

Issues in Financing

Kenneth F. Silver, Esq.
Hertz, Schram & Saretsky, P.C.
Bloomfield Hills

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This outline and presentation is intended to provide practical tips to legal counsel in negotiating end loan documents in commercial real estate transactions.

1. Choosing a lender, Banks vs. Real Estate Mortgage Investment Conduit (“REMIC” or “Conduit”) under IRC §860 D. Often considering whether to deal with a bank or a REMIC is the battle of flexibility vs. rate.
 - A. Start now
 - B. The Application will become your commitment for most non-bank lenders. Pay attention to issues such as assumability, restrictions on back-up deals and various hidden costs.
2. The loan commitment is the first and best place to negotiate general matters of critical importance in any loan transaction in addition to the basic economic conditions of the loan.
 - A. Business Issues
 1. Interest rate floors and ceilings
 2. Lender’s fees
 3. Lender’s counsel fees
 4. Third party reports. To the extent due diligence materials have been provided to the lender, request pre-approval and acceptance. Limit cost of lender fees and inspector fees.
 5. Replacement, lease-up and tenant improvement reserves and tax/insurance escrows.
 6. Sales to third parties. This is particularly important in a positive interest rate climate. Try to negotiate unlimited sales so the mortgage continues to be an assumable loan regardless of the owner.
 7. Use of insurance and condemnation proceeds to re-build.
 8. Timing of penalties and interest i.e. grace periods.

9. Bank supervision and approval of tenant improvements. No approval or supervision should be required for less than 10% of total square footage.

B. Legal Issues

1. The “reasonables”. There is an implied covenant of good faith and fair dealing in every contract. Hammond v United of Oakland, Inc. 193 Mich App 146, 483 N.W. 2d. 652). Note also that Michigan courts do not recognize the tort of breach of the covenant of good faith. Ulrich v Federal Land Bank of St. Paul 192 Mich App 194, 480 N.W. 2d 910). Although Michigan hasn’t addressed the issue with regard to a lender many other states have addressed the issue and there is little doubt that the present covenants would apply to loan documents. California courts have determined that a bank has a duty to act with reasonable care Chazen v. Centennial Bank. 61 Cal.App.4th 532, 71 Cal.Rptr.2d 462).
2. Removing unfettered discretion is probably more important than inserting “reasonables”.
3. Notice and cure. It is critical that all defaults be subject to cure and reinstatement. Otherwise the lender has no obligation to cease pursuit of remedies such as collecting assigned rents. Many loan documents do not provide for reinstatement after cure. If language is not in the document, do not assume you can reinstate.
4. Non-recourse carve outs (see Appendix 1).
5. Borrower Representations and Warranties. Be careful of cookie cutter reps and warranties that don’t necessarily apply such as representing the financial situation of tenants in a multi family project and the existence of “microbial matter.”
6. Assignment of Leases and Rents
7. Estate planning transfers
8. Due on further encumbrance
9. Be careful of the GAAP! Most borrowers do not keep their books in accordance with GAAP! Use language such as “in accordance with accounting principles consistently applied” or accounting principles consistent with Borrower’s previously submitted financial statements.”
10. Bank as attorney-in-fact coupled with an interest. Try to negotiate appropriate triggers instead of granting a blanket power.

C. Basic loan documents

1. Promissory Note
 - i. Notice and Cure. Always insert qualifications on remedies “after the expiration of any notice and cure periods.” Also insert “material” for defaults along with additional time if the Borrower is proceeding diligently to prosecute a cure. Obtain written notice

whenever and wherever possible, although lenders are routinely reluctant to do this.

- ii. Late fees and charges. (Usury)
 - iii. Prepayment. The last year of the loan should allow for prepayment without penalty.
 - iv. Payment amount and maturity. Verify the calculation. Note the use of a 360 day year.
2. Mortgage
- i. Right to rebuild. Increase time periods and reduce lender discretion wherever and whenever possible.
 - ii. Events of Default – rights to cure. Eliminate discretionary defaults, insert “materiality” provisions and obtain written notice whenever and wherever possible.
 - iii. Control issues- Eliminate or reduce lender discretion with regard to review and approval of the following
 - new leases (comprising greater than 10% of the gross square footage)
 - construction of improvements (see above)
 - transfers in a positive interest rate environment
 - cross default (note problems with discharges)
 - reasonables
 - dragnet language
3. Assignment of Leases
- Unconditional vs. conditional assignment. Note MCL §554.231 requires filing of a notice of default with the register of deeds before rent can be collected. Many out of state lenders may not be aware of this provision
4. Guaranty/Indemnity agreements. Traditional carve outs for bad acts.
5. General Loan Agreements
3. Use of Title Company. Flexible and friendly agent can be very helpful in dealing with a difficult lender. Be aware of over zealous lenders who may require expensive endorsements.
1. usury endorsement
 2. zoning endorsement
 3. Living Trusts
4. Borrower organization (bankruptcy remote single purpose entity requirement). SPE language requires that advance consideration be given in allowing for

administrative amendments to organizational documents. Attached as Appendix 2 is some sample SPE language.

