# Loan Documents and Their Purposes

## Steven Roy Management
## Cambyses Financial Advisors, LLC

Cambyses Financial Advisors, LLC
Steven Roy Management

13027 Victory Blvd. PMB 722
North Hollywood, CA 91606
WWW.StevenRoyManagement.Com

[o] (818) 489-4228
[f] (818) 450-0426

Steven@StevenRoyManagement.Com
[Telephone] (818) 489-4228
[Fax] (818) 450-0426

Reviewed and Drafted By:

- Nastaran Motiei MBA (Managing Member)
- Steven J Roy MS, MST, EA (Managing Member)

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Most commercial loan transactions generate, analyze, or execute anywhere from a few to several dozen documents. Those documents range from deceptively simple single pages to book-thick tomes. If you have ever wondered what all that paper was for, you are not alone. Here is a list of some common commercial loan instruments and what they mean.

## Amortization Schedule

An **Amortization Schedule** is a table that shows each periodic payment on a loan, the date it is due, and the amount of the payment that will be considered principal and interest if the payment is made as scheduled.

Amortization Tables are usually prepared by the lender as a convenience for their customer-borrower to simplify the accounting entries that the borrower will make to record the loan payments. **Amortization Schedules** are customarily prepared only for fixed rate obligations, as there is no *a priori* way to determine what interest rate to use for any given period of a variable rate obligation.

**Amortization Schedules** usually include a “header section” that details all of the significant terms of the obligation: Total principal, interest rate, number of payments, payment interval, periodic payment amount, and the amount of any “balloon payment” due on maturity.

The **Amortization Schedule** also includes a multi-column table consisting of one row of numbers for each payment on the loan. Each line usually consists of: The payment due date, the opening balance of the note on that date, the amount of the payment, the amount of the payment that constitutes interest, the amount of the payment that constitutes principal, and the balance of the note after the payment is made (closing balance).

A vast number of **Amortization Schedule** calculators are available on-line.

## Automatic (Direct) Debit Authorization

The **Automatic (Direct) Debit Authorization** gives the lender permission to automatically collect loan or mortgage payments by deducting the amount of each payment from your account on the date your payment is due. The lender uses the form to set up automatic payments through your bank.

Ostensibly, automatic debits are a convenience that relieves you of the necessity to write a check each time a payment is due. They also, not coincidentally, reduce the lender’s transaction costs, assure the lender that your payment will made on time (unless you have insufficient funds), and reduce your ability/flexibility to manage your cash flow.

The **Automatic (Direct) Debit Authorization** must clearly identify both parties. Therefore, it includes the lender’s name, address, and other contact information (Since the lender will originate the “wire” debit or ACH transaction, the form usually does not identify your account number or the lender's internal accounting codes. These are "embedded" in the wire debit or ACH transaction and the lender's in-house software.)

Your identification, address, contact information, deposit account number, and signature, and your bank's ABA transit number are also indicated on the form. Often, the lender requests that you attach a voided check to the **Automatic (Direct) Debit Authorization** so their staff can verify the information and your bank can validate it.

## *Certificate of Acceptance*

You provide a **Certificate of Acceptance** to the lender (or lessor) to acknowledge that the equipment or premises you have purchased or leased have been delivered, are acceptable, and have been manufactured or constructed according to your specifications.

The **Certificate of Acceptance** authorizes the lender to release funds to the vendor from whom you bought property. It also prevents you from disclaiming the obligation later on the grounds that the property was either undelivered or defective.

The **Certificate of Acceptance** includes your identifying information, your supplier's identity, and a full description of the property. The property description should be substantially identical to the description of the same property that is part of your **Security Agreement**.

## *Closing Terms*

**Closing Terms** fulfill a function similar to escrow instructions in real property transactions. They specify the acts that the lender and the borrower (you) must perform in order to complete the transaction. Until all of those acts are completed, neither you nor the lender is committed to the loan. If there is a trustee or escrow intermediary involved in the transaction, the intermediary is responsible for ascertaining that all of the closing conditions have been met before transferring title or payments to the parties.

The **Closing Terms** acknowledge that you and the lender have both done the acts the contracts and documents require and that you have signed the required documents.

The **Closing Terms** almost always include a list of the documents that you must sign and return to complete the transaction. If, as is almost always the case, there is a requirement to provide proof of insurance, that will also be listed.

**Closing Terms** are unique to the particular transaction and therefore vary considerably from one transaction to another.

