

Structuring Cross-Collateral/Cross-Default Real Estate Loans

Single vs. Multiple Mortgages; Partial Prepayment and Partial Release; Intercreditor Agreements for Senior-Junior Lien Positions

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Today's faculty features:

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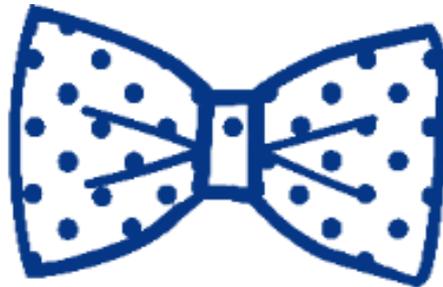
Complex Loan Structures: Mixed Collateral, Multi- Jurisdiction, Choice of Law

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Ren RH Legal Consultants

Always Working Smarter



Ren R Hayhurst

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 - Managing Partner Irvine, California office (2001-2011)
 - Real Estate Finance Team Leader (1998 – 2017)
 - Asia Coordinator (2009-2013)
 - Bryan Cave International Trade Board Director (2009 – Present)
 - 9 years as a banking trial lawyer
- Current (2020 to Present)
 - Managing Director of Ren RH Legal Consultants
 - Owner of The Law Offices of Ren R Hayhurst
 - Counseling for Complex Loan and Bond (Taxable and Tax-Exempt) Structured Loan Transactions for Lenders and Borrowers
 - Oversee Litigation and Enforcement or Defenses for Complex Structured Loan Transactions

Program Overview

- **Basic Underwriting Issues**

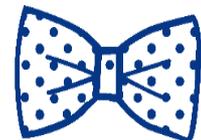
- Multiple Borrower Concerns – Who owns the collateral vs. who will receive the benefits loan funds,
- Multiple Lender Concerns – Potential enforceability collateral Issues; ultimately, the test requires an examination of the reasonableness of the locus of pledged of assets, the borrower, and/or the lender to coordinate all available remedies
- Multi-Jurisdiction Issues – What jurisdictions require each party to take advantage of any applicable statutory and common law rights and remedies of the or which will result from the choice of legal jurisdiction and venue, together with any procedural pros or cons arising from the parties' agreement at the outset for the controlling legal and procedural

- **Basic Legal Issues**

- Multiple borrower issues for loan structuring
- Multiple collateral issues for security purposes

- **Complex Choice of Law Issues Involve the Interplay of Legal and Business Issues**

- Applicable law for procedural purposes
- Applicable law for enforcement purposes
- Strategic applications



Structuring and Documenting Real Estate Loans with Cross-Collateralization and Cross-Default Provisions

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 - Commercial Real Estate Financing
- Commercial Real Estate Purchases and Sale
 - Commercial Real Estate Leasing
 - General Business Transactions

The Single Deed of Trust

An Introduction

- In a classic real estate financing transaction, a party (borrower or purchaser) seeks financing from a lender using a real property as collateral.
- The lender documents the financing transaction so that in the event of default, the lender may recover the amount financed plus other fees and costs.
- The transaction will be documented with a promissory note, a deed of trust (mortgage) and related documents.
- In the event of a default, a lender will bring an action using the deed of trust (mortgage) as the basis for recovery.

Additional Documents

- In addition to a deed of trust (mortgage), the following agreements may be included:
- Assignment of Rents;
- Environmental Indemnification;
- Guaranty;
- UCC-1 Financing Statement

Common Provisions to Include in the Loan Agreement

- Description of collateral, including both real property and personal property;
- Provisions relating to the borrowing entity, including:
 - Single purpose, bankruptcy remote entity, preferably a limited liability company, sometimes lender will accept pre-existing limited partnership;
 - Person (managing member (general partner) who has best knowledge with regard to representations and warranties;
 - Representations and warranties relating to real property;
 - Representations and warranties relating to personal property;
 - Representations and warranties relating to borrowing entity;
- Provisions relating to payments over life of loan, including:
 - Reserves to pay costs related to the property—taxes, insurance, etc.
- Availability of prepayment and availability of income stream to lender in event of prepayment (defeasance or prepayment penalty)