5. Opinion of counsel
 - usury
 - zoning
6. Mechanics of closing. Conduit closings often take days not hours. Documents must be received and approved before money is disbursed.

Appendix 1
Loan to Borrower

NOW, THEREFORE, to induce Lender to extend the Loan to Borrower and in consideration of the foregoing premises and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Indemnitors hereby covenant and agree for the benefit of Lender, as follows:

1. Indemnity and Guaranty. Indemnitors hereby assume liability for, hereby guarantee payment to Lender of, hereby agree to pay, protect, defend and save Lender harmless from and against, and hereby indemnify Lender from and against any and all liabilities, obligations, losses, damages, costs, fees, expenses, claims, demands, settlements, awards and judgments of any nature or description whatsoever (including, without limitation, legal fees and costs, as well as other expenses incurred in connection with the defense of any actual or threatened action, proceeding or claim) (collectively, “**Costs**”) incurred, suffered or sustained by Lender resulting from any acts, omissions or alleged acts or omissions arising out of or relating to, or otherwise arising out of or relating to, any one or more of the following items:
 - (a) The misapplication or misappropriation by Borrower of insurance proceeds, condemnation awards, lease security and/or other deposits and/or Necessary Property Receipts (as defined in the Mortgage);
 - (b) Rents, issues, profits and revenues of all or any portion of the Security Property received or applicable to a period after the occurrence of any Event of Default or after any event which, with the giving of notice and/or the passage of time, would constitute an event of default under the Loan Documents, which are not applied to pay, first (a) real estate taxes and other charges which, if unpaid, could result in liens superior to that of the Security Instrument and (b) premiums on insurance policies required under the Loan Documents and, second, the other ordinary and necessary expenses of owning and operating the Security Property and to sums due under the Loan Documents;
 - (c) Waste committed on the Security Property or damage to the Security Property as a result of intentional misconduct or gross negligence or the removal of all or any portion of the Security Property in violation of the terms of the Loan Documents;
 - (d) Fraud or material misrepresentation or failure to disclose a material fact (including, without limitation, with respect to any such fraud, misrepresentation or failure to disclose in any materials delivered to Lender) by Borrower, Indemnitors or the applicant under the application for the Loan or by any other person or entity authorized or apparently authorized to make statements or representations on behalf of Borrower, any one or more of Indemnitors or the Loan applicant in connection with the Loan application, Loan closing or security of or for the Loan, or otherwise in connection with the Security Property or the Loan, which personal liability, notwithstanding any provision in this Section to the contrary, shall be equal to all sums then outstanding pursuant to the Loan Documents (including, but not limited to, principal and accrued interest) and, to the extent not then outstanding pursuant

to the Loan Documents, any fees, costs, expenses, losses or damages incurred or suffered by Lender (including, but not limited to, legal fees and costs) by reason of such fraud, material misrepresentation or failure to disclose;

- (e) The filing of any petition for bankruptcy, reorganization or arrangement pursuant to state or federal bankruptcy law, or any similar federal or state law, by any one or more persons or entities within the Owner Group (other than Borrower or Indemnitors) against Borrower or any one or more of Indemnitors or if any proceeding seeking the dissolution or liquidation of Borrower or any one or more of Indemnitors shall be commenced by any one or more persons or entities within the Owner Group (other than Borrower or Indemnitors). As used herein "**Owner Group**" means collectively, Borrower, Indemnitors and any entity or individual which or who, directly or indirectly owns, controls or holds the power to vote twenty (20%) percent or more of the voting securities or other equity interest in Borrower; and/or
- (f) The failure by Borrower to maintain its status as a single purpose and, if applicable, bankruptcy remote entity as required by the Loan Documents.

