TALES FROM THE TRENCHES

BY BARRY C. MCGUIRE

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HOW SNOOPY SHOULD YOU BE?

Most members are involved in the retail side of investment real estate. That is, they buy homes, townhouses, other condominiums, duplexes and fourplexes. If there is new financing, the same lawyer usually acts for the buyer and the lender. Lender's instructions to lawyers are not near as tough as they are if there is commercial financing. Typically, once you are buying more than four or five units, lenders structure loans under commercial financing rules. Is the cut off point four units, or is it five units? You have to ask your mortgage broker.

One big difference between retail loans and commercial loans is that very often the lender has their own lawyer. Now you have a lawyer for the seller, a lawyer for the buyer, and a lawyer for the lender. The lender's lawyer has a lengthy checklist of diligence that needs to be done before he will give the lender his legal opinion that the loan can be safely made. Here are a couple of recent scenarios that came across my desk.

In the first scenario our member was entering into a joint venture in his personal name with an incorporated money partner. We knew the member and had acted for them previously. We didn't know the money partner. Our law firm was acting for the joint venture, buying a small apartment building. As is typical, the lender had their own lawyer.

We got the checklist from the lender's lawyer and one of the items was his requirement for our law firm to give him our legal opinion on the status of the money partner's corporation. To give our opinion we need to examine the corporation's minute book. This is a three ring binder that contains all of the incorporating documents, the certificate of incorporation, the initial and annual resolutions, share certificates and annual returns. In other words, it's all the paperwork that tells you basically everything about the corporation.

We got in touch with the contact person at the corporation; let's call him Bill Director, and asked for the minute book. On receipt, our review showed that the minute book was in terrible shape. Share certificates were not issued, they were behind one annual return and there were no resolutions confirming the current officers and directors.

The minute book had to be cleaned up in order for the corporation to properly execute lender paperwork and for our law firm to give our legal opinion. When we called Bill Director to advise what needed to be done, he was resistant and even combative. He owned 40% of the shares and was running everything so he could issue shares and sign resolutions. Well, no he couldn't. It took some time to get him to understand that the apartment purchase was going nowhere until the outstanding corporate issues were taken care of. He called the corporation's lawyer and got it moving. This issue took two weeks to resolve and delayed the closing.

The second scenario involves another joint venture between a member and non-member. Again, this was a commercial loan with the lender having their own lawyer. Lender's lawyers do lots of searches, more than for retail loans. One of the searches they did was a bankruptcy search. The non-member had been discharged from bankruptcy five years ago. Once the lender learned of the bankruptcy, they denied the loan.

Our member lost the deal because he was unable to find a replacement money partner within the time allowed for the financing condition and he was unable to obtain an extension from the seller.

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SUMMARY:

1. Overall,commercial loans have different rules than residential loans. For a good review, listen to or read Peter Kinch's 'Sandbox Rules'. Ask your own lawyer about differences including timing.

2. A corporation's minute book must be up-to-date and in good order. Lenders won't lend to bankrupts.

3. Add these questions to your JV diligence checklist. "Is your minute book up-to-date?" "Does your lawyer handle the minute book for you and do your annual returns?" "Have you ever gone bankrupt?"