How To Streamline, Simplify, and Save Money in the Loan Closing Process

The costs and crises of nonrecourse loan closings can be reduced through planning and use of common sense.

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Real estate finance today operates in a completely national market, with national closings. Industry participants may close a "one-off" deal in Dallas today, another in Upstate New York tomorrow, and then a portfolio loan in a random handful of other states the following week.

The increasingly national scope of financing arises in large part from the appetite of national capital markets for securitizable product. Even lenders who plan to hold their loans for portfolio will, more than ever, lend on properties in almost any location. And all categories of lenders want continuing relationships with solid borrowers who will be the sources of repeat business. "Deal flow" will come from wherever good borrowers find good deals.

At the same time, borrowers have become increasingly impatient with delays and transaction costs. They press lenders to figure out new ways to squeeze time and money out of the closing process. Increasingly, participants in real estate finance believe that the closing of every loan should require little more than "pushing a button"—once to generate documents and a second time to send money.

Documents and the money are, however, only two of the many elements of a real estate closing, and perhaps the easiest elements. By its nature, commercial real estate is a relatively complicated asset. Each piece of real estate is different in some way or another. Sometimes the differences are minor, but the fact that they exist at all requires some degree of asset-specific attention in every case. And attention takes time—both time spent to understand and deal with the asset, and lead time to get the job done. Variations in law and practice from state to state only further complicate matters.

The marketplace expectation of pure nonrecourse financing for permanent loans forces lenders to stay disciplined and as careful as possible about their collateral. If the lenders are not going to rely on the borrowers' credit, they must rely on their collateral. And they need to be sure that such reliance is sound. Consequently, they must ask for as much information and documentation as possible about the property and must take every possible measure to identify and eliminate property-related risks.

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Much of this information and documentation will come from third parties. Some of those third parties have no particular incentive to cooperate or, at least, to cooperate quickly. Even if a third party is being paid, they may have other things going on that take priority over helping a one-time customer who is trying to consummate a mortgage loan closing in another city.

A fundamental tension between the interests of lenders and developers colors the closing process.

At the same time, borrowers always have some compelling reason why their particular transaction must close by a particular date. Perhaps they have signed a contract with a "time of the essence" outside closing date, perhaps driven by their own or someone else's deadline for favorable tax treatment. Perhaps they have negotiated an agreement with an existing lender who will accept a discounted pay-off but only if the transaction closes by a particular date. Or perhaps they have found a tenant who is threatening to go elsewhere if the borrower hasn't closed new financing for tenant improvements by a certain date. Or they may have waited too long to arrange new financing to replace a loan about to mature.

In any of these cases, the borrower has probably shopped around for financing, playing one lender against the other to minimize rate and maximize loan proceeds until the actual time left to close the loan is short.

It would be easy to suggest that borrowers shouldn't get themselves into jams like these. But in today's real estate market, buyers outnumber sellers. If one would-be buyer won't agree to close quickly, then the next buyer will. So borrowers often have little choice. And even when they do have a choice, they typically push for a fast closing anyway because their new financing is priced more attractively than the old. (That's why they arranged it.)

For these and other reasons, today's multi-state multi-property loan closings—events that should be mundane, routine, and boring—often become far more exciting than any of the participants would like, containing elements of a horse race, a suspense novel, and a game of chess, with the stakes potentially measured in millions of dollars.

THE FUNDAMENTAL TENSION BETWEEN LENDERS AND BORROWERS

A fundamental tension colors the entire closing process. It arises from differences between a lender's view of the world and that of developers or borrowers. Developers and borrowers consider real estate to be an opportunity that carries both potential benefits and potential risks. A developer or borrower who invests in a diversified pool of real estate will have some degree of willingness to "roll the dice" concerning issues and problems that may arise from particular projects. Developers and borrowers accept some levels of risk and make acquisition or investment decisions based in part on an intuition that tells them whether a project is "a good deal" with a reasonable upside to balance possible downsides. These equity investors may be willing to make a quick decision based on limited information.

Lenders need to be more conservative. They don't have upside. They just have downside. As their best possible outcome, they will be repaid the money they lent. Their expected outcome never gets any better than that. Because of the nonrecourse nature of most real estate financing today, the lender will be the party left holding the bag—a big bag—if a project falls short of the parties' expectations or suffers from some fundamental flaw that the lender missed in its due diligence.

Borrowers may argue that the price of real estate financing adequately compensates lenders for the risk of sometimes being the "bagholder" for a bad project. According to this argument, lenders as a group should be more flexible and willing to accept risk and uncertainty, even on nonrecourse deals. Whether that is true, particularly today when spreads provide relatively little compensation for the pure use of money, is an issue outside the scope of this article.

Today's lenders believe that what they are being compensated for is a) the pure use of money, plus b) whatever minimal residual real estate risk remains after their due diligence. Consequently, they must try to identify every risk that can be identified and eliminated.

IDENTIFYING AND ELIMINATING RISK

It is the lender's process of identifying and eliminating risk that causes complexity, friction, and delay in the closing process. The problems typically arise in about a half dozen identifiable areas.

Most of them relate to the link between the actual real estate out there in the real world and the lender's need to obtain a) information about that real estate, and b) legal and practical comfort about the risks the real estate creates. Almost every one of these areas is unique to the real estate closing process. The problem areas are:

- The loan documents themselves;
- Title review, clearance, and endorsements (including survey);
- Out-of-state legal requirements, where applicable;
- Lease review and documentation supplied by tenants;
- Third-party property reports (appraisal, environmental, and engineering);
- Forming the borrower and issuance of an opinion of borrower's counsel; and
- The mechanics of actually moving the money and closing the deal.

In each case, lenders and borrowers can prevent delays, problems and crises by taking a series of specific steps, generally involving a combination of a) making each closing a routinized and mechanical process consistent with industry expectations and requirements for similar closings; b) the borrower's looking ahead, early in the process, to the lender's future closing requirements; and c) identifying a handful of new ways to speed along and simplify the process.

As a consistent theme, borrowers need to identify exactly what their lenders will require for the closing, then integrate those requirements and deliveries into the borrower's own closing process. That sounds perfectly obvious and easy. In practice, however, it is often not so.

In the pressure of making a deal, borrowers can often forget that they have a lender until a few days before the closing. At that point, the process of satisfying a lender's perfectly routine closing requirements becomes an emergency that requires far more time and attention (hence money) than it really should have. And lenders can do their part by identifying, standardizing, and simplifying their requirements for closings.

Often, a borrower will arrange an acquisition facility with a particular lender, where the lender commits to finance a series of future acquisitions on specified terms, after an abbreviated property approval process for each advance. A borrower under one of these facilities will often assume that because the facility is in place the money will simply be available when needed at every closing. It just doesn't work that way.

A loan, even a secured loan, starts out as a fairly simple proposition.

Even with a reliable acquisition funding line from an accommodating lender, the real estate is still real estate. The lender must deal with all the site-specific details in about the same way every time. An acquisition line may simplify and speed up part of the process—negotiation of the generic loan documents and underwriting of the borrower—but little more.

THE LOAN DOCUMENTS

A loan, even a secured loan, starts out as a fairly simple proposition. It is a promise to pay money backed by a lien on some real estate. From that starting point, though, the peculiarities of real estate and the discipline imposed by nonrecourse lending drive an ever increasing range of documents and closing requirements. Each document or delivery the lender requires is intended to memorialize something about the property or the deal, to create security, or to control some risk identified by the lender.

