

NEGOTIATING SECURITIZED REAL ESTATE LOANS; SIX TIPS FOR REPRESENTING THE BORROWER

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INTRODUCTION

Increasingly, commercial real estate loans are packaged into groups of loans, the interests in which are sold as securities, i.e. “securitized.” These loans, typically called “conduit” loans, have specific and unique underwriting requirements that are often different than those for traditional commercial loans offered by banks and other financial institutions. These underwriting requirements become incorporated into the loan documents, as well as imposing other obligations on the borrower.

This article offers six tips when negotiating conduit loans on behalf of the borrower, some of them contrary to conventional wisdom. Keeping these tips in mind as you proceed through the loan process will, I suggest, lead to benefits for the client/borrower, the attorney and even the lender.

Typical Scenario

Often the borrower does not seek out a conduit loan. Rather, a loan broker with whom the borrower is working will indicate that such a loan is preferable, either because of terms, or often because it is the only financing available. If the borrower has not previously obtained a conduit loan, it may be assumed that this type of loan is the same as any other commercial loan, differing only in that it will be later packaged with other loans and “securitized.” This is not accurate and leads to the first tip:

- 1. Explain to the borrower that this loan will be more difficult and probably more expensive to obtain.**

There are several reasons that a conduit loan will be more difficult and expensive, and this should always be explained to your borrower/client at the outset. Otherwise, when delays and added expense occur, the borrower may well be asking why you did not anticipate these difficulties.

Some of the main reasons for the added difficulty and expense are:

- Underwriting requirements that are more onerous and less negotiable than in a conventional loan;

- More sophisticated and sometimes less cooperative lender's counsel, often from large firms in New York or other major metropolitan areas;
- Strict single purpose entity requirements, including possible amendments to the organizational documents, as well as possibly a separate legal opinion relating to the effects of a bankruptcy of borrower related entity ("non-consolidation opinion").

2. Contrary to typical statements of the lender and its counsel, many loan terms are still negotiable.

Many attorneys believe, and lender's counsel often states, that because of strict underwriting requirements the terms in the loan documents are not negotiable. In my experience this is simply not true, although there certainly are some requirements (as in a conventional loan) that cannot be changed. However, do not be afraid to challenge unreasonable provisions, particularly overly broad "carve outs" that may impose personal liability on your client despite the loan being "non-recourse." And if the provision truly appears unreasonable, I have found that it is likely subject to negotiation and with persistence can often be changed.

3. Develop a good working relationship with lender's counsel.

Lenders generally rely on the advice of their attorneys. These attorneys can either help you when you need it or make it extremely difficult to close the loan if they wish. Whether they do one or the other may well depend upon the relationship you have developed. Often this will be important regarding "post-close" items, i.e. those items that the lender agrees can be provided after close of the loan. In my experience there is a great deal of latitude in what may be permitted, depending in part upon your relationship with lender's counsel and whether you and your client are perceived as trustworthy. Think about this long before you may need a favor, which will likely be shortly before close when it will be most important. By then lender's counsel will have put you either in the category of someone he/she wants to help close the loan or someone who has been difficult and therefore does not deserve a break. Who do you wish to be?

4. Do not get trapped by requirements of the lender regarding your legal opinion.

Try to uncover any unusual requirements of your required legal opinion as early as possible. That is, if you are asked to render an opinion on something you are uncomfortable with, and you raise the issue near the closing date, your client may view you as the problem in closing the loan. For example, I will not generally provide a zoning opinion. Therefore, anticipate that other means of satisfying the lender regarding zoning compliance may be required, e.g. a zoning letter from the appropriate governmental entity or an endorsement to the lender's policy of title insurance. Also, at the earliest opportunity obtain the lender's form legal opinion, review it and raise any concerns regarding items in it. Finally, although I try to use my form of opinion letter, as I suggest

you should, some lenders (and their counsel) insist upon use of the lender's form opinion letter, modified as appropriate.

5. Anticipate that you may need more than one attorney.

In particular if the loan is more than \$15 million, you will probably need another attorney to provide a "non-consolidation" opinion, providing comfort that the collateral would be unaffected by the bankruptcy of a borrower related entity or individual. This is obviously a specialized area of law and usually will require the opinion of another attorney familiar with bankruptcy and related issues. This opinion will also likely be expensive, a fact that should be brought to your client's attention as early as possible.

6. Anticipate that the entity documents and/or structure itself may well need to be changed.

Related to the "non-consolidation" issue is the requirement that the borrower in a conduit loan situation be a "single purpose entity", whose only asset is the real property securing the loan and whose sole business is operating the property. Lender's counsel will often, after reviewing the organizational and other documents of the borrower, require changes that will then potentially involve the Secretary of State in the state of organization. Although these issues can usually be resolved, they often take time and can delay the closing of the loan if not anticipated. And because governmental entities are often not inclined to go out of their way to expedite matters, e.g. filing of amended organizational documents, try to resolve any issues regarding organizational documents as early as possible.

In conclusion, negotiating a conduit real estate loan on behalf of a borrower will be more challenging, time consuming and expensive than a conventional commercial loan. However, keeping the above suggestions in mind will lessen the adverse effects of the experience, and most importantly result in a more satisfied client.