

Future Advance Obligations in Commercial Mortgage Finance: Structuring, Co-Lender and Securitization Issues

TUESDAY, APRIL 20, 2021

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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Future Advance Obligations in Commercial Mortgage Finance: *Structuring, Co-Lender and Securitization Issues*

Presented By

Virginia Bailey “Ginger” Rolfes



Future Advances - Basics

What is a future advance?

A future advance is a clause in a mortgage that provides for additional availability of funds under the loan documents.

Future advances can be optional or obligatory.

Future Advances - Basics

Mortgages routinely allow for the lender to advance funds to protect the value of the real estate.

Whether or not specific future advance language is required in the security instrument is a state specific evaluation.

SAMPLE LANGUAGE

Future Advances. This Security Instrument secures, and the Note evidences the obligation of Borrower to repay, any advances made with respect to the Property after the date hereof for payment of taxes, assessments, maintenance charges, insurance premiums, costs incurred for the protection of the Property or the lien of this Security Instrument and expenses incurred by Lender by reason of the occurrence of an Event of Default.

Conditions for Future Advances

In most cases, lenders want future advances to be at Lender's option. A maximum dollar amount and the total number of future advance is clearly stated and conditions for the release of such advances are listed. An end date for requesting advances may also be included.

SAMPLE LANGUAGE

Lender's obligations to perform in accordance with this Section and to make any Future Advance in accordance with the terms and provisions of this Agreement are an independent contract made by Lender to Borrower separate and apart from any other obligations of Lender to Borrower under the other provisions of this Agreement and the Loan Documents. The obligations of Borrower under this Agreement and the other Loan Documents shall not be reduced, discharged or released because or by reason of any existing or future offset, claim or defense of Borrower, or any other party, against Lender by reason of Lender's failure to perform its obligations under this Section.

Conditions for Future Advances

Basic conditions for release:

1. No Event of Default
2. Restatement of loan representations
3. Officer's certificate from Borrower
4. Title date down

Conditions for Future Advances

Additional Conditions for Capital Expenditures / Tenant Buildout

5. Must be for an “Approved Capital Expense”
 - Included in the annual budget previously approved by lender
 - Included in a Business Plan
 - Otherwise approved by lender
6. The Approved Capital Expenses Must require Borrower expenditures equal to or greater than the requested Future Advance.
7. Loan may be required to remain ‘in balance’, with potential for Borrower contribution.

Conditions for Future Advances

Additional Conditions for Leasing TI/LC Expenses

5. Delivery of fully executed new or replacement tenant leases
6. Approval of the new or replacement leases by Lender pursuant to the terms and conditions of the loan documents
7. Such leases require Borrower expenditures on tenant improvements or leasing commissions equal to or greater than the requested Future Advance.

Conditions for Future Advances

Additional Conditions for “Earnouts” tied to Key Metrics

Debt Service Coverage Ratio

- A measurement of available cash flow calculated by dividing net operating income by debt service (i.e., requirement payments of income and principal).
- A 1.0x debt service coverage ratio would mean the property is breaking even – the income equals the debt service.

Loan to Value

- A measurement used to determine Lender risk calculated by dividing the amount borrowed by the current appraised value of the property.

Conditions for Future Advances

SAMPLE LANGUAGE

Following the initial advance of Loan proceeds to Borrower made on the date hereof (the “Initial Advance”), Borrower may request in writing that Lender make one or more additional advances to Borrower (each, a “Future Advance”) and Lender shall make each such Future Advance to Borrower provided that all of the conditions set forth below have been satisfied with respect to each such Future Advance. Each such Future Advance funded by Lender shall, together with the Initial Advance, be and constitute part of the Loan. Notwithstanding the foregoing, (i) the maximum aggregate amount of all Future Advances made hereunder shall be limited to \$250,000.00, (ii) Borrower may request no more than five Future Advances, (iii) each Future Advance shall be at least \$50,000.00, and (iv) Borrower shall have no right to any Future Advances hereunder from and after the Monthly Payment Date occurring in December 2021. The conditions to any Future Advance shall be as follows:

