOT usually includes an assignment of rents, security agreement and fixture filing (so the lender will not need separate documents for each; however, some states require these be in multiple documents).

b. More complex loans may have the following additional documents:

- Separate assignment of contracts, general intangibles, etc.;
- Separate security agreement for personal property;
- Pledges of membership interests; and
- Deposit account control agreements (DACA).

4. Interest Rate. There are many permutations that you might see: LIBOR, prime plus, collared rates, periodic borrower election of rates.

a. “LIBOR Rate” is a rate determined by reference to the London Interbank Offered Rate; which is the short term lending rate between banks; it can be found at the British Banker’s Association Web page: BBA.org.uk.

b. Published Rates: If the interest rate is based upon a published rate, make sure publication of prime rate is identified, and includes “successors” to such publisher.

c. Simple or Compounding Interest Rates: if silent, the state law in the jurisdiction may have a default rate. For example, under current Washington it is simple interest. However, in Washington, if the loan documents state that interest is added to loan balance, it is deemed to be compounding.

d. I recommend stating specifically if the interest is simple or compound interest.

5. Prepayment

- Some loans allow a borrower to prepay at any time; others are “closed” entirely to prepayment until a date certain; and still others allow prepayment at certain times, but will exact a premium from the borrower for this privilege.

- Prepayment premiums are generally enforceable and not viewed as a restraint on alienation in a commercial loan.

- There is no requirement that lender allow a prepayment, although most will if a prepayment premium is paid.

- Some lenders allow partial prepayments, others only accept full prepayment:

___ With partial prepayment, ask if amortization (installment payment amount) can be re-cast after a partial pay down?

___ Try and get as much flexibility with partial prepayments as possible (number of times, amounts, etc).

a. Types of Prepayment Premiums

- It is common to see the premium as a schedule, with a percentage of the loan balance used, declining as time goes on;
- Others use a Yield Loss Premium—how much they will lose on the loan when they go out and reinvest the funds;
- Certain national forms use a “consequential loss” which appears to be the same as a yield loss but could include other losses;
- Others use a “Defeasance” requirement—essentially the borrower is required to purchase replacement security, a t-bill, that will pay off the loan at the original interest rate; there are defeasance businesses now (e.g., Defease With Ease) and some lender’s have “defeasance products” that borrowers are forced to purchase as part of the deal; defeasances can be very expensive and there should be careful consideration at the front end before the borrower opts for a loan with a defeasance requirement;
- The reason for some of the onerous prepayment premiums is because of the mortgage-backed securities industry, which promised investors a certain rate of return on their investment with the promise being based on the interest rate in the Note.

b. Exclusion from Payment of Prepayment Premium

- Most lenders will require borrower to pay premium if entire loan becomes due because of a borrower default;
- Most will not require the borrower to pay premium if there is a casualty or condemnation which results in partial or full prepayment (although some will—consider if the condemnation or casualty was the result of borrower’s actions); and
- Others will ask the borrower to apply for the premium as part of the condemnation proceeds, but will not require it be paid over unless the borrower actually receives it as part of such award (in that instance, be sure the loan document expressly states no borrower liability for the premium unless and then only to the extent such award is actually received).

6. Late Fees; Default Interest

a. Late Fees:

- Loan payments are often due on the first day of the month, but try and negotiate a payment due date of the 10th (kind of a built in grace period); otherwise try for some grace period before late fees apply;
- Some forms use a flat percentage of the delinquency; some lenders want a minimum flat rate; borrowers should try to limit the percentage or cap the late fees;
- NOTE: late fees are usually drafted to be in addition to default interest, and it might start to accrue even if no “default” or no “notice”—if the clause states it is simply due if payment not received within x days of due date.

b. Default Interest. Default interest is usually assessed after a default has occurred. However, the default interest provisions are usually separate from the loan default section and could be included in the late charge language—x days after payment due; x days after receipt (dispatch of notice of default), upon an occurrence of an event of default (this is a killer, because it could be an immediate situation causing

the borrower to incur default interest before a cure opportunity or other remedies are exercised, resulting in the default interest accruing because there is not mention of cure periods).

