

# COMMERCIAL LENDING REQUIREMENTS AND LOAN DOCUMENTATION IN VIRGINIA

## Part II. The Commitment and Planning Process

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The businessman comes to you with good news: he or she has identified a transaction that looks great. He needs to secure financing for it now, during the inspection or feasibility period of his contract. The seller would only accept a contract with no contingencies for financing: after all, this is not a residential property contract, where such contingencies are common. Rather, the seller insisted that the buyer “put his money where his mouth is,” in terms of the buyer’s representations that he, or his company, were strong buyers, able, as well as ready and willing, to complete the transaction.

To finalize the contract, therefore, the businessman buyer has placed substantial cash “at risk,” which he will lose if he defaults under the contract, such as by failing to secure financing. While he may indeed have the right to terminate the contract if he finds that other aspects of the transaction are not as represented, or are not as he expected them to be, chances are that a pure failure to procure financing is *not* an acceptable reason for termination.<sup>1</sup> Whether the contract is this wide open or goes to the opposite extreme, such

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<sup>1</sup> Depending on the economic laws of supply and demand, a buyer may be able to contract for a more wide open inspection or feasibility period, which would allow termination for

as not having any inspection or feasibility period at all, the transaction in all but the rarest of circumstances will require that the buyer have financing in place and ready to go by a specified closing date. We will assume that the contract does provide for some type of feasibility period, however.

This businessman has based his willingness to accept the risk of posting a cash deposit on many factors, including, first, the likelihood that the factors that he is entitled to review during the feasibility period will bear out his judgment in committing to the contract and, second, that all the factors involved will tie in to a reasonable expectation that this transaction is fairly priced for the market and is fairly capable of justifying a loan of the size and, thus, of the percentage loan-to-value ratio, that the businessman needs from a financial institution to finance the deal. The primary tasks at hand for him at this early stage are assuring that the deal passes his further review – his “due diligence” review – and that he procures the best financing that he can if he decides to proceed to closing. An example of a buyer’s due diligence checklist for documents and inquiries that it might want answered from a prospective seller of an office building is attached hereto as Appendix 1,<sup>2</sup> along with a buyer’s possible closing checklist that would help a buyer focus on what it might need to complete closing (in the event, this would be driven, in substantial part, by the requirements and entitlements of seller and buyer in the purchase agreement and of buyer/borrower and lender in the loan commitment).

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any reason within the specified time of the period, including lack of ability to procure financing as needed, or for no inspection or feasibility period at all.

<sup>2</sup> By inference, the items on this list also illustrate the nature of common inquiries that a buyer would consider making in performing its overall due diligence inspection.

A. Term Sheets and Commitment Letters

The businessman will analyze which tasks must be started first, and likely will realize, in most cases, that several things must be started almost simultaneously. One of these first items of business is to shop for financing from potential lenders.

Informal inquiries of potential lenders lead to discussions of prospective terms and conditions for loans, of timing requirements of both sides, and of pricing for the application process. Lenders will review either the pending contract itself or a summary of its terms, and then, if interested, may provide borrowers with informal term sheets, which are not intended by either party to be enforceable as contracts but rather allow borrowers to discuss the possible loan terms and conditions with investors and other principals and decision-makers. They also allow the borrowers, of course, to shop the issuer's deal to other lenders, unless the lenders have taken steps to prevent this (see below). Once a borrower decides on the loan he prefers, he will submit a more complete loan application, along with, most often, a substantial loan application fee that ensures to the lender that the borrower no longer is casually "shopping" for a loan. The borrower will generally, and if he is sane will always, seek to receive a loan commitment letter from the lender.

