Mortgage Refinance Process Tips

July 19, 2010

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As seen in the *Real Estate Finance Journal*.

The biggest question in the commercial real estate industry during this recession is, what will happen to all the loans that need to be refinanced if lenders are not lending money? That question remains unanswered, but let's assume a property is exceptional and lenders are willing to provide a commitment to refinance an existing mortgage loan. What will it take to get the new loan on the books? Following is a step-by-step explanation of the commercial real estate refinance process.

Step One: Choosing a Lender

A borrower may not have the luxury of choosing a lender in this current economy, but for the fortunate, there are several types of lenders from which to choose. Two of the most common sources of funds for commercial real estate financing are traditional banks and permanent lenders, primarily life insurance companies. Which type of lender is chosen depends on several factors, including whether a borrower wants a long-term or short-term loan, a fixed or variable interest rate, and whether personal liability (at some level) is acceptable for the principals of the Borrower. For short-term financing (generally 5-7 years at the outside) and a variable interest rate (ignoring the possibility of an interest rate swap), usually based on LIBOR, a traditional bank is the most likely lender. Banks frequently require a full payment guarantee from one or more financially strong principals. If the property will support a long term loan (10 years or more), a fixed (but possibly higher) interest rate and no personal liability (or very limited liability), then a permanent lender is the correct choice. For expert guidance in choosing a lender best suited to a particular property, mortgage bankers are invaluable. Mortgage banking companies also provide experienced closers to facilitate the process.

Step Two: The Loan Commitment

Once a borrower has selected the best lender to fit its needs and preferences, the business terms of the loan will be negotiated. This is a critical step in the entire process because the borrower will have to live with these terms for the next 5, 10, 15 or 20 years. One major mistake business people make is not getting their legal counsel involved at the loan commitment stage. The commitment letter, if signed by the lender and the borrower or otherwise accepted by the borrower, is a legally binding agreement. Ambiguous or inconsistent language in the commitment, for payment of fees, deposit refunds, closing requirements or other items, can lead to disruptions in the closing at best, or can become a deal breaker at worst. Getting attorneys involved from the beginning will help alleviate these issues and save both parties time and money in the long run. Some important secondary terms in the loan commitment include when the commitment expires, what the deposit requirements are and how any deposits will be refunded, and what the closing requirements are.

Step Three: Loan Documentation and Due Diligence

Once the loan commitment is signed (or otherwise accepted), the closing process can begin. One critical document to ensure a smooth and efficient closing is the closing checklist (generally provided by the lender or its counsel). A good closing checklist will contain all of the due diligence items needed for closing and the party responsible for such items. The closing checklists should begin with a list of who the players are and their contact information. The checklist should also cover everything required by the loan commitment, including a list of applicable loan documents. The checklist should be broken down by category, i.e., loan documents, title documents, surveys, tenant documents (including leases), business items such as appraisals and environmental reports. Lender's counsel should update and circulate the checklist regularly to all parties during the closing process.

1. *Loan Documents*. While some lenders have unique documentation requirements, all lenders have certain standard loan documents: a) Promissory Note; b) Mortgage or Deed of Trust (depending on the laws of the state in which the property is located); c) Assignment of Leases and Rents; d) Guaranty, either full recourse, partial recourse or non-recourse with carve-outs for "bad boy" acts such as fraud; and e) Environmental Indemnity Agreement. With a few exceptions, the terms and conditions contained in these documents are consistent across all commercial real estate lenders. The question then becomes, what is negotiable in these documents? The answer, in theory, is anything.

   In reality, there are certain provisions that a lender generally will not negotiate. Any term in the loan commitment that is recited in the loan documents is not negotiable. The argument is a fair one - if the borrower didn't like the terms in the loan commitment, it should have negotiated those terms before signing or accepting the loan commitment. Lenders also will typically refuse to modify the terms of any environmental indemnity or guaranty. Cure periods for payment defaults usually are declined, although non-monetary defaults can be negotiated. Property-specific terms, such as parameters for new leases or provisions dealing with renovation of the property, will be negotiated in good faith by any lender.

   "Hyper-negotiation" of loan documents is a sign of inexperienced borrowers or their counsel. When a borrower requests numerous revisions to every section of a lender's documents, the process slows to a crawl. Costs begin to rise (borrower can expect to pay the lender's legal fees, along with its own attorney's fees). An efficient borrower will focus on provisions which are genuinely important to the operation of the property. The format of the loan documents tends to be industry-standard and should not contain any "surprises" for reasonably experienced borrowers.

2. *Due Diligence*. It is critical for a borrower and borrower's attorney to be organized and think ahead about due diligence items that need lead time. Most lenders will require an ALTA survey of the property that is acceptable to the lender. Typically, an ALTA survey will require the surveyor to research the real property records and perform field work. The lead time for completion of an ALTA survey is 3-4 weeks (and can be longer), so a borrower must account for that if it has a particular closing date in mind. Lenders will require a lender's title insurance policy for the property. The borrower will need to hire a title company to perform a title search and issue a commitment to insure the property. Depending on the nature and location of the property, a borrower should allow 2-3 weeks of lead time for the title company to complete the title search and issue a title commitment. It will be helpful to the title company if the borrower can provide a copy of the existing title policy for the lender which most recently financed the property. Perhaps the most important piece of due diligence to the lender is the appraisal of the property, which will be the baseline for the lender's underwriting to determine how much money to lend to the borrower. The appraisal often takes several weeks to complete. Ordering the appraisal can occur before the loan commitment is even finalized and signed. Failure to get that started early will most assuredly delay the closing.

