The Bankruptcy of General Growth Properties

Changing the way we think about bankruptcy remote, single-purpose entities

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H. Scott Miller

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Historical Perspective
The downturn of the early 1990s

- Last significant real estate downturn occurred in the early 1990s
  - Direct mortgages secured by individual projects
  - Secured lenders were typically whole-loan lenders
  - Series of individual negotiations concerning individual borrowers and individual properties
  - Guidelines for substantive consolidation start to be delineated by the courts

Historical Perspective
The rise of structured lending and securitization

- Securitization began in early 1990s and peaked in the 2000s.
    - Corporate bond-like method of providing real estate financing
    - Lending structures became inherently complex
    - Easy capital and rising real estate values helped sponsors grow larger and larger
- Strength of sponsor carried importance, but structured transactions relied principally on underwriting separate assets
- Attempted to insulate loans from bankruptcy risks

Historical Perspective
Basic SPE structure

- If followed, separateness covenants should prevent an entity from being drawn into another bankruptcy
  - Prevents a company from engaging in business other than owning a specific property
  - Prevents a company from commingling its assets
  - Prevents confusion in the identity of the company
- Bankruptcy-remote structure attempts to prevent borrower mischief through bankruptcy
  - Vote of independent directors required for bankruptcy filing
  - Goal is to ensure that a non-recourse lender gets the basis of its bargain - which doesn't include a bankruptcy filing

The General Growth Bankruptcy
The properties are filed

- GGP filed 388 entities, including the project owners of roughly 166 of its 219 malls
- Only a handful of the 166 malls were in default; all other properties were performing
- Filing was effected by removing and replacing independent managers
- First-day hearings involved GGP's continued use of a centralized cash management system with pooled cash collateral

The General Growth Bankruptcy

Administrative vs. substantive consolidation

- Each of the GGP entities were administratively consolidated into one proceeding
- Court goes out of its way to state that no substantive consolidation is ordered
  - Pooling and use of cash collateral in the centralized cash management account was the status quo
  - Court states that the act of filing the enterprise is appropriate
  - Court acknowledges separateness of entities and expressly notes that it is not granting substantive consolidation

The General Growth Bankruptcy
Separateness concepts: Lender's perspective

- GGP's property-level filings were improper:
  - Individual assets are specifically underwritten
  - Bankruptcy is not the basis of the bargain: in exchange for no personal liability, lender gets the property when something goes wrong
  - Performing properties with distant maturities
  - Resulted in transfer of value from lenders to GGP's equity

The General Growth Bankruptcy
Separateness concepts: GGP's perspective

- GGP's property-level filings were perfectly proper:
  - Lenders relied on strength of core GGP functions
  - Lenders required sponsor guaranties and the refinancing of balloon payments at maturity; each required sponsor strength
  - Perceived inability to refinance in the future would make corporate reorganization impossible
  - Inability to negotiate with most lenders because of sponsor's financial issues
  - Cash collateral and cash management orders simply preserved the status quo and avoided a massive forfeiture
  - Exactly what bankruptcy is designed to prevent

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Separateness concepts: Historical perspective

- Separateness documentation became industry standard before:
  - Lenders ability to work out loans were constrained by securitization rules, complex loan structuring, intercreditor documentation and accounting rules
  - The remarkable growth of real estate enterprises as a result of easy capital and rising real estate values
- The General Growth bankruptcy was the first test of these standards in today’s industry climate:
  - Avoided a massive forfeiture, which courts abhor
  - Complex real estate cases, with plenty of collateral and good recordkeeping, are easily handled by courts

The General Growth Bankruptcy
The effects on bankruptcy-remote documentation

- GGP plans of reorganization modifications:
  - Changes to separateness covenants to account for centralized cash management
  - Lender consent required for independent managers, unless hired from a corporate services provider
  - Notice to lender prior to removal of independent managers
- Other proposals:
  - Full lender consent over identity of independent managers
  - Requirement for pre-filing negotiations with lender
  - Minimum standards required to effect a filing
  - No removal of independent manager unless for cause

For Additional Information Contact

H. Scott Miller
860.240.2817
scott.miller@bingham.com

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bingham.com

 One Federal Street, Boston, MA 02110-1726