

**2011 ABA SPRING RPTE MEETING
(Washington, D.C.)**

**SALE AND ACQUISITION
OF
DISTRESSED DEBT**

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1. LOOK BEFORE YOU LEAP – THE IMPORTANCE OF DUE DILIGENCE AND CONFIDENTIALITY AGREEMENTS

- a. Loan Document Review –Who owns that Loan Anyway?
 - i. Ultimate goal of purchaser – sell the loans later or loan to own?
Option – buy the asset(s) and pay off loan?
 - ii. Tax implications and limitations for borrower-related purchasers and material loan modifications after acquisition of debt.
 - iii. Obtaining access to the loan file.
 - i. Who is the keeper of the files?
 - ii. Confidentiality/Non-Disclosure Agreements.
 - iii. Completeness of the file.
 - iv. Scope of Due Diligence – Knowing what you are looking for.
 - i. Individual Loan versus Portfolio or Pool of Securitized Loans
 - ii. Lender party contact – intermediary or decision-making party?
 - iii. Loan type – mortgage loan, mezzanine loan, construction loan, CMBS pool.
 - iv. Product type – how many “other parties” are involved?
 - a. Condominium – owners association
 - b. Hotel – third party franchisor, management company – existence of a comfort letter from franchisor
 - c. Mixed Use – REA, commercial tenants
 - d. Ground Lease – Ground Lessor
 - e. Letter of Credit issuer
 - f. Contractor
 - g. Governmental authorities – FDIC, local governments
 - v. Collateral Matters – Lockbox Account, Reserves, Payment Bonds and Guarantees to local governmental authorities relating to construction.
 - v. Holder of the Note and the Holder of the Mortgage and other security – Same? Are there title and/or perfection issues?
 - vi. Required Seller Consents/Approvals – Status and effect on timing of closing
 - i. Pooling and Servicing Agreement
 - ii. Participation/Syndication Agreement
 - iii. Court orders – Receivership order; assignment of judgment
 - vii. Status of Loan – Cataloging what actions Lender has taken to date?

- b. Leases and Other Contracts that Affect the Property
 - i. Tenant leases
 - i. Accurate rent roll plus status of any leases under negotiation.
 - ii. Status of SNDAs.
 - iii. Rollovers and early kickout rights (triggers and timing; termination payments; co-tenancy violations). Evaluate risk – e.g., contract rent versus market rent, inducement options, tenant improvement requirements.
 - iv. Landlord obligations for tenant improvements and existence of reserves.
 - v. Any Tenant ROFO or ROFR to purchase the real estate?
 - vi. Tenant bankruptcies or impending bankruptcies.
 - vii. Security Deposits – Status; effect of applicable state law; any letters of credit.
 - ii. Ground leases – Review leasehold mortgagee provisions and any peculiar ground lessor rights.
 - iii. For hotel properties or other real estate-related properties, such as assisted living facilities/senior housing facilities – is there a management agreement or master lease in place?
- c. Property Inspection
 - i. Date of last inspection report and revelations. Any major repairs or replacements contemplated?
 - ii. Review any notices of violations and status of cure.
 - iii. Certain geographic areas – mold testing.
 - iv. For “flagged” hotel properties, is there a PIP (if so, status)?
 - v. Review of insurance claims and other property-related claims files.
 - vi. REA-affected properties: compliance with obligations and control provisions.
 - vii. Title policy, bringdown (liens, judgments and/or other claims) and survey. Existing liens – validity and timing of sale or foreclosure.
 - viii. Construction Loans – status of construction, type of construction contract, permits and development approvals, escrows, bonds, budget and cost overruns, mechanics liens (if any), completion guarantee and other lender rights under the loan documents.
- d. Appraisals – estimating the value of a real estate secured loan recovery versus a standard appraisal. Require as part of “appraisal value” -
 - i. Lender Resale Adjustment.

