

Understanding Mezzanine Loans in Troubled Times

Presented by:

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Overview

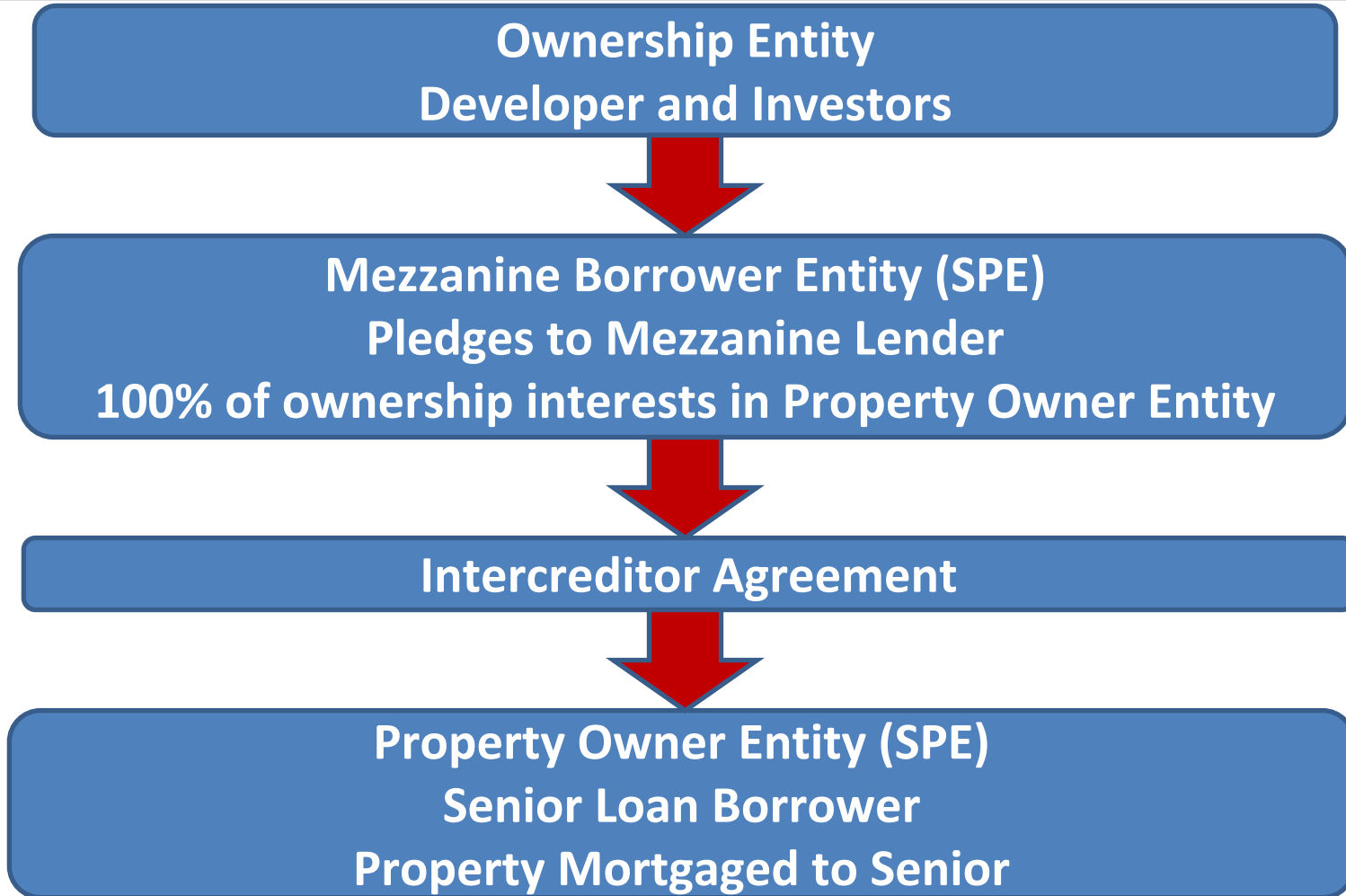
1. Understanding the capital stack in a project
2. What is a Mezzanine Loan? Mezzanine Loan Documents
3. Intercreditor Agreement
4. What happens in Mezzanine Loan Workout

I. Understanding the capital stack in a project

- **Capital Stack: Total amount of each stack equals 100% of capital invested into project**

Equity
Preferred Equity
Mezzanine (Junior)
Mezzanine (Senior)
B Piece
A Piece
Senior Debt- Property Level

II. What is a mezzanine loan? Mezzanine Loan Documents



II. What is a mezzanine loan?

Mezzanine Loan Documents

Mezzanine Loan Documents:

- Sometimes if Senior Lender and Mezzanine Lender are the same institution, basic form of loan documents is the same, except for modifications that are particular to each level of debt.
- Covenants against modifying senior loan documents, etc.
- Pledge Agreement
- UCC Insurance Policy
- Endorsements to owner's policy of title insurance to protect Mezzanine Lender

III. Intercreditor Agreement

Intercreditor Agreement: Governs the relationship between the Senior Lender and the Mezzanine Lender with respect to the project (including payment and exercise of rights and remedies).