Notwithstanding anything to the contrary above or otherwise in the Loan Documents, in the event that: (A) payment of the first full installment of the Monthly Payment Amount (as defined in the Note) (together with all reserves required under the Loan Documents) is not paid when due; (B) Borrower fails to obtain Lender's prior written consent to any subordinate financing or other voluntary lien encumbering the Security Property or direct or indirect interests in Borrower; (C) Borrower fails to obtain Lender's prior written consent to any assignment, transfer or conveyance of the Security Property or any portion thereof or any interest therein or directly or indirectly in Borrower as required by the Loan Documents; or (D) any petition for bankruptcy, reorganization or arrangement pursuant to state or federal bankruptcy law, or any similar federal or state law, shall be filed or consented to, or acquiesced in by, Borrower or any one or more of Indemnitors, or Borrower or any one or more of Indemnitors seeks (or consents to, or acquiesces in) the appointment of a receiver, liquidator or trustee, or any proceeding for the dissolution or liquidation of Borrower or any one or more of Indemnitors shall be instituted or consented to, or acquiesced in by Borrower or any one or more of Indemnitors, then (i) the Loan shall be fully recourse to Indemnitors and (ii) Lender shall not be deemed to have waived any right which Lender may have under Section 506 (a), 506 (b), 1111(b) or any other provisions of the U.S. Bankruptcy Code as same may be amended or replaced (the "**Code**") to file a claim for the full amount of the Loan or to require that all collateral shall continue to secure all of the indebtedness owing to Lender in accordance with the Loan Documents.

This is a guaranty of payment and performance and not of collection. The liability of Indemnitors under this Agreement shall be direct and immediate and not conditional or contingent upon the pursuit of any remedies against Borrower or any other person (including, without limitation, other guarantors, if any), nor against the collateral for the Loan. Indemnitors waive any right to require that an action be brought against Borrower or any other person or to require that resort be had to any collateral for the Loan or to any balance of any deposit account or credit on the books of Lender in favor of Borrower or any other person. In the event, on account of the Code or any other debtor relief law (whether statutory, common law, case law or

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otherwise) of any jurisdiction whatsoever, now or hereafter in effect, which may be or become applicable, Borrower shall be relieved of or fail to incur any debt, obligation or liability as provided in the Loan Documents, Indemnitors shall nevertheless be fully liable therefor. In the event of a default under the Loan Documents which is not cured within any applicable grace or cure period, Lender shall have the right to enforce its rights, powers and remedies (including, without limitation, foreclosure of all or any portion of the collateral for the Loan) thereunder or hereunder, in any order, and all rights, powers and remedies available to Lender in such event shall be non-exclusive and cumulative of all other rights, powers and remedies provided thereunder or hereunder or by law or in equity. If the indebtedness and obligations guaranteed hereby are partially paid or discharged by reason of the exercise of any of the remedies available to Lender, this Agreement shall nevertheless remain in full force and effect, and Indemnitors shall remain liable for all remaining indebtedness and obligations guaranteed hereby, even though any rights which Indemnitors may have against Borrower may be destroyed or diminished by the exercise of any such remedy.

**Appendix 2
Form**

THIS FORM IS INTENDED ONLY AS A SUGGESTION OF CERTAIN CLAUSES WITH RESPECT TO SINGLE PURPOSE/BANKRUPTCY REMOTE FORMATION. BORROWER MAY HAVE TO ALTER THIS AND OTHER ORGANIZATIONAL DOCUMENTS TO REFLECT TRANSACTION SPECIFIC, TAX, INTERNAL BUSINESS AND OTHER CONSIDERATIONS. IN ADDITION, FOLLOWING REVIEW OF A GIVEN TRANSACTION, LENDER MAY REQUIRE ADDITIONAL AND/OR DIFFERENT PROVISIONS.

NECESSARY PROVISIONS TO LIMITED PARTNERSHIP AGREEMENT (WITHOUT INDEPENDENT DIRECTOR)

Notwithstanding any other provision of this Agreement, any other organizational documents or any provisions of law that empowers

_____ (the "Partnership"), the following provisions shall be operative and controlling so long as the loan (the "Loan") by _____ or its successors and/or assigns (collectively, the "Lender") to the Partnership is outstanding:

1. The sole purpose of the Partnership is to acquire, own, hold, maintain, and operate (the "Property"), together with such other activities as may be necessary or advisable in connection with the ownership of the Property. The Partnership shall not engage in any business, and it shall have no purpose, unrelated to the Property and shall not acquire any real property or own assets other than those related to the Property and/or otherwise in furtherance of the limited purposes of the Partnership.
2. _____ is designated as the general partner of the Partnership (the "General Partner"). [The General Partner, and any additional or substitute general partner of the Partnership, may not be an individual and shall at all times have as its sole purpose to act as the General Partner of the Partnership, and shall be engaged in no other business or have any other purpose. Additionally, any additional or substitute General Partner of the Partnership shall have organizational documents that (a) conform in all material respects to the organizational documents of the General Partner, inclusive of all single purpose/bankruptcy remote provisions, and (b) are acceptable to the Lender.] [Use bracketed language only for level 3 and above.]
3. The General Partner shall have no authority to perform any act in respect of the Partnership in violation of any (a) applicable laws or regulations or (b) any agreement between the Partnership and the Lender.
4. The Partnership shall not:
 - (a) make any loans to the General Partner or other partners of the Partnership (individually, a "Partner" and collectively with the General Partner, the "Partners") or the Partnership's or any Partner's Affiliates (as defined below);
 - (b) except as permitted by the Lender in writing, sell, encumber (except with respect to the Lender) or otherwise transfer or dispose of all or substantially

- all of the properties of the Partnership (a sale or disposition will be deemed to be “all or substantially all of the properties of the Partnership” if the sale or disposition includes the Property or if the total value of the properties sold or disposed of in such transaction and during the twelve months preceding such transaction is sixty six and two thirds percent (66-2/3%) or more in value of the Partnership’s total assets as of the end of the most recently completed Partnership fiscal year);
- (c) to the fullest extent permitted by law, dissolve, wind-up, or liquidate the Partnership;
 - (d) merge, consolidate or acquire all or substantially all of the assets of an Affiliate of same or other person or entity;
 - (e) change the nature of the business conducted by the Partnership; or
 - (f) except as permitted by the Lender in writing, amend, modify or otherwise change this Agreement (or, after securitization of the Loan, only if the Partnership receives (i) confirmation from each of the applicable rating agencies that such amendment, modification or change would not result in the qualification, withdrawal or downgrade of any securities rating and (ii) permission of the Lender in writing).
5. The Partnership shall not, and no Partner or other person or entity on behalf of the Partnership shall, without the prior written affirmative vote of one hundred percent (100%) of the Partners: (a) institute proceedings to be adjudicated bankrupt or insolvent; (b) consent to the institution of bankruptcy or insolvency proceedings against it; (c) file a petition seeking, or consenting to, reorganization or relief under any applicable federal or state law relating to bankruptcy; (d) consent to the appointment of a receiver, liquidator, assignee, trustee, sequestrator (or other similar official) of the Partnership or a substantial part of its property; (e) make any assignment for the benefit of creditors; (f) admit in writing its inability to pay its debts generally as they become due or declare or effect a moratorium on its debts; or (g) take any action in furtherance of any such action ((a) through (g) above, with respect to any person or entity, collectively, a “Bankruptcy Action”).
6. The Partnership shall have no indebtedness or incur any liability other than (a) unsecured debts and liabilities for trade payables and accrued expenses incurred in the ordinary course of its business of operating the Property, provided, however, that such unsecured indebtedness or liabilities (i) are in amounts that are normal and reasonable under the circumstances, but in no event to exceed three percent (3%) of the original principal amount of the Loan and (ii) are not evidenced by a note and are paid when due, but in no event for more than sixty (60) days from the date that such indebtedness or liabilities are incurred and (b) the Loan. No indebtedness other than the Loan shall be secured (senior, subordinated or pari passu) by the Property.
7. A Bankruptcy Action by or against any Partner shall not cause such Partner to cease to be a partner of the Partnership and upon the occurrence of such an event, the Partnership shall continue without dissolution.
8. The Partnership shall at all times observe the applicable legal requirements for the recognition of the Partnership as a legal entity separate from any Partners or Affiliates of same, including, without limitation, as follows:

