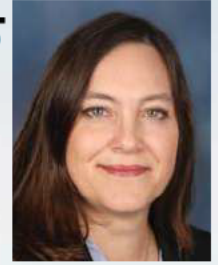


FIVE EASY PIECES Critical Clauses for the Deed of Trust



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As mortgage litigators, anytime there is a new lawsuit or a client has an issue with a loan, the first document reviewed is the deed of trust.

When it comes to consumer loan documents there is little variety. Most lenders use the standard Fannie Mae/Freddie Mac deed of trust (DOT). But for business purpose loans, there are as many sets of loan documents as there are lawyers to think them up.

Despite the variety, most loan documents contain the necessities to allow the lender to enforce the note and foreclose in the event of default. Let's look at **five nonstandard loan provisions** that should be in every set of loan documents but are often overlooked.

1. Judicial Reference

Many business purpose DOTs include an arbitration provision and/or a jury waiver. Unfortunately, should the borrower sue, neither provision is likely to keep the lender away from a jury.

In California, for example, jury waivers in loan documents are generally unenforceable. Moreover, many arbitration provisions are insufficient to mandate arbitration, giving anti-arbitration judges the option to deny a motion to compel. As a result, many lenders face the risk of a borrower-friendly jury.

Even if the arbitration provision is well drafted, arbitration is not always the best option. Depending on its scope and the arbitrator, the lender may lack the ability to conduct key discovery, take depositions or move for summary judgment. For lack of a better term, arbitration can be arbitrary! The

lender's exposure rests with one individual – the arbitrator – with very limited rights to challenge the decision on appeal.

Judicial reference, on the other hand, lets the lender avoid many of the dangers of the court system and the risk of a hostile jury, while preserving the right to conduct discovery, file motions and obtain the protection of the rules of evidence and civil procedure.

For lenders unfamiliar with judicial reference, it is an out-of-court process similar to arbitration. But unlike arbitration, a judicial referee (typically a retired judge) follows civil procedure and evidence rules. More importantly, the referee's decision is appealable, reducing the risk of a rogue arbitrator. A properly drafted judicial reference provision is more likely to put the lender in the position it wants – outside a jury's discretion without arbitration's risks.

However, if including this clause, remember to include self-help remedies like the right to nonjudicial foreclose, and to preserve the right to seek preliminary injunctions and provisional remedies.

2. Borrower Misrepresentations = Default

Lenders may foreclose only upon default under the DOT, so defining "event of default" broadly is critical. Every DOT provides that the failure to make payments or an unauthorized transfer constitutes a default. Sophisticated DOTs often add grounds such as senior obligation default, bankruptcy, missing financial statements, ownership changes or failure to reimburse advances.

One often overlooked default is material misrepresentation in loan documents. It allows lenders to act if borrowers lied about income, property value, occupancy intent or loan purpose. Without it, lenders may have no remedy.

3. Cross-Default Provisions

Sticking with the default theme, most business purpose DOTs omit or poorly draft cross-default provisions. A cross-default clause lets lenders treat a borrower's default on one loan as a default on others – even loans made by other lenders.

Declaring all loans in default helps prevent borrowers from abandoning unprofitable projects or underwater properties. Most provisions only cover one borrower. For single-purpose limited liability companies owning one property, this is ineffective.

A well-drafted clause can include defaults by any LLCs controlled by an individual or affiliated entities. Linked to a personal guaranty, it can also cover guarantor defaults on other loans or properties.

4. Guaranty Waiver Language

When lending to an LLC or a corporation, most lenders require the controlling member to execute a personal guaranty. This separate contract between lender and guarantor – distinct from the note and deed of trust – obliges the guarantor to repay the loan if the borrower defaults. To ensure full protection, lenders should include all applicable waivers of defense.

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In California, Civil Code §2845 gives guarantors the right to demand that lenders first pursue the borrower or foreclose under the deed of trust before enforcing the guaranty. However, courts consistently uphold waivers of §2845, allowing lenders to sue guarantors directly without first foreclosing or seeking recovery from the borrower. This leverage often motivates guarantors to reinstate or pay off the borrower's defaulted loan.

It is important to note that the personal guaranty must always be in a separate document from the note or deed of trust and cannot be executed by the borrower. A borrower cannot personally guarantee their own loan.

5. Mandatory Bundling of Properties

California lawmakers are highly focused on the rise of single-family homeownership by corporate investors. Many legislators assume investors buy single-family residences in bulk at foreclosure sales, but that has never been true.

Several years ago, California prohibited "bundling" properties under the same DOT in one foreclosure sale unless the DOT requires it. Since most DOTs give lenders the right – but not the obligation – to bundle, the amendment effectively prevents lenders from combining properties at one sale.

This prohibition can be problematic when selling unfinished developments or properties that should remain under common ownership. It also increases foreclosure costs through multiple notices of sale, which borrowers ultimately pay.

A simple potential solution is to include a provision in multi-security DOTs requiring that all properties be sold together at foreclosure, while allowing the lender to waive this requirement. This gives lenders flexibility to bundle or separate sales based on circumstances.

If a loan was originally secured by one property, consider adding this bundling

language when adding additional security through loan modification or extension.

Most standard private lending DOTs generally provide lenders the right to foreclose in the event of a monetary default. However, for more complex transactions or higher-value loans, lenders should consider using customized loan documents tailored to the specific deal – or at least ensure the suggested provisions are included in the loan.

The above information is intended for information purposes alone and is not intended as legal advice. Please consult with counsel before taking any steps in reliance on any of the information contained herein. 🌐

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