- (a) No Event of Default has occurred and is continuing at the time such request is made or at the time the applicable Future Advance is made;
- (b) At Lender’s request, Borrower shall deliver to Lender a date down or similar endorsement to the Title Insurance Policy with respect to any such Future Advance in form and substance acceptable to Lender;
- (c) Borrower shall be deemed to have re-stated each of the representations and warranties contained in this Agreement as of the date of any such Future Advance, all of which shall be true and correct except those that are no longer true solely due to the passage of time or one or more events permitted to occur under the Loan Documents;
- (d) Borrower shall deliver such other certificates, documents and instruments as Lender may request; and
- (e) Borrower shall pay all of Lender’s costs and expenses (including, without limitation, attorneys’ fees) associated with Borrower’s request for a Future Advance, whether or not the Future Advance is ultimately made.



Future Advance Obligations in Commercial Mortgage Finance: Approval and Disbursement Considerations for the Future Advance

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April 20, 2020



Approval and Disbursement Considerations for the Future Advance: Obligatory versus Discretionary Does Matter

- **Who has Priority and How do I Ensure My Priority?**
 - **Compare: typical commercial mortgages normally contemplate a single advance**
 - **Conditions precedent to disbursement baked into financing agreement dictate when funds will be disbursed**
 - **Conditions precedent largely built off requirements to satisfy lender of first priority lien status of its single advance mortgage upon recording and disbursement of funds**
 - **Title Loan Policy available to insure first priority lien status**
 - **Title Company provides third-party review of title to insure first priority lien status of lender single advance mortgage upon recording**
 - **Title Company requirements to issue loan policy intended to clean up title where necessary to insure first priority lien status**

Approval and Disbursement Considerations for the Future Advance: Obligatory versus Discretionary Does Matter

- **Who has Priority and How do I Ensure My Priority?**
 - **Compare: typical construction loan mortgages contemplate multiple tranching disbursements throughout the course of construction.**
 - **Like single disbursement commercial mortgages, however, a construction loan mortgage's conditions precedent baked into financing agreement dictate when each tranche will be disbursed**
 - **Conditions precedent largely built off requirements to satisfy lender of the continued first priority lien status of its construction loan mortgage**
 - **Conditions precedent ensure no intervening liens or title events which could endanger first priority lien status upon next disbursement**
 - **Lien waivers, payment of outstanding taxes, satisfaction of judgments, etc.**

Approval and Disbursement Considerations for the Future Advance: Obligatory versus Discretionary Does Matter

- **Who has Priority and How do I Ensure My Priority?**
 - **Title Construction Loan Policy available to insure continued first priority lien status**
 - Title Policy brought forward with each disbursement
 - Amount insured increased with each amount and date of policy brought forward by Title Endorsement
 - Only issued if title run down shows no intervening title events/title curative action and lien waivers obtained
 - **Construction Loans can convert to single Term Loan Mortgage upon completion of construction**
 - More typical in complex typical project financed transactions
 - Financing comprised of two components: construction and commercial operation
 - Conditions precedent typically the same at time of Term Loan conversion: clean title with no intervening title events

Approval and Disbursement Considerations for the Future Advance: Obligatory versus Discretionary Does Matter

- **Who has Priority and How do I Ensure My Priority?**
 - **But what about Commercial Loan Mortgages not contemplating construction but require multiple disbursements?**
 - **Commercial Loan advances made after initial closing raise a spectrum of issues**
 - **Senior Lender makes an advance of funds to Borrower after accepting and recording mortgage**
 - **Subsequently Junior Lender records its mortgage**
 - **Junior Lender records after Senior Lender records**
 - **Junior Lender records, however, before disbursement of additional funds under its loan**
 - **Who take priority? Why does not the first-in-time rule just apply?**
 - **Tranched Construction Loan Mortgages typically do not face priority conundrum**
 - **Construction Lender will usually not allow any other mortgage than its mortgage be on record/require discharge for next disbursement**
 - **Mechanic's liens and their ability to usurp lien priority status too risky for any other lender to finance and lien other than Construction Lender**

