

# Mortgage Loan Closings

## *Break the Bottlenecks in the Paperwork Process*

*Editor's Note: This article is part one of a two-part series. Part two will appear in an upcoming issue of Office & Industrial Properties magazine.*

To close any commercial real estate loan, borrowers and lenders need to orchestrate a wide range of activities and deliveries that involve a variety of third parties. This process often must be completed on a very tight schedule, leaving little room for delay or mistakes.

By the time of the closing, everything — not just *almost* everything — must be done and done right. To accomplish this goal, borrowers and lenders must master logistics and organization perhaps as much as they must master business, law and real estate.

This article, published in two parts, summarizes the major pieces of the commercial mortgage loan closing process, with specific, concrete suggestions on how borrowers and lenders can make the entire process work better.

### THE CHECKLIST

Borrowers and lenders should start their preparation by clearly understanding what will need to be delivered at or before closing. If the lender wants estoppel certificates, for example, identify the exact form required at the beginning. The borrower should ask the lender to provide templates or specifications for every required closing delivery as soon as the borrower signs the commitment letter or application, if not before.

Likewise, the information that lender's counsel will need for the loan documents is generally the same for every loan. Those information requirements can easily be summarized in a standard loan data sheet. The borrower can simply pull together everything lender's counsel will need to get started, rather than wait for a series of requests for missing items.

Finally, when a transaction begins, borrowers should request a standardized checklist from their lender (or create one themselves) that includes every required delivery, document or certificate.

The categories will always include at least the following, in about the same order:

1. Third-party property reports
2. Review of leases; tenant-related documentation
3. Borrowing entities
4. Loan documents
5. Out-of-state issues (where applicable)
6. Title insurance
7. Surveys
8. Opinion of borrower's counsel
9. Insurance coverage
10. Mechanics of transferring funds and closing the deal

### THIRD-PARTY PROPERTY REPORTS

A lender will typically want three third-party reports: an appraisal, an engineering report and an environmental report. Recently, some lenders have added an insurance report to the list. Here are suggestions for borrowers to speed up the process:

In the commitment letter, the borrower can ask the lender to pre-approve the borrower's choice of consultants so the borrower can have the reports prepared in advance. Using nationally recognized third-party consultants may help assure that a future lender will accept their work product.

Reach out to these third-party consultants early. Find out exactly what information they will need. Get it to them quickly and completely.

Try to persuade appraisers to say less rather than more, particularly by reducing the amount of general information that merely adds heft — not substance — to the appraisal. Of course, appraisals still must adhere to the standards of appraisal practice, which became as detailed and comprehensive as the Federal Register in the aftermath of the real estate depression of the early 1990s.

Building and zoning compliance is often a problem because typically no one wants to be responsible for it. Try to place the burden unambiguously on someone as early as possible — local counsel, a title company, the engineering consultant or a zoning compliance

service. Set a deadline for them to produce a written report on code compliance.

### LEASE REVIEW AND TENANT DOCUMENTATION

Because rental income ultimately drives all nonrecourse financing, lenders want to validate and then preserve rental income. To do it, they generally require estoppel certificates at closing and nondisturbance agreements to prevent problems later. Both documents require cooperation by tenants, so getting them is about as easy as pulling teeth. To simplify the process, borrowers can take the following steps.

Every lease should plan ahead to the requirements of future lenders, by building in (as exhibits) specific requirements for estoppel certificates and nondisturbance agreements the tenant must deliver. Or, in place of a nondisturbance agreement, the lease can go a step further and write the same lender protections into the text of the lease. Either way, the borrower will simplify future loan closings.

If tenants have already entered into nondisturbance agreements with an existing lender being refinanced, the new lender may be willing to take those agreements by assignment or enter into new nondisturbance agreements in exactly the same form. Either will save negotiating time.

Borrowers will often speed up the process if they give lender's counsel copies of all leases in a single, complete, integrated, well-indexed package instead of in a randomly selected mess delivered in installments. If the borrower has already prepared lease abstracts, include them, too.

### BORROWING ENTITIES

A borrower who waits until the last minute to form the borrowing entity may cause delays. For example, the name the borrower wants to use may not be available, or it may be unusable because of bureaucratic restrictions on entity names.

Borrowers might solve the problem by forming shelf entities (i.e., entities that are formed in advance with generic names ready for use as needed). To assure that the entity has been formed and to prevent any possible

confusion regarding its name, lender's counsel should obtain a copy of the entity's official charter document when the transaction begins. Internal approvals should require as few signatures as possible.

