<u>PHASE FOUR</u>: NEGOTIATING FOR MORTGAGE FINANCING

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I. The Loan Application and the Loan Commitment.

A. Why do we reduce agreements such as the Loan Application and the Loan Commitment (Appendix "A") to Writing?

1. Contract Principles. A contract, either oral or written is understood to be a promise for a promise supported by consideration. Sometimes, we refer to an "offer" and an "acceptance." Oral contracts are enforceable, unless required to be reduced to writing by the Statute of Frauds. Written contracts are more easy to enforce since they are better evidence of the agreement of the parties. Since a loan commitment has many complicated provisions, it is always reduced to writing. Because of an amendment to the Statute of Frauds in 1993, commitments to lend must also be in writing.

2. Original Statute of Frauds. The original Michigan Statute of Frauds provided that in order to be enforced, certain agreements had to be in writing. Concerning real estate, the following kinds of agreements must be in writing to be enforced:

a. sales of land (M.C.L. 566.106);

b. leases for more than one year (M.C.L. 556.108);

c. liens and mortgages;

d. easements;

e. sale of crops or minerals;

f. brokers agreements for commissions.

See also MCL 550.109 for explanation of how to prove the "consideration" required to enforce an agreement.

3. Amendment to Statute of Frauds. Effective January 1, 1993, the Michigan Legislature enacted Act 245, Public Acts of 1992. ("Act 245" or MCL 556.132). According to Act 245:

> "An action shall not be brought against a financial institution to enforce any of the following promises or commitments of the financial institution unless the promise or commitment is in writing and signed with an authorized signature by the financial institution:
>
> (a) A promise or commitment to lend money, grant or extend credit, or make any other financial accommodation.
>
> (b) A promise or commitment to renew, extend, modify, or permit a delay in repayment or performance of a loan, extension of credit, or other financial accommodation.
>
> (c) A promise or commitment to waive a provision of a loan, extension of credit, or other financial accommodation.

4. Purpose of Amendment. During the late 1980's and early 1990's, borrowers often sued financial institutions for various breaches of alleged oral agreements. Act 245 was a reaction to financial institution lender liability exposure. The goal of Act 245 was to increase certainty and contractual liability in order to reduce lender liability litigation.

5. Questions Regarding: Act 245. Act 245 applies to a state or national chartered bank, a state or federal chartered savings bank or savings and loan association, a state or federal chartered credit union, a person licensed or registered under the mortgage brokers, lenders and servicers licensing act, Act No.173 of the Public Acts of the 1987, being section 445.1651 to 445.1683 of the Michigan Compiled Laws, or Act No.125 of the Public Acts of 1981, being sections 493.51 and 493.81 of the Michigan Compiled Laws, or an affiliate or subsidiary thereof.

6. Who Can Sign? Act 245 requires that the writing be "signed with an authorized signature of the financial institution." The statute is unclear whether a loan officer, a member of the board of directors, corporate officer or other agent of the bank may serve as an "authorized" representative. Some borrowers have taken precautions by requiring a representative of the bank to sign mortgages, loan agreements, assignments of rents, and other loan documents in order to fulfill the perceived requirements of Act 245. Some lenders will sign these documents to avoid allegations of fraud. Other lenders have simply ignored Act 245. At present, there is little guidance from actual court decisions on these questions.

7. Excuse of Writing: In certain cases, the requirement of a writing can be excused in some situations:

a. a fully performed contract;

b. if the of property is conveyed by the seller (then the buyer must pay for it);

c. partial performance by buyer of the agreement;

d. equitable estoppel: the enforcing party relies upon a promise by the non-enforcing party to his detriment;

e. waiver: the non-enforcing parties fails to object to the lack of a writing;

f. torts such as lender's fraud.

It is not clear how all these historical defenses will apply to Act 245.

8. The Parole Evidence Rule. Extrinsic evidence (oral or written) of prior or contemporaneous agreements or negotiations is not admissible to contradict, vary, or modify an unambiguous written contract intended by the parties to be the final and complete expression of their agreement. The policy underlying the rule is to reduce the possibility of perjured testimony and the use of non-binding preliminary agreements as evidence. (Letters and drafts and therefore marked accordingly by some counsel).

9. Evidence. Court may consider all relevant evidence to determine if the parties intended a document to be a "final and complete" expression of their agreements. In legal terms, a final and complete expression of the agreement of the parties is a "totally integrated" agreement.