Traditionally, lenders received loan applications from prospective borrowers, performed the lenders' own due diligence procedures – underwriting the loan application in accordance with their particular standards and requirements – and then either rejected the loan application or issued a commitment to make the loan. A loan commitment constitutes, as you know, an offer by a lender to make a loan of a certain amount, for a

specified period of time, at a stated interest rate and terms of repayment, and is generally conditioned upon the lender's verification of many conditions, all of which should be, and most of which generally are, specified in the commitment letter that the lender issues. Once a commitment letter is accepted by a prospective borrower, it becomes a contract between the lender and the borrower: the lender has offered to make a loan on the stated terms and subject to the stated conditions, and the borrower has accepted the offer and, generally, paid a fee and/or agreed to be liable to pay a fee in connection with that acceptance. Most lenders today continue to issue commitment letters as their normal course of doing business, and these letters provide the greatest possible certainty and clarity between borrower and lender.

More often today than years ago, however, and perhaps in partial response to the concerns regarding lender liability, a lender that wants to finance a deal might not issue what it considers to be a loan commitment letter. Instead it may issue, and a borrower may be asked to acknowledge receipt and acceptance of, what may be called a "loan application" letter, or words to that effect, which purportedly do not bind the lender to make a loan at all, unless it decides to do so in its sole discretion or after "further approvals" or review. The concept behind these supposed "non-commitment" letters is that they are not binding upon the lender, ever. This concept is not well-established, however, and may not protect the lender from liability for failure to make a "non-committed" loan, at least under Virginia law.

The foundation for analyzing this issue is the "long-established existence in Virginia law of an implied duty of good faith when performance of a contract depends

upon the ‘satisfaction’ of one of the parties. [citations omitted.]” Forrest Creek Associates v. McLean Savings and Loan, 831 F.2d 1238, 1242 (4<sup>th</sup> Cir. 1987). Thus the idea that a “non-committal” commitment letter will allow a lender free reign to make the referenced loan or not runs afoul of this common law principle.

This principle of an implied duty of good faith was expressly embedded into the former Uniform Commercial Code, in § 8.1-203, and remains a foundation principle of the revised UCC. *See Va. Code* § 8.1A-304, 1950, as amended: “Every contract or duty within the Uniform Commercial Code imposes an obligation of good faith in its performance and enforcement.” The Virginia courts have recognized the existence of a claim for a breach of the duty of good faith, but in numerous leading cases have rejected the actual allegations said to constitute such a breach, generally finding in the bank’s favor, on facts not quite the same as those discussed above. *See, e.g., Mahoney v. NationsBank of Virginia*, 455 S.E.2d 5 (Va. 1995) and *Albright v. Burke & Herbert Bank & Trust*, 457 S.E.2d 776 (Va. 1995)

In each of the cases cited, borrowers or prospective borrowers failed to show that the lenders involved had breached their duties of good faith or their commitments or oral representations. Does this mean that lenders can, in fact, refuse to fund committed loans? Or does it only mean that in these cases, the lenders had other contractually based rights that they could exercise in refusing to act as the borrowers wished? Most likely it is the latter.

Thus the questions remain for consideration: If a lender issues a “non-binding” term sheet that states that the lender reserves the right to make its final decision to fund in

its discretion (and/or states that lender has the right to add new conditions after borrower pays the deposit), its prospective borrower pays a substantial deposit toward the lender's "expenses," the lender knows that the borrower is relying on the lender to fund if the borrower meets all stated conditions of the term sheet, and the borrower in fact meets the stated conditions, does the lender have the right to refuse to fund at closing for any reason at all? For specific reasons? Does the lender have no right to refuse to fund?

B. Due Diligence Considerations

Along with beginning the loan application process, the buyer will undertake its full-scale inspection of all unknown and material aspects of the assets that it desires to purchase, which is often called the feasibility, inspection and/or due diligence process. A buyer's checklist of such items is attached, as mentioned above.

Likewise, the lender will have its own due diligence to perform, on two fronts. First, it will underwrite the borrower, as to its credit, financial strength, and compliance with any applicable loan programs for which either the borrower applied or which the loan officers involved believe may fit best for the proposed loan. This may also involve a similar check of potential guarantors. The second front is to underwrite the value of the proposed asset as collateral, which is a review of much the same content as the borrower's own due diligence review of the assets being acquired, though with the slightly different purpose of comparing the results with, as stated above, the lender's own internal parameters or guidelines for lending. A lender's checklist is attached as an example of what might be on it, in Appendix 2 to this section.