## *Demand or Pay Proceeds*

The **Demand or Pay Proceeds** notice is most often part of a refinance or cash-out package. In the notice, your current lender makes formal "demand" for payment from the lender you have selected for the refinance, and promises to release security interests they have in the property you are refinancing. (This promise is usually fulfilled by means of a "release of security interests," "disclaimer of security interests," or "reconveyance" of the property and recording the release with the appropriate authority. The demand is seldom the only document necessary to accomplish this.)

The **Demand or Pay Proceeds** notice usually specifies the outstanding balance as of a particular date, and the interest amount per day that should be added to the demand for each day subsequent to that date until the demand is fulfilled (by payment from your new lender).

## *Disbursement Request and Authorization*

Using the **Disbursement Request and Authorization**, you tell your lender who to pay the proceeds of the loan, when, and how much.

Usually, you have very little control over who is paid from the proceeds of the loan (other than your choice of vendor, which you have already exercised). The parameters of the loan and security documents determine the parties and amounts: i.e. The vendor (or a previous lender) is paid the proceeds of the loan. In more complex cases (and very often in refinance transactions) other creditors (unrelated to the current transaction) will be paid from the loan proceeds in order to achieve debt ratios or debt coverage required under the terms of your loan. In "cash out" refinancing, you (or your company) will be one of the payees.

The disbursement request includes your identifying information, the transaction information, and the list of payees, their addresses, payment instructions (method and amount), and account numbers. Payment will usually be made directly by the lender, either by check or wire transfer to the vendor's (payee's) account.

## *Guarantee and Guarantor's Jurat*

A **Guarantee** is a promise by one person or entity to pay the debt owed by another person or entity under certain conditions. **Guarantee**s "sweeten" the collateral pool from which lenders may seek payment. Thus, if you guarantee your company's debt to XYZ bank and your company does not make the required payments, you (as **Guarantor**) are required to make payment from your personal assets.

The **Guarantee** must clearly identify the **Guarantor** (name, address, telephone, entity status, near relatives and business contacts), the transaction in which the **Guarantor** is acting, and the conditions under which the **Guarantor** will be required to perform (these are sometimes incorporated into the **Security Agreement**). **Guarantee**s must be reduced to writing.

The **Guarantor's Jurat** is a formal legal statement, usually notarized, that acknowledges the **Guarantor**'s obligation to pay the debt if the principal debtor defaults. It may also contain "representation language" that confirms the **Guarantor**'s understanding of the terms of the transaction and the validity of any representations made in the course of the transaction.

 

## *Incumbency Certificate*

The **Incumbency Certificate** identifies an entity's officers and confirms their authority to transact business on behalf of the entity. The lender uses the **Incumbency Certificate** to confirm that persons who represent that they have the authority to transact business on behalf of the entity actually do have that authority.

Typically, the entity's "Secretary" (or an officer/member with similar responsibilities) issues the **Incumbency Certificate.**

The **Incumbency Certificate** itself recites only the name of the officer, their position within the organization, and the scope of their authority to transact business. It may also refer specifically to the transaction.

Most lenders require one or more corroborating documents to validate the **Incumbency Certificate**:

- *State Officer Statement*: In California this is called the Statement of Domestic (or Foreign) Stock Company. The form, filed with the state corporation commission, gives the names and addresses of current officers and directors. Lenders request it from the State Commission to verify the identities of the authorized persons.
- *Statement of Good Standing*: Also obtained from the state corporation commission, it confirms that the entity is permitted to conduct business in the state.
- *Company Bylaws or Operating Agreement*: Confirms the scope of officers' authority.

## *Lien Release*

You will encounter **Lien Releases** most often in refinance or "cash out" transactions. In the **Lien Release**, your current lender "releases" their security interest in the property in return for the new lender's satisfaction of the balance due of their lien. Often, the **Lien Release** is recorded at the same time the new lender's security interest is recorded.

The **Lien Release** identifies the secured property, the specific obligation that is being released, and the identity of the releasing party. If it will be recorded, it must be notarized by the releasing party. (In real property transactions, this process – release, notarization, and recordation – is often called a "reconveyance" of the lender's interest in the property.

In some transactions, particularly when the existing lien will not be satisfied in full, the lender may not release their entire security interest. Instead, they may subordinate their interest to that of the new lender. Negotiations around this issue are often protracted – as both the old and new lenders seek as much protection (collateral) as they can get.