10. The Integration Clause in the Commitment. Lender's counsel will usually insert an "integration clause" in the Loan Commitment. In the absence of, fraud or mistake, an integration clause can be effective to establish the intent of the parties to make a final agreement:

> "No statements, agreements or representations, oral or written, which may have been made to Borrower and/or borrowing entity or to any employee or agent thereof, either, by Lender or by an employee, agent or broker acting on Lender's behalf, with respect to the Loan, shall be of any force or effect, except to the extent stated in this Application, and all prior agreements and representations regarding the loan are merged herein."

11. Side Letters Changing the Commitment. Borrowers should be aware of the significance of a merger clause in the Application/Commitment. The merger clause prevents the borrower from claiming any change in the terms of the Loan Commitment through prior or contemporaneous written or oral agreements. Some judges, however, and some legal scholars believe that a borrower may use prior agreements, both oral and written to prove that despite the merger clause, the borrower did not intend the Commitment to be the final agreement of borrower and lender regarding all the terms of the Loan.

12. Subsequent Modification of the Commitment. Evidence of subsequent agreements or transactions will always be relevant. Such subsequent agreements should be clearly marked as the "First Amendment" or "Second Amendment" to the Loan Commitment. These amendments should always conclude with the language that unless specifically modified by the amendment, an other terms of the Loan Commitment shall remain in full force and effect.

B. Protection for Regulators. Federal Regulations also protect financial institutions and their insurers against agreements which are intended, or tend to deceive creditors or banking regulators.

1. D'Oench, Duhme & Co. v FDIC, 315 U.S. 447 (1942) initially established the federal common law rule that secrete agreements between borrowers and financial institutions which result in an incorrect valuation of the institution's assets will not be enforceable later against the Federal Deposit Insurance Corporation.

2. Court Decisions. Court decisions have expanded the D'Oench Duhme doctrine to invalidate a wide range of agreements, including agreements with borrowers, guarantors and other lenders which were secret, oral, non contemporaneous or unapproved by the institution's board of directors, and to shield regulatory agencies from defenses such as fraud or misrepresentation, lack of consideration, modification of a loan by course of dealing, breach of fiduciary duty, breach of the covenant of good faith and fair dealing, waiver, laches and estoppel.

3. The Statutory Codification of Case Law. Section 12 USC 1823(e) provides that an agreement "which tends to diminish or defeat" the RTC's interest in an asset (such as a loan) is not enforceable against the RTC unless the Agreement:

a. is in writing,

b. was executed by the depository institution and any person claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the depository institution,

c. was approved by the board of directors of the depository institution or its loan committee, which approval shall be reflected in the minutes of said board or committee, and

d. has been, continuously, from the time of its execution, an official record of the depository institution.

4. Drafting Issues. Work-out agreements, loan modifications, and any revisions to the terms of the loan (as reflected in the loan commitment and the loan documents) must be drafted carefully and in compliance with 12 USC 1823(e). In RTC v Trammell Crow, 763 F. Supp. 887 (N.D. Tex. 1991) the trial court examined two letters which were intended by the parties to be binding contracts to refinance the loan. The agreement to refinance was not valid against the RTC because the letters were not executed contemporaneously with the new note.

C. What is the impact of the Statute of Frauds, Parole Evidence Rule and the D'Oench Duhme doctrine upon the negotiation of the Loan/Application Commitment?

1. Time Pressures. Although borrowers and lenders face extreme time pressures, the Loan Application/Commitment and the exhibits must be reviewed carefully.

2. Is the Loan Commitment the Final Agreement? The Standard Terms and Conditions attached to the Loan Commitment must be revised if not acceptable to the borrower. The Loan Commitment must precisely reflect the economic terms. If the terms of the Loan Commitment are altered, the modifications should be reduced to writing. If appropriate, borrower's counsel should document that the Application/Commitment is not intended to be the final agreement of the parties. Alternatively, any side agreement executed prior to or contemporaneously with the Loan Application should provide that the side agreement is enforceable despite the merger clause. The parties could also modify the merger clause so that it does not cover specifically listed letters.