Multiple Deeds of Trust (Mortgages)

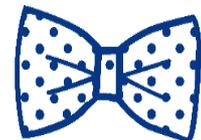
- The typical real estate loan described in the prior slides typically is based on a loan to value for the property that does not exceed 75% and may be considerably less
- The borrower may require additional financing to complete the transaction.
- Depending on the transaction contemplated (straight purchase with an existing structure on real property vs. purchase of property for redevelopment or development), additional financing may be mezzanine financing to bridge the difference between the value of the property when purchased and the value of the property to be developed or funds to finance the remaining loan to value
- Regarding the former financing, the second lender may have to look to other forms of collateral (*e.g.*, pledge of LLC membership interests)
- Regarding the latter financing, the second lender will require a second deed of trust (mortgage) [and so on, if additional financing is sought]

Tax Considerations

- Property Tax
 - For those of you who practice in California, Proposition 13 presents issues regarding value of real property for Property Tax issues
 - An issue on the ballot may make Property Tax unpredictable—it is proposed to remove Proposition 13 protections from commercial real property
 - This tax issue is premature for this webinar
 - Otherwise Proposition 13 presents issues for a lender, particularly where a real estate financing transaction involve real property in different states

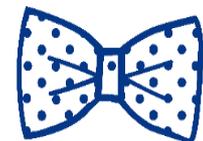
Key Distinctions For Multi-Collateral and Cross-Defaults

- **Basic Underwriting Issues**
 - Multiple Borrower Concerns – Who owns collateral vs. who receives the loan funds
 - Multiple Collateral Issues – Location of assets and coordinating remedies
 - Multi-Jurisdiction Issues – Choice of law and serial foreclosures
- **Basic Legal Issues**
 - Multiple borrower issues for loan structuring
 - Multiple collateral issues for security purposes
- **Complex Choice of Law Issues**
 - Need a logical and “organic” choice based on factual issues related to the locus of the collateral, the borrower or the lender
- **Interplay of Legal and Business Issues**
 - Applicable law for procedural purposes
 - Applicable law for enforcement purposes
 - Strategic applications



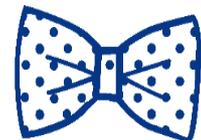
What is Ahead for 2020 and Beyond

- Multiple Property/Multiple Jurisdiction Transactions
- Mixed Collateral Situations
- More Flexibility in Subordinate Debt and Alternatives to Structured Lending
- Protecting remedies when dealing with multi-jurisdictional issues
- You Can Have Your Cake And Eat It Too!



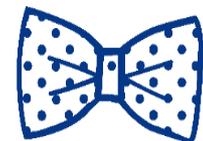
Cross-Default vs. Cross-Collateralization

- **Differences between cross-default vs. cross-collateralization**
 - Cross-default = Enforceability is directly related to specificity
 - Junior lender on real estate secured loan may be stuck with senior loan cross-default, but resist any other cross-default provisions
 - Junior lender on personal property secured loan can often negotiate no cross-default with senior loan if “permitted transfer requirements” are satisfied
 - Cure default, provide replacement guaranty, approval of new management and business plan, payment of costs
 - Cross-collateral
 - Borrowing Base facilities = Must accept cross-collateral nature of loan, but limit effect to “base allocation amount” for project senior loan advances



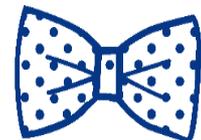
Multiple Collateral Issues: Risks, Issues and Strategies

