

Lending Law Update



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“For all you beach goers that engage in bank lending transactions, here is my “hot summer” list of due diligence warnings...”

On a recent vacation, I scorched my feet on beautiful beach sand. The incident reminded me to tread carefully even when circumstances appear to hold no apparent danger. For all you beach goers that engage in bank lending transactions, here is my “hot summer” list of due diligence warnings:

1. Be careful of 50/50 partnerships, LLCs, corporations or other entities

While business entities with equally divided ownership interests are routinely encountered, such entities can involuntarily create deadlock situations. Under Delaware law, even a profitable business may be subject to receivership or dissolution when the parties cannot agree on a course of action. Therefore, it is important to determine whether the controlling documents contain provisions or a default mechanism that will prevent deadlock situations without resorting to litigation.

2. Be wary of the credit application

Lenders often receive credit applications that are signed by not only the principal obligors or borrowers, but also by spouses or guarantors. Under the Federal Equal Credit Opportunity Act, only the true applicant for credit should execute the necessary documents. Unwittingly, a lender may be exposed to greater liabilities if there is discrimination or some other form of disparate behavior during the credit application process.

3. Pay attention to litigation and Uniform Commercial Code searches

These search reports are often glossed over. They provide evidence of old liens, misfiled liens, blanket liens or other encumbrances that create difficulties down the transactional road. Make sure you understand all current or pending litigation, as well as, maintain a clean title to your collateral. This will avoid priority fights between creditors.

4. If your collateral includes environmentally contaminated property or brownfields, determine if there is any future ongoing monitoring or remedial action that will continue during or well past the term of the loan

In many cases, if a lender were to receive the contaminated or brownfields property (through foreclosure or other means), applicable remedial action costs or future monitoring may be involuntarily assumed.

5. Be wary of reassessments, tax abatements and enterprise zones

Make sure you and your borrowers understand the events that can trigger a reassessment of real estate taxes, cause a tax abatement to expire, or an enterprise zone to cease to exist. All of these events may result in additional or increased real estate taxes which could prime the mortgage lien and create a problem for both the borrower and the lender.

6. Check the good standing status of borrowers and entity guarantors on your portfolio

Any time you modify or amend a loan or extend credit, make sure that the borrowing or guaranty entity is in good standing. Otherwise, there could be enforceability issues.

7. Congratulations! You just received an entity guaranty from a trust entity

Have you made certain that the trust is duly authorized to execute the guaranty? Trust agreements may seem to allow for broad guarantees, but the applicable statutes, as well as, the underlying trust instruments, must be reviewed to make sure they fit the transaction.

The moral of this story: Even when circumstances appear free from danger, make sure you carefully examine the transactional due diligence to uncover the issues that could burn you.