The topic of how to simplify loan documents goes far beyond the scope of this article.[1] This article focuses merely on multi-advance acquisition lines where the parties negotiate the basic loan documents once, then use those templates to close subsequent advances for particular properties. Nevertheless, the parties can take a few measures in every loan to simplify and streamline the loan documents, and hence speed up the closing process:

- *The loan documents should address each topic only once.* Rather than repeat a provision in the note, mortgage, and loan agreement, the loan documents should make the same point only once, in only one place.[2] Aside from simplifying the documents, this approach saves time and work and reduces the risk of mistakes, inconsistencies, and delays if (when) the terms of the transaction change.
- *Whenever possible, lenders should try to combine documents.* Instead of having the borrower sign four separate pledge agreements to

pledge four different types of non-real-estate collateral all on about the same terms, the lender should combine these agreements into one on appropriate terms. Or, better yet, if the loan involves a loan agreement, a lender might consolidate all the security agreement provisions into the loan agreement.[3] Similar principles apply to all the various certificates that a borrower delivers at closings. In general, whenever someone suggests creating another document or certificate for some purpose, the parties might ask whether they can simply live with or modify the documents they already have.

> Lender requirements drive an increasing range of documents and demands.

■ *Dealing with reserves.* The subject of "reserves" to address particular property-specific problems typically arises at the last minute as the last few "due diligence" loose ends get tied up. Because every dollar of reserves implies another dollar of cash equity in the deal at the closing, and negative arbitrage on frozen funds, borrowers hate reserves. And the details of each reserve often become more complicated than seems objectively justified. Lenders might re-examine how their documents treat "reserves" and try to streamline and generalize these provisions so they require less customized attention as each particular issue arises. (As an alternative to creating elaborate reserves and revising the documents to deal with them, the parties might, at least for small reserves, consider simply reducing the loan amount.)

■ *Side letters cause confusion.* When the parties agree on last-minute understandings to resolve last-minute problems, they often enter into one or more side letters. These documents are particularly likely to cause future confusion because they tend to be forgotten or lost. The preparation of side letters requires more logistical coordination (signatures, distributions, tracking, etc.)—hence time—than simply adding a few paragraphs at the end of the loan agreement or other document.

■ *Know when to stop.* A lender can always identify one more risk and think of some new document or delivery to require at closing to mitigate the risk. At a certain point, though, a lender should ask whether the incremental risk mitigation justifies the incremental bother and cost of yet another document or closing requirement.

■ *Variations among lenders.* It often seems that lenders that specialize in small and simple loans have the most complicated closing requirements and require the most numerous documents, perhaps inspired by the complex pile of paperwork required for residential mortgage loans under federal law and regulations. In contrast, lenders specializing in larger and more complicated transactions often have simpler and fewer standard documents. The differences in closing procedures between these types of lender may suggest further ideas for streamlining and simplification.

■ *Fewer drafts; fewer distributions.* For any loan or multiproperty lending facility, lender's counsel must at some point prepare a set of documents to secure each particular advance. Ideally lender's counsel should have all the information they need about each property before they start preparing the security documents for that property. First drafts are easy to prepare and distribute. Subsequent drafts, because they require significant editing, can be more work than first drafts to prepare and distribute. All parties should therefore try to make sure that the first draft of property-specific documents is also the last. Borrower and lender should develop and follow a coordinated set of procedures to give lender's counsel—once—all the information they will need for each set of property-specific documents. This might take the form of a formal "loan data sheet," with blanks for every item of information required for each advance. (For an example, see Appendix 2.) In a perfect world, the borrower would obtain all that necessary information—not just most of it—before forwarding the "loan data sheet" to lender's counsel to start work on the documents.

"Over-Negotiation" of the Loan Documents

Borrowers often add complexity, delay and expense to the loan documentation process by over-negotiating the documents. As is true of every element in transactional real estate, every possible change that a borrower might request can be logically justified. Looking at the bigger picture, however, a borrower might conclude that whatever the documents say, realistically only one of two things will happen: the borrower will pay the loan and everyone will be happy; or the borrower will not pay the loan and the lender

will eventually own the property. A borrower taking this approach might then conclude that only these four elements of the loan documents have any practical significance or meaning:

Many of the problems of title renewal and clearance can be avoided or eliminated.

- *Basic accuracy.* The loan documents should property reflect the fundamental economics of the business deal.
- *No instant default.* The loan documents should reflect reality at least to the extent that the borrower will not automatically be in default the moment they sign the documents.
- *Control of personal liability.* To the extent that the borrower's principals have agreed to be personally liable for any obligations under the loan documents, that liability should be as limited and carefully defined as possible, consistent with the business understanding, and, if possible, it should not extend to any risks that the principals cannot themselves control.
- *Prepayment flexibility.* The borrower might also want to maximize its prepayment flexibility, as the right to refinance and prepay give a borrower the ultimate escape hatch (or threat) if the lender turns out to be uncooperative down the road.

Measures like those suggested above for both lenders and borrowers can help the parties streamline and simplify the loan documentation process. But the loan documents are within the control of borrower and lender. They are the easy part. The process gets harder as soon as third parties enter the picture.

TITLE REVIEW, CLEARANCE, AND ENDORSEMENTS (INCLUDING SURVEY)

The process of title review and clearance, which culminates in issuance of a title insurance policy, typically requires significant work and time during the closing process. Much of this work and time can be avoided or eliminated by identifying what makes the process require so much work and time.

When the borrower and lender have agreed to any multi-advance "line," they should try to choose and then use the same office of the same title company again and again for each acquisition or refinancing under the "line." The chosen title company will become familiar with the needs of the parties. It then needs only to deal with the nuances and idiosyncrasies of each particular piece of real estate.

On the other hand, the title insurance and survey requirements of any sophisticated national lender (even typical "acquisition line" lenders) are—or should be—not all that different from the title insurance requirements of any other sophisticated national lender. As sellers in a service business, title companies should do a better job than they do of taking some of the work out of the title process for the parties to a transaction and their counsel.

Regardless of who the lender is, and whether or not a title company has worked with that lender before, title companies should know that they will be requested to omit certain exceptions from their title commitment. They should know that almost any lender will require them to provide affirmative insurance about particular exceptions. For example, they should not seriously suggest that any lender would accept an exception for whatever other documents may be recorded between the date of the closing and the date the title company finally gets around to recording the closing documents.

They should simply remove or modify these exceptions as part of the first commitment or title report they send out. This approach could help eliminate the repetitive and expensive back-and-forth of a title clearance process that really does not vary much from site to site. (In issuing to the lender a pared-down commitment of this type, the title company would want to memorialize somewhere that the commitment is not legally binding and assumes delivery of various unlisted documents from other parties.)

Lenders could go a step further, by telling the title company to skip the title commitment, with its long litany of pre-closing "exceptions" and "requirements" that the borrower will inevitably remove or resolve by the closing. The title company should instead issue a pro forma title policy at the beginning of the transaction (a sample policy—not yet legally binding) to show the lender what the title company thinks the title coverage should look like at the end of the day. The title company would then act as the "motor" to get whatever documents it needs to issue a title policy consistent with the pro forma.

This approach would mean that a lender could no longer rely on the title commitment as a "checklist" of closing requirements. Most of the closing requirements listed in the title commitment are for the borrower anyway, so there is little purpose to forcing the lender and its counsel to wade through them again on every transaction.[4]

The goal is to prevent last-minute preventable title insurance emergencies.

Title Insurance Endorsements

Title insurance endorsements are largely another act in the same play. Routine title insurance policies start out by providing only basic protection against a handful of title-related risks. If asked, however, title companies will almost always freely cover additional title-related risks beyond the "standard" ones, often for only a nominal additional premium. This "additional coverage" may need to address specific problems raised by particular properties or particular title matters. More commonly, it protects the lender against generic risks and issues that are likely to arise in every loan transaction.

Lenders develop lists of additional title coverage they will require (see, for example, the "Additional Title Insurance Requirements" in Appendix 3). They ask the title companies to provide this extra coverage because it is available for relatively little extra cost. If the cost were great, or if a particular state prohibited certain coverage, the lender would probably close the transaction without it.

Does this mean lenders are "crying wolf"? Not really.