In forming a borrowing entity, do so in a way that will comply with any future lender's single-purpose entity requirements, including a requirement that the borrower never conducted any business before closing.

To facilitate future transfers of equity, consider setting up the new entity so it consists of several other constituent entities (e.g., a limited liability company with a corporate managing member and a couple of passive members, not just one).

### LOAN DOCUMENTS

The parties rarely forget to focus on the loan documents. But even the loan documents can create needless delays and trouble. Lenders who want to streamline their closings can streamline their loan documents in several ways.

They should address each topic only once. Instead of creating four separate pledge agreements to pledge four types of

miscellaneous incidental collateral, the lender can perhaps combine them into one or build them into the mortgage or loan agreement.

If the loan will require a lockbox, document the whole thing in the lockbox agreement or the loan agreement, but not strewn through both of them. Try to collect deal-specific business terms and blanks in one place so they are easy to modify, even at the last minute.

Try not to create side letters. Instead, incorporate every agreement into some existing document.

Generalize reserves so they require less attention. If a proposed reserve would be very small, consider eliminating it. Reduce the loan amount instead.

Consider whether some risks truly justify the incremental cost of more documents or closing requirements. Even though it's possible to identify and mitigate another risk, is it always necessary? This is, of course, a business decision and not a legal decision.

When a borrower or its counsel receives a pile of loan documents for a transaction,

the potential for negotiations — and hence delay — is almost endless. Smart lawyers can always find more issues. Borrowers who want to speed up the closing process might tell their attorneys to focus on only three things in the loan documents.

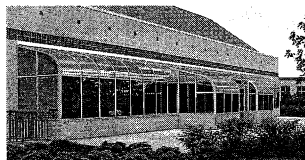
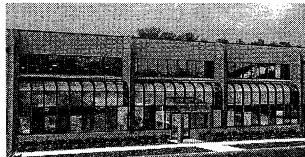
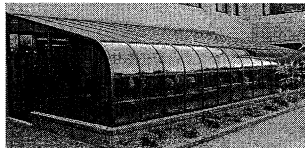
The documents should reflect the economics of the deal, particularly the interest rate and prepayment rights.

If the borrower simply signs the loan documents and goes about its normal and usual business, nothing in the loan documents should automatically put the borrower into default.

Finally, to the extent that anyone has personal liability, that personal liability should be as minimal as possible consistent with the business deal. ❖

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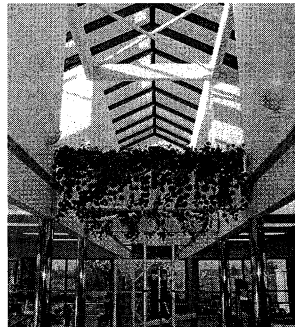
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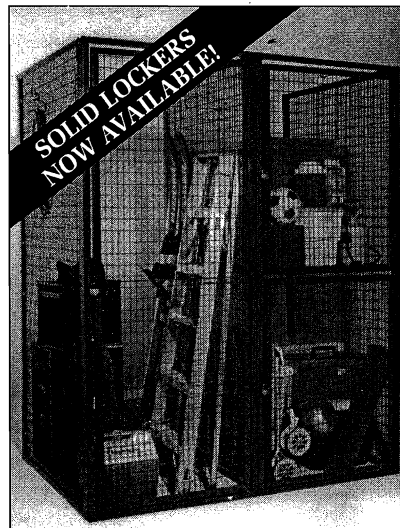


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## *Don't Wait Until the Last Minute*

*Editor's Note: This article is the second part in a two-part series. Part one appeared in the November 2000 issue of Office & Industrial Properties. Both articles can be found in the Finance Online section of our web site at [www.officeandindustrial.com](http://www.officeandindustrial.com).*

To close a major commercial real estate loan, borrowers and lenders must coordinate a process not too different from staging a Broadway show. When the curtain goes up, all the elements of the show need to be on their marks and ready to go.

If a lender closes a loan in one state secured by a property in another state, the lender often will hire local counsel to advise on out-of-state legal issues. As an understatement, this process is not altogether satisfactory. Lenders can simplify and improve it as follows:

1. Provide the required form of local counsel opinion at the beginning of the transaction. Try to make it standard and normal, although standardization is harder for local counsel opinions than for a "borrower's counsel" opinion. Then, try to make sure local counsel focuses on the loan documents and the opinion process early.

2. Try to write the local counsel opinion so local counsel does not need to see any final signed documents before the transaction closes.

3. If the borrower and the lender share local counsel and local counsel provides any advice to the lender beyond declaring the documents "enforceable," a conflict of interest may occur. Try to identify and solve that problem sooner rather than later.

