Because we have seen more and more actions on defaults and workouts presented over the last six months, we have examined our older records (in some cases, going back to the early 1980's) to refresh our memories on procedures applicable to workouts. In doing so, we prepared an internal checklist to assist us in very preliminary reviews, with some emphasis on unusual situations which our attorneys have experienced over the years.

It occurred to us that much of this review could be done by the loan and compliance officers, and probably should be done before any true issues arise with respect to a troubled credit. In other words, many of these items should be checked as a preventative measure before attorneys become involved.

Because we have worked with you in the past, we printed this list along with an annotative outline for your use. We hope it is of some help in examining files before missing or inaccurate items become an issue.

If you find it helpful, and would like additional copies, please let us know:

PREPARING FOR POTENTIAL WORKOUTS

Whether you are of the opinion that a "recession" started with the last quarter of 2007 or is still an avoidable potentiality, this is a good time to review your loan portfolio and conduct a legal audit of the documentation. This practice, familiar to those who were around in the late 70's and early 80's involves a proactive approach to risk management. While a loan is fully performing it is much easier and safer from a bankruptcy prospective to obtain the necessary documentation required to fully perfect security interests, support the signatories, and even to shore up collateral positions.

Knowing that you may be faced with numerous loans to review, and having experienced the need to address many issues at once, we are happy to share a preliminary checklist which we have used for a very cursory reviews of files.

PLEASE UNDERSTAND THAT THIS IS NOT TO BE CONSIDERED A SUBSTITUTE FOR A FORMAL LEGAL AUDIT. WE CANNOT INTUIT THE CONTENTS OF YOUR LOAN FILES AND OMPLIANCE WITH THIS CHECKLIST IN NO WAY IMPIES ANY ENFORCEABILITY OF YOUR LOAN.

While your determination of compliance with these checklists is in no way to be interpreted as our approval of the same, we realize that you may need to "triage" the files you have and to set about first addressing problems which may take longer to resolve. We only offer this as "first aid" in attempting to address any problems which may exits in the files.

The table on the following page summarizes some of the initial inquiries we generally make in examining files. Where further discussion regarding the checklist item is helpful, we offer references to the attached outline.

INITIAL AUDIT CHECKLIST WITH RESPECT TO POTENTIAL WORKOUTS

Document	In File	Proper Form	References to Outline
Certificate of Existence			1.1.3, 1.2.1
Good Standing Certificate			
Qualification to do Business			
Organizational Document (Bylaws, Operating Agreement)			
Resolution			1.4
To Borrow			
To Guarantee			
For Deposits			
Incumbency Certificate			
Note			
Or Lease Agreement			2.2.2
Or Chattel Paper			2.2.1
Or Draft			2.2.3
Endorsement or Allonge			2.4
Security Instrument (other than mortgage – see below)			
Determination of Positions			3.4
Judgment Search			
Bankruptcy filings			
UCC 11 Search			
Statutory Issues			3.5
Perfection			3.3
Possession			
Filing			
Notation on Certificate			
Consumer Goods			
Date of Filing / Continuation			
Definition of Mortgage Real Estate Interests			4.1
“Clear” title			
Policy			4.2.3
Endorsements			
Concurrent Interests			4.2.2
Conflicting Interests			4.2.1, 4.2.4
Mortgage			
Third Party Consents and Subordinations			4.3

Assignment of Rents			**4.3.1**
Copies of Leases			
Source of Mortgage interest			
“Down” leases – source of revenue			
Subordination/Non-Disturbance/Attornment			**4.3.1.1**
Rent Roll			**4.3.1.2**
Estoppels			**4.3.1.3**
Survey Matters			
Physical / Compliance			
Environmental			**4.5.5**
Engineering			**4.5.1**
ADA			**4.5.2**
Licensing			**4.5.3**
Insurance			**4.5.7**
Asset Based Issues			
Franchise issues			**5.1**
Management and Service Contracts			**5.2, 5.3**
Client Contracts			**5.6**
Service			
Sales			
“Up” and “Down” Leases			**5.4, 5.5**
Guaranties			
Modifications			**6.1**
Statutory “Put” right			**6.2**
“Partnership” with Guarantor			**6.3**
Guarantor Releases			**6.4**