A lender's flexibility on extra title insurance coverage simply demonstrates a fundamental principle of nonrecourse lending. If a lender can identify a risk and figure out an economical and practical way to shift it to someone else, it will do so. Every risk shifted to someone else implies some small improvement in the expected outcome of the transaction. Over the long run, and over a large portfolio, each small improvement ultimately puts more money in the lender's pocket. But the allocation of any particular garden-variety risk—such as a particular title risk covered (or not covered) by a title insurance endorsement—will typically not drive the lender's fundamental decision as to whether to make the loan. These decisions aren't that close.

Streamlining the Endorsement Process

The process of dealing with title endorsements invites streamlining and simplification along the same lines as the "title commitment" and "title review" process. If lenders consistently ask for the same set of title endorsements (and if the title insurance companies are consistently willing to issue those endorsements for almost no cost) doesn't it make sense for the title companies to roll these endorsements into the basic coverage of the basic policy? Why wouldn't a lender automatically always want to know that a loan is not usurious (assuming nominal cost for a usury endorsement)? Why wouldn't a lender automatically always want to know that existing improvements do not violate a utility easement across the property? Why should the lender or lender's counsel have to ask for these endorsements every time?

A lender that does a heavy volume of business should probably require the title company to issue a certain set of endorsements automatically in all cases, as part of the first title document that the title company distributes. If the title company for any reason believes that it will not be able to issue a particular endorsement, it should raise the problem as an "exception" as part of the first title document that it distributes (commitment, pro forma title policy, preliminary report, letter, or whatever). If the title company cannot legally issue an endorsement, it should say so. If a problem with the deal or the property prevents issuance of the endorsement, the title company should say that too.

For this "streamlining" of the title process to work, the lender must identify its requirements and communicate them to the borrower early, well before the borrower tells the title company to prepare its first distribution regarding title. When the borrower opens a title order, whether with a familiar company or with a company that a particular one-time seller brings into the transaction, the borrower must communicate its lender's title requirements to that title company as soon as the title company has been selected.

As another way to prevent last-minute preventable title insurance emergencies, the borrower should routinely direct the title company to distribute copies of the very first draft of the title report (and survey), and all subsequent drafts,

directly to lender's counsel, along with legible copies of any recorded documents that will survive the closing. Again, the goal is to prevent last-minute problems by identifying and dealing early with the lender's normal closing requirements, every one of which is utterly predictable.

If the parties do use a different title company for each advance in a multi-site acquisition line, then the title company will typically at some point decide that it wants to see the underlying loan agreement regarding the financing. Rather than hope that the question does not come up, the parties should ask the title company early in the process whether they want to see this documentation, to prevent last-minute problems when the title company realizes the current transaction is actually governed by some other document and the title company asks to see it.

Title insurance sellers, regulated as to price, should be asked to compete on service!

Dealing with Surveys

Surveys can be streamlined in much the same way as title work, with a few extra comments:

■ *Local variations.* Surveyors are mostly quite local and their practices vary widely. Therefore it is all the more important for a lender and borrower to communicate specific written survey requirements as early as possible.

■ *The survey certification.* One of the most important elements of a survey is a certification of the survey addressed to the specific lender. If the borrower has been "shopping around" until the last minute looking for the best possible loan, though, it may not know the name of its lender when the borrower orders the survey, or even when the surveyor delivers it. At the last minute, the absence of a proper survey certification can become a problem for the closing. Surveyors typically don't move as quickly as some other participants in the closing process. If a borrower is considering three possible lenders, they can solve this problem by asking the surveyor to prepare three possible certifications, each on a separate piece of paper. Each would refer to the same survey. Each certification would refer to "XYZ (or ABC or DEF) Lender and its successors and assigns." When the borrower finally chooses its lender the night before the closing, the borrower can attach to the survey whichever certification is appropriate. This precaution eliminates any need to go back to the local surveyor at the last minute to request that it properly certify the survey to the lender ultimately selected.

■ *Always something more.* Many lenders have special requirements about what surveys must show. For example, Lender A might be satisfied if the surveyor counts the parking spaces, shows the perimeters of the parking area, and states that the parking provided complies with law. Lender B might decide the survey needs to show the stripes for every parking space. To Lender C, however, a survey is obviously defective if it doesn't show every disabled space separately, along with wheelchair curb cuts. If Lender D can't think of something else to require, its counsel can (perhaps the dimensions and placement of the special sign for the disabled parking space?). Each incremental requirement gives a lender some additional level of comfort, some second or third level of cross-checking, some incremental protection from a possible property-related risk. But each new level of comfort can create one more level of cost. It can also create one more opportunity for last-minute problems if the lender is really serious about the requirement, and someone else overlooks it. Requirements like these underscore the importance to all parties of identifying specific survey requirements and then communicating those requirements to the surveyor as early as possible in the process. And, as in so many other areas, borrowers should try to encourage lenders to be as standard and "plain vanilla" as possible, accepting customary national survey standards (such as a particular level of ALTA/ACSM survey standards) rather than demanding something tailor-made and hence particularly likely to cause problems.

■ *Survey substitutes.* Tailored title insurance coverage can fill comfort gaps that a problematic survey creates or even make up for a missing survey. In cases where it is impractical to obtain a survey, the parties can explore use of title insurance instead.

Some of these suggestions about title and survey vary from standard practice. And a title company may object that some of these suggestions would require them to do more work and to provide more service than they traditionally do. But title insurance is largely a "regulated" industry. Vendors can't compete on

price. So borrowers and lenders should ask them to compete on service. That pressure will be particularly compelling when the parties can deliver a steady stream of transactions.

Lenders typically mitigate local legal risks by engaging local counsel.

DEALING WITH OUT OF STATE LEGAL REQUIREMENTS

Lenders often choose to use the same law firm to close a series of loans even when many are in other states. Each set of mortgage documents must take into account the peculiarities of out-of-state law, which may include the very names of the required documents and range from special "magic language" that needs to appear on the cover to particular statutory requirements for the lender to obtain particular rights or to save on local mortgage tax. If lender's counsel does not properly consider these requirements, the results may include a worthless lien, an unexpected tax bill, malpractice claims, and a violation of legal ethics. These problems cannot be avoided as long as real estate transactions take place in multiple states, each with its own body of real estate law. They are part of the price of multistate real estate lending in a federal system.

Use of Local Counsel

Lenders typically mitigate these risks by engaging local counsel in the particular state in addition to its regular counsel. Local counsel will advise regarding the documents and, at closing, issue an "opinion of local counsel" for the transaction. This opinion gives both the lender and its regular closing counsel comfort about a series of common problems and issues that arise under state law.

Unless the parties have previously closed other loans in the same state under the same lending facility with the same local counsel, negotiating the local counsel opinion and tailoring the loan documents for local law can take a significant amount of time and effort.

To simplify this process, a lender may want to start by limiting the scope of the local counsel opinion. Instead of asking local counsel to provide 100% comfort about every possible issue that the transaction might create or that the lender might possibly think of, the opinion might cover only the basic points, and only in a way that previous local counsel have found generally palatable in the past.

On the other hand, even a trimmed-back opinion of this type can lead to issues, objections, changes, and negotiations, often in areas that were never raised by previous local counsel. There is something about opinions that brings out an exceptional level of care and creative issue-spotting on the part of attorneys asked to render them. This may be part of the purpose of these documents. Some lenders may therefore find no benefit in "prenegotiating" the local counsel opinion, as it will not streamline anything.

The borrower can also help speed up the local counsel opinion. As soon as the borrower realizes that it may close a transaction in a new state, it typically hires its own local counsel to help with contract negotiations, title, and other local issues. At that early time, the borrower should also look ahead to the future loan closing. The borrower should give local counsel a copy of the standard local counsel opinion that its lender will require and make sure that the local counsel is willing to issue more or less the opinion requested by the lender. The borrower can make these preparations long before lender's counsel prepares and distributes loan documents.

As early as possible in the life of the transaction, local counsel should provide central counsel with specimen loan documents for their state, or better yet a standardized memo identifying any particular state requirements for mortgage documents. This way, central counsel can reflect those requirements in the first draft set of loan documents that it circulates—thereby saving one iteration of the documents.

