OPINION LETTERS FOR LOAN CLOSINGS

By Gordon L. Gerson, Esq.

Delayed loan closings, swollen legal fees. Why?

The opinion letter of borrower's counsel often times has the effect of either delaying a loan closing or increasing legal fees of both borrower's counsel and lender's counsel -- both whose fees must be swallowed by the borrower.

Lenders require opinion letters for most loan closings. Mortgage bankers seldom understand issues relating to them. At times attorneys bury themselves in discussions relating to the academic subtleties of issues pertaining to opinions and qualifications; and sometimes battles brew. Hey borrower, it was only a loan you wanted to close, right?

Why an opinion letters at all if the result is too often increased fees or risk of a delayed closing? The opinion letter is a type of estoppel certificate. Just as a tenant's estoppel certificate is relied upon by a lender as to the status of a lease and ostensibly precludes a tenant from later arguing about issues pertaining to its lease, the attorney opinion letter allow the lender to rely on the opinion of borrower's counsel as to certain matters relating to its borrower and the loan. Borrower's counsel may protest that the lender by requiring an opinion letter attempts to obtain an additional level of underwriting or insurance at cost only to borrower's counsel. But lenders want to board a loan following the closing with a measure of added comfort that there are no open issues relating to several matters, including that the borrower, if an entity, had all necessary approvals and the authority to enter the loan transaction, and that in the event of a default of the loan, borrower's counsel will not mount a defense that the loan documents are not enforceable based upon expressed terms.

There are generally three different forms of opinion letters that may be required as a condition of closing a real estate secured loan by a life insurance company, conduit lender, or a commercial bank (although with a commercial bank the requirement of an opinion letter may depend upon the size of the loan and nature of modifications to loan documents). They are:

1. A due organization, authorization, execution and delivery opinion;
2. An enforceability opinion;
3. A nonconsolidation opinion.

Due Organization, Authorization, Execution and Delivery Opinion Letter

A due organization, authorization, execution and delivery opinion letter (usually referred to by shorthand as simply a due organization opinion letter) only requires that borrower's counsel provide a written opinion:

1. That the borrower is duly organized and validly existing as an identified entity under the laws of the jurisdiction of its formation and is in good standing under the laws of such jurisdiction and any other jurisdiction in which it is required to qualify to do business;

2. That the borrower has the full power and authority to carry on its business and to execute, deliver, and perform its obligations under the loan documents;
   That the loan documents have been duly and validly authorized by all necessary corporate, limited liability company or partnership action by or on behalf of the borrower; That each individual who executes the loan documents on behalf of the borrower has the authority and legal capacity to do so; and

3. Execution and delivery of the loan documents to the lender will not cause the borrower to be in default of in violation of any other agreement to which the borrower is a party, nor will conflict with any judgement or governmental regulation affecting the property.
   The due organization opinion letter is generally required by Fannie Mae and Freddie Mac, and sometimes by banks or life insurance companies; and depending on the lender, there may be a few additional opinions required. Legal counsel for a borrower when rendering a due organization opinion, may rely upon a borrower's certificate as to some matters. Seldom does the requirement due organization of opinion letter result in any controversy, loan closing delay, or increased cost.

Enforceability Opinion

All conduit lenders, most life insurance companies, and banks for loans over a certain threshold (varying from bank to bank), will always require an enforceability opinion as part of the borrower's counsel opinion letter. The enforceability opinion letter includes all of the items required in a due organization letter, as well as an opinion that the loan documents executed by the borrower are the legal, valid, binding, and enforceable obligations of the borrower. Some lenders will also require, as part of the opinion of enforceability as set forth in the preceding sentence, that, although the enforceability of the loan documents may be limited by (i) bankruptcy, insolvency, or other similar laws affecting the rights of creditors generally, and (ii) general principles of equity or other qualifications set forth by the borrower in the opinion letter, "such enforceability will not render the loan documents invalid as a whole or substantially interfere with the realization of the principal benefits and/or security provided thereby." The first clause of the language in quotations, in isolation does not present controversy; but some lawyers are unwilling to provide the second clause, which is referred to as the "substantial realization" clause. Lenders requiring an enforceability opinion may or may not waive the requirement of the substantial realization clause. The enforceability opinion sometimes includes an opinion about the collateral for the loan and that the lender has a validly secured and perfected interest in the collateral. Other matters may also be required, including an opinion that the loan is not usurious.

Most borrower lawyers will only provide the enforceability opinion (with or without the substantial realization clause), providing they are able to make some qualifications, assumptions, and clear statements that there are some matters to which they make no opinion. Although it is prudent for the opinion giver to make certain qualifications, assumptions, and statements of no opinion, at times here lies the battleground between counsel for borrower and lender.

