

## REAL ESTATE TRANSACTIONS CHECKLIST

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### I. First Mortgages

Applications have served as long commitments.

#### A. Issues to be raised in applications.

1. Exceptions to prepayment clause
2. Exceptions to non-recourse clause
3. Exceptions to due on sale clause
4. Exceptions to full environmental indemnity
5. Form of borrower's counsel opinion
6. Use of insurance and condemnation proceeds for rebuilding
7. Restrictions on leasing activity
8. Relationship with tenants and use of subordination and non-disturbance agreements

### II. Non-recourse Carve-outs

Lenders have been adding significant exceptions to the non-recourse carve-outs language. These carve-outs protect the lender against borrower bad conduct and borrower action to defeat the lender's remedies.

#### A. Lenders have been adding significant exceptions to non-recourse language in order to discourage certain practices by borrowers and may be expected to continue this practice. Some typical carve-outs, designed to reimburse lender for any losses caused by certain conduct, are as follows:

1. Fraud or misrepresentation in the making of the loan
  - a. Restrict to intentional misrepresentations?
  - b. Restrict to statements made in writing?
  - c. Misapplication of loan proceeds or insurance or condemnation funds released to borrower for restoration.

- d. Misapplication of tenant security deposits or prepaid rents (but did the lender have security deposits included as collateral?).
- e. Misapplication of revenues from the improvements by not paying expenses of operation and maintenance or the indebtedness occurring after default or a period prior to default.
- f. Liability under hazardous waste indemnities.
- g. Failure to pay mechanics' liens, perhaps including subordinate liens.
- h. Failure to pay taxes, assessments and/or utility charges.
- i. Violation of the due on sale and due on encumbrance clause
- j. Violation of the covenants regarding use of hazardous materials.
- k. Resisting enforcement of the documents by the lender.
- l. Filing for protection under bankruptcy laws.

Some lenders provide for total recourse in the event certain covenants are breached as a method to control undesirable borrower conduct.

The last four carve-outs may provide for total recourse. Any exculpation language should be included in the note and the security instrument. All carve-outs should be negotiated in the commitment stage.

### III. Defeasance Pre-payment Premiums

The use of securitization has altered the playing field for yield maintenance.

- A. Normal yield maintenance is usually a minimum of the greater of (i) 1% or (ii) the differential between the interest to be earned over the course of the loan from a treasury bill based formula discounted to present value.
- B. Defeasance takes the place of yield maintenance. In defeasance, the borrower is required to put a deposit in the hands of a fresh entity which pays interest at the same rate of the original obligation and where the principal, upon termination, is paid to the lender from the escrow sources. Defeasance prevents early interruption of cash flow.

### IV. Mezzanine Financings

Mezzanine financing has taken the place of second mortgage financings which is not permitted in securitized loan situations.

- A. The mezzanine lender owns the ownership interest in the borrower so that upon foreclosure it can own all of the ownership entities comprising the borrower and effectively control the borrower.
- B. The mezzanine borrower may have to move down several levels in the ownership chain in order to preserve itself with respect to bankruptcy.
- C. Mezzanine lending is a pledge of ownership interest secured by either Article 8 or Article 9 of the Uniform Commercial Code. The mezzanine lender does not own any interest in the property.
- D. Foreclosure is done by Uniform Commercial Code pursuant to Article 8 or Article 9 of the Uniform Commercial Code.
- E. The mortgage loan/mezzanine loan intercreditor agreement is quite different from the normal first mortgage/second mortgage because the mezzanine lender does not have a recorded lien against the property.
- F. There are significant insurance products available from title insurance companies to protect the mezzanine lender's Uniform Commercial Code interest.

#### V. Leasehold Financings

Elements of a financeable ground lease:

- A. An unencumbered fee with all fee mortgage being subject to or recognizing the leasehold mortgage.
- B. Term: The term of the lease must be longer than the term of the mortgage and at least for the term of the amortization.
- C. Rent should be fixed or, if variable, capable of being ascertained by use of a formula.
- D. Tenants' rights to mortgage must be clear in the lease.
- E. Tenants should not have the right to change the lease without the leasehold mortgagee's consent. The lease must recognize the leasehold mortgagee.
- F. Damage and destruction: Use of proceeds for rebuilding should be permitted except for total destruction in the last four years of the lease.
- G. Defaults: The leasehold mortgagee must have notice, separate adequate opportunity to cure with additional time, and there should be no right to terminate by the landlord unless the leasehold mortgagee has failed to assert its cure rights.
- H. The landlord should be obligated to provide the leasehold mortgagee with a new lease for the unexpired term of the old lease on the same terms and conditions.