Of course, the preceding discussion about local counsel assumes that a lender will be willing to use as its local counsel the same law firm that represents the borrower. But won't that be a conflict of interest? Should not local counsel advise the lender on how to achieve maximum leverage against the borrower, taking into account local law, if the loan ever goes into default? Should not the lender, therefore, hire its own separate counsel? And, if it does, won't that eliminate whatever efficiencies and streamlining the borrower can achieve by identifying local counsel, and getting them started early in the process?

The answer, of course, is that almost any "conflict of interest" can be waived. And the "conflict of interest" inherent in borrower's and lender's using

the same local counsel can be waived particularly easily and usually is. But it is a decision for the parties involved, and not automatic. Some parties care very much about all conflicts, including those relating to local counsel. Nearly every lender would refuse to waive a conflict if the local law firm were actively suing the lender.

If the parties are not careful, however, the "conflict" issue might not surface until late in the process. Suppose, for example, local counsel does not focus, until literally the night before the closing, on the degree to which a careful lender's "local counsel" requirements place it (the local counsel) in a position squarely adverse to the borrower's interest.

A last minute issue is likely to cause more consternation and excitement, hence delay and expense, than it really justifies. So, before bringing "shared" local counsel into the transaction, a careful borrower will confirm that the lender and the local counsel themselves have no problem with this. The borrower should also give local counsel whatever conflict waiver they require.

Once local counsel starts work, they will probably start asking for details about the underlying arrangement between the borrower and the lender—i.e., the terms of the "future advance" line under which this particular loan is being originated. That means local counsel will want to review the underlying loan agreement in order to understand the deal. If the transaction is otherwise ready to close, this late request will cause delays, excitement, and very long fax transmissions.

A careful borrower will foresee those questions and requests, and will provide local counsel, early in the game, with whatever background information they will need to understand the documents they are being asked to review.

Local Counsel and the Closing

At the time of the actual closing, the "local counsel" process can again create a bottleneck that can easily be prevented or at least managed. Local counsel often insist that their opinion cannot be released or delivered until they have seen final changes in the closing documents and the borrower's signature in the signature blocks. If the lender insists on unconditional delivery of the local counsel opinion at the moment of closing, this request can create a significant chicken-and-egg problem. The problem can be prevented in either of two ways:

- *Wait.* As the easiest option, the lender can wait until the day after closing to get the local counsel's opinion. As long as local counsel has committed to issue the opinion when they have seen final signature pages, the risk to the lender should be minimal. Waiting a day can eliminate all the last-minute excitement.
- *Reword the opinion.* The parties could reword the opinion so that local counsel does not need to actually see the final loan documents. Local counsel could, for example, assume in the opinion that the documents will be signed in substantially the same form last circulated. This change adds a bit of vagueness and uncertainty, but it is a compromise that should be tolerable to most lenders.

Eliminating Local Counsel

A lender that closes a large volume of loans around the country can further streamline the local counsel process by eliminating most of it. Instead of retaining local counsel to provide full review of the documents for each loan closing, a lender can modify its standard multistate closing documents so they include for each state whatever state-specific language and provisions have been recommended by previous local counsel. Once the lender revises these "standard" documents (according to local counsel recommendations), any additional role for local counsel—ideally the same local counsel the lender previously used—on future transactions would be quite limited.

LEASE REVIEW AND DOCUMENTATION FROM TENANTS

For commercial real estate, value depends mostly on rental income. Rental income comes from tenants. Any nonrecourse lender must therefore absolutely assure itself that the borrower has supplied accurate information about the tenants and leases in the building. And the lender must go a step further, by protecting itself against future lease-related surprises and impairments of rental income.

Lenders must protect themselves against future lease-related surprises.

Lenders therefore require "estoppel certificates" from as many tenants as possible in order to confirm the status of the leases at the moment of closing. Lenders often also require "subordination, nondisturbance, and attornment

agreements" ("SNDA's") to help them control future lease-related risks after the closing. In addition, many lenders' counsel review the important leases to confirm they will produce cash flows consistent with the lender's expectations and that they conform to industry standards. Occasionally, lenders may also ask their counsel to summarize or abstract some or all of the leases.

Borrowers find that obtaining estoppel certificates and SNDAs is much like pulling teeth.

To obtain estoppel certificates and SNDA's for a closing, the borrower must deal with potentially dozens of tenants, most of whom may have no particular desire to cooperate (or to cooperate quickly), even if their leases say they must. If the loan is being made to finance the borrower's acquisition of the underlying real estate, the borrower does not yet have any relationship with the tenants, and it may have only limited rights under the purchase and sale contract regarding these tenant documents.

A borrower in this position can start by taking some familiar practical measures: start the job early; structure the buyer-seller relationship in a way that looks ahead to a future lender's requirements; and try to make sure those requirements are consistent with industry expectations and will not pose special burdens. Ideally, a borrower would ask the lender to identify the precise scope of SNDA and estoppel requirements—perhaps even the exact forms of the documents—as part of the initial commitment letter for the loan. At this early date the borrower can still realistically threaten to take the loan to another lender, and therefore encourage the lender to trim back its requirements. Furthermore, as soon as the parties sign a commitment letter, the borrower will be able immediately to start the process of obtaining these documents from tenants because there is no need to obtain comments on, or redraft and recirculate, the forms of estoppel or SNDA.

The Morass of SNDA's

Although an early start always helps, borrowers still find that obtaining estoppel certificates and SNDA's is much like pulling a large number of teeth. The process can be one of the more agonizing and time-consuming elements of any substantial loan closing.

The problem starts out as a logistical and procedural one: the borrower must communicate with dozens of tenants, all of whom have other things to do, and get each tenant to focus on, review, comment on, and hopefully sign the lender's documents. As long as lenders require estoppels and nondisturbance agreements, this logistical and procedural problem will not go away.

But even if tenants were wildly enthusiastic about responding quickly to any document that would help their landlord achieve a quick loan closing, SNDA's would still not be easy. That is because major tenants will typically object to at least half the substantive provisions that typically appear in any lender's standard SNDA. The issues raised by these documents have spawned a reasonable amount of written commentary, which unfortunately has not been able to define a lender-tenant relationship that satisfies both sides.[5]

Again and again, major tenants object to the same set of provisions in lenders' standard SNDA's: provisions that weaken the tenant's position, such as by changing the treatment of casualty or condemnation proceeds in the lease, or by saying that if the lender ever forecloses, it will not be responsible for the borrower's prior mismanagement of the property. In each case, the lender seeks to shift to the tenant a risk that the tenant did not previously bear. In each case the tenant does not understand why it should now bear this new risk.

In contrast, tenants are usually willing to live with certain other common provisions in SNDA's, such as provisions that insulate the lender, after foreclosure, from "landlord-tenant conspiracies" such as prepayment of five years' rent on the eve of foreclosure, lease amendments to reduce the rent, and similar bad faith arrangements between landlord and tenant. Tenants will also accept SNDA provisions that protect the lender without necessarily hurting the tenant (such as provisions negating any unintended lease termination upon foreclosure, or requiring the tenant to pay rent to the lender upon the lender's request).

A lender could vastly simplify and streamline SNDA negotiations, particularly with major tenants, by no longer demanding that tenants agree to SNDA provisions that shift risks away from the lender and onto the tenant. In virtually every case, major tenants will not agree to these provisions anyway. Therefore if a lender stops asking for them, the lender ultimately loses very little (at least with the major tenants), saves a great deal of time, and, in addition, greatly simplifies the SNDA. Indeed, with this approach, three or four paragraphs added to a standard tenant estoppel certificate can take the place

of a separate SNDA. Those few paragraphs can give the lender most or all of the protections that they usually end up with when they negotiate with any well-represented tenant.

It doesn't pay to insist on SNDA provisions that are unacceptable to major tenants.

Appendix 1 shows how a streamlined SNDA might look as part of a tenant estoppel certificate. This document could easily be placed in recordable form, if the parties wanted to record it.