3. Evidence of Intent That the Agreement is Not Final. Prior to signing the loan commitment, borrowers should not accept language which states that the loan documents will be in a form acceptable to the lender. While it is not practical to obtain copies of all loan documents prior to signing the Loan Commitment, the borrower should obtain the pages in the loan documents which cover prepayment penalty, the events of default, the right to use insurance proceeds and any proposed estoppel certificates.

The language regarding the form of the loan documents should, if properly worded, give the Borrower the opportunity to argue that the loan agreement is not the final agreement of the parties. Conversely, the lender will want to be certain that after the Commitment Letter is executed, there will be little negotiation of the provisions regarding assumption, prepayment, default, recourse or the right to use insurance proceeds or condemnation awards.

4. Ambiguities. Borrowers must be certain that all exhibits to the loan commitment are attached. If an ambiguity is created because an exhibit is not attached, parole evidence can be introduced to explain the ambiguity. Usually, the borrower benefits from any ambiguity. When a judge interprets a document, he must construe the meaning of the terms against the drafter. Therefore, lender's counsel must avoid providing the Borrower with the opportunity to claim an ambiguity.

II. How Have Courts Interpreted Disputes Over the Meaning of Terms in the Commitment Letter and in the Loan Documents?

A. Eyde Brothers Development Company v The Equitable Life Assurance Society of the United States, 888 F.2d 127, 1989, WL 130632 (6th Cir. Mich.) (Unpublished).

1. Preliminary Facts. Eyde Brothers Development Company ("Eyde") sued the Equitable Life Assurance Society of the United States ("Equitable") for breach of an alleged side agreement related to Equitable's refusal to consent to an assumption of its mortgage by a third party buyer. In 1978, Eyde desired to develop an apartment complex and borrowed $6,000,000.00 from Equitable. Equitable obtained a note and mortgage which provided that the note was repayable over thirty years, with complete repayment of the principal prohibited during the first ten years of the loan. The note also provided for an early repayment penalty, an acceleration of the entire indebtedness in the event of a default, and allowed Equitable to collect default interest during any default period.

2. Due on Sale Clause. The mortgage contained a due on sale clause which stated that:

> "The whole of the principal sum and the interest shall become due at the option of the mortgagee upon the transfer or other disposition or encumbrance, by mortgage or otherwise, of the premises or any part thereof, or upon the occurrence of a material change in the identity or control of the mortgagor (other than through death), without the written consent of the mortgagee."

3. The Sale. In November, 1985, Eyde notified Equitable that Eyde had located a qualified buyer for the property. Eyde requested Equitable's written consent and asked Equitable if the buyer could assume the mortgage. Without much discussion, Equitable notified Eyde that Equitable would not consent to the assumption of the mortgage at 9.25%.

4. The Compromise. The parties tried to reach a compromise. On November 21, 1985, an Equitable loan officer, Thomas Fleming sent a letter to Eyde indicating that Fleming would be willing to "recommend to our home office" a plan which would allow Eyde to repay the entire loan and which would waive prepayment penalties, the ten year closed prepayment period and the requirement of sixty day notice. The last sentence in the letter cautioned Eyde that "due to the policy changes from time to time, the recommendation should be sent to our home office within 90 days of the date of this letter." The loan officer was clever. Legally, he had extended an offer to Eyde which Eyde needed to accept. The loan officer was smart enough to place a time limit on the duration of the offer.

5. The Mistakes. Eyde decided to act upon the offer, but failed to notify Equitable. Eyde looked for alternative financing and eventually found another source of funds in order to pay off the loan. On March 27, 1986, Eyde sent a letter to Equitable offering to repay the entire obligation at the interest rate contained in the note, with no prepayment charges and no default interest. Eyde requested a response to the letter, but Equitable did not provide one. Obviously, Eyde did not send the response within the required 90-day period.

6. Foreclosure. After writing the March 27th letter, Eyde ceased making payments on the note. Equitable informed Eyde that it would foreclose. "Eyde insisted upon paying the entire balance without penalties. When the parties could not reach a resolution, Equitable elected to accelerate the entire balance, including default and prepayment penalties, since the loan was repaid during the ten year lock out.

B. The Lawsuit Filed by Eyde.

1. The Complaint. On November 19, 1986, Eyde filed suit against Equitable. In the lawsuit, Eyde alleged that at the time of the loan, Equitable would not refuse to consent to an assumption of the loan without good reason, based upon: (a) past practice; and (b) representations by the loan officer.

In the complaint, Eyde maintained that the parties had agreed that Equitable's consent could not be unreasonably withheld.

