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"What`s Up—Docs? Re-Imagining CMBS Document Automation"

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I. Introduction

Diminished efficiency anywhere in the loan origination process ripples through the actions of others, impacting transaction time and cost. Loan document preparation and negotiation is an obvious target in this respect, typically absorbing a significant portion of the legal fees in a securitized lending transaction. The ultimate outcome depends on various factors: the complexity of the loan terms, the appetite or tolerance for negotiating changes, and the skill of counsel in managing the process. But the stakes associated with getting the legal process right go beyond time and cost. Lender credibility and the overall management of legal risk can likewise hang in the balance.

To date, document automation has worked principally in environments where changes are minimal.

Technology now affords the capability to create sophisticated documents whose provisions vary based upon factual and legal circumstance without necessarily adding transaction cost. This article examines how loan document automation has evolved, and what options are available to the CMBS industry in the foreseeable future.

II. An Overview of Automation Technology

Stage 1 - Word Processing

The advent of computerized word processing in the mid-1970s revolutionized how legal documents were prepared. Out went typewriters and in came the capability to electronically save and edit documents. By the mid-1980s PCs had replaced dedicated word processing systems such as Wang. Programs such as MultiMate, WordPerfect and Microsoft's Word became prevalent. While word processing is a quantum leap over typewriters, it requires concentration and accuracy from humans who are doing repetitive and routine tasks that are better suited to automated systems. Thus stand-alone word processing presents law firms and lenders with quality control issues and costs.

Stage 2 - Data Merge

The next step in the evolution of document automation was the incorporation of data elements by using "merge" fields. This functionality allows for the inclusion of defined variables into a fixed document template. The following illustrates how this works:

[FIELD 1] ("Borrower" by its promissory note of [FIELD 2] is indebted to Lender in the principal sum of [FIELD 3] in lawful money of the United States

Field 1 = Name of borrowing entity

Field 2 = Date of note

Field 3 = Loan principal

The use of data merge allows a lender or law firm to have standardized documents that incorporate variable fields specific to a particular transaction. Thus, a legal secretary could input the values for merge fields and a complete 1st draft document could be generated. Any required deal specific terms are done manually.

Data merging does a good job of dropping in predictable terms such as entity names and deal specific quantitative data. In a highly standardized environment such as Fannie Mae lending where the universe of document changes is narrow, this technology is often adequate. However, in a more demanding document environment where greater variability must be accommodated, more sophisticated systems are appropriate.

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Stage 3 - Conditional Logic

The use of conditional logic, which started to become common in the 1990's, prompts information from the user through dialog boxes or similar methods, and then selects documents and specific text that is linked to the identified features. Depending on the skill of the information query, this approach can substantially reduce the need for manual mark-ups, and assure greater compliance with program protocols. For example, three different types of recourse carve-outs can be programmed as optional clauses. The attorney who has deal specific knowledge would see a dialog box or other menu with the relevant choices. The attorney makes the choice and the appropriate provision is chosen. There is no need to search through previous deal files to find model language, nor is there the possibility of accidentally dropping clauses or similar errors.

Stage 4 - Database Integration

By the mid-1990s many lenders had computer databases which were used to track loan status and accumulate statistical data. This meant that certain variables required for legal documents could be imported from these databases. For example, the address of a property, the property use (retail, office, etc.) and loan amount, could all flow from an existing database into a loan application. Flowing data from the database to documents is typically accomplished by "mapping" specific database fields with document merge fields. The downside of this approach is that the mapping entails a manual business analysis and programming effort—costly and time consuming.

Extensible mark-up language (XML) presents the potential for a standardized data element identification scheme. This should greatly reduce the time and cost of data mapping and it is why so much interest has developed in XML technology for the underwriting function in loan origination. From a legal perspective, XML enables the retrieval of legal information for securitization, servicing, credit review and workout purposes.