Approval and Disbursement Considerations for the Future Advance: Obligatory versus Discretionary Does Matter

- **Many States require commercial mortgages with multiple advances to clearly and explicitly state if Future Advances are contemplated**
 - **Some states require specific notices and disclosures**
 - **Certain states require specification of whether the multiple advances are contemplated for construction of improvements**
 - **Other states require mortgage to specify the absolute maximum of amount of debt to be secured**
 - **Fifteen states require specific statements in the mortgage that it secures future advances and a maximum principal balance**
 - **Disclosures are intended to ensure sufficient notice to subsequent title and lien holders of mortgage securing Future Advances**

Approval and Disbursement Considerations for the Future Advance: Obligatory versus Discretionary Does Matter

- **Many States distinguish between optional and obligatory future advances to determine priority**
 - **The general rule in States that distinguish between optional versus obligatory future advances:**
 - **If the advance is viewed as obligatory, it takes its priority from the date of the original recordation**
 - **The advance relates back to the date of the recording of the original mortgage**
 - **If the advance is viewed as optional, and the mortgagee has notice when an advance is made that a subsequent mortgagee or lienor has acquired an interest in the land, then its priority is lost to the intervening creditor**

Approval and Disbursement Considerations for the Future Advance: Obligatory versus Discretionary Does Matter

- **Many States distinguish between optional and obligatory future advances to determine priority: Example**
 - **Senior Lender accepts Borrower's Senior Loan Mortgage and records it, advancing to Borrower its initial Senior Loan Advance.**
 - **Junior Lender then loans and disburses to Borrower additional monies before Senior Lender Advances a subsequent Senior Loan Advance under the Senior Loan, secured by the same property under a Junior Loan Mortgage**
 - **Senior Lender then disburses a subsequent Senior Loan Advance**
 - **Whose advance after the initial Senior Loan Advance has priority?: Junior Lender's Loan Advance or Senior Lender's subsequent Senior Loan Advance?**

Approval and Disbursement Considerations for the Future Advance: Obligatory versus Discretionary Does Matter

- **Obligatory Advance**

- **Face of language of Senior Loan Mortgage and Senior Loan Financing Agreement, Senior Lender is obligated to make an advance**
 - **Language closely hews towards conditional precedent requirements and satisfaction of maintenance of first priority lien status for advance under loan documents**
 - **Once and if conditional precedents are met, Senior Lender obligated to disburse subsequent Senior Loan Advance**
- **Senior Loan Advance would have priority**
 - **Subsequent Senior Loan Advance relates back to the date of the initial Senior Loan Advance and recording of mortgage**
 - **Junior Lender should have been on notice that the Senior Loan Mortgage as intended as security for all advances, even if disbursed over time, by face of the Senior Loan Mortgage**

- **Discretionary Advance**

- **Face of language of Senior Loan Mortgage and Senior Loan Financing Agreement, advances by Senior Lender are discretionary**
 - **Senior Lender takes Senior Loan Mortgage as security for any future loans to Borrower that it chooses to make or arrange**
- **Priority determined by notice/knowledge of lien of Junior Lender**
 - **Junior Lender can achieve priority by notifying Senior Lender that it is make an advance**

Approval and Disbursement Considerations for the Future Advance: Obligatory versus Discretionary Does Matter

- **Obligatory Future Advance: Typical Conditions Precedent Language to Ensure Priority under Loan Documents**
 - **“Each and every one of the requirements listed in this Exhibit D is hereby incorporated into the Loan Agreement and expressly deemed to be conditions precedent of the Borrower, prior to the Lender becoming obligated to make any Loan Disbursements after the Initial Advance. The Borrower agrees: (a) to fully comply with each of the requirements listed below in a manner deemed acceptable solely to the Lender, and (b) that compliance with each and every one of the requirements listed below shall be determined by the Lender, in Lender’s sole discretion, just as if this sentence were incorporated into each requirement listed below.**
 - **Accordingly, in addition to the Borrower continuing to comply with all other requirements contained herein, the Borrower agrees that no subsequent Loan Disbursement after the Initial Advance under this Loan Agreement, shall be made unless the following conditions precedent are satisfied as determined by the Lender:**