4. If a lender closes a significant volume of loans in the same state, the lender can streamline the local counsel process by building all the necessary state-specific language into the standard loan documents. For individual transactions, a phone call to local counsel may suffice to confirm that the deal structure creates no state-specific issues and that state law has not changed.

### TITLE INSURANCE

As the most crucial task in the closing process, the lender needs to get a title

insurance policy in the right amount and one which shows the right state of title. The parties need to push that process from the beginning with the following guidelines:

- For repeat deals, try to use the same office of the same title company and the same closing personnel. They will learn how the borrower and lender do business.

- Define a standardized set of title insurance requirements, and attach it to the commitment letter when issued.

- Lenders can sometimes streamline the title process by asking the title company to skip the title commitment and issue instead a pro forma title policy (a sample policy that's not legally binding)

surveyor when the surveyor starts work. Second, use a complete and standard form of survey certification. If a borrower is considering three lenders, it can ask the surveyor to prepare a separate certification for each. Once the borrower chooses its lender, it can attach the appropriate certification to the survey and avoid delay.

### OPINION OF BORROWER'S COUNSEL

At the closing of any loan transaction, the lender will ask the borrower's counsel to issue an "opinion of counsel" to confirm that the borrowing entity legally exists, the right people signed the documents and

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to show the lender exactly what the title coverage will look like at closing. This can prevent a great deal of back and forth communication.

- Title companies will almost always cover additional title-related risks beyond the standard ones, often at no cost. Even before the title company issues its first report, the lender should identify what endorsements it will require and distribute those requirements to all concerned.

- The title company should prepare and deliver one complete report, with everything that lender's counsel will need. The package should at least include copies of all recorded documents that will survive closing, a survey and whatever endorsements the lender has requested.

### SURVEYS

Borrowers can streamline the process of dealing with surveys in a variety of ways. First, get the lender's survey requirements early in the process, and give them to the

similar matters. To avoid delays at closing, follow a few simple rules.

Treat the opinion as a significant loan document. It needs careful attention and review from the beginning, not merely the night before the closing.

If the law firm issuing an opinion will need to obtain any internal approvals or review of the opinion, it is best to start and finish that process early. Failure to do that creates the risk of 11th-hour opinion issues that may require involvement by some other attorney within the firm, who is guaranteed to be unavailable when needed.

Opinion requirements have become fairly standardized. Lender's counsel should ask for, and borrower's counsel should be willing to give, an opinion generally consistent with industry standards.

### INSURANCE COVERAGE

In a nonrecourse loan, the lender looks solely to its collateral and thus could

sustain a significant loss if the property was not properly insured. Insurance coverage, therefore, represents one area where lenders have little room to cut corners or compromise.

The commitment letter should specifically describe the insurance requirements so the borrower can have its insurance broker prepare the necessary documents early. Whoever will need to approve the insurance coverage should see it well in advance, so it will not be a last-minute problem.

### TRANSFERRING FUNDS AND CLOSING THE DEAL

Borrowers and lenders can streamline the final stage in the closing process — funding the loan and closing the deal — in several ways.

**Escrow.** Use a title insurance company's escrow, and set up the escrow mechanics before the last minute.

**Pre-funding.** When the closing escrow is established, set up the transaction so the lender can pre-fund, even before all the closing conditions have been satisfied. Then, when the transaction really is ready to go, the parties need not wait for the lender to disburse into escrow before the escrow can begin releasing funds. (The lender will need to document what happens if the deal never closes and the treatment of interest on these funds.)

**Closing Statement.** Decide early who will prepare the closing statement, and have that person prepare a draft with preliminary numbers. This can give everyone a general idea of what will happen at the closing and helps identify any misunderstandings.

**Wire Transfers.** The borrower and its counsel should obtain wire transfer instructions for all disbursements and give the lender this information as early as possible.

**Final Loan Amount.** If the loan amount drops at the last minute, the parties probably do not really need to revise all the documents. Instead, perhaps they can memorialize in the closing statement or a side letter that the final loan amount was actually less than the face amount of the documents.

### PREPARE FOR THE RUSH

With today's accelerated closing schedules, transactions often begin at the last minute and must close almost instantaneously — sometimes, it seems, merely because such speed is attainable. In these

transactions, there is no such thing as planning ahead. But parties to loan closings need to realize that if every transaction becomes an emergency, transaction costs increase, along with the likelihood of mistakes and omissions.

As a consistent theme, borrowers and lenders should identify closing requirements early instead of waiting until the

last minute. By doing that, borrowers and lenders can minimize the problems and delays of the real estate loan closing process. ❖

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