C. Other Preliminary Agreements

A lender, seller and/or buyer/borrower may perceive that it/they have an interest in confidentiality, which of course can be the subject of an independent agreement to that effect. More likely, they simply can be in the form of provisions in either the loan commitment, if it is some or all of the terms of the lender's loan offer that is to be barred from disclosure, or in the purchase agreement, if it is the terms of that document that are to be kept confidential. To ensure that each party is not prevented from doing what it needs to do in its due diligence or underwriting for the transaction, the well-drafted confidentiality provisions will allow for disclosure on a defined and limited basis, such as to bankers, shareholders/members, directors, and the parties' attorneys and accountants. Sample provisions of such an agreement is attached in Appendix 3.

If in preparing for the subject acquisition the prospective buyer/borrower may also bargain for the right to visit the property to inspect or survey it, or to interview employees of seller. These can be addressed in part in the kinds of confidentiality agreements described above. As to the physical access and testing/inspections, however, access, inspection and indemnity agreements may be used or be included in the purchase agreement. Sample provisions of such agreements are also included in Appendix 3.

## Appendix 1

### **BUYER'S LIST OF REQUESTED DUE DILIGENCE DOCUMENTATION FOR OFFICE BUILDING**

1. current rent roll
2. copies of the existing leases with any applicable amendments and/or addenda.
3. to the extent available, any lease abstracts of current tenant leases.
4. update of the current leasing activity underway at the property.
5. preliminary title report with exceptions.
6. copy of an updated survey preferably with a flood hazard certification for the property.
7. list of current vendors
8. copies of current service contracts
9. copy of any documentation regarding proposed real and personal property taxes.
10. operating statements for the property (the operating statements for the last three years would be ideal).
11. copy of the original certificate of occupancy and any other permanent certificates of occupancy for specific tenant space.
12. any environmental reports that have been prepared in the past.
13. any report information in connection with the Americans with Disabilities Act.
14. any Y2K compliance information/documentation.
15. any correspondence from municipalities with respect to the use of the property, compliance with zoning laws, and/or compliance with building/fire codes.
16. copy of correspondence files with any tenants over the last three years.
17. original construction plans for the building and parking structure, the HVAC system, electrical, etc. (preferably "as built")
18. copy of current tenant improvement plans
19. copies of any warranty/guarantee information that may still apply for the roof, HVAC system, other major systems, etc.
20. list of personal property to convey.

**CHECKLIST FOR CLOSING:<sup>3</sup>**  
**(Seller [Name] to Buyer [Name])**

<u>Item</u>	<u>Resp. Pty</u>	<u>Status</u>
Promissory Note		
Deed of Trust		
Corp. Guaranty		
Individual Guaranty		
UCC-1's		
Security Agreement		
Assignment of Rents/Leases		
Insurance f/b/o Lender		
Title Insurance Commitment & Endorsements		
Environmental Report/Assessment		
Contract documents to Lender		
Appraisal		
Opinion of Counsel		
Copies of any new leases to L		
Mechanics for delivery of keys, and property and tenant files		
Documentation of S		
Partnership documents		
Corporate GP documents		
Various applicable resolutions/consents		
Documentation of B/Borrower:		
Articles of Incorporation & Bylaws		
Certificate of Good Standing		
Documentation re: Corp. Guarantor:		
Articles of Incorporation & Bylaws		
Certificate of Good Standing		
Deed		
Current Rent Roll, payment status		
Bill of Sale and Assignment		
Notice to tenants of transfer and rent payments		
Assignment and Assumption of Leases		

<sup>3</sup> Legend of abbreviations is as follows:  
    B = Buyer/Borrower   BC = Buyer's Counsel  
    S = Seller                SC = Seller's Counsel  
    L = Lender                LC = Lender's Counsel  
    TC = Title Company

