MAKING YOUR REAL ESTATE DEAL FINANCEABLE

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An important part of many real estate transactions is to negotiate and draft the relevant documentation in a way that will allow subsequent financing to be put in place with as little disruption as possible. While it is tempting to focus solely on the task at hand- negotiating a great ground lease or purchase agreement- these documents will almost always lose in a war between existing documentation and lender requirements. Accordingly, it will save lawyers time and frustration and, even more importantly, will save clients money if a real estate deal is structured and documented with an eye toward future financing requirements.

This article and the corresponding presentation will highlight some issues that can be addressed up front to reduce the number of changes a lender will request during the financing change. Keep in mind, however, that all lenders (and all lenders' lawyers) are different, with varying experience, priorities and checklists. There will almost always be some document revisions to be made during the financing stage. The goal is to keep the revisions manageable, so the deal- and the timeline for construction and other applicable milestones - remain more or less intact.

The most obvious and common structure where subsequent financing requirements lead to requested document revisions is the ground lease scenario. The developer/tenant finds property that, for one reason or another, the owner/landlord cannot or will not sell. The parties enter into a long-term ground lease. After some due diligence, the tenant designs its project and seeks financing. Suddenly, there is a new player in the game. The lender, who has (or at least believes it has) a lot of bargaining power and a list of underwriting requirements that are unaffected by the existence of a highly negotiated ground lease and ancillary documents. All of us have faced situations in which lenders looking to finance a project submit a long list of issues with the existing documentation. The goal is to identify some of these issues in advance, so that they can be negotiated and documented in a way that will reduce the lender's wish list.

As noted above, the ground lease scenario is the most common structure where this process occurs. Many of the examples below will be taken from ground lease transactions, but some of the issues arise in other scenarios. Where appropriate, other structures will be addressed.

1. **<u>First, Do a Deal</u>**

   The idea that we should keep future loan requirements in mind when documenting real estate transactions is intended to make the real estate transaction, from beginning to end, easier and more efficient. It is not intended to make it overly difficult or impossible to get that real estate deal done. For there to be financing, there must be a deal to finance. Many viable real estate deals have suffered premature deaths as a result of an obsessive focus on possible lender-related issues, or a unwavering desire to address every issue in the most lender-favorable way. First, do a deal. Try to keep in mind the major issues that your future lender will likely want to address, but do not make every issue a financing issue. If you can't reach agreement on the initial documentation (e.g., the ground lease, purchase agreement, covenants, conditions and restrictions, etc.), financing is irrelevant.

In this regard, play the “lender card” wisely. It is tempting to use the prospect of future financing as a negotiating tool to get a better deal, generally. Most lawyers and some clients are sympathetic to the desire to preplan for the loan phase of the transaction. We’ve all been caught between the unmovable object in the form of a seller or landlord and the irresistible force of a lender. When negotiating a deal with another party who contemplates subsequent financing, it is both understandable and appropriate to be suspicious when even routine deal points become “a lender issue.” Play the lender card when you need to, but avoid overplaying it. I can remember one transaction- the sale by my client of a highly desirable portfolio of office buildings to a newly formed fund- which died an agonizing death because the buyer continually said that it “could not” agree to common terms and provisions, because “the lender would not like it.” Eventually it became clear that the buyer was using the “lender card” as a sword, in a battle to get a better deal. After wasting way too much time and money trying to make a deal where there was not one, we terminated negotiations with that buyer, and found another buyer who seemed to have more flexible lenders (or at least played the lender card more appropriately).

2. **Term.**

a. Length.

The term of the applicable document (again, the most obvious example is a ground lease, but time is important to lenders in all scenarios) should be long enough to accommodate both a thorough inspection and assessment (and even if the buyer/tenant does them, the lender may want to do more), as well as a length of time to give the buyer/tenant all of the indicia of ownership for the period of construction, development, operation and financing of the project. Ground leases tend to have a term of 50 to 99 years, with leases on the shorter end of that range often including renewal terms.

In purchase agreements and other transactions in which the buyer is acquiring title to the property, the inspection period must be long enough to allow for a thorough physical and environmental assessment, as well as any additional assessments (e.g., a Phase II Environmental Assessment) indicated or recommended by the initial inspections. Keep in mind that the risk assessment decisions made by the buyer/tenant may be very different (e.g., less conservative) than those typically made by lenders. Since the seller/landlord may insist on direct or indirect compensation for subsequently negotiated inspection period extensions, one compromise is to permit the inspection period to be extended if reasonably required to accommodate verifiable lender requirements. This is not ideal from the seller/landlord’s prospective, since those requirements can potentially be engineered, but it is at least preferable to an open ended, cost-free extension right. In one recent acquisition, my buyer client was able to negotiate for an inexpensive extension of the inspection period, conditioned on the buyer’s demonstration that it had performed certain physical and

Title search: Making Your Real Estate Deal Financeable

Also available as part of the eCourse
Financing the Deal and the Changing Landscape of Mortgage Lending

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