Approval and Disbursement Considerations for the Future Advance: Obligatory versus Discretionary Does Matter

- **Obligatory Future Advance: Typical Conditions Precedent Language to Ensure Priority under Loan Documents**
 - **1. All of the Conditions Precedent to The Initial Advance as set forth in Exhibit C have been (and continue to be) satisfied by the Borrower;**
 - **2. No Default or any event of default which, with the giving of notice or the lapse of time, or both, could become a Default, exists under any of the Loan Documents;**
 - **3. The representations and warranties contained in this Loan Agreement, and in each of the Loan Documents continues to be true and correct in all material respects on and as of the date of any subsequent Loan Disbursement;**
 - **4. No mechanic's lien, materialmen's lien, judgment lien or other lien or encumbrance shall have been filed or remain in effect against the Real Property, and all releases or waivers of mechanic's liens and materialmen's liens and receipted bills showing payment of all amounts due to all parties who furnished materials or services or performed labor of any kind to or for the benefit of Borrower in connection with the Real Property as to any prior advance, shall have been obtained on forms and in a substance acceptable to the Lender and the Title Company in connection with the subsequent advance;**

Approval and Disbursement Considerations for the Future Advance: Obligatory versus Discretionary Does Matter

- **Obligatory Future Advance: Typical Conditions Precedent Language to Ensure Priority under Loan Documents**
 - **6. As of the date of making any Loan Disbursement, no event shall have occurred, nor shall any condition exist that constitutes a material adverse change, since the date of this Loan Agreement, to the financial condition of Borrower or any Guarantor, or which would impair the ability of Borrower or any Guarantor to fulfill its material obligations under the Loan Documents;**
 - **7. That subsequent advances do not violate any Federal regulations governing the Lender;**
 - **8. The Borrower and or Guarantor has delivered to Lender such other information, documents, supplemental legal opinions, updated lists and other information as may be reasonably required by Lender.**
- (**use caution with catchall obligations such as No. 8 that can be construed as giving lender too much discretion**)**

Approval and Disbursement Considerations for the Future Advance: Obligatory versus Discretionary Does Matter

- **Many States distinguish between optional and obligatory future advances to determine priority**
 - **Junior Lenders are at greatest risk when it comes to priority**
 - **Junior Lenders should thoroughly diligence terms of the Senior Loan**
 - **Junior Lenders should give Senior Lender notice of its intended junior lending**
 - **Junior Lenders must obtain a beneficiary statement from the Senior Lender recognizing the junior lending**
 - **Senior Lenders should seek title endorsements ensuring the priority of its advances**
 - **If an optional advance, Senior Lenders run greatest risk of exceptions as to liens, encumbrances, or other matters after the initial lending that are known to the insured Senior Lender before the date of such advance**
 - **Standard forms of Title Insurance also exclude matters that are known to the insured but unknown to title insurer and not shown by public records**

Approval and Disbursement Considerations for the Future Advance: Obligatory versus Discretionary Does Matter

- **Many States distinguish between optional and obligatory future advances to determine priority: A Lesson Learned**
 - Know the leading laws of the State that your mortgage and loan documents are subject to ensure that your priority is maintained
 - Even if a statute would seem to clearly state that no distinction is made between optional versus obligatory advances, jurisprudence of that state may think otherwise
 - Washington State's very broad and lender-favorable priority statute for future advances on its face seem to clearly allow a mortgage or deed of trust to remain prior to subsequent mortgages, deeds of trusts and other liens even as to non-obligatory future advances made after recording of the subsequent lien
 - Decisions by the Ninth Circuit Court of Appeals implies that the priority scheme in the statute may apply only where the junior lien is a mechanic's or material supplier's lien

Approval and Disbursement Considerations for the Future Advance: Obligatory versus Discretionary Does Matter