7. Defaults

a. **Payment Default.** Most loans provide for a 5 or 10 day grace period after a payment due date; not after notice; some might even say failure to make a payment results in an immediate default, but the lender might not enforce its rights until any cure period expired; this particularly true if there is a requirement to send payments via ACH—in which case you will want the borrower’s agreement with its depository bank to have that bank assume full liability for late payments caused by the depository bank’s error.

b. **Other Defaults.** Usually the Note contains cross references to other Loan Documents; it might even contain cross default language with other loans (indeed, there are national lenders with form commercial loan documents which state that any default on any contract or obligation to anyone—not just the lender—is an event of default!); and reference the default provisions in those documents or deals—so you will want to make sure those documents are all consistent.

c. **No Transfers (aka “Due on Sale”).** This usually appears in the deed of trust (discussed below); note that the transfer can be defined pretty broadly and some documents do not have any cure periods before (i) calling loan due; and (ii) triggering FULL recourse carve out liability.

d. **Lender Remedies.** Lenders often require the right to immediately accelerate the note upon payment default and to collect on the entire balance—be careful here. If the lender decides to go the non-judicial foreclosure route, then in reality borrower will have right to reinstate loan up to 11 days before foreclosure sale under Washington law (but every state is different, very different)—by curing defaults and paying lender’s expenses; but if Lender decided to simply sue on the note, the borrower may not have same right to de-accelerate, unless it files for bankruptcy; it is important to determine what rights a borrower would have under the state law that applies to the loan.

e. **Attorneys’ Fees.** Attorneys’ fees clause should be bilateral. The law in some states (e.g. Washington) requires that unilateral attorney’s fees be interpreted as bilateral.

8. Other Miscellaneous Clauses:

a. **Waivers of Statutory Rights and Jury Trial.** Query whether waiver of jury trial is enforceable? This may vary by jurisdiction. I recommend a general carve out in the opinion letter for the enforceability of any waiver of a statutory right given prior to a default by a borrower.

b. **Subordination of Rights.** When there are multiple borrowers or guarantors, they are often required to agree to “subordinate” any rights against each other to the lender’s rights until the Note is paid in full.

c. Notice Sections: Notice sections can provide for effectiveness upon a variety of events. For example, notice could be effective on dispatch, regardless of delivery; or the lender could require appointment of someone locally as the borrower's recipient of notices.

d. Partial Releases:

- The borrower should be concerned and make sure that provisions for partial releases do not include any subjective elements whereby the lender could delay or extort terms that a desperate borrower might be forced to agree upon in order to close its pending flip sale;
- Try to use predetermined schedules and amounts for partial releases and not leave anything up to lender's discretion; and
- Do not allow the lender to include partial release prices in the deed of trust because this could provide a future buyer with information that could skew sales negotiations.

e. Assumption Provisions and Rights. Some lenders permit a one-time right to assign the loan and allow the original borrower and guarantors off the hook; the borrower's counsel will want to review the criteria for assignment and assumption and get the lender's commitment to flexibility in evaluating and approving such replacements as much as possible.

III. DEED OF TRUST (DOT)

A. Initial Pointers

1. Public Document. The borrower will want the DOT to contain a minimum amount of information. For example, release prices for partial reconveyances should be put in the promissory note and not the DOT. Also, the financial structure of the borrower entity may be private information; put it in the loan agreement, not the DOT (consider that the names of guarantors or permitted transferors may be "confidential" and you will want to simply refer to an exhibit to the promissory note or other unrecorded document).

2. Deed of Trust Act. Most loans secured by real property will be secured by a deeds of trust; other documents that serve a similar purpose are mortgages and real estate contracts.

B. Specific Sections of DOT

1. Parties. The borrower may also be referred to as the trustor or grantor. An initial trustee will be identified. The initial trustee can usually be changed by the lender/beneficiary upon giving notice to parties.

2. Certain Defined Terms

a. **Indemnified Matters (or “Claims”):** The lender may try and include consequential damages. I recommend trying to get this excluded.

b. **Loan Documents:** be careful if the DOT states that all obligations under the “Loan Documents” are secured by the DOT. If Loan Documents is defined to include the Environmental Indemnity and the Guaranty, then there is a question whether they survive foreclosure—which you may need to raise with the lender or at least address in the opinion letter.

c. **Rents and Profits Definition (see discussion of collateral below):** Be careful here—rents and profits are often included in the definition of the lender’s collateral.

d. **Secured Indebtedness Definition:** Sometimes lenders try to secure all amounts owed to that lender, not just the amount owed under the current loan.

e. **Transfer Definition:** Carefully review the DOT restrictions on transfers. Assignments, pledges, and encumbrances are frequently included in the definition of a “transfer” which means that a limitation of a transfer of the ownership in the borrower would include a limitation on pledging the stock or membership interest in the borrower as part of mezzanine financing.

