



Lessons from the Fall – Loan Documents After the Downturn

The difficulties in obtaining financing in the post-downturn world are well documented and have been experienced by all borrowers in every sector of the market. Today's market is showing us that, not only are new loans a challenge, but existing loans have their problems too. In the good-old-days, most borrowers happily signed loan documents with terms that they never expected to read again after leaving the closing table. Concepts like "cash sweeps", "recourse carve-outs" and "earn-outs" were fancy terms for pesky little lender rights that would never be an issue since properties were cash-flowing and everyone was happy. As it turns out, those provisions have meaning, and many borrowers are learning valuable, but painful lessons.

In many deals, lenders and borrowers provided for the possibility of a cash sweep under certain circumstances, such as a loan default or failure to meet debt service covenants. If the cash sweep is triggered, notices are sent to tenants to pay their rent to a lender-controlled lock-box, and the lender has various liberal rights to deal with the funds. Most borrowers felt that if the loan was in default, they would lose the property or refinance, so the cash sweep would have little meaning in practical application. However, as we now know, lenders don't want the properties, and finding

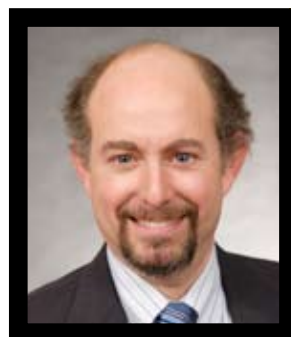
money to replace a lender is all but impossible. Now the borrower is faced with the prospect of owning the property while the lender is holding its funds, and borrower has little or no control over how the lender applies those funds. Questions such as "how do I pay operating expenses" and "what about the excess after payment of expenses" are now being asked. Fortunately, most lenders realize that the tenants, few as they may be, still want the properties maintained and taxes paid, so there is a recognition that operating expenses need to be paid, but most lenders are not so generous on the excess proceeds. In most cases, the excess proceeds are being held as security and not even being used to pay down principal.

A related issue is non-recourse carve-outs. Borrower nirvana was the day the borrower refinanced with a non-recourse loan, limiting the individual sponsor's personal liability for the debt.

There were always exceptions (or carve-outs) to non-recourse, but nobody was too concerned because the exceptions were often tied to "bad acts", such as fraud, environmental issues and bankruptcy. However, in most cases, failing to pay taxes and insurance is a recourse event, because that affects the value of the lender's collateral. If a lender sweeps cash, or if the rent roll drops so badly that there is not enough money to pay taxes and insurance, we now see that the borrower, who once thought it was immune to liability, is now potentially personally liable for these expenses. Worse yet, if a lender decides to apply funds to principal, the result is that lender improves its position and increases the sponsor's personal liability.

Finally, "earn-outs", or the right to draw more funds after certain hurdles are met, were a common way to pay the borrower a bonus when new leases were signed or other similar beneficial events occurred. Most earn-outs were written giving the lender a good deal of discretion when determining whether the borrower qualified for the funds. Unfortunately, like all underwriting decisions these days, lenders are much more conservative in approving the release of funds. Earn-outs once thought to be readily achievable are now facing more scrutiny than ever imagined, and in some rare cases, lenders are simply saying "no" and forcing the borrowers to challenge their decision.

Experience is knowledge, and we are certainly learning even in the new market.



By Jeffrey L. Silberman, Esquire

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Seminars

Coming Soon – a breakfast seminar to discuss electronic discovery in litigation. The electronic era has made it extremely important for every business person to have a document retention policy in place. If you are involved in litigation, or potential litigation, you need to have command of your electronic data so you can produce responsive information. Our attorneys will update you on the law regarding electronic discovery and what you need to do to preserve and produce electronically stored information. If you are interested in attending this seminar, please contact Bonnie Vandenberg at 610.941.2574 (gvandenberg@kaplaw.com) to receive an invitation.

Robert Korn, principal in the Construction Law group, will be a presenter at the Pennsylvania Bar Real Estate Institute on December 2, 2010. His presentation will be “Recent Developments in Mechanics’ Lien Law.” **Barbara Anisko**, principal in the Real Estate Litigation group, and **Amee Farrell** of the Land Use, Zoning & Development group, will also be presenters at the Pennsylvania Bar Real Estate Institute on December 3, 2010. Their presentation will focus on “Obstacles to Successful Redevelopment.”