Many states have established guidelines and commentary for opinion letters. California and New York are among such states, and lawyers closing loans in these states or other states where a state bar association has issued guidelines will generally follow the state guidelines. In states where there are no guidelines promulgated by the state bar association, lawyers may rely upon guidelines promulgated by the American Bar Association (ABA). If both lender's counsel and borrower's counsel would simply follow the promulgated guidelines, why then are there controversies? The common problem is that state bar associations and the ABA have simply provided guidelines to be followed. A good example follows:

In 1991 the Committee on Legal Opinions of the Business Law Section of the ABA's Report entitled "Third-Party Legal Opinion Report (including the Legal Opinion Accord of the Section of Business law, American Bar Association)," (sometimes referred to as the Silverado Report), viewed its efforts as an attempt to forge "a national consensus as to the purpose, format, and coverage of a third-party legal opinion, the precise meaning of its language and the recognition of certain guidelines for its negotiations" However, in the 1995 California Real Property Opinion Report of a Joint Committee of the Real Property Section of the State Bar of California and the Real Property Section of the Los Angeles County Bar Association on the Legal Opinion Opinion Reports of the ABA Section of Business Law, the ABA Section of Real Property, Probate and Trust Law, and the American College of Real Estate Lawyers, it significantly noted that:

"Even among themselves, California lawyers will need to consider the positions taken by the Silverado Report in the course of negotiating and preparing legal opinions involving only California property, parties, and law. The parties, of course, remain free to determine whether to use the Legal Opinion Accord to govern a third-party legal opinion."

Thus, while reports such as the Silverado Report are generally influential in creating ground rules for lawyers to follow in providing legal opinions, lawyers are not required to follow them. Long before cluster bombing combined with precision bombing became a strategy of the American military, lawyers spurred by both intellectual challenges and the desire to not underwrite a lender's loan and bear resulting liability, created broad-based and precise qualifications, assumptions and statements of no opinion; if allowed, this not only dilutes the opinion, but in extreme instances may render it worthless. This is the goal of some lawyers, and it is this gamesmanship that drives up attorneys' fees and sometimes has the effect of extending loan closings.

Most midsize and larger law firms have "opinion letter committees" which create standard-form opinion letters for their lawyers to follow when representing borrowers. Although a lender may have its own form opinion letter and require use of its model form, some lawyers will fight vigorously that, (i) both the form and the substance of the opinion letter be consistent with its firm's model form, and (ii) any deviation requires the opinion letter committee's approval, which may be a cumbersome process depending upon the management structure of the law firm.

Other borrower lawyers may agree to use the lender's form letter, but may include as many as 10 to 18 pages of qualifications prepared and required by their law firm's opinion letter committee for all loan transactions in which a member of the firm acts as a borrower's counsel. These qualifications will, often times, be in addition to those set forth in promulgated guidelines; and they may not be waived or modified without the opinion letter committee's approval. Again, this may prolong the closing and drive up the cost of attorneys' fees always paid by borrowers.

Nonconsolidation Opinion

A nonconsolidation opinion letter is a separate opinion letter which will be required in addition to an enforceability opinion letter for loans that are over a certain threshold (e.g., depending upon the lender, the threshold level may be $8,000,000, $12,000,000, $15,000,000, or more), or where a lender has particular issues of concern relating to overlapping ownership structures of a borrower and its affiliates. Most often, nonconsolidation opinions are largely driven by the rating agencies in any transaction that requires a single-purpose entity (SPE).

The nonconsolidation opinion, on its face, seems like a relatively simple matter. As an example, Standard & Poor's requires opinions of counsel that, if any equity owner who owns more than 49% of the equity in an SPE were to become insolvent, the assets and liabilities of the SPE would not be substantively consolidated with those of the equity owners. Furthermore, under established Standard & Poor's criteria, the general partner of a limited partnership must also be an SPE; and, if its general partner is a corporation, an opinion is also required that, upon the insolvency of any shareholder who earns more than a 49% interest in the general partner, the general partner (or its assets and liabilities) will not be substantively consolidated with those of the insolvent shareholder. In some instances, a nonconsolidation opinion letter must also include nonconsolidation opinions about the relationship between an SPE and certain indirect affiliates, such as property managers.

Sound confusing? What is even more confusing is the range of attorneys' fees for the nonconsolidation opinion letter. The nonconsolidation opinion letter is, often times, a document 25 to 35 pages in length. It will be subject to a thorough review by lender's counsel and may be heavily negotiated. Most experienced real estate finance lawyers have created their own templates of nonconsolidation opinion letters, and only certain factual matters relating to the borrower's structure change in the letter from transaction to transaction. Nationwide fees range from $3,500 to $35,000 for nonconsolidation

opinion letters. The price variation on a particular transaction may or may not relate to the level of the complexity of the transaction or borrower structure; and given the size of loan transactions in which a nonconsolidation opinion letter is required, some law firms have a heightened sense of potential liability they may have to a lender if in the event of a borrower's insolvency in which a court consolidates the assets of the borrower and its affiliates, even thought the law firm opined otherwise. Because of the wide range of fees, it is not unusual for borrowers or their mortgage bankers to "shop" law firms to obtain a nonconsolidation opinion letter at the lowest price.

Mortgage bankers and a lender's loan closing staff are well advised to maintain a close watch on the opinion letter process. Lender's counsel should be required weeks before a closing to provide the lender's approved form opinion letter for borrower's counsel. Thereafter, borrower's counsel should be prodded to quickly provide its draft opinion letter (redlined to show revisions from the lender's exemplar) for lender's counsel to review long before the closing. Lender's counsel should also determine if the lender has previously accepted an opinion letter from a specific law firm in any other transactions and, if so, determine if there is any reason why it should not be accepted in the instant transaction, as opposed to being renegotiated. All parties should attempt to find timesaving and cost-cutting solutions in order to avoid delayed closings or swollen attorneys' fees as a result of attorney opinion letters.