- ii. Contested Foreclosure Adjustment (as necessary).
- e. Environmental Reports
- f. Intercreditor Agreements –
 - i. Is debt seller in the first or second position?
 - ii. Are there “Qualified Transferee” requirements, do they apply and, if so, does the purchaser satisfy them?
 - iii. Have appropriate notices been given (e.g., to junior lienholders)?
 - iv. Mezz piece purchases – review of requirements (if any) to cure defaults under the senior loan as a condition to foreclosing on the equity of the fee owner.
- g. Escrow Agreements
 - i. Construction loans – improvement and escrow agreements that are part of development approvals from local government authority.
 - ii. Other loans – tenant improvements, leasing commissions, etc.
- h. Evaluation of Litigation Risks. For a foreclosure, purchaser should examine the facts, legal issues and applicable regulatory concerns.
 - i. Risk of borrower filing for bankruptcy.
 - ii. Other litigation – mechanics liens, tax sales, other creditors
 - iii. For Hotels – compliance with WARN Act (Worker Adjustment and Retraining Notification Act) to the extent applicable.
 - iv. Understanding the law on receiverships in the applicable state(s).
 - v. Understanding Foreclosure Laws in the states where the assets are located. One-action rule; judicial foreclosure versus non-judicial foreclosure (power of sale, confession of judgment); deficiency judgment statutes (if relevant); transfer taxes. For hotel properties, confirm the law allows foreclosure of real property and personal property to be combined in one action. Impact on structure of loan being purchased – e.g., single note with multiple borrower SPEs collateralized by individual mortgages on properties across different locations.
 - vi. Venues for bringing a foreclosure action – state court versus federal court.
 - vii. Existence of possible lender liability claims.
 - viii. Will the purchaser seek a recovery through recourse parties?

2. NUTS AND BOLTS – HOW TO PUT THE DEAL TOGETHER AND WHY

- a. Be Careful What You Ask For - *U.S. Bank National Association v. Ibanez*, 941 N.E.2d 40 (Mass. 2011)
 - i. Involved a residence in Springfield, Massachusetts

- ii. Massachusetts is a non-judicial foreclosure state and lender published in Boston Globe, not in Springfield, Massachusetts
 - iii. The title company was not convinced that the publication was sufficient
 - iv. Foreclosure purchaser sued for declaration that had clear title
 - v. The securitization documents failed to demonstrate that the lender was the holder of the loans at the time of publication
 - vi. An assignment in blank failed to assign anything
 - vii. An assignment of the note does not carry with it the assignment of the mortgage
 - viii. A post-sale assignment with an “effective date” was insufficient
 - ix. Lender did not establish that it was the holder of the mortgages at the time they foreclosed and therefore failed to acquire title.
- b. Standing to Foreclose or Sue on the Note - *U.S. Bank N.A. v. Pamela Mallory, et al.*, 982 A.2d 986 (S. Ct. Pa 2009).
- i. The lender filed a foreclosure complaint and did not set forth any assignment of the mortgage to itself.
 - ii. The borrower claimed the lender lacked standing to foreclose.
 - iii. “Standing” means the party has sufficient stake in an otherwise justiciable controversy to obtain judicial resolution of that controversy. It is a jurisdictional issue that concerns the power of a court to hear and decide a case.
 - iv. The complaint said: “Plaintiff is now the legal owner of the mortgage and is in the process of formalizing an assignment of same.”
 - v. Pennsylvania law does not require that a party have a recorded assignment as a prerequisite to filing a foreclosure complaint.
 - vi. The court stated that the lender’s “averment that it was in the process of formalizing the assignment sufficiently explained why...a copy of the written assignment was not attached to the complaint.”
 - vii. The court also said: “...the recording of an assignment of the mortgage was not a prerequisite to [Lender] having standing to seek enforcement of the mortgage...”
 - viii. The assignment of mortgage was executed after the complaint had been filed but before the judgment was entered. It was not recorded until after judgment had been entered.
- c. Does Being a Holder in Due Course Matter? *Bank of America, N.A. v. Joline A. Ensign et al.* CV095005940S (Sup. Ct. Conn. 2010).
- i. The lender filed a foreclosure complaint without having recorded an assignment of the mortgage to itself.
 - ii. The complaint alleged that the assignment was “to be recorded”
 - iii. The note was endorsed in blank.

