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# Mixed-Use Construction Loan Finance: Senior Lender Due Diligence, Multiple Lender Challenges

Ensuring Proper Collateral Structure and Loan Documentation  
in Event of Borrower Default or Project Failure

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THURSDAY, OCTOBER 22, 2015

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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Today's faculty features:

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# **I. CURRENT TERMS/KEY DOCUMENTS**

## **COMPLETION GUARANTIES**

- Issues/Challenges with enforcement
- Scope of work to be covered
- Completion of job vs. responsibility for paying costs of completion
- Right of guarantor to use loan proceeds
- Liquidated damages
- Carving out portions of project not being financed

## **PAYMENT AND CARRY GUARANTIES**

- Limits of liability
- Caps and burn offs
- Net worth/liquidity tests
- What is covered by carry guaranty – interest, taxes, expenses, LIBOR brokerage, insurance, etc.
- Termination events
- Tender conditions

## **NON-RECOURSE CARVE OUT GUARANTIES**

- Losses vs. springing recourse
- What is covered?
- Bankruptcies
- Current trends in what is being negotiated
- Liability caps

## **COLLATERAL ASSIGNMENTS AND OTHER ANCILLARY DOCUMENTS**

- Collateral Assignment and Subordination of Development Agreement
- If third party documents with municipalities or other stakeholders in Project, need for assignment and possibly consent of those third parties
- Dealing with Other Parties' Rights – Example: If garage is part of mixed use development, what rights does owner have to use; control over pricing and preferred and valet parking; recognition of lender rights
- Need for Mortgagee protections in certain documents

## **II. LENDER DUE DILIGENCE ISSUES**

### **GENERAL OVERVIEW**

# **LAND DISPOSITION AGREEMENTS**

- Overview
- Covenants
- Mortgagee Protection Provisions

# CONDOMINIUM DOCUMENTS

- Overview
- Governance
- Easements/Use Concerns
- Mortgagee Protection Provisions
- Local Law Concerns

# PROPERTY DILIGENCE

- Title
- Survey
- Zoning
- Environmental

### **III. MULTIPLE LENDERS**

- Co-lenders (same collateral)
- Lenders financing separate collateral within mixed use development

## IV. INTERCREDITOR ISSUES

### GENERAL

- Importance of intercreditor agreements between mezz lender and senior lender
- Development of modified S&P Form as standard “starting point”
- Intercreditor includes restrictions on transfers of mezz lender’s interest except to “qualified transferee”; and limited exceptions for transactions to affiliates and minority participations
- Includes right on mezz lender’s part to foreclose on its collateral, subject to certain limitations
- In connection with foreclosure on pledged equity interests, mezzanine lender may be required to cause replacement carveouts guarantor to assume obligations under limited recourse guaranty for mortgage loan

## **APPROVAL RIGHTS OVER LOAN MODIFICATIONS**

- Mortgage and mezzanine lenders may have certain approval rights with respect to approval of modifications of the other's loan. These rights may be limited to modifications that involve a fundamental economic features such as:
  - (a) Increase in interest rate, principal amount or fees
  - (b) Increase in required principal payment or amortization
  - (c) Extension or shortening of the scheduled maturity date
  - (d) Modification of terms relating to application of payments; cash trap triggers and mechanisms; required reserves or escrows
  - (e) Extension of lockout period or period during which prepayment premium applies; or imposition of any additional prepayment premium

Certain of these approval rights over changes in the senior loan may be suspended during the pendency of any senior loan workout following a default, unless the subordinate lender cures the default

## CURE RIGHTS OF MEZZANINE LENDER

- Cure rights for monetary defaults:
  - Cure periods granted to mezzanine lender usually don't exceed 10 business days, and may be shorter
  - Limits on number of cures; consecutive and "lifetime" caps
  - To cure, mezzanine lender will be required to reimburse servicer advances and interest thereon; should be able to avoid default rate and late charges if cure within the cure period
- Cure rights for non-monetary defaults:
  - Cure periods granted to mezzanine lender
  - Rights of extended cure for defaults that do not result in material adverse effect
  - Mezzanine lender may be granted rights to foreclose on equity pledge if necessary to cure and the mortgage lender may agree to waive the borrower's defaults following foreclosure by the mezzanine lender if the defaults do not involve material adverse effect

## **PURCHASE RIGHTS OF MEZZANINE LENDER**

- Rights of mezzanine lender to purchase the mortgage loan:
  - May be triggered only when senior loan is accelerated or becomes “specially serviced” (vs. “mere” Event of Default)
  - Purchase price for senior loan (may be able to negotiate to exclude prepayment premiums, default rate, exit fee, late charges and certain special servicer fees if purchase is timely, but will have to cover servicer advances and interest)

## **RESTRICTIONS ON TRANSFER BY MEZZANINE LENDER**

- Restrictions on ability of mezzanine lender to transfer interests in or foreclose upon mezzanine loan without rating agency confirmation or senior lender approval
- Typical formulation contains exception for transfer to “Qualified Transferee” (generally defined as institutional entity with \$600+ MM in assets and \$200-\$250+ MM in shareholder equity) and limited exceptions for transfers to affiliates and minority participations
- Further restrictions if construction loan; mezz lender to bring in Qualified Developer

## **FORECLOSURE MAY REQUIRE REPLACEMENT CARVEOUTS GUARANTOR**

- In connection with mezzanine lender's foreclosure on pledged equity interests, mezzanine lender may be required to cause a replacement carveouts guarantor to assume the obligations under carveouts guaranty for mortgage loan going forward

## **INTER-LENDER ISSUES ON CONSTRUCTION LOANS**

- Defaulting lenders; Borrower's or Non-Defaulting Lender's problem
- Possible solutions
  - Right to stop funding
  - Allow Borrower to fund
  - Replacement of defaulting Lenders
- Issues arising where two different lenders (or groups of lenders) are financing different aspects of a mixed use project
  - Self help remedies
  - Priming liens
  - Solutions if one lender stops funding

## **V. CASE STUDY**

### **A HIGH PROFILE MANHATTAN PROJECT THAT IS PART OF A MASTER PLANNED DEVELOPMENT**

- Understanding the Ground Lease Structure – Master Ground Lease and “Severed Leases”
- The Co-Construction Agreement:
  - Risks that the work does not get completed and Lenders’ respective rights
- The Role of EB-5
- Construction of the Platform
- Different stakeholders in the Tower;
  - What if they don’t fund
- Requirement to construct community facilities

## **VI. CONSTRUCTION LOANS WITH AN EB-5 MEZZANINE LOAN**

- Overview of program
- Program basics
- Role of the Regional Center
- The EB-5 process
- Why is it going “mainstream”
- Intercreditor issues
- Senior lender risks

# THANK YOU

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