- **Single Deed of Trust/Mortgage Securing Multiple Properties**
 - Can pursue serial sales of portions of the collateral under one security instrument as long as you have the correct waiver of the borrower’s right to require a single sale
 - Same rights can be built into multiple security instruments used for multiple properties located in different jurisdictions
- **Can use a single instrument to secure senior and junior obligations in cross-collateral situations**
 - In most jurisdictions, it is easier to foreclose multiple debts with a single instrument to protect deficiency recovery and guarantor liability
 - Make sure to include (i) express cross-default between multiple debts secured by a single instrument and (ii) specific debt priority provisions in the application of sale proceeds provisions
 - Avoid the self-imposed “sold-out junior” problem with 1st and 2nd liens



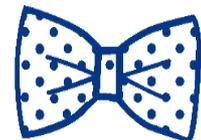
Multiple Collateral Issues: Risks, Issues and Strategies

- **Multiple Deeds of Trust/Mortgages Securing Multiple Properties**
 - Usually required when collateral exists in multiple counties within a single state or in different states
 - If properties in different states, can choose the State law of one jurisdiction to control all security instruments, but each instrument must meet the procedural requirements of each state
 - Also can pursue serial sales of different collateral under multiple security instruments as long as you have the correct waiver of the borrower's right to require a single sale
 - Make sure to highlight on the cover of the security instrument that each instrument is one of multiple security instruments securing a single debt which are cross-defaulted
 - Make sure to include express cross-default provision between all security instruments



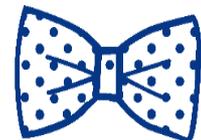
Multiple Collateral Issues: Risks, Issues and Strategies

- **Interplay of Real Property Collateral and Personal Property Collateral**
 - In all States, UCC remedies against personal property can be pursued independently of real property remedies
 - Beware in “one-action rule” states where real property rules trump the UCC for public policy reasons
 - Foreclosure = Unified real property and UCC sale remedies
- **Be Aware of Fixture Filings rules vs. Removable personal property rules associated with real property collateral**
 - Fixture filings should be included in the DOT/Mortgage, but also need to file a UCC for non-fixture personal property listed as part of the personal property collateral (i.e., proceeds, equipment, non-integrated HVAC equipment, etc.)



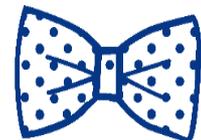
Multiple Collateral Situations

- **Enforcement of remedies with multiple security instruments on separate properties.**
 - Single note secured by multiple deeds of trust
 - If properties are in different jurisdictions, best course is to make a single choice of law for all loan documents
 - Design security instruments to permit serial foreclosures or combined foreclosure to yield best recovery results
 - A/B note structures with subordinated lien structure
 - Beware of multiple notes secured by separate properties which are cross-defaulted and cross-collateralized
 - Options to placing first and second liens on multiple properties
 - “Structural subordination” within multiple security instruments



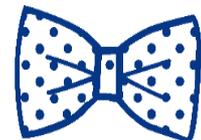
Multiple Collateral Situations

- **Enforcement of remedies with multiple security instruments on a single property**
 - A/B note structures with subordinated lien structure
 - Advantages of using a single security instrument with structured subordination vs. taking a first and second lien on one property to secure separate debts
 - Purposes of taking multiple liens on a single property
- **Enforcement of remedies with single note/security instrument for subordinated tranches of debt**
 - “Unitranche” deals are really just syndicated deals with structural subordination between co-lenders, with a standard agent and co-lender relationship wrapped into single set of note and collateral documents.