- iv. The mortgage stated that it conveyed to property to the initial lender “and Lender’s successors and assigns.”
 - v. The note was a negotiable instrument under UCC 3-104, that was payable to bearer under UCC 3-109 since it did not state a payee
 - vi. The lender had possession of the note
 - vii. A holder in due course is one who takes an instrument for value, in good faith and without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person
 - viii. A holder does not become a holder in due course of an instrument by purchase of it at a judicial sale or by taking under legal process or by acquiring it as part of a bulk transaction not in regular course of business of the transferor
 - ix. The court stated that so long as the lender was the holder in due course of the note, the lender had standing to foreclose even if the mortgage had never been assigned to it.
- d. Servicing Actions after acquisition of debt
- i. It is tempting to not record mortgage assignments in connection with portfolio acquisitions but to instead obtain assignments that are not recorded until needed
 - ii. Raises issues when need to undertake servicing actions, such as partial releases or intervention in condemnation actions – who would get served with a condemnation action?
 - iii. Could be an issue if the assignor undertakes a corporate transformation after signing the assignment but before the assignment is recorded
 - iv. What if the assignment is needed but cannot be located later?
 - v. No UCC-3 filing is required to continue perfection if a secured party assigns a perfected security interest or agricultural lien (*See* Article 9-310(c)). However, if no UCC-3 assignment is filed, then assignor would continue to be the party obligated to file UCC continuations and termination statements
- e. Reps and Warranties
- i. No litigation pending that would draw into question the validity of the sale
 - ii. No consent of any party needed to the sale
 - iii. No untrue information given by seller
 - iv. Seller is sole owner of loan
 - v. The loan is not cross-collateralized with any loan that is not part of the transaction
 - vi. The loan is free from any security interest
 - vii. The loan has been fully disbursed
 - viii. The loan documents are the valid and enforceable obligation of the borrower
 - ix. The mortgage is a first lien
 - x. All taxes and assessments are current

- xii. There are no mechanic's liens affecting the mortgaged property
- xiii. The loan file contains a survey certified to the seller reflecting no encroachments
- xiv. The mortgage is insured by an ALTA loan policy
- xv. The mortgaged property is in compliance with applicable laws
- f. Auction deals, portfolio deals, single loan purchases

3. CLOSING THE DEAL – WHAT DO I REALLY NEED?

- a. Loan Purchase and Sale Agreement
- b. Third Party Approvals
- c. Conveyance Documents, Escrows, Insurance, Loan File, Notices to Borrower or Others
- d. Considerations when the Loan Purchaser is an Affiliate of the Borrower
- e. Title Insurance – Successor to Insured Lender? Endorsements to obtain at Closing and what the Title Company will Require
- f. Opinion Letters – On what?
- g. To Record or not Record? Fees and Taxes
- h. Closing with the FDIC
- i. Substituting Parties in Pending Foreclosure and Receivers

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Acquisition of Distressed Debt



Presented By:
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AND WHY**



- Be careful what you ask for----
Ibanez
- Standing to Foreclose----*Mallory*
- Does Being a Holder in Due
Course Matter?----*Ensign*

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**HOW TO PUT THE DEAL TOGETHER
AND WHY**



- Servicing Actions after
acquisition of debt
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WHAT DO I REALLY NEED?



- Loan Purchase and Sale Agreement
- Third Party Approvals
- Conveyance Documents
- Purchaser as an Affiliate of Borrower
- Title Insurance – Successor to Insured
Lender?



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