

Issues Relating to the Acquisition of Real Estate Secured Debt

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Presented to various Real Estate Investment Groups 2009



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Overview



- **Consider the entire Life Cycle of the Transaction**
 - Extensive Due Diligence first
 - Loan Acquisition
 - Workout
 - Foreclosure/Deed in Lieu/BK Issues
 - Asset Acquisition
- **Consider all Costs when Pricing Deal**
 - Legal
 - Business



Overview



- **Buying Debt**
 - **Stepping into the shoes of the Lender**
 - Manage the Loan Like a Lender until you acquire the Asset
 - **You are Buying the Documents**
 - Loan Documents
 - Loan File / Servicing File
 - Note and right to payments
 - Guaranty
 - Deed of Trust / Mortgage and right to foreclose
 - **Consider Performing Loans for Yield play (Servicing)**



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Letter of Intent



- **Form Letter of Intent**
- **Preliminary Pricing**
 - Develop “draft” Foreclosure Strategy
 - Consider Cost & Time to acquire
- **Due Diligence and Closing Timetable**
 - Refundable Deposit during DD Period



Loan Purchase Agreement



- **Competitive v. Negotiated**
 - Complete due diligence pre-bid
- Aggressive Negotiation
- Reps and Warranties
- Allocation of Risks



Loan Purchase Agreement



- **Purchase Price**

- Credits or Transfer of Reserve Accounts
 - Escrow Accounts, Tax and Insurance Reserves
 - Advance Accounts
 - Borrower Accounts
 - TIs, CapEx, Commissions



Loan Purchase Agreement



- **Due Diligence Period**
 - Terminate deal for any reason
 - Refund of Deposit, Buyer discretion
- **Transfer of Servicing Rights**
- **Transfer of Reserve Funds**
- **Closing Timetable and Instructions**



Loan Purchase Agreement



- **Reps & Warranties (example only)**

- Seller owns the loan and can sell it
- All documents & correspondence in possession
 - Loan Documents and Loan File
 - Correspondence (LL Claims)
 - Servicing file
- Not cross collateralized or cross defaulted
- UPB plus costs and fees outstanding
- Status of Foreclosure or Workout if any
- No other litigation pending
- Property reps and warranties (tougher to get)



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Loan Purchase Agreement



- **Allocation of Obligations & Risks**
 - Allocation of loan payments
 - Indemnification
 - Default or Breach by Seller
 - Remedies
 - Covenants regarding pending foreclosure action



Due Diligence



- **Extensive due diligence is the most critical thing you can do *BEFORE* your deposit goes hard on the loan acquisition**
 - Loan Document
 - Loan File
 - Property level
- **Document and Materials Request List to Selling Lender**



Due Diligence



- **Extensive Property & Business level due diligence**
 - **Asset Summary Report (ASR)**
 - Financial Summary of Asset, Borrower and Guarantor
 - Pay History of Loan
 - Third Party Reports in file (Can you get access to property?)
 - Property Inspection
 - Construction Consultant
 - Engineering / Soils Report
 - ADA, Zoning, Land Use PZR report
 - Environmental Update of Phase 1
 - Unfinished Construction – Check status of licenses/permits/entitlements
 - As-Built Survey



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Due Diligence



- **Legal Due Diligence Summary**

- Material Issues Summary Report & Document Checklist
- Title Update / Lender's Policy
 - Liens, CC&Rs, Sub Lenders
- Loan Documents and Loan File
 - Note and Deed of Trust (Status of Advances / Funds)
 - Inter-creditor Agreements (Participation)
 - Extensions/mods and Forbearance Agreements
 - Guaranty (recourse v. non recourse) – Proper Waivers
 - Correspondence, understand Lender/Borrower Relationship
 - Lender's Original Checklist
- Borrower Structure– true SPE



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Due Diligence



- **Legal Due Diligence Summary (cont'd)**
 - Review Correspondence for Possible Lender Liability Claims (Punitive Damages)
 - Breach & Bad Faith
 - Negligent servicing
 - Failure to give notices before exercising remedies
 - Meddling in day-to-day management of borrower
 - Interference with contracts/third parties
 - Evaluate Lender actions post default
 - Reserve fund and Escrow/Fund Control
 - Review Reserve Fund Agreements
 - Survey (ALTA)



Due Diligence



•Legal Due Diligence Summary (cont'd)