 

## *Loan Agreement*

The **Guarantee**, **Loan Agreement**, **Promissory Note**, and **Security Agreement**, taken together, contain the majority of the substantive provisions of the loan.

Most of the other documents (e.g. **Amortization Schedule**, **Automatic (Direct) Debit Authorization**, **Certificate of Acceptance**, **Demand or Pay Proceeds**, **Lien Releases**, and **UCC Documents**) serve "ceremonial" or "procedural" purposes that are either required by law, or deemed necessary by the lender's counsel.

The **Loan Agreement** often repeats and combines many of the elements of the **Guarantee**, **Promissory Note**, and **Security Agreement** into a single document. The **Loan Agreement** thus becomes the reference document – all the information in one place. The **Security Agreement** (which is recorded) then does not have to recite the procedural elements of the transaction (protecting the borrower's privacy).

In other cases, the **Loan Agreement** also serves as the **Security Agreement** – there may be no separate **Security Agreement**. When this happens, the entire **Loan Agreement** is recorded and no separate **Security Agreement** is executed or recorded.

## *Notice of Insurance Requirements*

This one is pretty much exactly what it says it is. In the **Notice of Insurance Requirements,** you acknowledge and agree to maintain insurance coverage that protects the lender's interest in the property. (State laws often require the lender to notify you if there are insurance requirements that are part of your obligation. The **Notice of Insurance Requirements** fulfills that obligation.)

The **Notice of Insurance Requirements** specifies the types of coverage that the lender requires you to maintain (property, casualty, E&O, liability, etc.), the coverage limits (per incident and total), and details any loss payee, additional insured, and notice/certificate requirements. It also specifies what steps the lender may take in the event you do not provide the required coverage (or evidence of coverage).

The **Notice of Insurance Requirements** places the onus of obtaining coverage on you. Typically, it allows the Lender to "force place" the coverage if you fail to do so. The lender's forced coverage is considerably more expensive than what you can find on your own.

## *Promissory Note*

A **Promissory Note** details the terms of a promise by one party (the maker) to pay a sum of money to the other (the payee).

**Promissory Notes** identify the parties to the transaction, the amount of the obligation, the terms of repayment (the interest rate, and repayment schedule), and the remedies available to the parties in the event of a breach (e.g. penalties for late payment and an acceleration clause that makes the entire amount of the note due if one or several payments are missed). Many **Promissory Notes** also describe the consideration for the obligation (that is, what the debtor received in return for signing the note).

**Promissory Note**s are typically "unsecured." i.e. The note documents the existence of an obligation to pay, but does not create a security interest in specific property. A **Security Agreement** and "recordation" supplement the Note to create a specific security interest. (c.f. **Security agreement**s, Trust Deeds and Mortgages, and **UCC Filings**) If the note is "secured," it generally includes a reference to the **Security Agreement** and a description of the secured property.

## *Security Agreement*

The **Security Agreement** documents the existence and the terms of the lender's interest in the property you obtain using the proceeds of the lender's loan.

The **Security Agreement** must include the identity of the parties, a description of the collateral, the borrower's signature, and must use words that indicate intent to create a security interest. Most **Security Agreements** also contain clauses that insure the property will be properly maintained, that taxes will be paid in a timely fashion, and that the use of the property will not violate environmental or other laws. Inevitably, **Security Agreements** also include provisions that determine who pays the legal costs if the security interest must be "perfected."

**Security Agreements** seldom contain descriptions of acts that will result in foreclosure of the **Loan Agreement**. Those provisions are most often incorporated in the **Loan Agreement** itself. On the other hand, **Loan Agreements** sometimes incorporate terms similar to a **Security Agreement**, thus obviating the need for a separate security instrument.

The **Security Agreement** creates a legally enforceable property right. Hence, selling property covered by a **Security Agreement** without paying off the underlying **Promissory Note** or informing the lender may be criminal in some jurisdictions, e.g. California (This property crime is called "conversion").

## *UCC Statement(s) and Forms*

**UCC Forms** (particularly UCC-1) are used to record the lender's security interest. The deceptively simple form, when recorded, creates a legally enforceable property right in the property and gives public notice to any potential purchaser or refinancer that the property is "spoken for."

The form and content of the **UCC Form** is specified by state laws and conventions established under the Uniform Commercial Code (UCC). In almost all jurisdictions, the **UCC Form** identifies the parties, describes the collateral, and points to the **Security Agreement** for amplification.

 