

WRITTEN TESTIMONY IN SUPPORT OF HOUSE BILL 6233

To: Senator Duff and Representative Barry

From: Jonathan Anderson and Richard Sellman, CATIC

Date: February 17, 2009

Re: Proposed Revision to Connecticut General Statutes Section 49-2(c)

Many real estate-secured commercial credit facilities are requested by borrowers and underwritten by banks and other lenders as so-called "closed-end" loans. In this type of loan, the primary feature is that the full principal amount requested is advanced by the lender to the borrower at the closing, to be repaid over an agreed term often in some installment fashion. The loan is evidenced by a promissory note and secured by a real estate mortgage on the borrower's property. In this type of loan, another feature is that, as the loan principal is repaid, the borrower has no ability to request that additional principal advances be made; hence the term "closed-end" loan.

In this instance, there is no issue concerning the priority of the lien of the mortgage securing the closed-end loan. The priority is established as of the time the mortgage is recorded and it covers the principal loan amount advanced at that time.

There are also other real estate-secured types of credit facilities requested by borrowers and underwritten by commercial lenders that are referred to as "open-end" loans. In this type of facility, the lender agrees to make available to the borrower a stated principal amount which may, but often is not fully advanced at the closing. Rather, by the terms of the loan agreement, the lender has reserved a sum of money for the borrower which may be drawn down for a period of time following the closing. The facility may or may not contain a "revolving feature" whereby the borrower can request advances from time-to-time, repay various principal sums from time to time, and reborrow principal again, within the parameters of a certain total principal amount limit.

The issue in the State of Connecticut, for commercial lenders, is the priority of loan advances made pursuant to a loan facility secured by real estate mortgage after the mortgage is recorded. The issue was created by a body of Connecticut case law developed over a number of years. A key determinant under the case law is whether the future loan advances were obligatory or discretionary on the part of the lender. Only obligatory future advances were protected. Clearly, the lending community prefers to retain control over future risk and discretionary advances are desirable.

The legislature has addressed the issue in Section 49-2, subsection (c) of the General Statutes, by creating a statutory safe harbor for the priority of certain future advance mortgages. Currently the statute grants priority to future discretionary advances made under a commercial revolving loan facility, without regard to whether the authorized amount of indebtedness is either, at the time of recording of the mortgage, or at any future time, fully advanced.

For various business and credit underwriting reasons, commercial lenders may be willing to, and often do, write real estate secured future advance loans, but without a revolving feature. From the borrower's perspective, it may be important to be able to reserve the use of a certain principal sum over time, even though it is not necessary or desirable to take the full authorized loan amount, or even any amount, at the closing, at the time the mortgage is recorded. Based on the current wording of the statute, such a loan facility secured by mortgage does not necessarily enjoy the priority of the future advance safe harbor provision. We do not discern any rational purpose in according different treatment to non-revolving future advance commercial mortgages.

The proposed amendment will make clear that mortgages securing either revolving or non-revolving future advance commercial loans will enjoy the same statutory priority with respect to future advances, provided the requirements of the statute are complied with.

Respectfully Submitted  
CATIC

By Jonathan Anderson and Richard Sellman