



# Don't Commit to Loan Without Careful Thought

by Mimi Lines Esq.

You have just found an ideal, fairly-priced piece of land on which to build your company's next residential subdivision. You must move quickly, however: The seller needs fast cash and must close on the purchase of the land within 30 days.

## "Boilerplate" Loan Commitments

Several subcontractors in town have agreed to hold favorable prices for you if they can start work within the next 45 days. This, you assure them, will not be a problem, because you've just had a very productive meeting with your banker, who agreed to give your company a construction loan. You receive a commitment letter from the bank that seems a little long, but appears to be "boilerplate." In the interest of moving the deal forward, you sign the commitment and return it with a check for half the commitment fee.

A few days later, you receive a call from your lawyer, Walt Worrier, who has just received a copy of your commitment and draft loan-closing documents from the bank's lawyer. After Worrier gives you his standard lecture about the dangers of signing documents without your lawyer's advice, he informs you that:

- The survey that the bank requires will cost you \$4,000 and take four to eight weeks to complete.
- The bank will not close without an environmental site assessment on the property, which will cost you \$5,000 and take four to six weeks to complete.
- You've agreed in the loan commitment that all subcontractors on your job will be bonded. The subcontractors you've hired are not bonded.
- To satisfy the bank's closing requirements, Worrier and his staff will have to spend three to four weeks in the land records office and other federal, state, and local offices to make sure your use of the site does not violate any laws or regulations.
- The draft loan documents will require you to get the bank's consent before you do almost anything during the term of the loan—such as lease the property or transfer any of your company's stock.
- The bank wants additional security for the loan, and your wife, mother, and three brothers (all stockholders in your company) will have to guarantee the loan and will be personally liable for its repayment.

Worrier also tells you that, for the most part, you'll have to live with these provisions because you've already agreed to them in the commitment. Finally, you'll have to go back to the seller to negotiate an extension of the 30-day closing deadline, because under these circumstances it's an impossible target.

## Negotiating for Better Terms

What should you have done to prevent this situation?

You should have negotiated the loan commitment with the bank. The commitment is a blueprint for your closing. It includes not only the material terms of your loan, but also a set of conditions that must be met prior to closing. Though the commitment might seem to be "boilerplate," many of its terms can be varied by agreement.

The commitment addresses the following important issues:

**Liability.** Who is responsible for the loan's repayment? The primary borrower always is responsible for repaying the loan, with the exception of certain nonrecourse loans. If the borrower is a corporation, the bank generally will request a personal guaranty by one or more individuals involved in the control of the corporation. In our case, the bank required the signatures of the company's stockholders. If the company had a strong financial statement, or if the value of the collateral was far in excess of the loan, our borrower might have been able to limit the liability of his family members.

**Collateral.** What security will the bank require for the loan? It is very unlikely that a bank will loan money—even to its most valued customers—based solely on a signature. In a construction loan such as the one described above, the bank certainly would want a mortgage on the property. If this were a particularly risky loan, the bank also might look for additional collateral, such as a mortgage on other real property owned by the borrower, a security interest in bank accounts, or property of one of the guarantors.

**Control.** How much control over your project will the bank have? The bank must be able to determine the viability of the project throughout the loan's term. Thus the loan commitment will spell out the level of control over the project that the

bank will exercise. This control may include, for example, periodic review of the borrower's financial statements or approval of any leases on the property. In a construction loan, this control is expanded to include review and approval of plans and specifications, construction contracts, and major subcontractors. In the loan described above, the bank's control also extended to transfers of the borrower's stock. With careful negotiation, the borrower might have been able to limit the bank's control to a more comfortable level.

**Investigations/due diligence.** How much "due diligence" will the bank require before the loan can close? "Due diligence" refers here to the process of evaluating a site's environmental, land-use, and zoning suitability for the use proposed. Lenders often require investigations by third parties, such as engineers, surveyors, and architects, regarding these issues. In addition, the bank will seek an opinion from the borrower's lawyer stating that the property complies with applicable laws and regulations. This option often takes weeks to prepare.

Clearly, the amount of due diligence the bank requires affects the borrower's cost and closing date. In our case, the borrower could have limited the scope of due diligence to those issues that were most important to the bank, saving a great deal of time and money.

## Read It Carefully

When you receive a loan commitment that appears to be "boilerplate," take the time to read it carefully or have your lawyer review it with you. Careful review and up-front negotiation of the commitment's terms may save you a great deal of money and anguish at a closing time. ■

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