

Morgan Lewis

Acquiring Mortgage and Mezzanine Loans in Distress: Ten Mistakes to Avoid

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OVERVIEW – Ten Mistakes to Avoid

- Misunderstanding the Market and Its Opportunities
- Entering the Market Without a Strategy
- Misunderstanding Enforcement Procedures
- Misunderstanding the Foreclosure Process
- Negotiating Carelessly
- Making Too Many Assumptions
- Limiting Due Diligence
- Misunderstanding Intercreditor Issues
- Forgetting About Lender Liability
- Misunderstanding the External Factors

Understand the Market and Opportunities

Strategy for Surviving Shifting Market Dynamics

- Enlightened Bail-Out Strategy
- Modifying Mark to Market
- Capital Adequacy versus Transparency
- CMBS Impasse
- Systemic Revisions
- Tortious Interference

Understand the Market and Opportunities

Cause of Distress Triggering Sale

- Seller Distress
- Borrower Distress
- Asset Distress
- Tenant Distress

Understand the Market and Opportunities

Market Opportunities and Discounts

- Commercial Loans
- Residential Loans (Pools)
- Performing Loans
- Non-Performing Loans

Understand the Market and Opportunities

Seller Motivation and Differences

- Regulatory Pressures
- Effect of CMBS Shutdown
- Avoid Future Funding Requirements
- Seller Financing

Understand the Market and Opportunities

Bankruptcy Asset Purchase

- Section 363 Sale as an Alternative to Foreclosure
 - Benefits:
 - *Faster and potential transfer tax savings if sale is pursuant to a Chapter 11 plan.*
- Buyer Protections
 - Stalking horse--break-up fee
 - Sale free of liens and encumbrances

Develop a Strategy (and Be Prepared to Change It to Reflect Market Opportunities)

Type of Investment

- Asset vs. Pools
- Product Type
- Commercial vs. Residential
- Current Market Opportunities

Develop a Strategy (and Be Prepared to Change It to Reflect Market Opportunities)

Internal Tolerances and Strengths

- Risk Tolerance
- Control Tolerance
- Ability to Manage/Service Loan or Asset
- Additional Capital; Exit Strategy

Develop a Strategy (and Be Prepared to Change It to Reflect Market Opportunities)

Loan Purchase vs. REO

- Speed vs. Risk
- Bankruptcy and Enforcement Risk
- Loan to Own
- Seller's Motivation

Understand Enforcement and Foreclosure Process

Rights Upon an Event of Default Mortgage Foreclosure

- Process
- Timing
- Bankruptcy

Understand Enforcement and Foreclosure Process

UCC Foreclosure

- Process
- Timing
- Bankruptcy

Understand Enforcement and Foreclosure Process

Foreclosure Costs

- Transfer Taxes
- Condominium Refilings

Use Care in Negotiations

Establish a Framework

- Note vs. Asset Sale
- Capital Stack
- Loan to Value Metrics
- Whole Loan vs. CMBS
- Underwriting Criteria
- Performing Loans at Risk
- Tenant Representation in At-Risk Building
- Seller Financing
- User Sale/Premium

Use Care in Negotiations

Binding vs. Nonbinding

- Binding Email
- Due Diligence Period
- Term Sheet vs. Loan Purchase Agreement
- Seller's Motivation

Don't Assume Anything

Don't Assume Loan Was Properly Documented

- Originations: Competitive Frenzy
- Lax Underwriting
- Waiver of Closing Conditions
- Inadequate Structures

Don't Assume Anything

Don't Assume the Information Delivered is Accurate

- Trading Desk vs. Asset Management/Servicing
- Lack of Information - Pools
- Seller's (Lack of) Knowledge of Loan Documents
- Seller's (Lack of) Knowledge of Assets

Don't Assume Anything

Don't Assume Seller Won't Give Representations

- Key Representations
- What Is Market
- Asset vs. Pool Purchases
- Buyback and Escrow Provisions

Always Perform Due Diligence

Chain of Ownership

- Undocumented Assignments
- Controlling Holder
- Failure to Locate Originals
- Recent Foreclosure Cases

Always Perform Due Diligence

Common Errors in Loan Documents

- Collateral Description
- Structure
- Duplicating Mezzanine Loan Documents
- Guarantees

Always Perform Due Diligence

Property and Legal Due Diligence

- Leases
- Title and Survey
- Physical
- Zoning

Always Perform Due Diligence

Financial

- Property Financial
- Borrower and Guarantor Credit
- Cash Flow; Waterfall (pre- and post-default)

Understand Intercreditor Issues

Transfer Requirements

- Participations
- Qualified Transferee; Rating Agency Approval
- Required Notices
- Future Transfers

Understand Intercreditor Issues

Foreclosure Requirements

- Right to Pledge/Transfer vs. Right to Enforce
- Common Requirements
- Replacement Guarantees
- Guaranty Claims

Understand Intercreditor Issues

Loan Modification Requirements

- Market Limits on Modifications
- Senior Loan
- Subordinate Loans
- Work-Out Exception

Understand Intercreditor Issues

Subordinate Lender Rights

- Cure Rights
- Purchase Rights
- Approval Rights
- Cross-Defaults

Beware of Lender Liability

Covenant of Good Faith and Fair Dealing

- Implied Covenant
- Interpretation
- Sole Discretion of Lender
- Discussions Letters

Beware of External Factors

Potential Cram-Down Legislation

Potential Changes to State Foreclosure Laws
(e.g., extending cure periods, foreclosure timing)

Federal Government Legacy Loan Program

Questions?

- If we do not have an opportunity to answer your questions during the webcast, we will follow up with you shortly after the webcast concludes.

Disclaimer

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