For properties with commercial tenants (retail, office, industrial), a lender will require tenant estoppel certificates and subordination, non-disturbance and attornment agreements ("SNDAs"). These documents can require unanticipated lead time. A property owner should begin the process of getting these documents to the tenants immediately, especially in the case of a retail center with national tenants. Some of the larger national tenants are notorious for taking 30 days or more to negotiate, process and sign tenant estoppels and/or SNDAs. Waiting until the last minute is not an option.

Most lenders will require a legal opinion from the borrower's attorney as to the validity of the loan documents and the borrowing entity's legal authority to execute and be bound by the terms of the loan documents. Lenders generally require "unqualified" opinions, meaning the opinions given by the attorney cannot be limited to the attorney's knowledge. Sometimes the borrower's attorney does not want to give an unqualified opinion, especially with respect to pending or threatened litigation. The Lender may allow a knowledge qualifier with respect to threatened litigation, but is less likely to allow a knowledge qualifier for pending litigation; however, the lender may permit the opinion to be based on a current (a few days before closing) search of the state and federal court dockets where the borrower/guarantor resides.

A borrower will need to provide most or all of the following additional due diligence, before the lender will release the loan funds: a) zoning and building code compliance information; b) organizational documents, including certificates of good standing and authorizing resolutions of the borrower and any controlling entity of the borrower; and c) various property reports including a property condition report, Phase I environmental site assessment and, if necessary, a Phase II environmental study. All due diligence items are important to the lender and producing those items to lender and lender's counsel as early as possible will ensure an on-time closing.

Step Four - The Closing

Once the loan documents have been negotiated and finalized and all the due diligence is completed, the parties will agree on a date to close and distribute the money. Before that can happen, both lender and borrower need to make sure all of their I's are dotted and their T's are crossed. With the advent of the internet and electronic mail, live closings rarely take place. Most documentation is transmitted electronically for signature by the relevant party. Original signed documents are delivered either to the title company or to lender's counsel, as instructed by lender's counsel.

Closing mechanics require great attention to detail and organization so that everything is completed well enough in advance to give the lender sufficient time to verify that all closing requirements are satisfied. Those borrowing from a long-term lender must be cognizant of the lender's sometimes specific funding mechanics. Many lenders require that all due diligence be completed and all loan documents executed and in lender's possession (or held by the title agent in escrow) at least twenty-four hours in advance of funding the loan.

Generally, documents to be recorded (mortgage, assignment, financing statements) are delivered to the title company. The title company also prepares a settlement statement and receives and disburses all funds. It is important for a lender's attorney to have a very good instruction memorandum or letter to the title agent for an escrow closing. An escrow instruction letter will direct the title agent to collect the documents for recording, ensure that all of the lender's closing requirements have been met, pay off the existing mortgage loan, release the existing mortgage and disburse the remaining loan funds in accordance with the final, approved and signed settlement statement. The title agent should sign the escrow instructions acknowledging receipt and his or her compliance with the instructions. Lender's attorney will review and attach to the escrow instructions an approved proforma lender's title policy with an instruction that the final title policy must be issued consistent with the approved proforma. Once everything is signed, received, reviewed and the money has been disbursed, the transaction is complete. The post-closing clean-up begins.

Step Five - Post Closing

An essential but often overlooked part of the loan refinance process is compiling and distributing the closing binder. The closing binder should track the closing checklist in terms of content and should be organized in a logical way so that someone who did not participate in the loan closing can understand the facts surrounding the closing. The closing binder is especially important for a life insurance company lender because these entities are heavily regulated and often have their commercial real estate loan files audited.

All original, recorded documents must be received from the title company. Any post-closing deliveries must be managed. Most important, the final title insurance policy must be received, reviewed and approved. The date of the final title policy should always be the date and time the mortgage is recorded to ensure there is no gap between the date of the policy and the recording of the mortgage. Because of this, the title company cannot produce the final title policy until after the mortgage is recorded and the recording information is provided. The final title policy sometimes is not consistent with the proforma policy attached to the lender's escrow instructions, and revisions are required. The key to getting the post closing work completed efficiently and at a low cost is having good paralegal and staff support.

Final Observations

Refinancing a commercial real estate loan can be as easy or difficult as the parties want to make it. If some very basic concepts are followed by the borrower, lender and attorneys for both, the transaction will close quickly and effectively. Some of those key points are as follows:

1. *READ THE LOAN COMMITMENT*. This sounds obvious enough, but there have been instances where the borrower or even the lender hasn't fully focused on the business terms contained in the loan commitment.

2. *Know the property being refinanced*. Anticipating and managing property-specific issues (difficult tenants, environmental concerns, structural problems, access or title deficiencies) will head off potential problems before they become actual problems.

3. *For borrowers, start the due diligence early*. During the loan commitment negotiation stage, the borrower should ask lenders for a sample closing checklist, title requirements survey requirements, and form tenant documents (estoppels and SNDAs) so borrower and its counsel can start compiling the due diligence items even before the loan is committed.

4. *Hire experienced legal counsel early*. For both lenders and borrowers, getting legal counsel involved at the beginning is critical and will save both sides time and money in the long run. Borrower's legal counsel must be experienced in commercial real estate finance. It may be tempting to use, for example, the litigation specialist who handled a recent case so effectively, but if borrower's counsel is not experienced in the commercial process, delays will result and costs will rise. In particular, borrower's counsel should be familiar with standard documentation provisions and requirements for commercial loans.

One final tip. If a borrower is new to a particular lender, ask for contact information for lender's closing counsel. Most lenders' attorneys are willing to discuss general requirements (but not specific deals) with borrower's counsel even before a commitment is in place. Not only can this resolve any initial questions about the lender's general requirements before any significant investment is made, it can establish an early level of confidence and goodwill between the attorneys - which helps everyone.