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Rising Interest Rates

Will They Lift All Boats?

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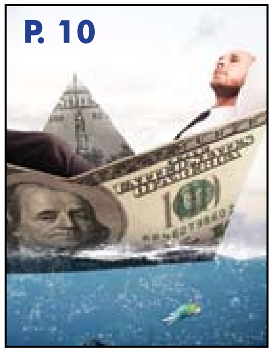

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Lending Law Update

by
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"The five pitfalls mentioned here and other lien risks can be minimized by careful closing diligence and documentation."

Top Five Ways Banks Can Lose Mortgage Lien Priority

Commercial real estate lending is underwritten on the value of, and cash flow from, the financed property, making the enforceability and priority of the mortgage paramount. Here are five common situations in which banks can end up with mortgages that are impaired or with lien priority that is less than expected:

1. Erroneous Property Description. An incorrect metes and bounds description used in a mortgage can result in liens on adjacent properties overlapping with the mortgage and the inability to foreclose the mortgage because it does not encumber only a subdivided, conveyable parcel. Typical errors include keying errors that result in a description without an enclosed parcel or not matching the survey, and descriptions being taken from old deeds that do not match revised record plats.

2. Hidden Pre-Existing Rights. Pre-existing purchase options and rights of first offer can be buried in leases or management agreements, leading to rights that can impair the ability to foreclose. It is essential to not only carefully review title reports for these rights, but also obtain estoppel certificates from commercial property tenants regarding the absence of these rights.

3. Statutory Liens and Assessments. Banks have always had to live with "super priority" tax liens for periods after loan closing that prime existing mortgages. These super lien rights now extend beyond basic real estate and school taxes, to assessments for special improvement districts (such as Wilmington's Business Improvement District), community association assessments (which have priority over first and second mortgages to the extent of assessments for a six month period under the Delaware Uniform Common Interest Ownership Act), and assessments imposed to repay loans made for renewable energy improvement costs under Property Assessed Clean Energy (PACE) programs.

4. Lack of Power and Authority. If a business entity's or trust's organizational documents do not provide proper power and authority to obtain a mortgage loan, the mortgage lien can be void. It is essential to review the borrower's documents and resolutions to determine that obtaining the loan for the purpose at hand is in the borrower's power, that the borrower can and has authorized the loan, and that the person signing the mortgage has the authority to do so.

5. Lack of Consideration and Fraudulent Transfers. If the real estate securing the loan is owned by a guarantor, the lack of a sufficient nexus between the guarantor and the borrower can result in an unenforceable mortgage due to no benefit given to the guarantor; and if reasonably equivalent value is not provided to the guarantor for the mortgage, the mortgage can be set aside as a fraudulent transfer under the United States Bankruptcy Code and Delaware Uniform Fraudulent Transfer Act.

There are many other ways that banks can lose mortgage lien priority. Fortunately, the five pitfalls mentioned here and other lien risks can be minimized by careful closing diligence and documentation.