

Practice Pointer: Review Your Loan File Now to Avoid Problems Later

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When a loan becomes distressed, it is essential for the secured lender to conduct a file review to determine if there are any deficiencies that need to be addressed. If deficiencies are not addressed, the lender's collateral position might be jeopardized, and the lender may well encounter obstacles enforcing the loan.

One of the first steps when reviewing a loan file is to order a UCC search as to all borrowers, guarantors, and significant principals of the borrowers, and a title search on all mortgaged real property. These searches will disclose whether the lender has a priority lien on the collateral securing the loan. They also will provide insight as to a debtor's other creditors and the problems that a debtor might have.

For loans secured by real property, the lender must determine if a mortgage was signed by the actual property owner, contains an accurate legal description, and has been recorded in the correct county. Examine the mortgage to determine the indebtedness secured, and to determine whether a notice of default is needed and what remedies are available. An updated title search will disclose if there are any lien priority issues, including any unpaid real property taxes that prime the mortgage lien. Depending on the length of the real property tax delinquency, the mortgage might be at risk of being extinguished by a tax foreclosure sale. Finally, the lender should confirm that there is insurance in appropriate coverage amounts describing the lender as the mortgagee and loss payee.

For loans secured by personal property, the actual owner of the property must sign the security agreement. The asset description in the security agreement should correspond to the description in the financing statement. The UCC lien search, using the borrower's exact legal name, will disclose if the lender's financing statement is indexed properly and is still in effect. UCC-1 filings are valid only for five years, unless continued. A UCC lien search also will reveal if there are any lien priority issues. For example, a federal tax lien will take priority over the lender's security interest on advances made after 45 days immediately following the filing of the federal tax lien and only as to receivables arising during that same period. Additionally, UCC searches of any guarantors or significant principals can disclose information such as the borrower using assets outside of the collateral package's scope, as well as additional debt of parties related to the borrower. Finally, the lender should obtain evidence of personal property insurance in appropriate coverage amounts describing the lender as the lender loss payee.

In addition, borrowing resolutions should be reviewed to confirm that the appropriate persons have signed the loan documents.

Undertaking the lien searches are an imperative. More than once, we have found from searches that a mortgage was not filed in the right jurisdiction, or was discharged unintentionally. On several occasions, we have been able to renew UCC-1 financing statements in the nick of time. We also have found UCC-1 filings that had expired or were never filed.

A final consideration is who should undertake the file review. Although the loan officer can do so, the work product from that review will be discoverable in a court proceeding (**see Practice Pointer #5**). One way to protect this work product from discovery is having an attorney, either an in-house counsel or an outside counsel, undertake the file review. When this occurs, the written review memo will be protected by the attorney-client privilege.

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This e-alert is the sixth in a series of practice pointers on lending-related issues, with a particular focus on distressed credits. If you have any questions, or would like further information, please do not hesitate to call one of the authors or your favorite Miller Canfield attorney.