Neil Stein and **Amee Farrell** of the Land Use, Zoning & Development group, presented a program to the Home Builders Association Green Building Council on November 10, 2010 on “Contracting Risks in the Economic Recovery.” Among the issues covered in the program were “What to watch for in agreements with townships; tips for getting your financial security back quickly; hidden traps in the next generation of bank documents; what you need to include or omit from your next land purchase contract; and, risks associated with ‘green’ construction projects.”

Neil Stein and **Amee Farrell** also presented a program at the American Institute of Architects (AIA) Design on the Delaware Conference on October 21, 2010 together with David Schoenhardt and Maki San Miguel Paulson of Wulff Architects. The program was entitled “Legally Green: Law & Liability Summary for Sustainable Design.” Neil and Amees’ presentation focused on the various issues that arise from a legal viewpoint for all parties involved in the process of building “green.”

Maury B. Reiter, a principal in the Corporate & Business Planning and Tax Law groups, taught a course on “Negotiating and Tax Aspects of Buying and Selling Businesses” to the Connecticut Society of CPA’s on September 23, 2010 in Rocky Hill, Connecticut. He also presented “Legal Toolkit for Business Owners” to the Pennsylvania Society of CPA’s on October 20, 2010 at the Penn State Malvern Campus.



Kaplin Stewart has been named to the Best Law Firms 2010 list by *Best Lawyers*, which partnered with *U.S. News & World Report* to compile the “Best Law Firm” rankings for 2010. We are proud of achieving 1st tier ranking for the Metropolitan Philadelphia area in Land Use and Zoning.

Best Lawyers has also honored **Marc B. Kaplin**, principal in the Land Use, Zoning & Development group, as the Philadelphia area Land Use & Zoning Lawyer of the Year for 2011.

Sandhya M. Feltes, a principal in the Commercial Litigation and Construction Law groups, has been appointed to the Board of Directors of the Philadelphia Surety Claims Association. She was also named one of the Vice Presidents of the Association. As part of her practice, Ms. Feltes provides counsel and advice to surety companies and contractors in drafting agreements, and handles a wide range of complex bond claim and indemnity issues.

Maury B. Reiter, a principal in the Corporate & Business Planning and Tax groups, has been re-elected to the National Board of Volunteers of America, and the Board of Volunteers of America Delaware Valley.

Robert A. Korn, a principal in the Construction Law group, and a Fellow of The College of Commercial Arbitrators, is the College’s representative to the American Arbitration Association’s National Construction Dispute Resolution Committee whose mission it is to foster the delivery of arbitral services in a prompt, cost-effective manner.

Neil A. Stein, a principal in the Land Use, Zoning & Development group, was selected by the American Bar Association and Temple University School of Law to serve as a Judge for the ABA Client Counseling Competition that was held on November 6, 2010. The competition consisted of teams from law schools throughout the area simulating a law office consultation in which law students, acting as attorneys, are presented with a client matter. They conducted an interview with a person playing the role of the client and then explained how they would proceed further in the hypothetical situation.

Pamela M. Tobin, **Lisa LaPenna** and **William A. Levant**, of the Commercial Litigation group, were one of the Bee Teams at the Montgomery County Literacy Network’s Corporate 16th Annual Spelling Bee on October 6, 2010 in Plymouth Meeting, PA. The Montgomery County Literacy Network is an alliance of non-profit organizations, businesses and professionals dedicated to promoting adult literacy in Montgomery County.

The employees of Kaplin Stewart participated in the Association of Legal Administrators’ Community Challenge again this year by collecting and donating non-perishable items to Manna on Main Street. The collected food will help those in need in the Montgomery County, Pennsylvania area.



Meet Our Land Use Professionals

This month, Kaplin Stewart shines the spotlight on Amee Farrell, an associate in the Land Use, Zoning, and Development group. Amee takes a “soup to nuts” approach to her practice, assisting private developers throughout Pennsylvania and New Jersey in all aspects of their projects; from early planning, through entitlements, and into building permits and certificates of occupancy. Amee’s practice routinely finds her in front of municipal boards and commissions, state and federal agencies, and state courts.