COMMENTS TO GENERAL CHECKLIST (APPLICABLE TO MOST LOANS)

1. **Organizational Matters**

1.1 As a start, it is advisable to make certain that the borrowing entity is still in existence and good standing. Checks with various Secretaries of State websites can determine:

1.1.1 Good standing in Domicile State

1.1.2 Qualification to do business in the Subject State

1.1.3 Same as above for all constituents of the Buyer Client, and its related parties, such as its management company or revenue producing lessees, as well as for the Seller involved in any transfer financed by the loan.

1.2 More formal evidence of such due formation and existence include:

1.2.1 Good Standing certificate of the Seller or Borrower and any constituent of such parties

1.2.2 Qualification of the above in the subject State

1.2.3 An Opinion letter of the such party's attorney with regard to organization, good standing, qualification to do business, valid proceedings and enforceability of documents.

1.3 Note that the failure of an organization to be in good standing will not, in most cases invalidate the loan. In most jurisdictions, such failure may result in the entity being treated as a joint venture or general partnership, with the result that personal liability may attach to all of the constituent parties.

1.4 Resolutions which upon their face appear to be duly adopted at a meeting of the members, shareholders or governing board of the entity need to be reviewed to see:

1.4.1 If the same are certified as true by an authorized officer (usually, but not necessarily, the secretary)

1.4.2 If the same were adopted in accordance with the organizational documents

2. The Note – Primary Evidence of Debt

2.1 Requirements. Contrary to common opinion, a properly executed promise to pay is the primary and sufficient requirement of a note. It should be checked for execution in the name of the proper borrowing entity. Often, the borrowing entity is formed at the time of the loan transaction, and documentation may be in the name of a constituent rather than the actual borrower. Other note requirements speak to negotiability, which may provide immunity from certain defenses, but at a minimum the note should contain a promise on the part of the maker to pay to the holder, the lending institution or to the bearer the amount of the loan.

2.2 Rare Substitutes.

2.2.1 Chattel paper. Usually found in the case of automobile financing or some asset based lending, the note and the security agreement in the personalty will be combined into one document. A "promise to pay" will be found in the document, which usually satisfies the requirements of a note.

2.2.2 Drafts and Acceptances. If the financing is made in connection with the sale of goods, and generally in the context of international trade, a draft may evidence the obligation of the borrower ("applicant") to "reimburse" the lender upon presentation. This reimbursement may come from an existing account or there may be a line of credit to cover the drafts upon acceptance. The draft may call for reimbursement in the future in which case it is accepted and discounted in a separate financing transaction (banker's acceptances, once used as a means of avoiding usury limitations)

2.2.3 Leases. A lease with a periodic lease payment may substitute for the note payments. In such lease financing, it is common to schedule the payments to coincide with a standard note amortizations, together with a factor for depreciation. Often used with very limited principal amortization and a fair market value purchase option when the borrower wishes to keep the asset off its balance sheet (but certain accounting rules regarding purchase option prices must be observed.)

2.3 Endorsement. The development of the note as an instrument of trade necessitated its transferability for value, and this is the sole purpose of the endorsement. It should be placed on the note and contain "pay to the order of" language. It may be further restricted to limit recourse to the endorser. Lending institutions trading in packaged loans often use a blanket endorsement or an "allonge", a separate endorsement intended to be "affixed" to the note so as to be inseparable from the note (though the latter requirement is often ignored, and the allonge simply references the note and contains the "pay to the order of" language).