3. **Granting Clause.** The granting clause grants the “power of sale” to the trustee and states that the property will not be used principally for agricultural uses, which is a requirement for non-judicial foreclosure (at least in most jurisdictions).

a. **Collateral Included in Grant.**

- The granting provisions often grant rights in more than just land and improvements, and may include profits, proceeds, personal property, insurance proceeds, permits, and plans:

__ Watch for instances in which there may be conflicting or senior interests in the same collateral: practice pointer—condition the grant of the security interest in items such as fixtures and equipment located within the property ‘to the extent of borrower’s interest therein’ since they might be owned by tenants; and

__ Watch out for restrictions within the collateral to such assignments or transfer (e.g., plans and permits, contract rights).

- Particularly watch for a grant of a security interest in deposit accounts:

__ Pitfall in Residential Apartments: the security interest the lender has in those deposits is junior to the tenant’s claim to the deposit—by statute; the practitioner will want to carve out from opinion letter or try and get carved out of loan entirely (*see, e.g., Wash. Rev. code §59.18.270*);

- **Grant of Interest in Leasehold Estate:** It is not uncommon to see loans and deeds of trust against a ground lease rather than fee simple title; usually the lender has to agree its loan is junior to the lessor’s interest, although there are instances in which the lessor has agreed to subordinate its fee to the deed

of trust—particularly when significant improvements are being made to the property with the loan proceeds:

— A borrower will want careful drafting in the mortgagee protection section of the ground lease to make sure it does not mess up potential for future loans—the “mortgagee protection” section of should give the lender time and the right to cure borrower defaults under the lease and to step into tenant’s shoes; in addition you will want a ground lease term that exceeds the loan term and have the lease state the tenant owns its improvements until the term expires.

4. Other Security Interests. In addition to a lien on real property, accomplished by the grant to the trustee, there is usually a grant of a security interest directly to the lender and there should also be a provision authorizing the lender to file UCC financing statements and stating that the DOT is a fixture filing.

5. Borrower’s Representations, Warranties, and Covenants.

a. In addition to authority to execute the loan documents and encumber property there are often representations, warranties, and covenants regarding status of collateral and subsequent use and protection of it. Examples include the following:

- No construction liens, etc: Watch for potential liens for pre-closing work such as surveys and engineering. As counsel to the borrower, you will want to carve out any representation for such liens and state whether they are subordinating to the lien under the DOT at closing or will be paid and lien waivers will be recorded at closing;
- I would also recommend negotiating a cure period if a lien gets filed, such as get it removed from title within 30 days after notice.

b. Taxes, etc: Make sure the borrower is only required to pay current “installments of assessments” rather than entire assessments; often local improvement district assessments run over 20 years or more; and consider whether to add in some right to contest taxes and a delay in performing this covenant during such contest.

c. Insurance Coverage:

- Need to confirm ability to obtain required coverage as soon as possible;
- In some places it is not possible to get occurrence policies for reasonable prices, but only coverage for claims made—which means this section would need to be changed;
- Also look at language like: “Such other insurance... as from time to time may be required by Holder...” this is a real hornet’s nest; the borrower may want to get a side letter or exclusion for terrorism, earthquake, etc.;
- Look at insurer requirements and check with your broker to see if required ratings are reasonable; and
- In general, consider if you want to ask to be permitted to self-insure, or have this property included as part of a blanket policy.

d. Insurance Proceeds:

- First consider whether the borrower wants the right to rebuild the property if there is a casualty; if so, you may want to draft a section with a construction draw process where the lender or a third-party escrow holds the insurance funds and the borrower draws down as it rebuilds; and
- Consider also that lenders under a DOT often want the right to “settle or adjust any claim...” but the lender’s motivation to settle may be limited to paying off its loan; so you will want borrower to have a right to participate as well.

e. Reserves for Insurance, Taxes, Assessments:

- Try to defer obligation to pay into an escrow account until there has been an event of default;
- Some lenders will go even farther and say you only need to pay if you are “in default”;
- The DOT may provide the lender can keep any excess and decide to apply it to future obligations or paying down your loan;
- These provisions usually state the lender does not have to pay interest and can commingle the funds; and
- If there is a default, most DOTs provide the lender has a security interest in these funds and can apply them to loan balance and NOT pay the taxes or insurance.

f. Condemnation:

- Again, the borrower may want a right to use the funds to rebuild, rather than have lender apply the proceeds against the loan; and
- Some loan documents contain a clause that if lender applies insurance or condemnation proceeds to pay down the loan balance, the lender STILL wants borrower to pay the prepayment premium—a borrower should be able to negotiate for the deletion of these provisions.

g. Maintenance, Repair, Restoration, and Operations. Some things to keep in mind:

- Watch for strict limitations on borrower’s ability to improve the property unless lender consents;
- Try to build in provisions that the lender’s consent will not be unreasonably withheld, delayed, or conditioned;
- For construction projects you might try to build in a process for approvals (such as 10 days), after which silence equals approval;
- Watch out for provisions allowing the lender to require the borrower “tear down” an improvement on the property; and
- Another common restriction is on anything that will increase insurance premiums.

h. No Other Liens: This type of provision would preclude any junior financing secured by the property even though senior lender is adequately secured. Also, borrower’s counsel may want to negotiate for the right to certain junior financing if you know it will be necessary.

i. **Further Assurances.** These provisions generally do not seem onerous, the borrower is just agreeing to execute other documents needed to secure the loan properly and comply with banking laws, but often the lender includes that the borrower is going to pay all costs associated with those extra documents; the lender will argue these are reasonable expenses because it is part of the loan, but the borrower should argue back that it is a surprise waiting to jump up and should either be asked for it now, or if lender messes up then lender pays later.

j. **Fees and Expenses.** The responsibility for these is usually resolved in the commitment and closing statement. Some lenders try to include “allocated cost of services provided by in-house counsel.” Try to carve out lender’s subsequent expenses relating to the transfer or participation of the lender’s interest in the loan (e.g., if the lender sells the loan to another bank and needs to get a new environmental study in connection with the sale, the borrower should not have to pay its cost).

k. **Indemnification.** Get a carve out for lender’s negligence and misconduct. To the extent this indemnification is mirrored in any other loan documents, those other documents might not be enforceable post foreclosure. For example, if there is a separate Environmental Indemnity and the DOT also includes an indemnity for hazardous materials. Watch for other miscellaneous documents that could have indemnities that get wiped out.

l. **Taxes on Note or Deed of Trust.** Often there is a provision which states the borrower pays any taxes assessed on the loan, such as a mortgage tax; the borrower will want to carve out estate taxes and income taxes generally. Consider revising this section so that the borrower is only obligated to pay new taxes resulting from charges after date of loan closing and then the borrower should have the right to prepay without penalty if such a tax is imposed in the future (on enough advance notice to find replacement financing).

m. **Estoppel Statements.** Try to get 10 business days to obtain estoppel certificates; also try to limit frequency with which the lender can make such requests, at least pre-default, to no more than twice per year.

n. **Status of Borrower.** The lender will require covenants by the borrower to permit lender to file UCC statements in correct state (e.g.: state of formation, UBI number, actual legal name). Frequently the borrower must give the lender advance notice of a change in the state of formation. Watch for instances in which the lender wants to have consent rights over such changes—argue it is overreaching for the lender to control the state of formation for the borrower entity.

o. **Rent Rolls, Operating Statements, Tax Returns.** Try to get some confidentiality provisions here if possible and make sure requirements are reasonable with regard to frequency of reporting information and format required.

6. **Performance by Holder: Cure period.** Sometimes at end of covenants is section that gives lender right to cure if borrower fails to perform a covenant:

- There should be some cure periods allowed for the borrower before the lender acts. Also check to see this section is consistent with the provisions in defaults and remedies section;
- A cure period of five days after notice is common for monetary defaults (at a minimum);
- 15-30 days after notice for non-monetary defaults, with additional time necessary for defaults that are not curable within the shorter time, so long as the borrower is diligently and continuously pursuing (may need to agree to outside deadline but try to just say no default if diligent); and
- The borrower should have at least 10 days to reimburse the lender for any expenditures after notice has been given, before it becomes a payment default (although default interest probably will accrue from date of expenditure).