- **Many States distinguish between optional and obligatory future advances to determine priority: Lessons Learned**
 - Know the leading laws of the State that your mortgage and loan documents are subject to ensure that your priority is maintained
 - Even if by its face your mortgage and financing agreement clearly is intended to secure future advances that a lender is obligated to make, broad discretionary language could render your mortgage to be discretionary
 - Washington State authority held that fairly typical conditions precedent to disbursement which otherwise would render advances obligatory may be found to give lender such broad discretion thereby rendering the advances optional rather than obligatory for the purpose of determining liens
 - In Washington, even advances relating to a construction loan mortgage which normally are deemed obligatory on its face due to the conditions precedent for an advance can be rendered optional if the remedies provision of the mortgage are discretionary in nature and lender has knowledge of a junior lien

Approval and Disbursement Considerations for the Future Advance: Obligatory versus Discretionary Does Matter

- **Some states permit Future Advances necessary to preserve:**
 - Title to mortgaged property
 - Priority of the mortgage
 - Integrity of the mortgaged property to have priority from the date of original recordation
- **Such perfunctory advances necessary to preserve title, priority and integrity of the mortgaged property typically viewed as an obligatory advance**
- **Review State requirements necessary to insure status as an obligatory advance and relation back of initial advance and recordation of mortgage**

Loan Title Policy for Future Advances: What does it Insure, exactly?

- **Refresher – Generally, a Loan Title Policy insures three key interests:**
 - That the mortgaging borrower possesses vested title to the real property being offered as security/collateral for the repayment of the subject loan;
 - That the mortgaging borrower has the vested right and authority to encumber or hypothecate a mortgage lien on the real property being offered as security/collateral for the repayment of the subject loan; and
 - That the mortgage lien in favor of the insured lender has first lien priority.
- **A Loan Policy for Future Advances insures an additional key interest**
 - That upon each advance, the priority of all prior disbursed amounts and the advance are insured and title is brought forward.

Compare: Versus Insured Coverage Under Owner's Extended Title Policy

- Insured owner hold unencumbered, vested title interest in property.
- Mis-execution of title instruments
- Forgery, fraud and duress
- Defective recording of title instruments
- Restrictive covenants
- Lien on title due to a pre-existing deed of trust, judgment, tax or special assessment
- Title becomes unmarketable after date of policy
- Lack of right of access to and from land
- Coverage of all surveyed encumbrances of record

How Do Title Companies Insure and Mitigate Against Title Risk?

- **Performing search and diligence of land records.**
 - Extensive review of any and all land records affecting the collateralized real property
 - Does not necessarily have to be a recorded instrument, may come from any source available to title company.
- **Establish clear (or sometimes unclear) chain of title.**
 - Does the mortgagor's vested right travel?
 - Are there gaps in mortgagor's vested rights?
- **Determine "Hidden" Risks**
 - Errors or Omissions in Records
 - Fraudulent Impersonation or Forgery
 - Mechanics Liens
- **Identify Encumbrances, Liens, Record Defects and Other Clouds of Title**
 - Unsatisfied Liens & Mortgages
 - Burdening Easements
 - Leases
 - Rights-of-ways
 - Future Interests
 - Land Use Restrictions
 - Unsubordinated Interests
 - Unpaid taxes
 - Tax liens against current or past vested real estate interest holders
 - Mechanics liens by contractors
 - Court Actions

Unique Risks When Insuring Title for Future Advances

- **Entirety of the mortgaged loan amount may not be immediately insured.**
- **Periodic disbursements of loan proceeds after initial closing and after initial date of policy pose significant risk.**
- **Increasing amount of indebtedness to be insured with each disbursement.**
- **Presents unique circumstances requiring special considerations due to significant and ongoing risk for title insurers.**
- **Due to unique risks, higher level of scrutiny and review by title insurers and their underwriters**
- **Risk of intervening liens and lending, including junior lenders, pose significant risk to the insured interest of the first lien priority status of the insured lender's lien if language of loan documents and mortgage are not ironclad and clear (and depending on what jurisdiction you are in).**
- **What happens once all advances are made and the loan comes to term?**