However, "one time data entry" (including XML) may still require human oversight. For example, a loan officer entering property location information in a deal tracking database might refer to a property as the "Four Corners Shopping Center", while an attorney preparing a loan document might use the street address, or a block and lot identification. The ability to verify and, if necessary correct, information that has been imported from another source is an essential part of any document automation system.

Stage 5 - The Internet

The Internet has caused a dramatic acceleration in the use of technology within commercial real estate and a willingness to reexamine and reengineer the loan origination process. New companies have emerged that are applying technology to the document automation area. Some of these companies are concentrating solely on the legal document field while others are building broad loan origination processing systems. Additionally, many companies are now incorporating other technologies with document automation, such as knowledge management, e-signature authentication, and Internet based document management with electronic file cabinets where files and scanned documents can be securely stored and made available to deal participants.

III. How to Select a Document Automation System

Let us examine the features and benefits that lenders and their counsel should consider in choosing an automation system.

Loan Applications, and Commitments

Applications, commitments, term sheets, and engagement letters are typically produced by loan officers and underwriters with occasional supervision of counsel. These documents can benefit the most from integration with existing "pipeline" databases. A document automation system can allow a loan officer to quickly generate these documents without having to re-key information. The lender should examine the extent to which these documents have different provisions for different circumstances. If ground leases, partial releases of collateral, hospitality properties, lease-up requirements, etc. result in

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customized changes then the automation system should be able to offer the loan officer a limited number of pre-approved provisions for these conditions.

Loan Documents

Preparing loan documents involves integrating three types of potential changes:

- (i) collateral conforming changes;
- (ii) state law conforming changes; and
- (iii) deal term conforming changes.

Type (i) and (ii) changes can be readily handled by a medium level document automation system with data merge and some conditional logic capabilities. Type (i) and (ii) changes can be made by the lender's in-house closing staff, outside document services, or most commonly, by a law firm's paralegals and secretaries.

Type (iii) changes are best handled by a sophisticated system with knowledge management and other advanced features. Type (iii) changes are where a law firm produces its greatest value and where the right automation system can produce the greatest payoff. Deal-conforming changes include unusual structural or negotiated provisions or other matters uncovered in legal due diligence. This is the area where legal knowledge, experience and an understanding of the lender's and capital markets issues come into play. It is also the most time consuming and costly part of the document process. A sophisticated automation system should (1) contemplate the need for customization, (2) provide appropriate drafting precedent, (3) provide guidance to the drafting attorney, and (4) allow, on an exception basis, for totally customized changes.

Knowledge Management

A significant element for both lenders and their counsel is the need to insure quality control by supervising the document output of junior staff. To meet quality standards time and energy is expended by junior staff in seeking guidance from more experienced people in regard to real estate business, legal and capital markets issues. The communication process, whether by voice mail, e-mail or in-person is a costly and repetitive method for conveying knowledge. A sophisticated document automation system can provide significant benefits in this area. Such systems couple document choices with: drafting precedents, explanations of general legal and real estate issues and lender specific perspectives. For example, a loan officer completing an application could be provided with two options for collateral release provisions. They would be explained and the officer would be given the lender's guidelines as to their applicability. A junior associate drafting a deed of trust might be provided with an explanation of the legal reasons for the standard Brundage clause as well as that lender's perspective on whether it can ever be changed.

Knowledge management also goes beyond junior/senior interaction to deal with "institutional memory". The typical maturity for a CMBS fixed loan is ten years, although prepayment and defeasance can shorten the loan oversight period. During that time lender, counsel and servicing staff can change. Knowledge as to why a particular provision was drafted precisely one way and not another can be lost. A sophisticated document system can capture that knowledge and make it available for the life of the loan. It is also intriguing to consider whether loan pricing would improve if a complete and cogent snapshot of legal risk features were provided.

Automated document systems can ideally provide opportunities for self-teaching and inquiry. This could be a significant benefit, because it could afford actors in the system the opportunity to maintain a high level of mental engagement in the document production process. One can imagine prompts that could invite further subject matter inquiry or communication with underwriters. Best practices that develop over time could be identified and shared for future system users.