3. Security in General

3.1 Specific Collateral. With respect to land or other items of specific collateral, please see Sections 4 and 5 below.

3.2 Collateral Instrument. In general, collateral instruments will be either in the form of mortgages (deeds of trust, deed to secure debt) or security agreements. These should be executed in the correct name of the owner of the collateral, in most cases, the Borrower. However, there are times when another party offers collateral for the Borrower's debt. In such case, that party should sign the security instrument, <u>not</u> as has been seen, a power to allow the Borrower to do so, as the latter opens the door to fraud. Also, some support (consideration or a relationship supporting the accommodation) for the grant of a security interest on behalf of another should also be present.

3.2.1 Notations on Certificates. Many state motor vehicle title forms allow for the notation of a lien on the title. There is some questions as to whether this takes the place of a security agreement, and the better practice is to have a separate security agreement (often contained in chattel paper, see Section 2.2.1 above). Also certificated stocks should have the stock power (basically a power of attorney to reissue the certificate in the name of the lender) filed in.

3.2.2 Pledges. Where personalty or certificates embodying all the rights of ownership (bills of sale warehouse receipts, certain types of certificated stock, negotiable instruments or some certificates of deposit) are in the possession of the lender, the security agreement may be unnecessary.

3.3 Perfection. The perfection of the security interest will most usually involve filing the UCC – 1 (Financing Statement) or the mortgage. In the case of other items, (deposits and certain intangibles) a letter of "control" will be used, and in the case of title certificates (aircraft, motor vehicles and trailers, and some boats) a notation on the title serves as the perfection of the interest. Note that these are signed by the owner of the Collateral. In still other cases, possession may be the preferred method of perfections, and the uniform commercial code allows for automatic perfection in certain cases or for certain limited times.

3.4 Conflicting security interests. If the filing of a UCC financing statement is the proper means of perfection, the file should usually show a UCC -11 search or other evidence of due diligence to show the filing to be prior to any other interest. It may still be defeated by possessory perfection or by preferences given certain purchase money security interests under the uniform commercial code, but such incidents are generally rare in commercial instances.

3.5 Conflicting statutory interests. Items to review in anticipation of realizing against collateral include.

3.5.1 Taxes and Successor Liability in Financed Transfers

3.5.1.1 Successor Liability – Buyer/Borrower may become liable for all unpaid personal property ad valorem taxes of the Seller, even on personalty not sold to the Buyer which may be a lien on the personalty superior to the lender's. Similarly for sales taxes in addition to those generated by the sale and in some instances unpaid business taxes..

3.5.1.2 Withholding taxes. -- In financing an acquisition, if the Seller is not a resident of the State in which the property is located, the State may have a FIRPTA type statute requiring withholding by the Buyer. (Mississippi, Georgia, South Carolina, New York, Rhode Island). This obligation may create a lien superior to the lender's.

3.5.1.3 Fair Labor Standards Act — Note that claims under the Fair Labor Standards Act may have priority over your lender's deed of trust and security interests.

3.5.1.4 Note that in some states (e.g. Nebraska, North Carolina) personal property taxes accrued to the date of sale may be immediately payable at transfer. Normally, this is the prorated amount attributable to the Purchaser.

3.5.2 Other Impositions in financed acquisitions:

3.5.2.1 WARN Act Compliance — In certain instances notice must be given prior to the acquisition to employees losing their jobs, and their salaries may be a prior claim on the assets financed.

3.5.2.2 Hart-Scott-Rodino antitrust compliance may result in superior claims, or in worst case scenarios, a rescission of the acquisition.

4. Real Estate as Security

4.1 Title

4.1.2 Insured Estate. It is important to appreciate the nature of the estate in land being mortgaged. Most often, these will be the fee simple interest or long term leases. But also insurable are the following appurtenances, which may be crucial to the use of the fee parcel:

4.1.2.1 Easements for reciprocal or unilateral ingress egress rights located away from the fee property. If improvements are located on any such easement, affirmative insurance should be obtained covering the loss of any forced removal, obtain a containment letter from the applicable utility.

