

LAST WORD

## Pros and Cons of Loan Assumptions

Borrowers often save money, but lenders typically have wide discretion on who qualifies. **By Daniel Brozost, Esq.**

In the commercial real estate market, the availability of credit has diminished significantly over the past few years. The Mortgage Bankers Association quarterly survey of commercial/multi-family mortgage bankers clearly illustrates this trend. Loan originations in the second quarter of 2009 were 54% lower than during the same period in 2008, and 83% below the peak reached in the second quarter of 2007.

Given the difficulties of finding financing in the current commercial real estate market, loan assumptions may provide an attractive option for buyers of real property seeking the funding they need in order to close deals. The concept of a loan assumption is quite simple.

A buyer of real property assumes the existing financing of the seller/borrower by stepping into the shoes of the existing borrower on substantially the same terms. Prior to considering a loan assumption, however, buyers should understand the advantages and disadvantages, and what they can expect to encounter during the process.

### Benefits of loan assumptions

Loan assumptions may provide several advantages to a prospective purchaser, particularly if the seller has a pre-negotiated assumption right built into its loan documents. In such a scenario, the loan documents allow the existing borrower to transfer the property and the loan to a buyer upon satisfaction of certain conditions.

Specifically, a lender is likely to require payment of a transfer fee of around 1% of the loan amount, payment of its legal and administrative expenses and approval of the transferee's financial condition and experience.

Although lenders can generally exercise a great deal of discretion in approving a prospective transferee, the fact that a seller has a pre-negotiated right to

transfer the property and assign the loan is a good sign that an assumption will be feasible. A buyer should ask whether such a pre-negotiated right exists as early as possible in the purchase process.

In many instances a loan assumption will also save a buyer time and money. Loan assumptions can often be fully approved and documented in less than 30 days. Conversely, a newly originated loan may take weeks and even months to complete. Furthermore, a loan assumption generally requires less documentation than an origination, which can reduce a buyer's administrative and legal expenses.

Additionally, an assumption may permit a buyer to benefit from the seller's existing interest rate and other pre-negotiated terms, which may be better than prevailing market rates and terms for an origination. If considering a loan assumption, buyers should ask for, and carefully review, copies of the loan documents as early as possible in the purchase process.

### Pitfalls of loan assumptions

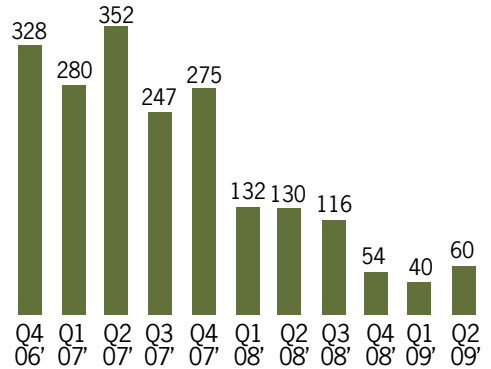
Even where pre-negotiated assumption right exists, lenders have broad discretion as to whether a new borrower is qualified. For instance, lenders will scrutinize a buyer's financial condition and its specific operational expertise in order to determine if the buyer is at least as qualified as the seller.

If a seller does not have a pre-negotiated transfer right, lenders have the ability to alter loan terms. In such a scenario, lenders may raise the interest rate, require more stringent oversight or cash management provisions, and increase or require borrower reserves.

The length or complexity of the assumption process will also depend on the type of loan and lender involved. For

### NEW LOANS IN SCANT SUPPLY

Commercial loan originations at the end of June had fallen 83% from their peak in the second quarter of 2007.



Source: Mortgage Bankers Association

instance, if the loan in question is structured as a commercial mortgage-backed security, the process will likely be much more complicated and time-consuming.

As a result of these potential difficulties, buyers should ensure that they have a broad enough financing contingency in case they need to explore other financing opportunities.

Buyers should be aware of the specific loan provisions involved with a loan assumption, particularly the assumption and release provisions. Buyers should carefully review the provisions of the loan assumption agreement and any other documents required by the lender, in order to ensure that any changes to the loan terms are accurately described in the assumption documents. Many provisions may be subject to negotiation.

Loan assumptions offer a potentially attractive alternative to buyers seeking financing for purchases of commercial property. It is critical, however, that they understand the pros and cons prior to committing to an assumption or removing financing contingencies as part of a purchase.



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