2. Eyde's Damages. Eyde requested as damages, recovery of the default interest, the prepayment charges, damages spent procuring alternative financing, and a determination that the note and mortgage were an unreasonable restraint upon alienation. Under protest Eyde paid the entire amount requested by Equitable on December 26, 1986.

3. Dismissal of Eyde's Claims. In June 1988, Equitable filed a motion and was able to dismiss all of Eyde's Claims except one. The District Court ruled that:

a. the due on sale clause in the mortgage was clear and unambiguous and imposed no limitation on Equitable's right to refuse consent to an assumption;

b. as a matter of law, Eyde's proposed interpretation of the note and mortgage could not prevail. Therefore, Equitable had not breached any of the loan documents and was entitled to collect default interest;

c. the note and mortgage provisions did not amount to an unreasonable restraint on alienation; and

d. Equitable could not at the same time elect acceleration as a remedy for default, collect default interest and assess prepayment charges.

The District Court ruled in favor of Eyde on the unreasonableness of the prepayment penalties. The District Court ordered the prepayment penalty to be returned to Eyde. This action by the court gives some hope to borrowers, but does not provide much analysis.

C. The Appeal Filed by Eyde.

1. Parole Evidence. Eyde argued that the District Court committed an error when it refused to consider the parole evidence which provided that at the time of contracting, Equitable agreed that it would not unreasonably withhold consent to an assumption.

2. Ambiguity. In order to introduce the Parole Evidence, Eyde argued that the agreements were ambiguous. Eyde relied upon Michigan law which provides that in the case of an ambiguity, outside evidence may be used to interpret an agreement. Union Oil Co. v Newton, 397 Mich. 486, 245 N.W.2d 11 (1976); Goodwin. Inc. v Orson E. Coe Pontiac. Inc., 392 Mich. 195, 224 N.W.2d 53 (1974).

3. Decision by the Appeals Court. Unfortunately for Eyde, the Court of Appeals agreed with the District Court that the due on sale clause was unambiguous. The court would not re-write the agreements to include provisions which were not agreed upon by the parties at the time of contracting. Shaffner v City of Riverview, 154 Mich. App. 514, 397 N.W.2d 835 (1986). Courts may not rely on external evidence of the parties intent when the contract is clear and unambiguous. Grau v Detroit Automobile Inter-Insurance Exchange, 148 Mich. App. 82, 383 N.W.2d 616 (1985); In re Bluestone Estate, 121 Mich. App. 659, 39 N.W.2d 446 (1982)

In reaching its decision the Court of Appeals quoted from Shalit v Investors Sav. & Loan Ass'n, 101 N.J. Super. Ct. 283, 244 A.2d 151 (N.J. 1968) where the court held that a developer could not offer parole evidence to establish that the lender had agreed to grant consent to an assumption, so long as the proposed buyer was financially sound. The Shalit court stated:

> "the proffered evidence would not serve the purpose of interpreting debatable language. Rather, it would insert into the clause a condition precedent entirely alien to its express written terms."

4. Restraints on Alienation. In Eyde the Court of Appeals also upheld both the due-on-sale clause and the clause prohibiting prepayment. These were not unreasonable restraints on alienation because:

> "Whenever a long-term financing contract is entered into, the parties must allocate the risk of fluctuating interest rates. By insisting upon the due-on-sale and prepayment penalty provisions, Equitable simply negotiated the deal so Eyde would bear the risk."

5. Lessons from Eyde. The Appeals Court noted:

> "Language limiting defendant's discretion easily could have been negotiated for and included but, not being incorporated into the contract, this court is powerless to add such a limitation."

6. What could have been done differently? This litigation could have been avoided or the result would have been different if:

a. The Commitment Letter had been modified to incorporate the oral representations regarding the assumption of the loan which were made by the loan officer at the time of signing the loan documents. If in fact Equitable had agreed to allow an assumption of the mortgage, this issue should have been addressed by the borrower in the commitment.

b. The Mortgage or Note had been modified to provide for an assumption.

c. Eyde had accepted the offer provided by the loan officer, within the 90 day deadline established in the November 21 letter.

d. The court had found that the loan commitment on the loan provisions related to the assumption of the loan were ambiguous.