4.1.2.2 Easements (Utilities) Locate all easements on the survey, and make certain no improvements (buildings) are located on the easements. If an easement cannot be located help from the surveyor may be needed.

4.1.2.3 Mineral Rights Make certain that local law, municipal ordinance or the deed or reservation of mineral rights prohibit disturbance of the rights of the surface owner in the extraction of minerals.

4.1.2.4 Joint maintenance agreements

4.1.2.5 Easements to public rights of way

4.1.2.6 Off site parking rights

4.1.2.7 Options to purchase (inside or outside a lease), or to expand or extend a lease

4.1.2.8 Association rights and interests. Make sure current Associations estoppels are in place where applicable (condominiums, PUD's) and that the association bylaws are complied with respect to foreclosure actions.

4.2 Obtaining Clear Title

4.2.1 Obtain and review all payoffs from any lien which was removed. Special direction and care is important if the property or any title holder has been involved in bankruptcy during the last seven years or if a potential creditor is deceased. Where a prior lien is paid off, but not released on record, the doctrine of subrogation may be employed to preserve or in some cases better the priority of a lender's claim.

4.2.2 Where concurrent estates are involved (i.e. leases and sub-leases as well as some easements), the relative priorities need to be established before the loan become non-performing. For example the practice of "Subordinating" a fee owner's interest to a mortgage made by his lessee can have disastrous and unintended consequences. The proper approach is either to take a mortgage in the fee or to establish a non-disturbance right to keep the estates separate after foreclosure or deed in lieu thereof.

4.2.3 Lender's title policies are usually required and can be found in the file. In reviewing these, check to see that the latest survey description was used in both deed and policy. Note that in some jurisdictions, dual deeds are given quit-claiming the new description and warranting the old. Some of the coverages to check on in the policy are:

4.2.3.1 Zoning (Note: expensive and unnecessary where the certificate of occupancy, zoning letter, building permit or surveyor's certificate covers the issue

4.2.3.2 Contiguity Should be obtained where several parcels are being consolidated

4.2.3.3 Same as Survey Should be obtained if new survey differs from old legal description

4.2.3.4 Subdivision Should be obtained if the property is not separately platted in the local real estate office

4.2.3.5 Tax Parcel Be sure that your tax information sheets cover the entire property and this may not be readily determinable from the title file. If any issue remains, this endorsement should be obtained

4.2.3.6 Tie-in Where several properties all stand for the same debt.

4.2.3.7 Comprehensive.

4.2.3.8 Fairway Keeps from losing coverage when there is a change in the makeup of the partnership (currently deemed of diminished importance)

4.2.3.9 Non-Attribution Where the new owner is made up in part from old owners, whose knowledge or imputed knowledge is sought to be discounted as a defense to coverage.

4.2.3.10 Creditors rights affirmative coverage Where there is any transaction among related parties or between lender and borrower.

4.2.4 Construction Contracts (mechanics and materialmen's liens). If the loan was made for construction, assuming there has not been sufficient seasoning of the loan to address all mechanics and materialmen's liens, check for waivers of liens or notices of completion which may avoid potential claims. Different states have differing procedures, and local counsel (most inexpensively through the title insurer) can give direction.

4.3 Non-Title Issues

4.3.1 Lease Income as a Source of Debt Service. Often, the presence of a tenant to generate the needed debt service is crucial to debt service. Some of the protections needed with respect to such tenants include:

4.3.1.1 SNDA -- The subordination portion states that even though the mortgage has been put of record before the lease, foreclosure of the mortgage will not terminate the lease. The non-disturbance portion states that the mortgagee or the new bidder and owner at foreclosure will therefore not disturb the possession of the lessee, conditioned upon the attornment of the Lessee to the new owner, i.e. the recognition of the new owner as the lessor entitled to performance under the lease. Note, if the mortgage is placed after the lease, the objectives of the SNDA (other than attornment, which is arguably a result of privity of estate after foreclosure) are met, and an SNDA may not be necessary.