Smaller tenants might still be willing to sign whatever is put in front of them, but even this tendency is diminishing. Moreover, even if a lender is able to get their "standard SNDA" from small tenants, if they ever take over a failed project after foreclosure, they may find that on a practical level they can't claim whatever benefits and protections their SNDA document gave them.

Tenant Leases that Anticipate SNDA's

A borrower's standard lease forms and lease negotiations should foresee and deal with the requirements of future lenders. Ideally, every lease should expressly provide for a lender-tenant relationship that will arise automatically as soon as a mortgage is recorded or, at latest, when the tenant receives notice that the lender exists. (The lease should specify that the lender need not even obtain the tenant's signature or confirmation of the notice. For the lender to be protected the lender would merely need to have a receipt for delivery of a notice.)

It is certainly true that a smart tenant will negotiate these "automatic" provisions so that they are no more favorable to a lender than what the tenant might later negotiate with the lender itself. Nevertheless, having these provisions built into the lease will short-circuit the SNDA negotiation process and save time. And by reading the leases the lender can determine, early in the process, what they'll be able to get from tenants and decide whether they can live with those clauses or whether they need to take measures to mitigate any remaining risks. (Typically, they can live with the tenant clauses, particularly if the issue is presented at the commitment letter stage while the borrower can still take its business elsewhere.)

Some borrowers attempt to further simplify and cut back SNDA negotiations by asking why lenders need even the most minimal SNDA protections. Lenders reply that even the most minimal SNDA helps assure the lender that the borrower cannot destroy the value of the leases if the loan ever goes into default. It is part of the lender's discipline imposed by any nonrecourse loan. When the lender agrees to look solely to the property upon default, it needs to make sure the property (and its rental income) will "be there." To do that, they need to identify every possible risk—including, particularly, landlord-tenant conspiracies and other lease-related problems—and reduce the likelihood that any of them will occur. If this requires obtaining assurances from third parties, like tenants, then the borrower simply has to go get them.

A Few Less Common Ways to Simplify the SNDA Process

A borrower's principals may be willing to assure the lender that even if the loan were to go into default, the borrower would do nothing to damage the leases or impair the lender's receipt of the rental income. Although the loan is nonrecourse, the borrower's principals can assume personal liability for the loan (or some part of it) if the borrower ever does something that damages the lender's collateral by impairing the leases. If these principals have substantial balance sheets, they may be able to persuade the lender to stop worrying about the concerns that drive it to require SNDA's. The parties would then be using deep-pocket personal liability as a tool to make it easier for the lender to identify and mitigate certain lease-related risks,[6] and make it completely unnecessary for the borrower to go through the exercise of obtaining SNDA's from tenants.

As another way to simplify the SNDA process, the parties can often take advantage of SNDA's already in place—previously negotiated—between the tenants and an existing lender whose loan is being replaced and refinanced. This assumes, of course, that the existing SNDA's are tolerable to the new lender, or at least that the new lender is resigned to accepting them.

Instead of negotiating new SNDA's, the borrower would have the old lender assign the SNDA's to the new lender. Then the tenant's estoppel certificate would acknowledge the assignment and both the tenant and the new lender would confirm that the terms of the old SNDA govern their relationship. If the former lender refused to cooperate, or if the parties wanted to save a step, the parties could make this agree-

ment whether or not the old SNDA was actually assigned to the new lender.

With measures like these, lenders and borrowers can vastly streamline the process of dealing with SNDA's, and perhaps mitigate or eliminate the largest headache, time drain, and source of delay in most commercial real estate loans.

Reviewing leases is a piece of cake compared to dealing with tenants!

Reviewing the Leases

Compared to the process of dealing with tenants, the related process of reviewing the leases themselves is a piece of cake.

The major delays and avoidable expense in any lease review project will typically arise from pure logistics and mechanics. Typically borrowers have trouble collecting all the lease files—including all the required amendments, side letters, notices of default and so on. When they do manage to collect most or all of the leases, they have trouble getting the leases to the right place at the right time in a single organized collection ready to be reviewed or abstracted by lender's counsel.

Perhaps the borrowers' files are a mess, or perhaps the borrowers hope the lender won't actually look at the leases. Whatever the cause, piecemeal or delayed delivery of leases means that lender's counsel often runs up significant legal (or paralegal) fees checking to see what the borrower has delivered and what's still missing, organizing what's there, and repeatedly following through with the borrower to try to obtain missing documents. Instead of being able to review the leases in a single integrated, quick, and efficient process, lender's counsel may start and stop repeatedly, and need to go back to make corrections and updates, simply because of the quality and timing of the borrower's delivery of the leases.

A borrower can vastly simplify the lease review process and reduce its cost by recognizing, early in the pre-closing process, that the lender may very well want to review the leases and the borrower should be ready to provide all the leases at once in a single integrated package to facilitate that process.

THIRD-PARTY PROPERTY REPORTS (APPRAISALS, ENVIRONMENTAL, AND ENGINEERING)

Lenders rely on third-party consultants to help them understand and value their collateral and discover physical or environmental problems. Like legal work, these reports require third-party consultants to analyze and arrive at conclusions. To do this work correctly and present it well takes time. But just as the pace of modern transactions often leaves little time for any legal work that goes beyond assembling and distributing the next set of documents, it also leaves little time for appraisals, inspections, and thorough analysis of the property.

Borrowers and lenders that want to streamline real estate finance transactions can adopt a few measures to speed up the process. Four measures are suggested below:

Jump the Gun

If a borrower hasn't yet chosen its lender, but knows the loan will be on a "quick fuse" once the lender is lined up, the borrower might take its chances and engage nationally recognized third-party consultants to prepare these reports in advance. The borrower thus starts the analysis process before the lender is chosen, hoping that the lender will live with its choices of consultants. (The borrower may be in a position to make sure the lender will approve its choices by insisting that the lender's commitment letter preapprove the borrower's choice of consultants.) When this works, it can eliminate a major source of delay. A lender must consider, however, whether accepting the borrower's choice of consultants may expose it to issues under FIRREA, under internal control procedures, or otherwise.

Appraisers or other third-party consultants often start work by requesting reams of information about the real estate they will analyze. A borrower should anticipate these needs and have all the information ready to deliver to the third-party consultant(s), in an organized way, as soon as they are engaged. To lose a week or two against a tight timeline while the borrower's staff gathers a perfectly predictable pile of information is inexcusable.

Appraisals and third-party reports often contain long general discussions that bear no specific relation to the particular property but increase the heft of the report and, possibly, help justify the consultant's fee. A lender might want to encourage its consultants to say less rather than more, and only whatever is specifically neces-

sary—and worth reading—to support their conclusion.

The issue of whether the property "complies with law"—particularly zoning and building codes—is one that no advisor wants to touch. This third-party assignment therefore often falls between the cracks, precipitating a last-minute crisis at the closing. In structuring the third-party property reports, the parties should, as early as possible in the process, make sure that someone is unequivocally responsible for this issue and for delivering a written report to the lender by a deadline well in advance of the day before the closing.

Delaying creation of a single-asset borrowing entity is shortsighted and can be costly.

FORMING THE BORROWING ENTITY AND OBTAINING AN OPINION FROM BORROWER'S COUNSEL

Every loan closing requires a borrower—typically a single-asset entity that legally did not exist until just before the closing.

The principals of this entity often wait until the very last minute to form it. They seem to want to defer the organizational expenses until the last possible moment, because until then they can't be totally sure the loan will actually close and they don't want to risk wasting the organizational costs (a few thousand dollars at most). This is the same shortsighted calculation that leads borrowers to delay other preparations for loan closings. What should be an uneventful, inexpensive and routine transaction then becomes an expensive and complicated fire drill, in which the parties need to move heaven and earth to meet unnecessarily tight deadlines.

