

Selling and Purchasing Performing and Non-Performing Loans: Threshold Issues to Consider

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In the current economic climate there will be increased interest and volume in the sale and purchase of performing and non-performing commercial mortgage loans and mezzanine loans. The following is a list of threshold issues that sellers and purchasers need to keep in mind whether they are contemplating a single loan transaction or a portfolio transaction.

1. **Business Relationship.** Do the parties intend to have a continuous business relationship such that the seller and purchaser will be transacting over a period of time with a series of loan transactions or will it be a single non-recurring sale and purchase transaction? If the parties envision a series of transactions, the parties should consider implementing a master mortgage loan purchase and sale agreement to govern all transactions going forward. Although this may require a greater time investment at the outset, having a programmatic document in place may be more economical over the long-term.
2. **Nature of Interest Transferred.** Do the parties intend for the entire loan to be sold and transferred or do they envision the seller retaining an interest in the loan? If the business deal envisions the seller retaining some interest in the loan, additional documentation in the form of an intercreditor agreement, co-lender agreement or participation agreement (depending on the nature of the interest retained), will need to be entered into by the parties.
3. **Servicing.** Will the seller or its affiliate retain any servicing rights and obligations or will the loan be transferred "servicing released" to the purchaser? If the seller retains servicing rights and obligations the parties will need to document that arrangement and agree upon the scope and the amount of the servicing fees.
4. **Deposit.** Do the parties envision the purchaser having to make a deposit under the terms of the purchase and sale agreement? If so, additional provisions dealing with the delivery, return and/or application of the deposit under various scenarios should be discussed. Alternatively, some parties find it easier and faster to simply agree to forego a deposit and employ a "sign and close" purchase and sale agreement that is executed simultaneously with the closing.
5. **Representations and Warranties.** The scope of the seller's representations and warranties should be discussed, at least in general terms, at the outset of the transaction. Addressing this at the beginning will avoid conflict down the road when the purchase and sale agreement is being negotiated. This way, for example, the seller is not expecting a completely "as is/where is" transaction with minimal representations and warranties while the purchaser is expecting a comprehensive set of corporate and property-level representations and warranties. The parties should also discuss how long the seller's representations and warranties are intended to survive the closing and what remedies may be available to the purchaser should a breach of representations and warranties be uncovered post-closing.
6. **Data Room.** The importance of a comprehensive and well-organized virtual data room cannot be overemphasized. Members of the seller's team including the broker (if a broker is involved) should take time and care in organizing the loan documents, legal opinions, title policy and exceptions, survey(s), zoning report(s) and other materials, including the property condition report and environmental report. For non-performing loans, copies of default letters and any litigation pleadings that have been filed should be posted and made available for the purchaser's review. A comprehensive data room can also protect the seller against a claim that it failed to disclose important information to the purchaser. The purchaser, in turn, is afforded the opportunity to review all relevant loan documents, property-related materials and any related default letters, if applicable, in the seller's possession or control.

7. **Transferability.** Although the vast majority of mortgage loans are freely transferable, there are occasionally deal-specific conditions regarding the transfer of the loan, but that is not typical. If, however, the transfer involves a mezzanine loan or a subordinate interest in the mortgage loan such as a "B Note," the applicable intercreditor agreement or co-lender agreement with the senior lender will likely restrict the type of entity that can hold the mezzanine loan or B Note. The purchaser will want to take care in confirming that it qualifies as a "qualified institutional lender," a "qualified transferee" or other similar designation.
8. **Other Due Diligence Considerations.** Most loan agreements allow the lender to obtain an estoppel certificate from the borrower regarding the status of the loan. Some purchasers request that the seller obtain such an estoppel from the underlying borrower as part of their due diligence and as additional comfort regarding the status of the loan. Such an estoppel is obviously more valuable for older loans as opposed to newly originated loans. In addition, some purchasers will also consider doing lien, judgment and bankruptcy searches as part of their due diligence. At the moment, whether such searches are realistic given the closure of many governmental offices and recording offices is certainly a question.

Activity regarding the sale and purchase of performing and non-performing mortgage loans and mezzanine loans will likely increase in the coming months and, while not exhaustive, this list will help both sellers and purchasers as they consider potential transactions.

If you have questions or would like guidance related to these steps, please contact Tim Davis, (davist@whiteandwilliams.com; 215.864.6829), Will Johnston (johnstonw@whiteandwilliams.com; 215.864.6341), Rachel Schneidman (schneidmanr@whiteadwilliams.com; 212.6311254) or another member of our Real Estate and Finance Groups.

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