- (a) The Partnership shall maintain its principal executive office and telephone and facsimile numbers separate from that of any Affiliate of same and shall conspicuously identify such office and numbers as its own or shall allocate by written agreement fairly and reasonably any rent, overhead and expenses for shared office space. Additionally, the Partnership shall use its own separate stationery, invoices and checks which reflects its separate address, telephone number and facsimile number.
- (b) The Partnership shall maintain correct and complete financial statements, accounts, books and records and other entity documents separate from those of any Affiliate of same or any other person or entity. The Partnership shall prepare unaudited quarterly and annual financial statements, and the Partnership's financial statements shall substantially comply with generally accepted accounting principles.
- (c) The Partnership shall maintain its own separate bank accounts, payroll and correct, complete and separate books of account.
- (d) The Partnership shall file or cause to be filed its own separate tax returns.
- (e) The Partnership shall hold itself out to the public (including any of its Affiliates' creditors) under the Partnership's own name and as a separate and distinct entity and not as a department, division or otherwise of any Affiliate of same.
- (f) The Partnership shall observe all customary formalities regarding the existence of the Partnership, including holding meetings and maintaining current and accurate minute books separate from those of any Affiliate of same.
- (g) The Partnership shall hold title to its assets in its own name and act solely in its own name and through its own duly authorized officers and agents. No Affiliate of same shall be appointed or act as agent of the Partnership, other than, as applicable, a property manager with respect to the Property.
- (h) Investments shall be made in the name of the Partnership directly by the Partnership or on its behalf by brokers engaged and paid by the Partnership or its agents.
- (i) Except as required by Lender, the Partnership shall not guarantee, pledge or assume or hold itself out or permit itself to be held out as having guaranteed, pledged or assumed any liabilities or obligations of any Partner or any Affiliate of the Partnership, nor shall it make any loan, except as permitted in the loan agreement with the Lender.
- (j) The Partnership is and will be solvent.
- (k) Assets of the Partnership shall be separately identified, maintained and segregated. The Partnership's assets shall at all times be held by or on behalf of the Partnership and if held on behalf of the Partnership by another entity, shall at all times be kept identifiable (in accordance with customary usages) as assets owned by the Partnership. This restriction requires, among other things, that (i) Partnership funds shall be deposited or invested in the Partnership's name, (ii) Partnership funds shall not be commingled with the funds of any Affiliate of same or other person or entity, (iii) the Partnership shall maintain all accounts in its own name and with its own tax identification number, separate from those of any Affiliate of same or other person or entity, and (iv) Partnership funds shall be used only for the business of the Partnership.

- (l) The Partnership shall maintain its assets in such a manner that it is not costly or difficult to segregate, ascertain or identify its individual assets from those of any Affiliate of same or other person or entity.
- (m) The Partnership shall pay or cause to be paid its own liabilities and expenses of any kind, including but not limited to salaries of its employees, only out of its own separate funds and assets.
- (n) The Partnership shall at all times be adequately capitalized to engage in the transactions contemplated at its formation.
- (o) The Partnership shall not do any act which would make it impossible to carry on the ordinary business of the Partnership.
- (p) All data and records (including computer records) used by the Partnership or any Affiliate of same in the collection and administration of any loan shall reflect the Partnership's ownership interest therein.
- (q) None of the Partnership's funds shall be invested in securities issued by, nor shall the Partnership acquire the indebtedness or obligation of, any Affiliate of same.
- (r) The Partnership shall maintain an arm's length relationship with each of its Affiliates and may enter into contracts or transact business with its Affiliates only on commercially reasonable terms that are no less favorable to the Partnership than is obtainable in the market from a person or entity that is not an Affiliate of same.
- (s) The Partnership shall correct any misunderstanding that is known by the Partnership regarding its name or separate identity.

For purposes of this Agreement, Affiliate means any person or entity which directly or indirectly through one or more intermediaries controls, is controlled by or is under common control with a specified person or entity. For purposes hereof, the terms "control", "controlled", or "controlling" with respect to a specified person or entity shall include, without limitation, (i) the ownership, control or power to vote ten percent (10%) or more of (x) the outstanding shares of any class of voting securities or (y) beneficial interests, of any such person or entity, as the case may be, directly or indirectly, or acting through one or more persons or entities, (ii) the control in any manner over the general partner(s) or the election of more than one director or trustee (or persons exercising similar functions) of such person or entity, or (iii) the power to exercise, directly or indirectly, control over the management or policies of such person or entity.

9. **[If the Partnership Agreement provides for a Partnership indemnity obligation, the following applies:]** Any indemnification obligation of the Partnership shall (a) be fully subordinated to the Loan and (b) not constitute a claim against the Partnership or its assets until such time as the Loan has been indefeasibly paid in accordance with its terms and otherwise has been fully discharged.
10. **[If the Partnership is required to provide a nonconsolidation opinion, the following applies:]** No transfer of any direct or indirect ownership in the Partnership may be made such that the transferee owns, in the aggregate with the ownership interests in the Partnership of transferee's Affiliates, more than a forty-nine percent (49%) interest in the Partnership unless such transfer is conditioned upon the delivery of an acceptable nonconsolidation opinion to the Lender and any applicable rating agency.