Buyer's closing instructions		
Seller's tax ID (if not already provided to TC)		
Letter terminating any Contracts (as defined)		
Estoppel Certificates from tenants		
Estoppel Certificates from seller for missing tens.		
Reconfirmation of reps and warranties by S		
Reconfirmation of reps and warranties by B		
Arrangements/notices to transfer utilities		
Prorations (rents, notes, tenant credits for overpayment of pass-throughs; utilities?)		
Settlement statements		
Misc. closing documents		

## Appendix 2

### LENDER'S LEGAL CLOSING CHECKLIST

B	=	Borrower
BC	=	Borrower's Counsel
L	=	Lender
LC	=	Lender's Counsel
TC	=	Title Company
S	=	Surveyor: to be provided

This legal checklist is for convenience only to assist in the closing of the loan contemplated hereby. Nothing herein shall bind Lender or constitute any commitment, approval, or waiver by Lender. Lender reserves the right to require that all of its requirements be fully satisfied prior to closing, whether or not listed or shown as satisfied in this legal checklist. This legal checklist is only a partial listing of Lender's requirements, and does not include other matters set forth in the Commitment Letter, the Closing Letter or Lender's underwriting checklist.

#### A. LOAN ITEM/DOCUMENT

1. Commitment Letter/Term Sheet/Loan Application
2. Loan Agreement
3. Note
4. Deed of Trust, Assignment of Leases and Rents, Security Agreement and Fixture Filing
5. Assignment of Leases & Rents
6. Financing Statement (State, County) & Schedule of Collateral
7. Hazardous Materials Indemnity Agreement
8. Loans to One Borrower Certificate

#### B. ORGANIZATIONAL DOCUMENTS/EVIDENCE OF AUTHORITY

##### 1. Borrower

###### Limited Partnership

- a. Limited Partnership Agreement and Amendments
- b. Certificate of Existence/Status from Secretary
- c. Certificate of Authority to Transact Business [if foreign partnership]

###### Corporation

- a. Articles of Incorporation and Amendments
- b. Bylaws

- c. Certificate of Existence from Secretary of State
- d. Certificate of Good Standing from Comptroller's Office
- e. Certificate of Authority to Transact Business [if foreign corporation]

Limited Liability Company

- a. Operating Agreement and Amendment.
  - b. Certificate of Existence from Secretary of State
  - c. Certificate of Good Standing from Comptroller's Office
  - d. Certificate of Authority to Transact Business [if foreign corporation]
- 2. Managing Member [Same as above]
  - 3. Certificate and Consent of Member(s)
    - a. Borrower
    - b. Managing Member
  - 4. For Corporate General Partner: Certificate of Corporate Resolutions
  - 5. Other Consent Documents [describe if transaction requires special consent]
  - 6. Legal Opinion

C. TITLE/SURVEY/UCC DUE DILIGENCE DOCUMENTS

- 1. Commitment for Title Insurance Company
- 2. Title Exception Documents
- 3. Insured Closing Service Letter
- 4. Title Company Closing Instruction Letter
- 5. Title Company's Wiring Instructions
- 6. Closing Statements
- 7. Mortgagee Policy of Title Insurance
- 8. Facultative Reinsurance Agreement (Coinsurance), if applicable
- 9. Current Survey (5 originals)
- 10. Ad valorem tax certificates (current year)
- 11. Documents relating to Refinance:
  - a. Payoff Letter, if applicable (existing liens)
  - b. Release Documents, if applicable (existing liens)
  - c. Sec. 275 Affidavit (Assignment)
  - d. Assignment of Loan Documents
  - e. Sec. 255 Affidavit (for Amended Mortgage)
  - f. Sec. 255 Affidavit (New Assignment of Leases and Rents)
  - g. Original Mortgage Documents
  - h. UCC/Tax Lien/Litigation Search Letter
    - i. Borrower
    - ii. Seller
    - iii. General Partner(s), if applicable
    - iv. Guarantor(s)