4.3.1.2 Rent Roll — A Certified rent roll may be necessary if tenants are about to be directed to make payment to the lender.

4.3.1.3 Estoppel Certificates -- Tenant estoppels become necessary to insure that your Borrower has not collected prepaid rentals at a discount, or taken other steps which may impair the flow of funds for debt service.

4.3.2 Allowing Second Mortgages. Often, it is in the lender's best interest to allow for a second mortgage, because another interested party may wish to take out or purchase the first mortgage or otherwise service the same in order to preserve such second party's interests. These are especially beneficial if made to discharge superior debt such as ad valorem taxes On foreclosure, care must be taken to keep these persons on notice of actions to avoid jeopardizing their positions and creating a claim against the first position lender. .

4.4 Survey Issues When preparing for foreclosure or workout, a review of the survey can be helpful. Often it has been prepared on an as built basis, and this affords the opportunity to see if the improvements have been properly placed according to plans. Make sure the certification to the Lender, the Buyer, and the title company is in a form proscribed by the Lender. A good way to review the survey is to follow a few of the ASCM / ALTA Table A guidelines, checking the following:

4.4.1 Item 1 Monuments at all corners

4.4.2 Item 2 Vicinity map

4.4.3 Item 3 Flood Zone Designation

4.4.4 Item 4 land area in acres

4.4.5 Item 6 Zoning and subdivision set-back lines

4.4.6 Item 8 Visible improvements

4.4.7 Item 9 Parking areas, striping, handicap designation, number of handicap and non-handicap places.

4.4.8 Item 10 Curb cuts and access

4.4.9 Item 11 Surface aspects of subterranean utilities

While reviewing, it is also a good time to double check

4.4.10 Zoning designation

4.4.11 Legal description with acreage

4.4.12 address

4.4.13 Street R.O.W. width

4.4.14 Legal description of appurtenant easements

4.4.15 Square footage of building footprint

4.4.16 Landscape easements

4.4.17 Utility lines

4.4.18 Variances for any encroachments on set backs

4.4.19 Drainage flow

4.4.20 Wells

4.5 Physical and Compliance Aspects of Real Estate Collateral -- In determining value of the property on which foreclosure or a deed in lieu is to occur, the file should have support for certain physical characteristics of the land and the improvements thereupon.

4.5.1 Engineer's report — covering HVAC, electrical, plumbing, roof, elevators, sprinkler systems etc. should be in the Client's possession and all should evidence code compliance.

4.5.2 ADA Americans with Disabilities Act. If lender has financed any construction, see if evidence of compliance with the ADA has been obtained from the project architect.

4.5.3 Licenses Depending on the business, several licenses may be necessary. A certificate of occupancy evidences code compliance as well as the ability to operate from the location. In addition, boiler licenses, elevator permits or other special fixture permit (generally holdovers from another era) may apply in your location to all buildings. Other special licenses may include:

4.5.3.1 Special operations licenses (e.g. pool, dancing, food service)

4.5.3.2 Liquor. If necessary, retain Borrower as agent to operate liquor concessions on a temporary basis during and after foreclosure. In some state, this can be extremely difficult (e.g. Mississippi, Michigan).

4.5.3.3 Business Licenses. Make sure that the necessary licenses for local operation have been obtained by the on-site manager.

4.5.4 Appraisal — check for the original appraisal as this may become of importance is the creation of a deficiency judgment or in the allocation of value for a deed in lieu.