Technology Platform

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The Internet provides document automation two significant benefits: potentially universal access from any location via a Web browser, and cross platform compatibility without regard to operating system or applications. Some of the newer document automation companies have developed their products to make full use of these advantages. Using these products, documents can be created and modified at any time from any place. It allows a loan officer who is at a potential borrower's office in another city to use the borrower's computer, or his own laptop PC, to access the Internet, and produce and have a completed customized loan application e-mailed to the borrower within a few minutes. Cross-platform compatibility makes irrelevant issues such as: Word vs. WordPerfect, and IBM PC vs. Apple. Document automation products that are designed for the Internet can also be used in an Intranet setting (i.e. it can run on a lender's internal servers behind the lender's firewall).

Legal Risk Capture

Securitization requires the analysis and capture of significant amounts of data concerning the legal features of the loans. The demand for this information stems from three sources: (i) disclosure required for securities law purposes; (ii) compliance with loan-level representations and warranties, and (iii) investor and rating agency inquiries. Legal risk information in turn is drawn from the loan documents and from property-level due diligence information (i.e., title, survey, zoning or environmental matters). Traditionally, this has meant reviewing loan files and identifying information deemed relevant. A sophisticated loan document automation system can facilitate this exercise by capturing document legal provisions (not just data merge fields) for securitization. This approach offers substantial time, cost and quality advantages over less automated alternatives.

Program Maintenance Environment

Lending programs, master documents, and substantive legal requirements all change over time. The ability to update form provisions easily (and to assure awareness and compliance with the updated changes) is an especially attractive feature of advanced document automation systems. Program and forms maintenance work in law firms is not typically given a high priority in the absence of an immediate need. How should a document automation system enable changes to be made? Some lenders with limited staff may want a document vendor to provide a turnkey operation. A change to a master form, annotation, help text, or conditional rule could be communicated via e-mail to the vendor, which would have its programming staff make the needed changes. Other lenders and counsel may want the ability to make changes themselves at any time. For example, a real estate lending executive using a PDA with Internet access, such as a wireless Palm Pilot, could change and immediately effect a program rule – such as requiring a hard lock box for certain types of deals. The lender's counsel could similarly make a change in a loan document master form which would immediately become part of all new loan documents being prepared across the country for that lending program.

Total Cost of Ownership

Technology professionals understand that the total cost of owning technology ("TCO") goes far beyond purchasing hardware and licensing software. TCO includes the cost of support for: user training, program upgrades, backups and user requested changes. TCO can be often be many multiples of initial acquisition cost. Over the past decade escalating TCO for many applications, has resulted in enterprises outsourcing technology services. More recently, the growth of the Internet has led to the development of Applications Service Providers ("ASPs") where a specific business process is executed via an Internet-based solution. Several companies are now offering loan processing and document automation services via an ASP model.

Real estate lending operations are frequently technology orphans within large financial institutions. While they may play a significant role in the investment business they are not generally accorded the technology resources that securities trading or commercial banking receive. A real estate lending executive should consider (a) the level and costs of internal technology support they receive, and (b) the alternative benefits and costs that a vendor will pass on to them for reasonably foreseeable training needs, upgrades, and document and program modifications.

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IV. Answers for the Modern Workplace

In addition to providing processing advantages that could lead to increased market share, loan document technology has the potential to make legal risk information retrievable and to transform how legal risk decisions are made. Document automation, used correctly, may create meditative space for complex matters that deserve time and attention while speeding through the ordinary transactions. In an era when training resources are scant and employee turnover is high, knowledge of an institution's past problem solving practices can be extremely valuable. If, as part of the bargain, document automation lightens the burden of performing the more mundane and routine tasks from system users, and affords them outlets for intellectual inquiry, so much the better. The potential rewards are considerable.

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