#### D. DUE DILIGENCE ITEMS

1. Evidence of zoning, sufficient parking, permitted use and rebuildability (including copies of zoning ordinances)

(If not obtained by L, B should obtain the following:

- a. Zoning comfort letter
- b. Zoning ordinance provisions
- c. Zoning Map showing property
- d. Approved/Signed Final Site Plan
- e. Certificate(s) of Occupancy
- f. Management Agreement
- g. Rent Roll)

#### E. SPECIAL CONDITION ITEMS

1. Insurance Carrier and Coverage
2. Tenant Estoppel Certificates
3. [Additional conditions to be inserted from Loan Commitment, if issued]

### Appendix 3

## **CONFIDENTIALITY AND OTHER MISCELLANEOUS PROVISIONS**

### **I. SAMPLE RECORDS ACCESS AND CONFIDENTIALITY AGREEMENT**

THIS PROSPECTIVE BUSINESS PURCHASER CONFIDENTIALITY AGREEMENT ("Agreement") is entered into this \_\_\_\_ day of \_\_\_\_\_, 20\_\_\_\_, by and between \_\_\_\_\_, Inc. ("Owner") and \_\_\_\_\_ ("Company"). The purpose of this Agreement is to describe and define the conditions under which Company shall be given access to and evaluate Owner's Business Records, as such term is defined herein.

#### **1. Grant of Access.**

Subject to the conditions herein, Owner shall permit Company to have access to the Business Records for an evaluation period of not more than seven (7) days, commencing on the date first set forth above. Within five (5) days of (i) the close of such period or (ii) Company's receipt from Owner of a request for return of the Business Records, Company shall comply with Section 4.d of this Agreement.

#### **2. Scope of Use.**

Company agrees that it shall not use all or any portion of the Business Records except to the extent reasonably necessary to perform an internal evaluation of the Business Records with the intent to make a purchase of AAAAAAAAAA Inc. Company agrees to make no other use of the Business Records or any portion thereof or any of the related materials and documentation furnished by Owner to Company. Company shall not at any time incorporate all or any portion of the "Confidential Information" into any other work or product.

#### **3. Definition of "Business Records."**

"Business Records" shall mean in the context of this Agreement any and all accounting records (including cash receipts journal, accounts receivable, accounts payable, inventories, work in process, future work commitments, etc.), contract records and information, employee records and operating systems.

#### **4. Definition of "Confidential Information."**

For the purposes of this Agreement, "Confidential Information" shall mean information or material proprietary to Owner or designated as "Confidential Information" by Owner, and not generally known by non-Owner personnel, which Company may

obtain knowledge of or access to as a result of its evaluation of the Business Records. The Confidential Information includes, but is not limited to, the following types of information or other information of a similar nature (whether or not reduced to writing): all documentation and other tangible Business Records, discoveries, ideas, concepts, software, designs, drawings, specifications, techniques, models, information, source code, object code, diagrams, flow charts, procedures and "know-how" comprising all or any portion of the Business Records and all related computer programs and documentation, or revealed to Company in connection with any negotiations relating to purchase of AAAAAAAA. Confidential Information also includes any information described above which Owner obtains from another party which Owner treats as proprietary or designates as Confidential Information, whether or not owned or developed by Owner. Confidential Information does not include information that Company can demonstrate: (a) was in Company's possession prior to its being furnished to Company under the terms of this Agreement, provided the source of that information was not known by Company to be bound by a confidentiality agreement with or other continual, legal or fiduciary obligation of confidentiality to the Owner; (b) is now, or hereafter becomes, through no act or failure to act on the part of Company, generally known to the public; (c) is rightfully obtained by Company from a third party, without breach of any obligation to the Owner; or (d) is independently developed by Company without use of or reference to the Confidential Information.

For purposes of this Agreement, the term "Company" shall be deemed to include the named Company as well as all affiliates, subsidiaries, and related companies of Company, as well as Company's directors, officers, employees, agents, and financial, legal, and other advisors, and Company acknowledges and accepts its liabilities therefor.

