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Excerpt from **Stein on New York Commercial Mortgage Transactions**

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Chapter-by-Chapter Overview

SYNOPSIS

OV.01 Chapter-by-Chapter Overview

[1] The New York Commercial Real Estate Finance Market Generally (Chapter 1 *below*)

Chapter 1 provides a thumbnail description of commercial real estate finance—describing the real estate investment cycle in § 1.01 and the nonrecourse nature of typical mortgages in § 1.02. In Section 1.03 the chapter describes what makes the New York real estate market different from all other markets. A brief overview of the loan closing (§ 1.04), and the agendas of both lender (§ 1.05) and borrower (§ 1.06), follow. Section 1.07 summarizes the 12 major pitfalls—the "deadly dozen"—that counsel should try to avoid when preparing or negotiating a set of New York mortgage loan documents, with cross references to more detailed discussions. The deadly dozen are:

- Lien Law trust fund clause (§ 1.07[1]),
- No revolving loans (§ 1.07[2]),
- Waiver of notice of appointment of receiver (§ 1.07[3]),
- Nonjudicial foreclosure (§ 1.07[4]),
- Random usury problems (§ 1.07[5]),
- Unindexable documents (§ 1.07[6]),
- Powerless power of attorney (§ 1.07[7]),

- Statutory mortgage (§ 1.07[8]),
- Security deposits for apartment buildings (§ 1.07[9]),
- Construction loans (§ 1.07[10]),
- Unpaid real estate taxes (§ 1.07[11]), and
- Satisfaction of mortgage (§ 1.07[12]).

[2] New York Usury Law (Chapter 2 *below*)

Chapter 2 turns to New York usury law. This is not because usury law matters much for most commercial transactions. Usury comes first only because the starting point for any loan is its interest rate (a minor detail often lost in a morass of legal and practical issues). The chapter provides a brief overview of usury in Section 2.01 with the warning that in the occasional weird case in which usury restrictions apply, a violation can potentially invalidate an entire loan and constitute a felony. The chapter discusses New York's usury ceiling (§ 2.02) and the limitations on a lender's ability to collect compound interest, independent of usury restrictions (§ 2.03). It discusses penalties for usury (§ 2.04) as well as criminal usury and predatory lending (§ 2.05). The chapter discusses major exemptions from usury requirements in §§ 2.06 through 2.11 and mentions some common defenses to usury in § 2.12. The chapter concludes with a flowchart that seeks to summarize New York's usury maze in § 2.13.

[3] Mortgage Terms and Issues to Consider in First Draft of Loan Documents (Chapters 3 and 4 *below*)

In preparing the first draft of any commercial mortgage loan documents, a lender's counsel needs to consider a few dozen minor issues and consider adding certain language to the loan document in response. Chapters 3 and 4 examine those terms and issues, which will arise for practically every mortgage loan.

Section 3.02 gives the reader the first whiff of the major role taxes play in New York commercial mortgage practice, by discussing the "commercial use" clause, required for administration of the mortgage recording tax. Section 3.03 reviews some New York statutes that can sometimes help put "flesh on the bones" of a minimalistic mortgage, and warns the reader against some of those statutory provisions. Section 3.04 offers a preview of construction lending in New York, by introducing the Lien Law "trust fund clause." Mortgage modifications are the subject of Section 3.05, which suggests an approach lender's counsel may want to take to the issue.

Although any mortgage will require the borrower to pay various taxes, New York's unusually high and varied transaction taxes may justify their own additional language, suggested in Section 3.06. A New York statute addresses the priority of future advances, and Section 3.07 recommends language that should satisfy the statute. Section 3.08 briefly considers some issues unique to New York corporations and a few other types of mortgagor. Payments on non-business-days are the subject of a New York statute, which Section 3.09 covers. Finally, if a mortgage names multiple mortgagees, they may want to think about the issues raised in Section 3.10.

All the issues covered in Chapter 3 usually culminate in adding a paragraph or two of "magic language" to the mortgage. In contrast, the issues covered in Chapter 4 require state-specific consideration but do not necessarily require "magic language," though they sometimes will.

After a brief introduction, Chapter 4 begins by considering appraisals in Section 4.02, with a discussion of a New York statute that gives any mortgage borrower the right to see any appraisal prepared at its expense. Mortgage assignments are the subject of Section 4.03 (and part of the foundation for Chapters 6 through 9, which cover the mortgage recording tax). Section 4.04 visits assignments of rents briefly, and then the next three Sections cover three "D"s: "doing business" in Section 4.05; "dragnet clauses" in Section 4.06; and "due-on clauses" in Section 4.07.