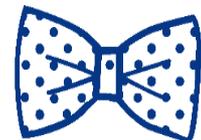
Multiple Collateral Situations

- **Mixed collateral with real and personal property liens**
 - Strategies involve combined sales vs. separate enforcement of real property and personal property remedies
 - Beware of one-action rule states and the need to tread carefully
 - Consider the merits of a “unified sales” approach, as opposed to multiple sales
 - Enforcement of provisions providing for multiple sales under single security instrument
 - Valid even in “one-action rule” states, but must draft such provisions carefully and expressly to provide the extent of remedies desired



Multiple Collateral Situations

- **Mixed collateral with real and personal property liens**
 - All States separate real property lien enforcement from personal property lien enforcement
 - This permits separate exercise of remedies against different types of collateral, so strategy should be aimed at maximizing recovery and taking advantage of expedited personal property remedies
 - Key Distinction in “One-Action Rule” States (CA, WA, NV, UT)
 - Despite UCC rules, a “real property secured loan” must be foreclosed under the real property rules, even if there is separate personal property collateral (i.e., letters of credit, pledge of cash and/or security accounts)
 - Look for statutory exemptions or limitations which provide express protections for lenders or borrowers



Complexity In Multiple Collateral Situations

- **Complexities with cross-default and cross-collateral issues**
 - Always review consideration issues between cross-defaulted/cross-collateralized loans if different parties involved
 - Different issues if the same parties involved in multiple loans
- **Key to these provisions = Be specific in describing the loans which are cross-defaulted and the rights granted by cross-collateralization**
 - “Catch-all” cross-default provisions not favored by courts
 - Beware of LaserPro style generic cross-default provisions
 - Consider the need for “third-accommodator” provisions in cross-defaulted/cross-collateralized security instruments
 - Beware of “conversion” of UCC-secured loans which are cross-defaulted with real property loans
 - Similar to risk adding an “abundance of caution” DOT or Mortgage



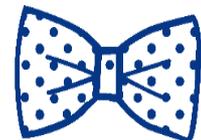
Multi-Jurisdictional/Choice of Law

- **Options with Collateral in Various Jurisdictions**
 - Look for “reasonable nexus” between the transaction and the choice of law (includes location of collateral, residence of borrower, principal place of business/administration for lender)
 - Balancing requirements of procedural lien requirements and legal contract enforcement options
- **Choice of Law Issues**
 - Again, specificity solidifies the enforcement of choices
 - Use of legal opinions (local law vs. choice of law opinions)
 - Limitations on Liabilities or Choice of Remedies
 - Forum presents non-conveniens issues
 - This right is “waivable” for both borrowers and guarantors



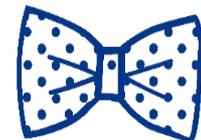
Overview of Subordination Relations

- **What is the relationship between the senior obligations and senior borrower and junior obligations and mezz parties?**
 - Both loans typically are for the collateral and ordinary business operations of respective obligors and not for re-investment in securities or for other investments
- **Interplay of real property liens vs. personal property liens**
 - Senior lender always underwrites both the collateral property and the manager/controlling party for the collateral property
 - Mezz lender is usually in a first risk position tantamount to equity investor
 - Obligations of partners/members vs. obligations of sureties and/or guarantors
- **Both duties and obligations arise from privity relationship**



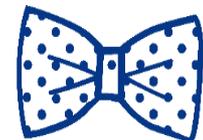
Initial Subordination Issues

- **Secured vs. Unsecured**
 - Lien, Membership Pledge or Both
 - Unsecured Loans and Other Payment Rights
- **Subordination/Intercreditor Agreements**
 - Name is Unimportant – Tri-Party Relationship
 - Subordinate Payment Rights
 - Subordinate Remedies
 - Standstill Provisions
 - First Right of Purchase
 - Importance of “Free Release” Provisions
 - Changes to Senior Loan
 - Protective Advances
 - Bankruptcy Rights



Key Underwriting Legal Issues – Senior Loan

- **What is the purpose of the senior loan?**
 - Re-financing; acquisition; cash-out re-finance; construction
- **Where is the value going?**
 - All proceeds to the borrower entity (and owners) and/or the property
- **Who is obligated to repay?**
 - Typically borrower should be the asset owner(s)
 - Extent of guarantor liability (i.e., repayment, bad boy carveouts, alternative guaranty liabilities)
- **Is there cross-default/cross-collateralization to other obligations of borrower or affiliates?**
 - Be wary of cross-collateralizing personal property or unsecured obligations with real property secured obligations
 - Avoid the “tail wagging the dog” dilemma