III. **Issues to Recognize When Reviewing the Loan Commitment.**

A. Entity Issues.

1. Limited Liability Company. The Operating Agreement is the document which governs the operation of the LLC. Lender's counsel must read the Operating Agreement to understand how members will be admitted, replaced and paid upon the occurrence of a triggering event. A triggering event is usually considered to be the death, disability, retirement, or dismissal of a member which requires the member to transfer his interest back to the LLC or to another member. The Operating Agreement should include buy-sell provisions with insurance to fund a purchase of the member's interest upon the occurrence of a triggering event. Without a properly funded buy-sell agreement, the borrowing entity could find itself unable to pay its monthly mortgage obligations if cash is needed to buyout a member .

2. Amendments to the Limited Liability Company Act. The Limited Liability Act was amended on July 1,1997. The revisions allow for single member LLCs and remove the restrictions on choice of corporate characteristics and adopt provisions consistent with new IRS "check a box" regulations.

Two of the important changes to the Limited Liability Company Act regarding real estate financing are in MCL 450.4501 and MCL 450.4509. MCL 450.4501 covers the situations in which a person may be admitted as a member of a limited liability company. The amendment states that if a person acquires a membership interest subsequent to the formation of a limited liability company, the new member must comply with the provisions of the operating agreement or be admitted by the unanimous vote of the members entitled to vote. Lender's counsel should request evidence to confirm that all members have been properly admitted to the LLC.

MCL 450.4509 covers the right of a member to withdraw. This section states that a member may withdraw from a limited liability company only as provided in the operating

agreement. A member withdrawing pursuant to the operating agreement is entitled to a withdrawal distribution only if expressly provided in the operating agreement. Previously, a member had a statutory right to withdraw and obtain a withdrawal distribution unless this right was restricted by the operating agreement. Now, a member cannot threaten to withdraw and obtain a withdrawal distribution, unless the operating agreement expressly provides for such a distribution. Lenders must be certain that they understand the withdrawal rights of the members in an LLC borrower.

3. Corporations. Lender's counsel will have similar concerns about triggering events as listed above for limited liability companies. If personal guarantees are given, the guarantors should not be burdened with the prospect of paying out cash to a partner when a triggering event occurs. Buy-sell agreements should also be in place for corporations.

4. Amendments to the Business Corporation Act. The proposed amendments to the Michigan Business Corporation Act will be effective in the fall. The most significant change is found in MCL 450.1488. This new section will allow shareholders to govern a corporation themselves without a Board of Directors and provide for other characteristics of partnerships. Lenders and their counsel must now review these "488 Agreements."

5. Partnerships. Partnerships will dissolve upon the death of a partner unless the partners vote to reconstitute.

B. Commercial Mortgage Backed Securities.

1. If a Commercial Mortgage Backed Security is being created, the lender wants to minimize the risk that the loan will be in default. Therefore, a single asset entity is required. The lender wants to ensure that nothing drains off cash flow (i.e. unprofitable operations elsewhere).

2. Lender wants to make certain that the Borrower cannot consolidate operations or merge with another entity without consent from the lender.

C. Fees. The Fees paid to all Lenders are not the same. They include the Application Fee, the Loan Fee, and the Due Diligence Fees. Usually, the rate for the loan is not fixed until these fees are paid. Borrower's counsel must understand when these fees are earned and when they can be returned. No escrow agent is involved so the borrower must know his rights. In Pakideh v Franklin Commercial Mortgage Group, 213 Mich App 636 (1995), the Borrower successfully argued for the return of his commitment fee because although the fee was paid, the Borrower did not sign and return the Commitment Letter. The Commitment Letter specifically provided that it could not be accepted unless it was signed and returned.

D. Monthly Payments. Options are several: interest only, interest only until a specified time, and principal and interest payments. The Borrower must do his homework or use a broker to understand current market rates, available sources of funds so that the most favorable repayment schedule can be negotiated.

E. Security.

1. Borrower's counsel must be certain that all of the property is owned by the same entity and that the property will remain in the same entity. A merger or conversion of a partnership into an LLC is not considered a transfer so deeds are not needed to transfer real property interests into the "transferred" or "converted" entity.

2. Borrower's counsel must be certain that the property is not subject to liens or judgments from other litigation.

3. Borrower's counsel must be certain that the property is zoned properly and that the legal description is correct. When preparing the loan application, borrowers must anticipate that spouses of partners will be required to waive dower interests.