Many commercial mortgage loans in New York and elsewhere require guaranties. In a rare blow for relative simplicity in New York commercial mortgage practice, New York law does not impose heavy burdens on lenders that accept guaranties. Section 4.08 discusses some of the issues that guaranties can create in New York.

Sections 4.09 and 4.10 turn to two issues near and dear to out-of-state lenders doing business in New York: income and franchise taxation and licensing requirements.

Unpaid interest—and its priority of lien—is the subject of Section 4.11, after which Section 4.12 discusses the use of mortgages versus deeds of trust in New York. Section 4.13 then examines a New York statute that governs options held by mortgagees. Section 4.14 introduces the New York statutory form of power of attorney, along with some easy ways to make such a power of attorney worthless.

New York courts tend to enforce prepayment premiums in commercial mortgage loans, as described in Section 4.15. Section 4.16 addresses some issues about a mortgagor's personal liability for the debt, after which Section 4.17 turns to personal liability for security deposits and Section 4.18 examines the possibility of using a "separate note" to evidence the New York portion of a multistate loan.

Finally, Sections 4.19 and 4.20 explore two little-known pitfalls of New York commercial mortgage law: the "Streit Act" and a prohibition on certain bizarre fees that commercial mortgage lenders might conceivably try to charge.

[4] Construction Loan Issues (Chapter 5 *below*)

New York construction lending raises a host of incredibly intricate and almost inscrutable issues, all spawned by New York's archaic Lien Law. Chapter 5 attempts valiantly to make sense of this mess.

Section 5.02 begins by summarizing the law of mechanics' liens: the procedures that lien claimants need to follow, and the rights they obtain by filing a lien.

The problems begin in Section 5.03, which introduces the issue of relative priorities between mechanics' lien claimants and mortgage lenders, an issue that consumes the next seven Sections. Section 5.04 explains building loan contracts, Lien Law affidavits, and some issues they raise. Section 5.05 provides a sample Lien Law Affidavit. In Section 5.06, the reader learns the differences between "improvement" and "cost of improvement" and why it might matter. Section 5.07 discusses the loan disbursement process during construction.

Why do New York construction lenders use three mortgages instead of one? The answer lies in Section 5.08. And Section 5.09 turns to some administrative issues for a construction loan. Finally, Section 5.10 wraps up this part of the discussion with a summary of construction lending and the Lien Law.

Section 5.11 examines how the use of a single general contract for an entire construction job affects some of the analysis in the preceding ten Sections. Section 5.12 describes how borrowers might "bond" liens on construction jobs. Section 5.13 focuses on the distinction between "public" and "private" construction jobs.

Finally, Section 5.14 turns to Article 3-A of the Lien Law. A recent Court of Appeals interpretation of Article 3-A has spawned a new form of Lien Law compliance (or at least new attention to an old form of Lien Law compliance), as if the issues discussed earlier in this Chapter were not already enough.

[5] New York's Mortgage Recording Tax (Chapters 6, 7, 8, and 9 *below*)

For about 100 years, New York has imposed a tax on the recording of mortgages. That tax alone justifies four chapters in this book, and leads to layers of complexity and spurious issues that would be inconceivable in almost any other state.

Chapter 6 introduces this delightful topic by pointing out, in Section 6.02, that New York's mortgage recording tax is not just one tax but actually six taxes piled on to different mortgages depending on the circumstances. Section 6.02 explains those gradations and briefly compares New York's mortgage recording tax against those in other states.

Section 6.03 explores how the tax is calculated and measured for a new mortgage (as opposed to one that refinances an existing loan), and Section 6.04

briefly considers how the tax applies to some mortgage-like transactions. The tax becomes crucial as soon as the parties start to modify an existing mortgage, as explained in Section 6.05, or increase its amount, as described in Section 6.06. After those explanations, Sections 6.07 through 6.09 offer sample language to use when modifying or increasing a mortgage.

Section 6.10 turns to refinancings, in which mortgage recording tax issues can drive more than half the documents at a commercial mortgage loan closing. And the most important of those documents will be the mortgage assignment, for which Section 6.11 offers a sample and a checklist, and Section 6.12 offers a sample accompanying affidavit.

Section 6.13 questions whether New York commercial mortgage lenders are well served by the usual practice of "consolidating" mortgages, or might be better served by keeping multiple mortgages separate.

Swap agreements can create their own issues, which Section 6.14 explores.

Finally, Section 6.15 concludes with a summary of the first of four chapters on the mortgage recording tax.