•Asset Class Specific

- HOA Documents / CC&Rs (Are you a successor)
- Status of DRE Report or subdivision report (maintain if converting to Rental)
- Challenges to converting to rental
- DRE Bonds
- Construction Contract and Dev Agreement Issues
- Insurance
- Leases / Sales Contracts
- Third Party Agreements, Subsidy and Maintenance Agreements
- Historic Tax Credit Issues for Urban Projects



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Due Diligence



- **Legal Due Diligence Summary (cont'd)**

- Record Searches
 - Bankruptcy
 - Litigation and Judgments
 - UCC
 - Criminal



Post Due Diligence



- **Re Trade**

- Communicate with Seller issues in advance of end of DD period

- **Regroup on Foreclosure strategy if necessary.**

- Reassess costs to get to asset



Loan Closing



- **Point Person**

- One Business – One Legal

- **Clear Escrow Instructions**

- All original Loan Documents
- Instructions to record Assignment of Deed of Trust and other documents



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Post Loan Closing - Workout



- **Default Letter and reservation of rights**
- **Pre-Negotiation Letter BEFORE communication**
 - Negotiations do not modify documents
 - Acknowledgement, Release and Waivers
 - Dual Track (Foreclosure proceeds while in negotiations)
 - Evaluate Borrower cooperation
 - Foreclosure Strategy: Is Deed in Lieu possible
 - Email correspondence
 - Drawbacks of Pre-negotiation letter



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Post Loan Closing - Workout



•**Forbearance or Work out Agreement**

- General Release: Lender Liability Issues
- Borrower & Guarantor Reaffirm Loan Terms
- Cooperation provisions
- Get something you do not already have
 - Fix defects in Loan Documents
 - Guaranty spring into effect if Borrower files BK
- Short period for pay off for quick yield play
- Keep foreclosure process moving



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Asset Acquisition



- **Deed in Lieu**
- **Non-Judicial Foreclosure**
- **Judicial Foreclosure**



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Asset Acquisition



- **Deed in Lieu**

- With cooperative borrower - fast (30—45 days)
- Similar to purchase agreement
- Coordinate transition
 - Obtain needed cooperation on transfer
 - Keeping borrower in place to finish construction or facilitate and finish the development process
- No Merger of Deed of Trust/Mortgage



Asset Acquisition



- **Non-Judicial Foreclosure**

- Trustee Sale (CA 120+ days)
- Trustee Sale Guaranty, Why?
 - The TSG assures the following information:
 - Legal description and vesting.
 - Liens on the property.
 - Property taxes.
 - Bankruptcies.
 - Mailing addresses required for service
- Title Company /Trustee should handle



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Asset Acquisition



- **Judicial Foreclosure**

- When to Use

- Timetable

- Cost

- Commenced by filing an action in Court

- Receiver, Why and When?

- Deficiency Judgment

- **Suing on the Guaranty and One Action**



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CA Law Issues



- California Civil Code Section 2923.5
 - New notice requirements for DOTs secured by residential real property.
- Civil Procedure Section 1161b
 - Tenant in possession of a rental housing unit when property is sold in foreclosure shall be given 60 days' written notice to quit.



Foreclosure Comparison



	CA	AZ	NV	FL
Judicial	Yes (Not common)	Yes (Not common)	Yes (Not common)	Civil Suit - Title Commitment
Non-Judicial	Yes, handled by trustee. Must be procedurally perfect	Yes Record Notice of Non-Judicial Sale. Can get receiver appt	Yes - NOD filed, similar to CA	No
Timeframe	120 Days	120 Days	120 Days	180 days to 18 months
Redemption Period	12 Months (3 months if no deficiency) following Judicial Foreclosure. No right of redemption following Trustee Sale (Can cure until 5 days before Trustee Sale).	Following Judicial action, borrower has one year to redeem. Reinstate up to 1 day before the sale date. No redemption post trustee sale	Borrower has 35 days from NOD recording to Cure/ or for the 90 day period post NOD pay off in full	Yes but subject to court procedure
Deficiency	With Judicial foreclosure action only	No One Action Rule Guarantor can get credit against deficiency of FMV of asset at Foreclosure sale	Yes -deficiency is available with a power of sale if filed within 6 months of the sale date.	Yes



Bankruptcy



- **Borrower Delay, how long?**
 - Relief from the Automatic Stay?
 - SPE issues
 - Borrower filing prior to loan acquisition
- **Guarantor Bankruptcy**
- **363 Sales**



Conclusion



- **Life Cycle of the Deal**
- **Consider Costs in Pricing**
- **Loan and Property Due Diligence**
- **Other issues and questions**



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