## **5. Obligations of Company.**

a. Acknowledgment of Title. Company acknowledges that title to the Business Records, all related documentation, and the Confidential Information delivered to Company under this Agreement shall at all times remain with Owner.

b. Restrictions on Use. Company shall not directly or indirectly disclose, display, provide, transfer or otherwise make available all or any part of the Confidential Information or the Business Records to any person or entity at any time during the period in which Company has access to the Confidential Information and the Business Records or thereafter, unless Company has received prior written permission from Owner. Company shall not make copies of the Confidential Information, the Business Records or any portion thereof. At no time and under no circumstances shall Company reverse engineer, decompile or disassemble the Business Records or the Confidential Information or attempt to use the Business Records for any other purpose. Company shall allow only its employees to have access to the Confidential Information or the Business Records. Company shall not provide access to the Confidential Information or the Business Records to third parties, including consultants and independent contractors. [Notwithstanding the foregoing, Company hereby is authorized to

c. Location Restriction. Company shall not remove the Confidential Information, the Business Records, or any portion thereof from its principal place of business, as identified below, without Owner's prior written permission.

d. Return. In accordance with Section 1 of this Agreement, Company agrees to return to Owner all Business Records and other materials of any nature whatsoever provided by Owner to Company. Upon the request of Owner, an officer of Company shall certify in writing that all such Business Records and materials have been returned to Owner. In addition, Company agrees to erase, delete or destroy any notes, documents, magnetic media or other computer storage, including system backups, which contain any Business Records or Confidential Information copied or derived from the Business Records and the Confidential Information.

#### **6. Full Investigation.**

Company agrees that its investigation of Owner's records shall be deemed a full and complete investigation and that Company shall reply upon its independent investigation of Owner's Business Records to the exclusion of any verbal representations by Owner or Owner's representatives.

#### **7. Nature of Obligation.**

Company acknowledges that Owner, because of the unique nature of the Confidential Information, would suffer irreparable harm in the event that Company breaches its obligation under this Agreement in that monetary damages would be inadequate to compensate Owner for such a breach. The parties agree that in such circumstances, Owner shall be entitled, in addition to monetary relief, to injunctive relief as may be necessary to restrain any continuing or further breach by Company, without showing or proving any actual damages sustained by Owner.

#### **8. Waiver; Assignment.**

No waiver or modification of this Agreement or any of its terms shall be valid or enforceable unless reduced to writing and signed by both parties to this Agreement. Company shall not assign or otherwise transfer any rights conferred upon Company by this Agreement without the prior written consent of Owner.

#### **9. Entire Agreement; Applicable Law.**

This Agreement contains the full and complete understanding of the parties with respect to the subject matter of this Agreement and supersedes all prior representations and understandings whether oral or written. This agreement shall be governed by and enforced according to the laws of the Commonwealth of Virginia.

#### **10. Attorney's Fees.**

The prevailing party in any action sought to enforce or interpret this Agreement or any provision thereof shall be entitled to recover reasonable attorney's fees and costs in conjunction with such legal proceeding.

**11. Survival of Company's Obligations.**

All obligations of Company under this Agreement shall survive the close of the evaluation period, the return of the Business Records, and the termination of this Agreement.

## **II. SAMPLE INSPECTION PROVISION**

From and after the date of this Agreement and until termination of the Agreement or its settlement as herein provided, Purchaser, its contractors, agents, servants, and employees shall have the right to enter upon all of the Property for the purpose of gathering information, performing planning, engineering and environmental (not however to exceed a level one assessment without the prior consent of Seller, in its sole discretion) studies and conducting surveys, analyses and test borings. All such activities shall be at the sole risk and expense of Purchaser. Purchaser shall defend, indemnify and hold harmless, including reasonable attorneys' fees and costs, Seller from any and all claims and suits resulting from or in connection with Purchaser's entry onto or tests or investigations on, under or in connection with the Property.