

Real Estate Loan Purchases:

Questions to ask before finalizing a deal

In an environment where real estate values are fluctuating and cash flows are difficult to predict, it is more important than ever to apply a comprehensive perspective when considering the purchase of real estate loans. Indeed, we believe it is essential for buyers to consider the following

threshold questions before buying.



Buyer

What is the purpose of the loan purchase?

Whether the loan buyer's aim is "loan to own" or investment may impact, among other things, the lens through which the buyer's diligence is conducted, as well as structuring considerations.



What is the nature of the collateral?

The answer to this question is important for numerous reasons, including analyzing potentially competing claims for the underlying asset and understanding the remedies available in the event of a borrower default.



What will be the extent of legal and nonlegal diligence?

The answer to this question depends on, among other things, the buyer's appetite for risk, the contemplated timing of the loan sale closing and the buyer's business plan.



Who are the relevant parties in interest?

In addition to the borrower and guarantor (if any), other relevant parties may be other lenders, the property manager, the cash management bank and major tenants. Proper diligence will uncover the relative priorities of the various interest-holders in the underlying asset.



What is the governing law of the loan documents?

This is particularly important in determining how long it will take to secure title to the collateral underlying a distressed loan, and what remedies can be pursued.

Is the loan fully advanced?

It is a very different situation to take on loan funding obligations, particularly in a construction loan context, as compared to the purchase of a fully funded loan. The loan documents must be reviewed to determine the extent of any funding obligations and can have significant tax consequences, particularly for offshore holders.

Is the loan distressed?

If so, to what extent is borrower/guarantor cooperation in connection with the lender's exercise of remedies to be expected? Lack of cooperation will likely result in significant costs and delays in obtaining title to the underlying real estate asset.



Is a restructuring of the loan contemplated?

A restructuring or modification of the loan could have material income tax consequences for a buyer of the loan. For example, regardless of whether the loan was originally issued with original issue discount, a buyer of the loan at a discount could be required to include all or a portion of the discount in taxable income following a restructuring or modification of the loan.

on an as-is basis?

In an as-is sale, the loan seller is making very few, if any, representations. This means that information about the property, and many times about the loan itself, can be obtained only through independent verification, and in a number of deals there is not enough time to perform thorough diligence.



Is the loan nonrecourse, partially recourse or fully recourse?

To the extent a guarantor may need to step in to cure a borrower default, the true value of a loan guaranty is dependent on the current creditworthiness of the guarantor. This issue can be mitigated if the loan seller is able to provide recent financial statements of the guarantor.