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Financing of real property - Pay attention to early stage details for late stage benefits

In the current real estate market, there is often a significant gap between buyers and sellers. This prevents owners of real estate from creating liquidity from an illiquid asset class.



One alternative often used by many real estate owners is to refinance the real property. This is particularly true in the current interest rate environment. This article will focus on certain key early stage portions of the refinancing transaction which are frequently overlooked by many people. Paying attention to these early stage issues should help to facilitate a smooth and efficient closing of the refinancing transaction for the real estate owner.

Review existing mortgages and leases

Prior to beginning discussions with the lender, the owner should review the status of its existing mortgages and leases for any provisions in those documents which may affect the financing transaction. In existing mortgages, the owner should review the right to prepay and any time frames for notices and prepayment penalties related to the upcoming refinancing. The existing mortgage should also

be reviewed to make sure that requesting a payoff letter does not trigger an acceleration of the loan if the prepayment is not actually completed. Existing leases should be reviewed to determine if any special agreements or provisions need to be obtained on behalf of a tenant.

Negotiate commitment letter

When refinancing, the lender will provide the borrower with a commitment letter. The commitment letter will detail the significant business terms of the loan transaction. The borrower should carefully review the commitment letter to ensure that it satisfies the borrower's expectations of the business terms of the proposed transaction. Any issues that are not satisfactory to the borrower should be raised prior to the execution of the commitment letter. In addition, certain issues which are important to borrowers are frequently not raised by the lender in the first draft of the commitment letter. Borrowers should review the commitment letter with its attorneys and accountants prior to executing the commitment letter, as the commitment letter is no different than any other binding agreement. It is generally easier to negotiate changes to business terms at the commitment stage than after loan documents are drafted particularly with respect to issues like

prepayment penalties, permitted transfers and post closing leasing rights.

Tenant estoppels

One item that should be negotiated at the commitment letter stage is the tenant estoppel requirement, which should state what percentage of tenants, and which specific tenants (if any), estoppels need to be obtained from. The lender relies on the estoppel certificate to know that it is not making a loan into a situation where there are disputes or disagreements existing between the owner and its tenants. In the estoppel, the tenant should be requested to certify, at a minimum, the following: date of lease, rent commencement date, current rent (including any common area charges and/or tax escalations), date rent paid through, lease expiration date, renewal options (if any), if any defaults exist under the lease and if any work or other concession is due tenant. The estoppel has a subtle benefit to the owner, as well, however, since the owner gets a statement from the tenant setting forth facts which the owner may rely on in any future disagreement with the tenant.

Tenants very often raise issues when asked for estoppels. This is because the tenant knows that it has leverage over the situation. The borrower needs to allow sufficient time to obtain the estoppels in case

a tenant attempts to extract work or some other form of consideration for the estoppel.

One way to minimize the leverage a tenant has is to set out the form of estoppel (or the minimum requirements for an estoppel certificate) in the lease itself. If this is the case, unless the tenant has legitimate grounds for contesting the estoppel request, the tenant may find itself in default of its lease obligations.

One caveat – if you have an agreed upon estoppel form with your tenants, get the form pre approved by your lender to make sure that you do not end up in a disagreement over the form or substance of the estoppel after you have obtained the estoppels back from the tenants.

Summary

Refinancing of commercial real estate is usually a long term commitment by the owner of the real property. It is therefore of critical importance that the owner of commercial real estate pay attention to details throughout the refinancing process. In order for the closing process to be smooth and cost efficient, however, it is important for the owner to pay particular attention to detail during the planning and negotiating stages of the loan transaction.

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