When a transaction involves more than one mortgage, the mortgage recording tax issues will only multiply. For example, multistate credit facilities secured in part by New York real property can be handled in one of two ways: the "traditional" approach described in Section 7.02; and an impractical statutory approach described in Section 7.03.

One mortgage can become two, for reasons described in Section 7.04, which also offers some sample language and documents to get the job done. And mortgages can move from place to place, although not as easily as a few years ago, all as described in Section 7.05. Finally, one mortgage can secure multiple loans, although this can create spurious mortgage recording tax issues, as described in Section 7.06.

New York's mortgage recording tax is at its worst as it applies to revolving loans—a perfectly ordinary animal in the world of real estate finance, but basically unavailable in New York because of the crabbed and hypertechnical positions taken by New York's statutes and tax collectors. Section 8.02 explains those positions. Sections 8.03 and 8.04 explore some techniques borrowers and lenders have sometimes tried to use to solve the problem. Those techniques either don't work at all (*see* Section 8.03) or work badly (*see* Section 8.04). Section 8.05 summarizes the sorry state of New York's treatment of ordinary commercial revolving loans.

Section 8.06 reviews a "safe harbor" for revolving loans below $3,000,000, after which Sections 8.07 and 8.08 explore a technique, developed by the author in 1992 and 1993, that can often solve the "revolving loan" problem for multistate transactions.

Finally, Section 8.09 discusses how New York mortgage recording tax might apply to secured letters of credit.

Chapter 9 turns to some general and procedural issues of the New York mortgage recording tax. The first of those is the "advisory opinion"—a ruling from the Department of Taxation and Finance directed to a particular taxpayer. Section 9.02 explains how advisory opinions work. Section 9.03 discusses the option of paying the mortgage recording tax under protest and filing for a refund.

Section 9.04 explores the penalties and other consequences to a lender if it records a mortgage without paying sufficient mortgage recording tax. (Does the mortgage still retain its priority? Section 9.04 tries to answer that question.) Section 9.05 summarizes some exemptions from the mortgage recording tax.

Before leaving the mortgage recording tax, Section 9.06 suggests a mechanism that could eliminate much of the complexity and gratuitous paperwork spawned by the tax.

[6] Closing (Chapters 10 and 11 *below*)

Once the parties have prepared their documents and considered all the issues discussed above, they need to close their transaction. Chapter 10 describes the role of title insurance in that process, and Chapter 11 considers some other issues that arise at any commercial mortgage loan closing.

Section 10.02 begins by summarizing the "New York style" closing process and the central role the title insurance company plays in that event. To supplement that discussion, Section 10.03 offers some sample recording instructions for a "New York style" closing.

The pricing of title insurance in New York would be an antitrust violation but for the fact that it is controlled by statute, as described in Section 10.04, which also introduces the title insurance "rate manual."

In addition to basic title insurance coverage, any New York commercial mortgage lender's counsel may want to order a variety of title insurance endorsements, all defined in the rate manual. Section 10.05 summarizes those endorsements, explains why each might add value (and when), and concludes with a summary table of the circumstances when particular endorsements might apply.

Changes in the marketplace have led to a handful of title insurance endorsements intended for use when lenders make "mezzanine" loans. Although such loans are normally outside the scope of this book, their title insurance endorsements are an important enough part of the title insurance picture that Section 10.06 explores them at great length.

Section 10.07 offers an annotated list of title insurance companies licensed to do business in New York, with estimates of their capacities.

Whenever issues arise in commercial mortgage loans, counsel often "checks with the title insurance company." This may and may not represent a reliable way to solve a problem or answer a question, for the reasons described in Section 10.09.

When title insurance companies act through "agents," this may raise special issues about liability and what happens when something goes wrong. In response to those issues, the industry has developed the use of "insured closing letters," which Section 10.09 discusses.

Finally, Section 10.10 considers who chooses the title insurance company and why, and Section 10.11 explores title insurance implications of post-closing loan modifications.

Title insurance aside, the closing process raises a handful of other issues not otherwise covered in this book.

Any recordable document must be acknowledged, and Section 11.02 explains how New York acknowledgments work. Cover pages are covered in Section 11.03. Recording offices can "bounce" documents for all kinds of reasons, which Section 11.04 tries to summarize.

Commercial mortgage loan attorneys often spend a great deal of time (though create almost no value) writing and negotiating opinions of counsel, and Section 11.05 explores some state-specific opinion issues. Section 11.06 reviews Uniform Commercial Code issues under New York law.

Section 11.07 then discusses New York statutes that purport to allow lenders to use a one-page mortgage incorporating by reference a boatload of statutory covenants—and also explains why lenders should hesitate to accept the invitation.