When a borrower waits until the last minute to form the borrowing entity, they may encounter at least the following problems and delays: 1) Some official finds some reason to disapprove the name of the new entity or the name may already be taken; 2) the process takes longer than anticipated; 3) the entity structure may run afoul of bureaucratic rules of which the parties were not previously aware; or 4) even if the process goes smoothly, the parties may not be able to obtain written proof of formation in a timely manner, which can create issues and concerns at closing. Problems like these are all utterly avoidable and unnecessary.

By waiting until the last minute to form their entity, the parties also make it harder to finish up and sign the internal documentation necessary to support their loan transaction: consents, officer's certificates, and title company deliveries. Whenever someone's last-minute signature is needed, it seems that person is on vacation and unreachable. The delivery of routine organizational documents then becomes a crisis that could have been prevented.

If problems in forming the borrower entity ultimately compel the parties to change the name of that entity (something that actually happens with some frequency), every single document in the closing needs to be reopened, revised, reprinted, checked, collated, put back together, and redistributed. The change may affect only a "couple of words," but it affects every document, takes time and costs money, and causes delay and mistakes. Redoing and redistributing a set of simple loan documents to change the name of the borrower can be about as much work as preparing and distributing the first set of loan documents for the transaction.

Shelf Entities

Delays of this type are even easier to avoid than most of the other delays and problems discussed in this article. There is absolutely no reason to wait until the last minute to form entities or to finalize entity-related documentation. These entities can be formed far in advance, or even mass-produced at trivial cost per entity, and put on the shelf until needed. Then whenever the next transaction comes along, borrower's counsel can use one of these entities as the borrower. These entities don't need to be named after their assets; they can simply be assigned numbers and names like "Streamlined Investments 3, L.L.C.," and so on.

When borrower's counsel sets up such entities in advance, they should try to make the entities flexible and easy to work with. Internal approval procedures for the entities should require as few signatures and documents as possible, and the signers should be easy to locate. The entities should in many cases include a small handful of constituent entities to facilitate future structuring, tax planning, and transfers. The entity documentation should facilitate future compliance with any future lender's "single-purpose entity" requirements. Once a "shelf" entity has been formed, it should conduct no busi-

ness of any kind until a transaction actually requires the entity.

Opinion of Borrower's Counsel

At the closing of a loan transaction, the lender asks borrower's counsel for an "opinion of counsel" that confirms the borrowing entity legally exists, the right people signed the documents, and a few other related matters. Like local counsel opinions, the opinions of borrower's counsel tend to attract far more attention and negotiation than they may (in the author's opinion) objectively justify. The parties can avoid some of this excitement as follows:

Avoid "brilliant" and "creative" opinions of borrower's counsel.

■ *Make the "opinion" a significant loan document.* The attorneys for both parties often treat the opinion of counsel as a minor or incidental document. At the last minute, it can become a bottleneck and far more exciting than it should be. If counsel for both parties begin to treat the opinion of counsel as a real loan document, to be prepared, reviewed, and negotiated as part of the overall document package, they can avoid a great deal of last-minute excitement.

■ *Obtain internal approvals early.* Just as local counsel opinions do, opinions of borrower's counsel often prompt an extremely high level of care on the part of counsel. Many firms require (or sometimes say they require) two partners or a "committee" to sign off on opinions. If the parties wait until the last minute to finalize the opinion, it is a virtual certainty that the one partner who needs to approve any changes will be hiking in the Himalayas. This is another reason why borrower's counsel must deal with the opinion of counsel early rather than at the last minute.

■ *Don't be too brilliant and creative.* Lenders can always think of more assurances they would like to obtain from the borrower's opinion of counsel, all of which can be justified logically and some of which might be reasonable to request. But borrower's counsel have been issuing and lenders have been accepting opinions of counsel for a very long time. The industry has well-developed expectations of what such an opinion should and should not say. Entire forests have been sacrificed in recent years to produce vast numbers of well-reasoned and high-quality treatises, reports, articles, accords, and model documents about what legal opinions should and should not say. The volume of this work probably dwarfs the volume of recently published work about issues that, in the author's opinion, justify far more attention, such as: interest rates, lender's rights and remedies, structuring of real estate loans, or how to simplify and streamline closing documents. As a result of the volume of previous work in this area, the subject of legal opinions of borrower's counsel is an area where brilliant innovation is neither needed nor appreciated. Deviations from the norm typically trigger complaints, objections, and disputes. Lenders should anticipate receiving an opinion of borrower's counsel that is consistent with industry expectations and stick with that form. And, of course, either party's counsel will never go too far wrong by following the Golden Rule of opinion practice: if you were on the other side and wouldn't give a particular opinion conclusion, don't ask for it; and if you would insist on obtaining a particular opinion conclusion, don't refuse to give it.

MOVING THE MONEY AND CLOSING THE DEAL

Once the borrower has formed the borrowing entity, delivered all the right third-party reports, helped the lender complete its due diligence, negotiated the loan documents, delivered all necessary opinion(s) of counsel, and otherwise satisfied all closing conditions of the lender, one last step requires the attention of the parties: actually funding the loan.

The lender cannot disburse a single penny of the loan until the final amount of all disbursements has been finalized and approved, and the lender knows how and where to send the loan proceeds. Calculating these elements is often surprisingly difficult purely as a mechanical matter. Significant delays may occur because of problems with the calculation and funding process. Borrowers and lenders can adopt several measures to simplify and streamline the funding process.

Escrow Funding

In any multi-state transaction, a third-party escrow—typically a title insurance company's escrow—works best. Title companies do better, quicker, and cheaper jobs as escrowees than law firms. And escrow funding works better than direct wire transfers in any transaction in which all the participants can't sit down in a single conference room for the closing.

■ *Use the same title company.* If a title company is the escrowee, the parties in a multi-advance loan

should not only try to use the same title company for each advance, they should also use precisely the same escrow and closing mechanisms. Even if a special nuance of a particular advance might seem to justify some degree of variation (like a direct wire to the seller), the likelihood of confusion will typically outweigh the benefits achieved. Once the parties have established an escrow mechanism for one advance, they should keep using it. This rule is particularly true when applied to last-minute changes in funding procedures, which are particularly likely to cause snafus and problems.

In multi-state transactions, third-party escrow funding is the best option.

■ *Lender's generic escrow instructions.* If the parties need to use a new title company, the borrower should, at an early date, give the new title company a generic set of its lender's escrow instructions, and make sure the title company focuses on what they say. This gives the title company an early opportunity to review and sign off on the escrow process and gives the parties time to deal with any objections or issues.

■ *Prefunding.* Properly structured, an escrow enables the lender to pre-fund the loan into escrow even before all the final closing conditions have been satisfied. When the transaction is finally ready to close, the parties need not wait for the lender to disburse into escrow before the escrow can begin releasing funds. Pre-funding can, however, require some lenders to "cut corners" in their internal funding procedures. It can also require some additional documentation between the parties.

Mechanical Details

At the last minute, the "minor details" of mechanical disbursement of money often create last-minute preventable problems. Those problems, and some strategies to prevent them, are:

■ *Closing statements.* For any closing, the parties need to agree on a "closing statement" or "sources and uses of funds" statement that shows exactly how the borrower intends to apply the loan proceeds. Although borrowers may start work on this spreadsheet a week or two before the closing, they typically refuse to show it to the other side until the last possible minute. (This reluctance probably reflects a desire to avoid questions about changes in the numbers from one draft to the next.) When the borrower finally distributes the closing statement, the lender inevitably has problems and issues that lead to last-minute closing problems and delays. Most issues could have been resolved earlier and uneventfully if the borrower had not kept early drafts so close to its vest. If the lender controls the closing statement, the same process often works the other way around.

■ *Wire transfer addresses.* One final mechanical detail constitutes a particularly weird source of last-minute problems: identifying the wire transfer addresses for the lender's disbursements. This information is easy to obtain before the closing. No matter how many times the lender and its counsel ask for wire transfer instructions in advance, however, this information rarely seems to arrive until the day of the closing. Even then, it is often illegible. To prevent these problems, which are utterly preventable, borrower and its counsel simply need to obtain and deliver this information early in the pre-closing process, perhaps as part of their draft closing statement or even in the loan data sheet at the beginning of the transaction.