4.5.5 Environmental -- Environmental reports which indicate anything other than a clear review without need for Phase II investigations should be carefully reviewed. Although many lenders rely on the "safe harbor " provisions of due diligence, matters may change in the event the lender should take actual title to the realty, and this is a matter to be consider in connection with a any restructure. While reviewing:

4.5.5.1 Check for the certification by the engineering firm. Make sure lender is included

4.5.5.2 Note the treatment of Asbestos. Reports vary widely

4.5.5.3 See that wetlands issues such as aquatic recourses alteration permits or necessary Corp of Engineer certificates have been included.

4.5.6 Special Zoning. Urban redevelopment areas, brownfields and other unique locations may cause addition issues to be considered in taking back real property, e.g., FAA height restrictions, if located near airports

4.5.7 Hazard and Liability Insurance. Uninsured losses during a workout can render the whole procedure academic. Make sure the liability limits are realistic and that hazard insurance is in an amount equal to the appraised value of the improvements. In this regard, an ACCORD 27 certificate is usually preferable to the ACCORD 25 notice.

5 Contractual and Personalty Security (Asset Based)

5.1 Franchise. If a franchise right is involved, and the continued operation of a business is crucial to a workout, the consent of the franchisor should be included. Often, such consent is contained in the initial estoppels forms, and it may not be unusual for the franchisor to subordinate franchise fees if the location is advantageous to the franchisor.

5.2 Management Contract. A commitment on the part of the manager (f applicable) to continue to manage and operate the business may be necessary. Such an agreement may have to be creative, with the equivalent of equity positions in manager as an incentive to defer fees.

5.3 Service Contracts. Obtain a list of all service contracts used in the operation of the property. Many will have to be terminated or renegotiated. Again, the assistance of the manager may justify his equity position in the business Check for termination provisions. Preferably, they should be terminable on 30 days notice.

5.4 "Down" Leases. If these are the major source of revenue, their preservation becomes key to a successful workout. If the Borrower is currently in default, the leases may require renegotiation or the infusion of additional capital in order to preserve the tenancy. Alternatively, new tenants or a change in tenant mix may be more advisable.

5.5 “Up” Leases:

5.5.1 Operational. Check for termination provisions. These leases are commonly used in telecommunications, office equipment and franchise related equipment.

5.5.2 Capital. These leases are financing transactions. These should customarily be discharged in the same fashion as any other lien in connection with the workout, but some consideration as to the exercise of he purchase options at the end of the is required.

5.6 Client Contracts. The loss of a major customer or the inabilities to provide a certain service due to a loss of expertise are commons sources of financial difficulty. Also related to such downturns is the loss of a major supplier, especially sole source suppliers. Before taking on any responsibility for the continuing operations of a debtor, the “reinstatement” of good standing with such parties may be necessary.

6. Guaranties and Guarantors

6.1 While most form guaranties allow for the modification of a guaranteed debt without the consent of the guarantor, it is always advisable to have such consent in that concessions or actions against collateral which disproportionately favor the ability of one guarantor to recover to the detriment of the other s can always be reviewed. All guarantors should be included in any amendment extension or modification

6.2 In some jurisdictions, a guarantor can arguably “put” the lender into taking action against the borrower or risk losing the guaranty.. For example, TCA section 47-12-101 could be read to require such an application, though no case law exists outside the use of surety bonds. Nevertheless, care should be taken with respect to guarantor requests.

6.3 A guarantor may wish to become a partner, especially if a guarantor is the sole financially accountable obligor in the transactions. In such cases, a guarantor may wish to purchase all or a participation interest in the Note, reducing the lender’s exposure. Note that this approach also works well with secondary collateral positions, where the subordinated lender has little chance of recovery from the second position. This is often seen in the second lender making debt service payments in order to preserve the second position as collateral for the original debt and the preservation costs.

6.4 Receipt of payment with respect to guaranteed debt to the detriment of general creditors may still an issue in bankruptcy (a revival of the discredited DePrizio doctrine.) A waiver of subrogation claims was originally put into guaranties to avoid this, and a series of legislation purporting to solve the issue has been enacted.