Most commercial mortgage lenders don't know it, but they can develop their own one-page mortgage by recording master mortgages in the land records, as described in Section 11.08.

Section 11.09 discusses New York City's system by which "violations" of various codes can be filed in central registries, where they can torment parties to real estate transactions for several decades thereafter.

Section 11.10 offers a sample closing checklist keyed to the various state-specific closing requirements discussed throughout this book, after which Section 11.11 explores how technology has changed the recording process in New York.

[7] Protecting Rental Income (Chapter 12 *below*)

Before this book turns to other views of the commercial loan transaction, Chapter 12 briefly reviews some issues about how a commercial mortgage lender controls—and asserts its rights to—rental income from the mortgaged property.

Section 12.01 starts by explaining the importance of rental income and the various unpleasant surprises lenders may face in this area.

A New York statute, Real Property Law Section 291-f, allows commercial mortgage lenders to give certain protective notices to commercial tenants, as described in Section 12.02. To do that, though, the commercial mortgage lender needs to make sure its mortgage includes the language discussed in Section 12.03. The notice itself might take the form suggested in Section 12.04.

Setting aside the Section 291-f process, commercial mortgage lenders might also want to enter into "nondisturbance" agreements with major commercial tenants. Section 12.05 reprints a report on this topic written by a New York State Bar Association Subcommittee that the author chaired in 1993. The same Section also includes the model nondisturbance agreement that the Subcommittee produced.

Finally, Section 12.06 discusses some ill-advised (and mostly ignored) New York case law that suggested a commercial mortgage lender must try to terminate the leases of all subordinate commercial tenants as part of any mortgage foreclosure action.

[8] Borrower's Concerns (Chapter 13 *below*)

Most of this book focuses on issues that concern a commercial mortgage lender, because it is the lender more than the borrower whose fortunes may rise or fall depending on what the mortgage papers say. Once the loan closes and the borrower has received the loan proceeds, the borrower's state-specific concerns about the mortgage loan documents are relatively attenuated. But they are not entirely nonexistent. Most of them relate to the mortgage recording tax.

Section 13.02 identifies every New York commercial mortgage borrower's single most important state-specific issue: the crucial need to ask the mortgage lender to agree to assign the mortgage to the next lender when the borrower refinances this one.

Sections 13.03 through 13.05 are variations on the theme. Section 13.03 explores how a mortgage assignment works when a borrower "defeases" a loan. Section 13.04 considers other potential opportunities for a borrower to plan ahead to achieve future mortgage recording tax savings. Finally, Section 13.05 considers some related issues that arise with partial releases of collateral.

Just as the bankruptcy system has become little more than one of many management strategies available to the managers of troubled companies, it has also become a potential technique for the mitigation or elimination of mortgage recording tax. Section 13.06 explains how this technique works, and the steps a borrower in bankruptcy needs to take to make sure it can take full advantage.

Given the importance of mortgage assignments in New York practice, what happens if the loan assignor has lost the promissory note? Although Chapter 18 discusses this topic in general, Section 13.07 introduces at least one step a borrower may want to take in negotiating the original mortgage documents.

Section 13.08 explains how a borrower might want to respond to Real Property Law Section 291-f, a topic introduced in Chapter 12.

In some states, any borrower's checklist would include remembering to ask the lender to agree to deliver a waiver of a lien against certain personal property of tenants. In New York, that issue is less important than elsewhere because New York law creates no such lien. Still, Section 13.09 suggests some related issues a borrower might want to consider.

Section 13.10 considers whether the borrower should insist that the lender countersign the mortgage. Section 13.11 turns briefly to the loan payoff process, and suggests how a borrower might ask the lender to agree to cooperate. Finally, Section 13.12 considers some opportunities to save title insurance premiums, an expense almost universally borne by the borrower.

[9] Mortgage Enforcement (Chapters 14, 15, 16, and 17 *below*)

Lenders insist on receiving mortgages because they want the ability to proceed against the borrower's real property if the borrower decides not to repay the loan. That's the purpose of the whole exercise.

Chapters 14 through 17 examine some state-specific issues in the mortgage enforcement process, but mostly only to the extent that those issues need to be considered in documenting, negotiating, and closing the original loan. These chapters generally disregard enforcement issues that a commercial mortgage lender's counsel would generally disregard in preparing a set of loan documents.[9]

Chapter 14 examines a series of default-related issues that can arise before the lender commences judicial proceedings.

Section 14.02 considers the likelihood that the borrower will claim that the lender somehow "waived" the right to accelerate, and suggests loan document language to respond to those claims in advance.