7. **Covenants Regarding Leases.** Look for limitations on the borrower's ability to manage the property. There are usually limitations on ability to lease—consider seeking advance approval of a standard lease form and rent range as well as limits on the borrower's ability to terminate leases—ask for ability to terminate leases in default without lender consent. Leases are usually required to be subordinate to loan.

8. Default

a. Events of Default

- Be concerned if there are no cure periods. This could result in a default occurring immediately. Either here or in the remedies section insist on some cure period (and hopefully notice) before lender can act; and
- Look to make sure any cure periods given are consistent with cure periods under other loan documents.

b. General Transfer Restrictions:

- You may want to build in a one-time assumption right into the note or loan agreement;
- List what criteria the lender might consider in approving a transfer, but if too much is left open it may not be useful tool later (e.g., can the lender raise the interest rate, keep the original borrower and guarantor on the hook?);
- These restrictions usually preclude junior encumbrances, since a “transfer” is usually defined to include pledges;
- Be sure to determine if the original borrower and guarantors can be released upon an approved transfer; and
- Try to get certain estate planning and other transfers permitted without fees.

c. Restrictions on Transfers of Interest in the Borrower:

- These restrictions preclude transfers of ownership interests in the borrower;
- Many borrowers want to be able to transfer interest for estate planning purposes; such transfers should be permitted so long as the same natural person remains in charge of borrower at end of the day; and

- These restrictions also often preclude the pledge of ownership interests for loans—aka “Mezzanine Financing.”

9. Remedies. The Remedies section is the usual place for cure periods. As a practice pointer, you will want to make sure the notice and cure periods are consistent in all loan documents— it is fairly common to see them in one document and not others. Consider enforceability of acceleration and termination clauses in DOT; if you are in a state that has a non-judicial foreclosure statute, that statute should trump, and the borrower should be given time to cure the defaults and reinstate the loan.

10. Miscellaneous Clauses

- a. Financing Statement: The DOT will constitute UCC fixture filing, but the lender will still need to file a UCC-1 financing statement in the state where borrower entity is formed to perfect its security interest in personal property.
- b. Waiver of Jury Trial: These provisions are commonly seen, but may not be valid since the waiver is given pre-default.
- c. Substitute Trustee: Although the ultimate trustee will end up being a neutral party at the time of a foreclosure, the beneficiary can usually appoint and change the trustee unilaterally under the Deed of Trust Act.
- d. Applicable Law: Watch for references to other states laws; the law where the property is located should govern foreclosure.
- e. Make sure legal description, permitted exceptions, and notary blocks are correct—particularly if the signatory is in another state.

IV. GUARANTY

A. General Points

1. In some states a guaranty will likely survive foreclosure, this is not the rule in all states. Check the law for your state.
2. Individuals as Guarantors. If the guarantor is a married person, has the spouse signed? Is the spouse consenting to the use of spouse’s separate property to secure the guaranty or just the use of community property? In a community property state there will be a presumption that the debt is a community debt even without the signature of spouse.
3. Types of Guaranties:

a. Unlimited, Joint and Several, Full Guaranty:

- Each guarantor is 100 percent liable for payment of the secured debt;
- The guarantor remains liable even if other guarantors are released; and
- For joint and several guaranties, consider if the guarantors want a formal agreement between them on liability.

b. Limited Guaranty:

- Set dollar amounts or time limits; and
- Also consider joint but not several guaranties; in which each guarantor only has a portion of liability.

c. Collection Guaranty:

- Try to get the guaranty to be “of last resort;” so that lender must first collect on loan, realize on collateral, before going after the borrower; and
- Difficult to get accepted by lender, but try (include in commitment letter negotiations if you want to get it).

4. Other General Considerations

a. Consider whether the guaranty ties up the guarantor’s assets unrealistically—if so:

- Argue that the loan is already fully secured by the collateral; and the lender does not need more collateral to secure its debt; and
- Argue that the guarantor needs to be able to transfer assets for estate planning purposes.

b. As a related matter, look at the frequency and type of financial reporting required of the guarantor. Is it onerous, unrealistic? Should the information be kept confidential?