■ *Final adjustments in loan amount.* The final discussions regarding funding the loan often lead to last-minute adjustments in the amount of the loan—typically downward because of last-minute issues as the lender finally receives the last few third-party reports and completes its underwriting analysis of the income stream. (Rarely does the property turn out to be better than the borrower said it was.) When these changes occur, many borrowers and lenders insist that the attorneys revise all the documents and replace the original loan amount with the reduced loan amount. Although this request is not unreasonable, particularly in states that tax mortgages, it leads to last-minute scrambles, legal expense, disruption, and risk of mistakes. Third parties probably have already signed and delivered documents that refer to the loan amount. Redoing those documents may not be easy.

Borrowers and lenders should consider leaving alone the stated loan amount in the documents, even if they agree to reduce it at the last minute. They might simply close using the original loan documents, with a slightly overstated loan amount. Somewhere the parties would memorialize in one paragraph, or even by signing the closing statement, the fact that the actual amount disbursed was a few dollars less than the stated amount of the loan in the documents.

The net result is no different than for any loan where the borrower has paid down part of the prin-

cipal: the lender's records rather than the loan documents provide an accurate picture of the true amount of principal outstanding. Borrowers and lenders live with this all the time. Why can't they take the same approach at the moment of closing? The cost, delay, and trouble saved may even justify a few extra dollars of mortgage tax. (The same short-cut would not work for last-minute increases in the loan amount, however. And the parties might want the loan documents to refer to a particular loan amount "or so much thereof as shall have been disbursed.")

Up to now, even unsecured lenders have not focused intently on a REIT's collateral pool.

SECURED VS. UNSECURED LENDING

As long as a segment of the marketplace favors nonrecourse real estate lending, lenders will require as much comfort (and hence information) as possible about their collateral. They will continue to try to increase their understanding and control of their collateral, and hence (they hope) reduce their risks.

Along the way, lenders will also continue to frustrate borrowers with all the delays and documentation requirements that result from the lender's concern about fully understanding the collateral—a burden that borrowers might perhaps treat as part of the cost of nonrecourse lending. On the other hand, to the extent that a borrower is willing to give the lender access to other assets if something about the lender's collateral turns out to be bad, borrowers might be able to persuade lenders to simplify the closing process because lenders will know they can rely on sources of repayment other than the property. The expansion of nonrecourse carveouts might be an example of this.

Looking at the larger picture for a moment, the expansion of unsecured lending to real estate investment trusts, which has seen six years of strong growth, might be considered to be a view of the world precisely opposite from the viewpoint of a nonrecourse lender as described in this article. Although unsecured loans to REITs ultimately rely on nothing but real property, they can completely sidestep much of the complexity of dealing with particular properties— security documents, local law requirements, surveys, title work, lease reviews, and almost everything else discussed in this article.

The sheer size and diversity of a REIT's collateral pool and the credibility of a publicly traded borrower have persuaded lenders that they need not focus so intently on individual properties and their characteristics. If and when the next real estate collapse occurs, though, unsecured lenders to REITs may look back fondly at the security of an earlier world that contained reliable mortgages on real property that the lenders fully understood at an asset level.

SUMMARY AND CONCLUSIONS

The process of closing nonrecourse real estate loans requires borrowers and lenders to bring together a range of documents and deliveries from a variety of third parties. Sometimes it is not easy, particularly in quick transactions in a very fast moving marketplace. But the suggestions in this article should help simplify and streamline the process.

Certain consistent themes run throughout: plan ahead; keep it simple; keep it standard; identify what's really necessary and what's not; short-circuit avoidable steps in the communications process; provide complete deliveries early in the process; and otherwise stay organized from beginning to end.

Most of these suggestions are logistical rather than legal. Borrowers and lenders that follow these suggestions should find that their closings require less legal time because most of the tasks really don't require legal expertise. In the absence of time pressure, they can be handled, routinely, by the lender's underwriting staff or by nonlegal personnel at the lender's law firm. These nonlegal tasks require legal attention only when they become last-minute closing problems because of poor planning.

Some of the techniques suggested in this article represent deviations from normal practice. In that sense, they are inconsistent with other advice in this article suggesting that lenders should simply do things the same way everyone else does them and should not try to identify and adopt "new and improved" closing procedures that will simply confuse people and cause mistakes.

Of course, some degree of internal inconsistency is to be expected in any set of suggestions. It is up to any recipient of advice and suggestions

to decide which to listen to, and which to ignore, in the context of their own business, culture, and marketing strategy. Some lenders might regard some of the steps suggested here as "sloppy" or "corner-cutting" or even "weird." Others might regard them as practical and perfectly workable.

For each measure a lender takes to simplify and streamline transactions, the lender may incur some identifiable incremental risk under some circumstance. Or lenders may have good internal reasons to want to handle a certain element of the closing process in the same way they always have. Any lender will also want to make sure that any short-cuts or simplifications in the closing process do not impair the lender's ability to securitize the loan or otherwise implement its exit strategy.

The lender must decide whether the competitive and operational benefits of simpler and quicker closings and lower transaction costs[7] exceed the costs and risks implied by making any particular change of the type suggested in this article. This is often a business decision for the lender, tied in part to the lender's appetite for risk and its ultimate exit strategy, rather than merely a legal decision for the lender's counsel. ▓

ENDNOTES

[1]See, for example, Joshua Stein, "Cures for the (Sometimes) Needless Complexity of Real Estate Documents," *Real Estate Review* (Fall 1995), p. 63.

[2]As a caveat, however, lender's counsel must include in the mortgage anything that needs to be placed of public record, even if it already appears in the loan agreement or the note. And the lender's exit strategy (e.g., securitization) may dictate certain requirements as to what goes where.

[3]In that case, the document should be renamed as a loan and security agreement. The lender will also want to make sure that whenever any security agreement creates a security interest in a bundle of various assets, the lender can exercise remedies sequentially and separately as to the various items in the bundle.

[4]Of course, there is some purpose to this exercise, but also some expense. Virtually any closing procedure and any closing requirements can be justified in one way or another. Some of the suggestions made in this article would short-circuit processes and requirements that, although perhaps not utterly pointless, may not be worth the time and trouble they take. This article respectfully suggests that some such processes and requirements should simply be eliminated, even if it is possible to construct an argument that they somehow add value. It is this type of simplification (even at the cost of some arguable lost value under some hypothetical set of circumstances) that is often required in any effort to streamline the closing process.

[5]See, e.g., *Report of Subcommittee on Nondisturbance Agreements, Commercial Leasing Committee* (Joshua Stein, Subcommittee Chair), Real Property Law Section, New York State Bar Association, 22 New York State Bar Association Real Property Law Section Newsletter, No. 2 (Spring 1994); Morton P. Fisher, Jr. and Richard H. Goldman, "The Ritual Dance Between Lessee and Lender—Subordination, Nondisturbance, and Attornment," 30 *Real Property, Probate and Trust Journal* (Fall 1995) p.355; Andrea P. Ascher and Joshua Stein, "The Logic of Subordination, Nondisturbance and Attornment Agreements: Overview and Some Questions," Practicing Law Institute Materials on Commercial Real Estate Financing: What Borrowers and Lenders Need to Know Now (1998), Vol. 1, page 487.

[6]For a discussion of the structure and theory of nonrecourse carveouts generally, see Joshua Stein, "Nonrecourse Carveouts: How Far is Far Enough?", *Real Estate Review* (Summer 1997) p. 3. This article lists over 40 common "nonrecourse carveouts" and implies that if lenders had their way, all loan obligations would ultimately become full-recourse to the borrower's principals except for the pure obligation to pay principal and interest of the loan. The market has, of course, evolved in precisely the opposite direction at time of writing. *See also*, Joshua Stein, "Lender's Model State-of-the-Art Nonrecourse Clause (With Carveouts)," *The Practical Lawyer* (October 1997) p. 31; John G. Wharton, "Negotiating Carveouts to Non-Recourse Loan Documents," *The Practical Real Estate Lawyer* (November 1997) p. 47; and Professor Gregory M. Stein (University of Tennessee at Knoxville), "The Scope of the Borrower's Liability in the Nonrecourse Real Estate Loan," law review article to be published (citation available from author).