Modifying Loan Title Policy Through Endorsements

- **The standard loan title policy can be modified by the issuance of endorsements**
- **Endorsement availability and pricing can vary per jurisdiction**
- **Endorsements typically are used to do the following:**
 - **Remove or modify exceptions**
 - **Modify standard coverage being provided**
 - **Provide the insured lender additional comfort re matters that a title agent is comfortable underwriting (e.g., access, survey, and contiguity)**
 - **Facilitate the assignment of the insured mortgage**
 - **Facilitate the process for future advances**

Standard Construction Loan Endorsement Requirements of Lenders

- **ALTA 3.2 (Zoning Land Under Development)**
- **ALTA 6 (Variable Rate Mortgage)**
- **ALTA 8.2 (Commercial Environmental Protection Lien)**
- **ALTA 9.7 (Restrictions, Encroachments, Minerals)**
- **ALTA 17 (Access and Entry)**
- **ALTA 17.2 (Utility Access)**
- **ALTA 18.1 (Multiple Tax Parcel - Easements)**
- **ALTA 19 (Contiguity – Multiple Parcels)**
- **ALTA 22 (Location)**
- **ALTA 24 (Doing Business)**
- **ALTA 25 (Same as Survey)**
- **ALTA 26 (Subdivision)**
- **ALTA 27 (Usury)**
- **ALTA 28.3 (Easement Damage Land Under Development)**
- **ALTA 33 (Disbursement) or script endorsement contemplating future advances**

What's it Going to Cost?: “The Biggest Racket in the Industry”

- **Title costs are tied to**
 - **The Amount of the Policy**
 - **Owner's Policy:** Issued at acquisition closing in the amount of the purchase price
 - **Loan Policy:** Issued in the maximum amount of indebtedness and liability decreases as the loan is paid
 - **Endorsements**
 - **Price can vary per jurisdiction**
 - Some states standardize endorsement costs
 - **Lender's and Borrower's counsels should be involved**
 - What does that endorsement get you and is it necessary given the coverage/cost?
 - **Future loan increases: Be wary of local rules! Are your advances obligatory or discretionary?**
 - **Future Advances where such advances pursuant to requirements under the loan documents are viewed as discretionary pursuant to local authorities can require a rewrite of policy with each advance, making loan policy insurance for future advances cost prohibitive**
 - **Future Advances where such advances pursuant to requirements under the loan documents are viewed as obligatory pursuant to local authorities less cost prohibitive, may just require run down of title to issue ALTA 33 or script endorsement**

Scope of Future Advance Coverage Under a Loan Title Policy

- **Certain endorsements extend coverage against a loss of priority of the insured mortgage's future advances**
 - ALTA 33
 - Script Endorsement bringing date of policy forward and increasing the amount covered
- **Title insurance can review and confirm that the future advance process will not create additional risk of loss of priority**
 - Must remove any standard exceptions for future advances from Schedule B, Part 1
 - Add the above endorsements
- **Insert or provide an endorsement recognizing Pending Disbursements Clause**

Must Establish Priority of the Future Advance to Obtain First Priority Lien Coverage of Subsequent Disbursements

- **CRITICAL to establish priority so there is no impairment or loss of the security of the insured mortgage.**
- **If you cannot establish priority of subsequent advance due to intervening liens, be prepared to satisfy any and all additional underwriting requirements and a delay of closing for such disbursement or refusal to extend coverage.**
 - **Lien Indemnity Agreement for Future Advance**
 - Individual
 - Business Entity Borrower with Guarantors
 - **Business Entity without Guarantors**
 - **Sworn Statement of Borrower**
 - **Discharge or Satisfaction of Existing Liens of Junior Lender**
 - **Subordination Agreement from Junior Lenders**
- **In some instances an Escrow and Indemnity Agreement may be necessary.**
- **Bond naming title insurer as obligee**

Must Establish Priority of the Future Advance to Obtain First Priority Lien Coverage of Subsequent Disbursements