Section 14.03 reviews some unfortunate New York law that indicated attorneys

[9] This book need not address New York mortgage loan enforcement more generally. The entire area has been covered, thoroughly and masterfully, by Bruce Bergman in his three-volume work, Bergman on New York Mortgage Foreclosures (LexisNexis Matthew Bender).

could not give formal notices on behalf of their clients, and recommends mortgage language to prevent problems in that area.

Nonmonetary defaults often cause concern to lenders, because lenders fear they can never foreclose based on such defaults. Section 14.04 demonstrates why that isn't really true and offers some drafting suggestions. Section 14.05 explores how the courts treat commercial mortgage lenders when they try to collect legal fees, and recommends some lender-friendly (and counsel-friendly) language for the mortgage.

Sections 14.06 and 14.07 consider late charges on acceleration and calculation of interest after acceleration and after judgment.

Chapter 15 begins where the peaceful borrower-lender relationship ends: the commencement of a foreclosure action. As the first step in any such battle, the lender will typically want to obtain the appointment of a receiver. Section 15.02 recommends some lender-friendly language along these lines, and reviews some issues that a receivership might create.

Section 15.03 introduces New York's rules on coordination of remedies, and explains why a lender can't foreclose on a mortgage and sue on the note simultaneously. Section 15.04 discusses limitations on the lender's ability to obtain a deficiency judgment against a borrower or a guarantor. Section 15.05 discusses how a lender might respond to these rules, and Section 15.06 discusses a particularly effective (but rarely adopted) response: the concept of using multiple loans and mortgages instead of just one.

When a property is in foreclosure, it often seems to burn to the ground shortly before the foreclosure, an event that raises some new issues for a lender (to say nothing of the arson squad). Section 15.07 discusses a handful of New York cases pointing in a handful of directions on this issue, and concludes by recommending certain language to add to the mortgage loan documents.

As if the mortgage recording tax were not enough, New York City and State impose an entirely separate set of taxes—of about the same magnitude—on any foreclosure or deed in lieu of foreclosure after a mortgage loan goes into default. Section 15.08 summarizes those taxes and discusses how a lender might respond to them in its loan documents.

Section 15.09 closes with a brief discussion of judicial foreclosure in New York.

In 1998, the New York legislature added nonjudicial disclosure to the arsenal of remedies available to commercial mortgage lenders. Section 16.02 discusses how a commercial mortgage lender can qualify for the use of nonjudicial foreclosure, and recommends some rather limited language to consider adding to a mortgage toward that end.

Sections 16.03 and 16.04 summarize the nonjudicial foreclosure process and timeline. Although these topics do not strictly relate to the commercial mortgage loan closing process or documentation, they provide answers to one of the questions that commercial mortgage lenders most frequently ask their closing counsel.

Section 16.05 summarizes New York's nonjudicial foreclosure process, after which Section 16.06 returns to pure loan documentation by suggesting some "nonrecourse carveouts" that a New York commercial mortgage lender might want to include in its documents based on the nonjudicial foreclosure process. Finally, Section 16.07 continues in that vein with a discussion of some possible opinion issues.

Chapter 17 turns to some special problems that arise when New York real property secures a multistate loan transaction, or a multistate loan transaction is governed by New York law.

Section 17.02 discusses a statute that allows substantial borrowers and lenders to choose New York governing law without fear that a New York court will invalidate that choice. Section 17.03 offers some sample language designed to comply with the statute.

Section 17.04 turns to some meatier issues: How New York's antideficiency and one form of action rules apply in loans governed by New York but secured by out-of-state real property. Section 17.05 turns to some opinion issues that arise in these transactions.

Finally, Section 17.06 considers how the New York courts might respond to a contractual choice of some law other than New York's for one of these transactions.

[10] Lost Notes (Chapter 18 *below*)

Chapter 18 examines the law of lost notes, an issue that arises at the end of any commercial mortgage lender's investment in any particular commercial mortgage loan (or at the beginning, depending on which lender is considering the issue). This body of law becomes crucially important in New York, given the need to "assign" old notes and mortgages to new lenders.

Section 18.02 introduces the concept of "lost note affidavits" and discusses their legal background in New York.

Section 18.03 turns to the related "lost document certificate and indemnity," offering a model document and a checklist for using it.

The likelihood of lost notes will also sometimes drive lenders to include certain language in their mortgages, as described in Sections 18.04 and 18.05. Finally, Section 18.06 explores the possibility of doing away with promissory notes entirely, and using "noteless loans." Thus far, that possibility has not had great appeal for commercial real estate lenders, although it is perfectly feasible and indeed prevalent in other areas of finance.