Amee grew up outside of Pittsburgh and, although there will always be a special place in her heart for Mean Joe Green and the Steel Curtain, she happily settled in Philadelphia for college (go Owls!) and has never looked back. At age seven, Amee knew what she wanted to be when she grew up...a bus driver. However, a run in with a curb several years later while learning to drive convinced her that she might not be well suited for professional driving, so she opted instead for her second choice, architecture. Amee spent the next several years pulling all-nighters in Temple’s architecture building, where she earned a Bachelor of Architecture. During her time as a Temple undergrad Amee was lucky enough to spend a semester studying in Rome, Italy, as well as a summer in Istanbul, Turkey.



Amee S. Farrell

Both stints abroad gave her the opportunity to travel throughout Europe – where she was officially bitten by the travel bug. (There is no cure).

Amee next joined the design staff of Cope Linder Associates, moving on to Daley + Jalboot Architects after two years. Thanks to D+J’s small size and hands-on approach, she gained extensive experience in all aspects of design and construction. Following an especially long evening spent with an overzealous shade tree commission, Amee realized two things: (i) West Nile Virus was a whole lot of hooey; and (ii) she was very good on her feet. So, back to Temple she went for her J.D.

Convinced that working all day and going to school all night did not make life crazy enough, Amee & her husband Eric welcomed their first child, Emma, during Amee’s third year of law school. A few years later they were fortunate enough to combine their love of travel with their wish to expand their family when they travelled to Vietnam to adopt their son, Owen. Somewhere in the middle, Amee joined Kaplin Stewart and is pleased to report she has yet to meet a shade tree commission (or any other board, for that matter) that she hasn’t been able to work with!

Do You Know...

that documenting corporate decisions by preparing and maintaining adequate records affords benefits beyond the advantage of protecting status and treatment as a corporation? Corporations are required to observe “corporate formalities” to ensure continued liability protection and tax treatment for which they are formed. One such corporate formality which corporations may fail to regard as “high priority” is maintaining a written record of decisions and how they were made. Keeping timely, clear and precise corporate records preserves corporate rights, and is also beneficial in settling shareholder disputes, facilitating business transactions, evidencing authority granted to corporate officers and directors, answering key legal, tax, and financial questions, serving as backup documentation in the event of an audit, and aiding to avoid or settle internal disputes or controversy among the directors and shareholders. Written minutes or corporate resolutions should be prepared for key decisions and those that require formal shareholder or director approval, such as:

- Annual shareholder/director meetings
- Electing and appointing new officers or directors
- Issuance and/or sale of stock
- Material and significant transactions, such as purchasing a business
- Authorizing executive salary and bonuses, as well as any deferred compensation or pension contributions
- Opening a bank account or securing a loan
- Changing the corporation’s tax status and documenting any tax matter that may be challenged by the IRS, or which has potential tax consequences

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Legal Perspectives

Pennsylvania Mechanics' Lien Claims—What's Your "Interest"?

As many people in the construction business know, the Pennsylvania Mechanics' Lien Law can provide a potential avenue of relief to the unpaid contractor (or subcontractor) by allowing it to obtain a Mechanics' Lien for labor and materials furnished on a project. What many may not know, however, is that a Mechanics' Lien does not necessarily provide the unpaid contractor with the ability to recover its full measure of damages including interest. The Law states that a lien may be allowed "for the payment of all debts due...for labor or materials furnished." This language might lead one to assume that interest on unpaid amounts is recoverable. However, the Pennsylvania Superior Court recently held that pre-judgment interest is not available under the Mechanics' Lien Law, finding that there was no statutory basis to permit such recovery. The Court also noted that any claims for contractual interest and attorneys' fees must be made in a separate action to enforce



**Mohammad
Ghiasuddin**

the underlying contract, if the contract contains contractual provisions for them. The Court held that only post-judgment interest, which would run from the date on which judgement on the Lien Claim was entered, was available in a Mechanics' Lien Claim.

The lesson to be learned is that an unpaid contractor should not assume that a Mechanics' Lien Claim will maximize its potential recovery. Rather, it should at least consider filing a separate action for breach of contract to recover interest and attorneys' fees, if the contract contains provisions allowing such recovery, and to assert claims for interest, attorneys' fees and other damages that may be available under other laws such as the Pennsylvania Contractor and Subcontractor Payment Act. A contractor who relies solely on the Mechanics' Lien Law may end up losing much of its "interest," so to speak, along with other potential claims.

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Unless otherwise expressly stated herein, all discussions and opinions are based upon the law of the Commonwealth of Pennsylvania and the State of New Jersey. **Your comments or suggestions are welcome... Phone: 610.260.6000 • Fax: 610.260.1240 • www.kaplaw.com**

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