F. Prepayment Privilege. You must negotiate this item very precisely. One of the first cases discussing the enforceability of a prepayment penalty was In re Skyler Ridge, 80 B.R. 500 (Bankr.C.D. Cal. 1987) in which a Kansas bankruptcy judge characterized the prepayment provision in a Traveler's Insurance Company mortgage, as an invalid liquidated damages clause because it was unreasonable under Kansas law. The formula used by the Traveler's in computing the prepayment premium was determined by the applicable treasury instrument rate and not by the market rate for comparable first mortgages and was not discounted to present value. The court found that the prepayment provision was unenforceable.

1. Since the Skyler Ridge decision, both insurance companies and financial institutions have made certain that prepayment premiums are calculated by using an appropriate index to preserve the yield on the loan. Likewise, most prepayment clauses now provide for some adjustment to present value. More recent decisions discussing the enforceability of prepayment penalties are: Parker Plaza West Partners v UNUM Pension and Ins. Co., 941 F.2d 349 (5th Cir. 1991) (prepayment provision held enforceable even though prepayment by the borrower was "involuntary"); Citicorp Mortgage. Inc. v Morrisville Hampton Village Realty Ltd., 443 Pa. Super. 595, 599, 662 A.2d 1120, 1122, (Super. Ct. 1995) (with respect to a prepayment provision which required payment of the premium regardless of whether the prepayment was voluntary or involuntary, the parties were bound by the provision since as sophisticated participants, the provision was fairly negotiated); Travelers Ins. Co. v Corporex Properties. Inc., 798 F. Supp. 423, 428 (E.D. Ken. 1992) (prepayment premium providing for a payment upon acceleration of the indebtedness is enforceable as a means as insuring the lender against the loss of its bargain if interest rates decline).

2. Lender's counsel should specifically draft that the lender will collect the prepayment premium in the event of an acceleration of the loan upon the default by the borrower. Borrowers should attempt to negotiate an exception to this provision or eliminate the provision completely. It should be noted that the majority view is that borrowers do not have any right to prepay a mortgage loan absent a provision in the loan documents permitting prepayment. See Brannon v McGowan, 683 So. 2d 994, 995-997 (Sup. Ct. Ala. 1996); In re A.J. Lane & Co., Inc., 113 B.R. 821, 827 (Bankr. D. Mass. 1990); Carlyle Apartments Joint Venture v AIG Life Ins. Co., 333 Md. 265, 269-270, 635 A.2d 366, 368 (Md. Ct. of Appeals 1994); McCae Management Corp. v Merchants National Bank, 553 N.E.2d 884,888 (Ind. Ct. of Appeals 1990). The minority view is that the borrower should be permitted to prepay the loan where loan documents are silent as to prepayment: Citicorp Mortgage. Inc. v Morrisville Hampton Village Realty Ltd. Partnership, 443

Pa. Super. 595, 599, 662 A.2d 1120, 1122 (1995); Hatcher v Rose, 329 N.C. 626, 629, 407 S.E.2d 172, 177 (1991); Skyles v Burge, 789 S.W.2d 116, 119-120 (Mo. App. 1990).

3. Borrowers must understand that the lender desires to preserve a yield for the mortgage loan. Lenders must understand that the provision must specifically notify the borrower of absolutely every instance in which the prepayment premium will be collected. Because of the size of most prepayment penalties, this issue is often litigated.

4. On this issue, there is great tension between borrowers and lenders. Lenders wish to preserve their relationship with customers, but must answer to shareholders, depositors and regulators.

G. Recourse Language. Before executing the commitment, the borrower should attempt to obtain the exact language to be inserted in the loan documents regarding personal liability. Quite often, the following exceptions apply to non-recourse provisions:

a. Hazardous waste;

b. Misapplication or misappropriation of insurance or condemnation proceeds released to the borrower for rebuilding;

c. Commission of waste or fraud or misrepresentation in the management, use and disposition of the security;

d. Fraud and misrepresentation in connection with the loan application, loan commitment, loan documents or any other information provided to lender;

e. Removal or disposition of any fixtures or personal property in violation of the loan documents;

f. Misapplication or misappropriation of rents after default;

g. Misapplication or misappropriation of all revenues not used to pay operating expenses, maintenance or debts;

h. Failure to turn over tenant security deposits;

i. Collection of rent more than one month in advance;

j. Prepayment penalties;

k. Breach of “Due on Sale” clauses;

l. Breach of “Due on Encumbrance” clauses;

m. Failure to pay real estate taxes, special assessments and insurance premiums;

n. Damages suffered by the mortgagee as a result of borrower’s breach of various loan covenants and loan documents, such as the insurance clause, waste clause, due on sale clause, due on encumbrance clause, hazardous waste, etc.;

o. Indemnification provisions;

p. All of lender’s fees, costs and expenses for procuring, closing and enforcing the loans;

q. Liability of parties under any guarantees;

r. Lender's right to exercise foreclosure remedies with the assignments of rents.