- **Be prepared that future advance coverage will most likely not be available.**
- **Be willing to take an exception to low risk liens.**
- **Remain open to offering a bond for those amounts at risk.**

Future Advance Lien Coverage Afforded Under ALTA 33 or Similar Script Loan Endorsements

- **Used in situations where there is question of priority of the lien of the future advances of the insured mortgage over intervening liens and where the agent will be reviewing draw request and disbursement records whether or not the title agent is acting as the disbursement agent.**
- **Each issued endorsement adds coverage for the loan advance on the date of disbursement, but this coverage is subject to**
 - **Limitations in the endorsement**
 - **Limitations in the policy jacket**
 - **Listed title exceptions**
- **Insures the disbursed future advance will not invalidate the mortgage**
- **Insures priority of the mortgage over encumbrances and intervening liens missed by the title insurer**

Expect to be and be Prepared to be Reviewed by Underwriting for Future Advance Coverage

- **Analysis of the Loan Agreement**
- **Obligatory or Optional Advancements**
- **Disbursement Controls**
- **Frequency of Affidavits**
- **Obtained Subordination Agreements and Discharges of Liens by Junior Lenders**
- **Determination if lender requires issuance of date down endorsement prior to each funding of each Future Advance or can rely on obligatory nature of each advance**

Future Advance Lien Coverage Afforded Under ALTA 33 or Script Endorsement

- **Date down endorsement for Future Advances.**
 - Advances the Date of Coverage up to the date of disbursement, but does not change the Date of the Policy
 - Requires the inclusion of any new title matters and exceptions identified in a title search performed in connection with the issuance of the endorsement, including intervening liens
 - Prudent lenders will disburse Future Advances only upon receipt of a clean ALTA 33

Pending Disbursement Coverage: Can You Get it?

- **Every Commitment should contain the following pending disbursement clause:**
 - *NOTE: Pending disbursement of the full proceeds of the loan secured by the Mortgage insured, this policy insures only to the extent of the amount actually disbursed without knowledge of any intervening lien or interest, but increases as each disbursement is made, up to the face amount of the policy.*

Pending Disbursement Coverage: Can You Get it?

- **Added at the end of Schedule B, Part I**
 - Provides that, pending disbursement of the full proceeds of the loan, the policy insures lien priority only to the extent of the amount actually disbursed, up to the full amount of the policy
 - Allows for the policy coverage to increase as disbursements are made
 - Requires that title is examined at the time of each disbursement so that new liens can be identified and discharged or subordinated before the disbursement
 - Usually known as a “Date Down” or “Down Endorsement”.

Securitization Issues

Problem:

How to allow for future funds to be released in a financing intended for securitization when a securitization trust is not capable of funding future advances?

Securitization Issues

Option 1: Holdback

This option is not a future advance. This is a holdback of loan proceeds that are placed in a reserve and released to the Borrower upon the occurrence of certain events. The release conditions can be similar to the conditions for a future advance.

Disfavored by Borrowers because it requires the payment of interest on reserve funds that may never be released.

Consider adding a deadline for the release of funds and, at such time the conditions for release have not been satisfied, the funds will be applied to prepay the loan and the amortization schedule will be re-cast. Prepayment penalty of 1% yield maintenance may apply.

Securitization Issues - Holdbacks

SAMPLE LANGUAGE

Holdback Reserve Funds.

(a) Borrower shall deposit into an account held by Lender (the “Holdback Reserve Account”) on the date hereof an amount equal to \$250,000.00 as additional security for the payment of sums due under the Note, and as additional security for all of Borrower’s obligations under the Loan Documents. Amounts deposited pursuant to this Section are referred to herein as the “Holdback Reserve Funds”.

(b) Provided no Event of Default has occurred and is then continuing, upon the occurrence of a Holdback Reserve Release Event, Lender shall disburse all Holdback Reserve Funds then on deposit in the Holdback Reserve Account to Borrower.