B. Specific Comments Regarding Guarantee Sections

1. Parties

a. As noted above, if the guaranty recital references “husband and wife,” this may imply that both the spouses’ community and separate assets will be subject to the guaranty; is that what the parties intend?

b. If it is desired to protect separate property, then such separate property should be specifically carved out.

2. Preliminary Recitals

a. This section should recite that the guaranty is executed on the same date as the note. This is necessary to show the note and loan were contemporaneous with guaranty; otherwise there is an argument of no consideration for the guaranty.

b. Often there will also be a recital that the guarantor has a financial interest in borrower or stands to benefit from the loan directly or indirectly (to show consideration for giving guaranty).

3. Guaranty of Payment

a. This may include the obligation to pay under the Environmental Indemnity, not just under the note and DOT; and

b. Frequently the guaranty includes a guaranty of all renewals, extensions, and modifications of the original loan.

4. Primary Liability of Guarantor and Transfers by Guarantor:

a. Death of a guarantor can be an event of default; the borrower may want to negotiate time period for replacing a deceased guarantor (such as the 45 days), and consider having a back up person already approved, or where there are several guarantees simply state that death of any one guarantor is not an event of default.

b. Guarantor's bankruptcy should be treated similar to death; if a substitute guarantor is available then a cure should be permitted—there should also be a distinction between voluntary and involuntary bankruptcy petitions, and a reasonable cure period (90 days) to get out of an involuntary bankruptcy.

c. Entry of Judgment—you will want a threshold amount and a reasonable time period to bond around or get reversed.

d. Writs of Attachment, Garnishment—again, you will want an exclusion for small writs and cure periods; particularly where they can be prejudgment attachments that are pretty easily entered against real estate.

e. Transfers—be concerned with limitation on estate planning transfers that might impede the guarantor in ways that were not intended or understood.

f. Remedies. Three points:

- Worry if there are no cure periods;
- Worry if there are no notice requirements (should demand notice of defaults); and
- Note if it is a full payment guaranty, the lender is not required to pursue borrower or collateral first.

5. Certain Agreements and Waivers. Two points:

- Waiver of limitations on recovery—it may not be enforceable; and
- Limiting objections—sometimes you will see a section which limits guarantor’s rights to claim amount received in sale of property too low.

6. Subordination. Four points:

- It is common for the lender to want the guarantor to agree its claims against borrower junior to debt;
- The guarantor may want the ability to collect certain amounts due from borrower even before loan is paid off—such as management fees, salary, income tax distributions;
- Some lenders are willing to allow distributions so long as there is no default; and
- Sometimes the guaranty contains a hidden grant of a security interest to the lender in claims against borrower, such as dividends.

7. Governing Law: Try to insist on the law of the jurisdiction where the property is located.

8. Attorneys’ Fees: Try to make this bilateral.

9. Financial Statements: Make sure they are confidential and that the required format and timing are not onerous.

10. Right to Set Off: Usually a guarantor has no right of offset against the lender; but lender can sweep the guarantor’s bank accounts to pay the debt any time there is an event of default.

V. Other Loan Documents You Might Encounter

1. Environmental Indemnity. Whether by borrower and/or the guarantor, the issue is post-foreclosure enforcement. You want to make sure that it does not include actions after lender takes possession.

2. SNDAs (Subordination and Nondisturbance Agreements). Consider the time to get these and be sure adequate time is allowed; whether there is a form already agreed upon in lease; and whether the lender is trying to modify tenant’s rights under the lease.

3. Intercreditor Agreements. Junior creditors often need the right to exercise their remedies, including foreclosing and stepping into the borrower’s shoes, but senior lenders can be reluctant to give this right (making it much harder to get junior financing).

4. Reserve Account Agreements. Watch for hidden fees and limitations on disbursements.

5. Assignment of Contract Rights. You will want to make sure that the contracts can be assigned.

6. Loan Agreement. They are common in Construction Loans, or other instances in which the loan will be funded in the future via draws.

7. DACA (Deposit Account Control Agreements). If there is a bank account which is part of the collateral for this agreement, the DACA between the lender, borrower and depository bank will determine whether the lender has an enforceable security interest in the account. Security interests in bank accounts are perfected by control.

8. Opinion Letters. They should cover:

- Valid organization;
- Authority to sign;
- Enforceable loan documents;
- Usury;
- No zoning or title; and
- Non-Consolidation

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