At the time of execution of the commitment, the borrower has the most leverage to eliminate or modify the recourse provisions in the loan documents. Once the loan commitment is executed however, it is much more difficult to obtain a modification of this language. Lender's counsel normally points to the commitment letter as a basis for refusing to modify the recourse provisions.

H. Right to Use Insurance Proceeds. Quite often, the lender will not permit the borrower to rebuild the project in the event of fire or other loss. Borrower's counsel should request this right so that the process is controlled by the borrower. Often, the lender will negotiate certain controls over the reconstruction such as approval of the plans and specifications for the rebuilding. In addition, the lender will insert certain time limits by which the construction must be completed. Borrower's counsel must be certain that a fire or other damage to the property does not trigger payment of the prepayment penalty or trigger a default if construction is not completed within a certain time frame.

I. Right To Assume Mortgage. As has already been discussed in the Hyde Brothers decision, the right to transfer the mortgage to a third party is an important right. Often, the lender will attach certain financial requirements to the assumption of the mortgage. Usually, the assuming party must have the same financial strength and reputation of the borrower and provide evidence of comparable experience in owning and managing similar properties.

J. Subordination Agreements and Estoppel Certificates. If a subordination agreement is required by the lender, borrower's counsel should make certain that the lender will not disturb the enjoyment of the premises by the existing tenants in the project. (Appendix "B") Borrower's counsel should be certain that the estoppel certificates are in a form which can be executed by any tenants in the project.

K. Extensions. Borrowers often desire to "buy" an extension for closing. Quite often, the lender will require the borrower to close by a certain date. Often, it is in the buyer's best interest to control the closing date. If possible, borrowers should negotiate the price and duration of the extensions in the commitment letter.

IV. The Loan Documents.

A. The Mortgage Note. The rate of interest in the note cannot violate Michigan's Usury Statute which is MCL 438.31. There are numerous exceptions to the Usury Statute. Quite often, lenders want assurance that loan transactions are not usurious and title companies will provide usury endorsements.

B. The Loan Agreement. The Loan Agreement provides the outline of the disbursements related to construction of the Retail Center. The important conditions for funding and manner for obtaining disbursements are set forth in this document.

C. The Mortgage Assignment of Rent and Security Agreements.

This security instrument may cause problems for you in the retail development. If your client has pre-leased the Retail Center, the mortgage lender will require a subordination from any tenant that has executed leases or recorded a memorandum of lease prior to the date of the mortgage. It is important that

all leases contain a clause which provides that each lease is condition upon approval of the Mortgage lender. The lender will insist upon a subordination from all tenants with a leasehold interest in the Retail Center.

1. Relevant Cases. In re Boyd, 185 BR 529 (Bkcy E.D. Mich. 1995) the bankruptcy court held that a mortgage which did not set forth the full terms of repayment of the note was not a legal mortgage under MCL 565.154. In another problem case for lenders, Wright v Pennamped et al, 657 N.E. 2d 1223 (Ind. App. 1995) the court held that a lender's failure to provide notice to borrower of changes in the loan documents supported allegations of actual and constructive fraud.

V. Sample Closing Documents.

A. Hold Back Agreement; (Appendix "C")

B. Escrow Letter to Title Company; (Appendix "D")

C. Borrower's Resolution; (Appendix "E")

VI. The Closing.

A. Closing Checklist/Due Diligence. Closing checklists must be consistent and must remind the borrower and the lender of the "deadlines" set forth in the commitment. Once a deadline is established in commitment letter, it should be confirmed in the closing checklist. Deadlines should be established for obtaining appraisals, surveys, title work, and organizational documents. Borrower's counsel should be certain to provide these documents as soon as possible to avoid problems at the closing table.