“Holdback Reserve Release Event” shall mean Lender’s receipt of evidence reasonably acceptable to Lender (which such evidence shall include, without limitation, an Acceptable Tenant Estoppel Certificate) that (1) the Tenant commonly referred to as “Retail Tenant”: (A) is in actual, physical possession of the space demised under such Tenant’s Lease, open to the public for business during customary hours and not “dark”, (B) is paying full, unabated rent under its Lease (and has paid three consecutive scheduled monthly rent payment) and (C) all required permits and/or certificate of occupancy necessary for it to operate its contemplated business have been issued, or (2) a replacement Tenant reasonably acceptable to Lender has leased the entire portion of the Property demised as of the date hereof to the Tenant commonly referred to as “Retail Tenant” in accordance with the applicable terms and conditions of this Agreement.

Securitization Issues

Option 2: Bifurcated Note

Initial Advance Note – At origination, there is a fully funded initial advance represented by an initial advance note. This note is securitized.

Future Advance Note – At origination, there is a note for the unadvanced portion of the loan. This note is retained by the originating lender.

Securitization Issues

Co-Lending Agreement

A bifurcated note structure requires an agreement between the two lenders setting forth the understanding of how the two notes and lenders will interact.

Issues addressed include:

- Who is the controlling lender? Does it vary by the issue?
- Who can provide specific consents?
- How are loan payments credited between the two lenders?
- Future advances made at the sole discretion of future advance note holder?

Securitization Issues

Servicer Rights

The servicer administers the loan evidenced by the initial advance note. The servicer is the “lender” of the initial advance loan.

The servicer may:

- Act on behalf of the Future Advance Lender if such lender fails to act or fails to act in a timely manner
- Override certain decision by the Future Advance Lender if it violates certain servicing standards (i.e., if Future Advance Lender refuses to make an advance, thereby resulting in a negative impact on the collateral or initial advance note)

Staying Informed

Trade organizations:

- CRE Finance Counsel (CREFC) – www.crefc.org
- Mortgage Bankers Association – www.mba.org
- International Council of Shopping Centers (ICSC) – www.icsc.com
- CREW (Commercial Real Estate Women) Network – www.crewnetwork.org

Staying Informed

Recommended Podcasts:

The TreppWire™ Podcast

The TreppWire Podcast (from data analytics firm Trepp) <https://www.trepp.com/the-treppwire-podcast>

CREative Talks! Hosted by Minjia Yan
<https://cre-media.com/podcast>



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Ginger is a real estate and finance attorney with more than 15 years of practice in the industry. She is experienced in commercial lending, asset management, finance, leasing, and general real estate matters. She has experience in originating commercial real estate loans that are securitized and sold on the bond market (also known as commercial mortgage-backed securities or CMBS) and routinely represents banks and other lending institutions making loans on commercial properties such as office developments, retail centers, hotels, and manufactured housing complexes, among others. Ginger also works with tenants in the negotiation of a variety of leases and related issues and regional developers in the purchase and sale of commercial properties. She regularly serves as local North Carolina counsel for real estate matters. Ginger provides efficient, cost-effective and decisive legal solutions to promote smooth transactions for each of her clients.

Questions?



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Mr. Escobar is a Partner with Dorsey & Whitney in its New York office with over 16 years of advising real estate companies, joint ventures, institutional owners, closely-held developers, lenders, investors, sponsors, project companies, public and private utility companies and private equity funds across the US and throughout the Americas on their financing and deployment of capital on complex and large-scale construction projects. Concentrating on real estate development, construction transactions and practices and project finance, Mr. Escobar's practice provides clients with key insight and in-depth knowledge into every stage of project real estate development, construction and financing. Focusing on the development and construction of commercial real estate and project financed-backed ventures, as well as energy, infrastructure, transportation and renewable energy projects, Mr. Escobar has led hundreds of large and complex vertical and horizontal projects spanning the Americas on behalf of key players in the merchant gas and energy, renewable energy, infrastructure, and commercial real estate industries – everything from the construction of a professional sports stadium and the development and financing of off shore gas and wind energy facilities in the Gulf of Mexico to construction of luxury residential developments.