[7]The borrower typically reimburses these costs, but regards a dollar of transaction costs as no better, and perhaps worse, than a dollar of loan fee, and tries to minimize both.

APPENDIX 1: A BASIC NONDISTURBANCE AGREEMENT

AS PART OF AN ESTOPPEL CERTIFICATE

[Note: This language assumes "Lessor," "Building," etc., have all been defined.]

Effect of Foreclosure. Any foreclosure or similar transfer affecting the Building, any conveyance of the Building pursuant to a transfer in lieu of foreclosure, or any sale or other transfer of the Building pursuant to a bankruptcy proceeding affecting Lessor (any of the foregoing, a "Foreclosure Event") shall not terminate the Lease. If any Foreclosure Event occurs, the Lease shall continue as a direct lease between Lessee and the transferee pursuant to the Foreclosure Event (the "Successor Lessor").

[Note: Lessee should ask Lender to countersign the above paragraph.]

Amendments, Terminations, Etc. A Successor Lessor shall not be bound by any modification, amendment, waiver, cancellation, termination (including a termination resulting from Lessor's rejection of the Lease in bankruptcy), or surrender of the Lease made without Lender's prior written consent, other than a unilateral termination made by Lessee pursuant to the terms of the Lease. Before exercising any right to terminate the Lease on account of Lessor's default, Lessee shall provide Lender with notice of such default and a reasonable opportunity to cure such default.

Prepayment. Any Successor Lessor shall not be bound by any payment of Rent made by Lessee to Lessor more than thirty days before such payment of Rent was due and payable under the Lease.

Payment of Rent. Upon Lessee's receipt of any written notice from Lender to do so, Lessee shall pay all Rent to Lender and not to Lessor, unless and until Lender notifies Lessee in writing to the contrary.

[Note: Problems Start Here.]

Certain Claims, Etc. Any Successor Lessor shall not be subject to any offset, defense, claim, counterclaim, deduction, credit, or abatement against Lessee's obligations under the Lease arising from the acts or omissions of the prior lessor under the Lease. Any Successor Lessor shall have no obligation to pay or reimburse Lessee for any sums that the prior lessor was obligated to pay or reimburse Lessee, and shall have no responsibility for Lessee's security deposit except to the extent actually received by such Successor Lessor.

Subordination. Lessee's rights and claims under the Lease with respect to any casualty or condemnation proceeds (the "Loss Proceeds") are subject and subordinate to any rights and claims of Lender to Loss Proceeds under the Mortgage. As to Loss Proceeds, any inconsistency between the Lease and the Mortgage shall be resolved in favor of the Mortgage.

APPENDIX 2: LOAN DATA CHECKLIST

IDENTIFYING INFORMATION.

A. Loan and Property

Scheduled Closing Date		
Loan Amount	Total Amount	Initial Disbursement, If Different
	$	$
Property Street Address(es)		
County State		
Tax Parcel I.D. Number(s) or Block and Lot(s)		

B. Borrower*

Exact Complete Name	
Address	
Type of Entity	
State of Formation	
Date of Formation	
Sample Signature Block (Please Edit or Provide on Separate Sheet)	NAME OF BORROWER By: ____________ Name: John Doe Its: President
Taxpayer ID No.	

C. Contacts

Borrower's Counsel (Main Contact Person for This Advance)	Name: Address:
	Office Telephone:
	Fax:
	Home Telephone:
	Email Address (if Any):
Local Counsel	Name:
	Address:
	Phone Number:
	Fax Number:
	Email Address (if Any):
Title Company	Name of Title Company to Issue Policy:
	Name of Agency, if Any:
	Address:
	Order Number(s):
	Contact Person:
	Phone Number:
	Fax Number:
	Email Address (if Any):
	Wire Transfer Address for Closings

INFORMATION NEEDED TO START WORK.

(Please Supplement on a Separate Sheet as Necessary.)

Legal Description (fully legible, preferably on diskette).

Any other parties to be considered or dealt with for closing (e.g., existing mortgagee, major lessee, ground lessor, limited partner, or seller): exact name, status, contact information, and closing requirements.

Any other information relevant to preparation of loan documents, such as changes from treatment of previous advances for this facility.

In addition to parties listed above, are there any other parties to whom lender's counsel should deliver or email copies of the draft loan documents?

APPENDIX 3: TITLE INSURANCE AFFIRMATIVE REQUIREMENTS AND INDORSEMENTS

1. *GENERAL REQUIREMENTS.*

1.1. *Indorsements.* Title insurance should include the following indorsements and affirmative insurance to the extent available: ALTA 9 (comprehensive) or CLTA 100 if ALTA 9 not legally permitted in the particular state; all leases (including any options to purchase) are subordinate; affirmative coverage re: any easements benefiting the insured estate; contiguity of multiple parcels; zoning (with affirmative insurance that zoning compliance does not depend upon any use or non-use of any real property other than the insured premises, otherwise similar to CLTA 123.2); usury; variable rate (CLTA 111.5); acreage; all mortgage taxes paid or none are payable; legal right of access; abutment on legally open street; subdivision compliance (CLTA 116.7); address of improvements; leasehold coverage (CLTA 119.1) where insured estate is a leasehold.

1.2. *Condominium Units.* If the insured estate is a condominium unit, provide a standard condominium indorsement, together with affirmative insurance that borrower is not in default in any of its payment or other obligations with respect to such condominium unit.

1.3. *Mineral Rights.* For any mineral or mining rights exception, affirmatively insure no rights of surface entry.

1.4 *Multisite Transactions.* Provide "tie-in," "first loss," and "last dollar" indorsements for the pool.

1.5 *Mechanics' Liens.* No exception for mechanics' liens.

2. *AFFIRMATIVE INSURANCE - SPECIFIC LANGUAGE.*

The following assurances or their equivalent should be provided.

2.1. *Tax Lots.* Company insures the insured against any loss that the insured may sustain by reason of any inaccuracy in the following assurance: The estate insured hereunder consists of one or more whole tax parcels, none of which includes any other land (or other interest in real property) not insured herein.

2.2. *Survey.* This policy affirmatively insures that as of date of policy the survey made by [John Doe Local Surveyors] dated ___, as redated ___ (the "Survey"), accurately depicts the premises described in Schedule A. This policy affirmatively insures against loss or damage by reason of any violation, variation, inaccuracy in acreage or square footage, encroachments of existing improvements located on the land onto adjoining land, or any encroachments onto the land of existing improvements located on adjoining land or other adverse circumstances affecting the title that would have been discovered by an accurate survey conducted on date of policy, other than matters disclosed on the Survey. The Survey discloses the following matters: [fill in survey reading].

2.3. *Promissory Note.* Company insures the insured against any loss or damage the insured shall sustain by reason of a final and unappealable court judgment or order that holds that the indebtedness created by that certain [promissory note and loan agreement] dated [date] and executed by the fee owner as identified in the policy is not at Date of Policy secured by and entitled to the benefits of the lien of the insured mortgage shown in Schedule A of the policy.

2.4. *Doing Business.* Company insures the insured against any loss resulting from the unenforceability of the insured mortgage due to a final decree of a court of competent jurisdiction holding that the making of the loan secured by the mortgage shown in Schedule A constitutes "doing business" within the State of ______. (CLTIC Special Indorsement 243.)

2.5. *Mortgage Recording Tax.* All mortgage recording tax has been paid, or none is payable, with respect to the insured mortgage, any "Loan Documents" as defined therein, and any document creating or affecting any estate insured under this policy.