B. Closing Memorandum. The closing memorandum should serve to provide an easy reference to the significant events in the closing. The memorandum should set forth a description of the transaction, the names of the parties, the names of the persons present at the closing, the time and place of the closing, the purchase price, the documents signed and delivered, the payments made, any description of any unusual circumstances such as escrows or matters to be completed after closing. Similarly, the closing statement should set forth the financial terms of the transaction, including payment of the purchase price, and any adjustments of the closing expenses.

C. Post Closing Follow Up Checklist. Both borrowers and lenders are well advised to complete a post closing follow up checklist. Lenders should make certain that all the documents and financing statements have been properly recorded. Borrowers should set up checklists establishing deadlines for providing year-end financial statements, rent rolls and any other information required by the loan documents. These post-closing checklists should be created immediately following the closing.

VII. Relevant Statutes.

A. Assignments of Rents Statute MCLA 554.211; MSA 26.1131 and MCLA 554.231; MSA 25.1137 (1);

B. Recording Statute MCLA 565.201; MSA 26.1221;

C. Future Advances Statute MCLA 565.901; MSA 26.977 (901);

D. Form of Mortgage Statute MCLA 565.154; MCLA 565.154; MSA 26.574;

E. Amended Statute of Frauds MCLA 566.132; MSA 26.922; (Appendix J)

F. Amended Limited Liability Company Act MCLA 450.4102 et seq.;

G. Lending Practices Act MCLA 445.1605

VIII. Good Web Sites.

A. Statutes, Rules, and Regulations.

1. Statutes, Rules and Regulations Index:
http://www.commerce.state.mi.us/fib/statutes.htm

2. Office of Policy and Legislative Affairs, House and Senate Bill Analyses:
http://www.commerce.state.mi.us/opla/bills.htm
Analyses of current bills, including property-related legislation;

3. Other
Real Estate Statutes and Regulation Online:
http://www.law.cornell.edu/topics/real-estate.html.

B. Cases.

Michigan

1. Michigan Supreme Court:
http://www.icle.org/misupct/index.htm

2. Michigan Court of Appeals:
http://www.icle.org/mictapp/index.htm

3. Michigan Tax Tribunal Property Decisions:
http://www.commerce.state.mi.us/tax/decision/home.htm

C. Government.

Michigan

1. Michigan Financial Institutions Bureau
http://www.commerce.state.mi.us/fib/
Contains recent statutes and regulations and links to other sites;

2. Michigan Tax Tribunal
   http://www.commerce.state.mi.us/tax/
   Contains recent property cases, the Tax Tribunal Act, and information about the tax tribunal.

3. State of Michigan Forms
   http://www.cis.state.mi.us/corr/
   All, state forms are available and information regarding filing by fax

D. Federal.

1. Department of Housing and Urban Development
   http://www.hud.gov/

2. Federal National Mortgage Association
   http://www.fanniemae.com/index.html

3. Federal Home Loan Mortgage Corporation
   http://www.freddiemac.com/

4. Federal Deposit Insurance Corporation
   http://www.fdic.gov/

IX. Ethical Obligations of Counsel.

From the Rules of Professional Responsibility Regulating Michigan Lawyers:

A. Rule 1.2 Scope of Representation

A lawyer shall seek the lawful objectives of a client through reasonably available means permitted by law and these rules. A lawyer does not violate this rule by acceding to reasonable requests of opposing counsel that do not prejudice the rights of the client by being punctual in fulfilling all professional commitments or by avoiding offensive tactics. (emphasis added)

B. Comment (to Rule 1.2):

Scope of Representation

Both the lawyer and the client have authority and responsibility in the objectives and means of representation. The client has ultimate authority to determine the purposes to be served by legal representation, within the limits imposed by law and the lawyer's professional obligations. Within those limits, a client also has a right to consult with the lawyer about the means to be used in pursuing those objectives. At the same time, a lawyer is not required to pursue objectives or employ means simply because a client may wish that the lawyer do so. A clear distinction between objectives and means sometimes cannot be drawn, and in many cases the client-lawyer relationship partakes of a joint undertaking. In questions of means, the lawyer should assume responsibility for technical and legal tactical issues, but should defer to the client

regarding such questions as the expense to be incurred and concern for third persons who might be adversely affected. (emphasis added).

C. Lenders and Borrowers counsel should cooperate with each other in most instances.