Key Underwriting Issues – Mezz or Junior Loan

- **What is the purpose of the junior/mezz loan?**
 - Typically form of equity investment
- **Where is the value going?**
 - All proceeds to the owner or borrower entity and/or equity for the project
 - Proceeds often used by investor for non-project related purposes
- **Who is obligated to repay?**
 - Typically borrower should be the borrower entity owner(s)
 - Extent of guarantor liability (i.e., repayment, bad boy carveouts, alternative guaranty liabilities)
 - Cash management requirements
- **Is there cross-default/cross-collateralization to other obligations of borrower or affiliates?**
 - Be wary of cross-collateralizing assets with other senior loan collateral



Key Intercreditor Issues – Senior Loan

Key Senior Lender Concerns

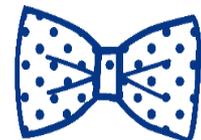
- **Focus on Subordination of Payments, Remedies and Bankruptcy Rights**
 - Deferred Payments vs. Permitted Pre-Default Payments
 - Remedies = Real Property Limitations (i.e., Standstill) vs. Personal Property (i.e., Permitted Transfer Requirements)
 - Bankruptcy – Key for senior lender is to control priority of payments, voting rights and claim rights
- **Loan Modifications**
 - Greater flexibility for wide range of permitted changes (usually limits only to amount, term, prepayment, rate and repayment terms)
- **Free Release and First Right to Purchase**
 - Free release required for partial release senior loans (preservation of claims for junior lien holder)
 - Senior Lender will usually allow junior lender to purchase senior loan for “par” on a non-recourse basis (issues relate to default interests, late charges, etc.)



Key Intercreditor Issues – Mezz Loan

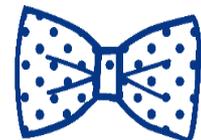
Key Junior Lender Concerns

- **Flexibility on Subordination of Payments, Remedies and Bankruptcy Rights**
 - Push for Permitted Pre-Default Payments (include excess net sales proceeds for partial release deals)
 - Remedies = Real Property – Limit length and conditions to standstill vs. Personal Property – Set up objective standards for pre-approved transfer rights
- **Loan Modifications**
 - Try to have both loans limited to “permitted modification” provisions
- **Free Release and First Right to Purchase**
 - Free release should preservation of claims against borrower on unsecured basis and try to sweep excess proceeds as available
 - Price for loan purchase should be limited to principal and regular interest
 - Also, beware of borrowing base senior loans – negotiate project allocation for both subordination and senior loan purchase rights



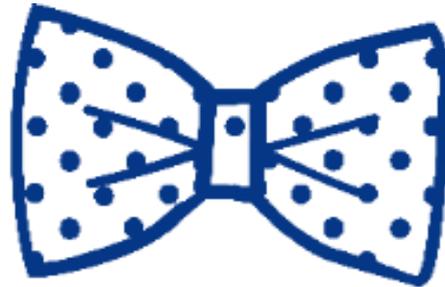
Technical/Legal Choice of Law Issues

- **Basic Rule: Choice of Law must have a reasonable relationship to the transaction**
 - Law of real property can always be the controlling law
 - Law of location of loan negotiation, loan funding, loan administration typically enforceable as an alternative choice of law, even when the other state law is significantly different than the law of the property state
- **Elements of Choice of Law**
 - Distinguish between procedural requirements (must be the law of the property state) vs. enforceability requirements
 - Add venue and forum non-conveniens provisions
 - Usually obtain legal opinions from both states at issue



Final Thoughts

- Ask The Right Questions Up Front When Exploring These Structural Options
- Build as Much as You Can Into Complex, Structuring LOIs, Term Sheets, and Loan Applications
- Call us if you have a question – It is Fun and Free!



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Always Working Smarter

Thank You

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