III. Intercreditor Agreement

- (a) Review and understand intercreditor agreement in order to protect interest in project:**
- i. Typical intercreditor: recites the parties to the project; requires each of senior lender and mezzanine lender to acknowledge the existence of each other's loan documents (including receiving copies); sets forth assignment/transfer restrictions; notice and cure rights; bankruptcy; amendments to loan documents; right to purchase senior loan
 - ii. If default under senior loan documents, confirm cure periods under senior loan documents and intercreditor agreement
 - iii. Mezzanine Lender has certain cure rights if senior loan borrower defaults
 - iv. If default under senior loan documents is not cured, Senior Lender can ultimately exercise rights and remedies and wipe out mezzanine lender by foreclosing the mortgage
 - v. If Mezzanine Lender is foreclosing, make sure all transfer provisions, including "Qualified Transferee" provisions in intercreditor agreement are satisfied.
 - vi. When negotiating intercreditor agreement, try to define "pre-approved" Qualified Transferees
- (b) Purchase senior loan.**

IV. What happens in Mezzanine Loan Workout

Mezzanine Foreclosure Sale

- a) If not already done, make demand upon Borrower and Guarantor (completion guaranty/bad act issues). Provide copies of all notices to all parties required by applicable loan documents.

IV. What happens in Mezzanine Loan Workout

- b) Get prepared to exercise rights and remedies and to own the project:
 - i. Due diligence. Gather as much information as possible to quantify risk of owning the project
 - ii. Reach out to Senior Lender:
 - 1) Clarify event of default and proposed cure; if cure requires foreclosure- Qualified Transferee issues
 - 2) Does bank have a Qualified Transferee set up or does a new one have to be formed. Consider co-lender issues as those will apply in post foreclosure asset management
 - 3) Debt Service on Senior Loan.
 - iii. Try to quantify costs up front.

IV. What happens in Mezzanine Loan Workout

- c) Either (i) conduct a public auction foreclosure sale in accordance with UCC or (ii) accept collateral in full satisfaction of debt, which requires consent of pledgor (“strict foreclosure”). Under (ii) no deficiency action can be commenced against debtor.
- d) Loan documents generally say that 10 days prior notice is commercially reasonable to conduct a public auction sale. That time frame is merely a safe harbor. Generally need at least 4 weeks. The goal is to conduct a commercially reasonable sale by advertising in order to attract as many bidders as possible.
- e) Engage an auctioneer and obtain a proposal as to costs for advertising the sale, attendance at auction, etc. Where will auctioneer advertise? Also may be helpful to engage a broker from the area to assist in marketing the project.

IV. What happens in Mezzanine Loan Workout

- f) Determine the terms of sale, i.e. where will sale be held; deposit, closing date, etc.
- g) Review senior loan documents to confirm your strategy with respect to the property if you are the successful bidder is consistent with the obligations under the senior loan documents.

IV. What happens in Mezzanine Loan Workout

- h) Create a bidder package so that qualified bidders will know what they are purchasing; confidentiality agreement. Consider including the following (depends on project):
- i. Copies of intercreditor agreement and senior loan documents
 - ii. Pledge agreement and organizational documents
 - iii. Provide certain diligence to increase potential bidders. BUT DO NOT PROVIDE COPIES OF APPRAISAL TO ANYONE INCLUDING AUCTIONEER. THE VALUE OF THE PROPERTY SHOULD NOT BE DISCLOSED TO ANYONE. “Sale Chilling” issue. Environmental reports may be restricted from being made available if it was prepared at borrower’s request.

IV. What happens in Mezzanine Loan Workout

- i) Coordinate bidding strategy. What you bid gets applied to the outstanding indebtedness. If you bid the full amount of your debt, there is no deficiency. Bid must be commercially reasonable, but shouldn't shock the conscience (especially if you intend to assert a deficiency claim against borrower or guarantor). In considering bid, factor in amount of senior liens.

IV. What happens in Mezzanine Loan Workout

- j) Assume mezzanine lender is going to buy property back.
 - i. Be prepared to own the property, including, making sure insurance up to date, engaging property manager, etc.
 - ii. Notify any tenants.
 - iii. Engage third party professionals if not done so already.
 - iv. Negotiate amendment to senior loan documents if necessary.
 - v. Remember that once you own the property, you are still bound by the terms of the senior loan documents.

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Kevin represents senior and mezzanine lenders in real estate financing transactions, asset-based lending transactions, restructurings, and work-outs. Kevin is a member of the firm's executive committee and works out of both the firm's Boston and New York City offices. Kevin regularly handles a broad range of lending transactions, working directly on all aspects of the transactions and playing a key role in supervising other attorneys in this practice. Much of his work centers on the representation of the agent in multi-lender real estate finance transactions, real estate portfolio finance transactions, mezzanine finance transactions, asset-based transactions, loan restructurings, and workouts on a local, regional, and national scale.

Representative Transactions

Restructuring of mezzanine line of credit secured by pledges of partnership interests in 60 limited partnerships

Foreclosure of membership interest pledge in mixed use real estate project

\$800 million commercial mortgaged backed securities loan to retail company secured by liens on 135 properties in 29 states

\$251 million senior secured borrowing base revolver and term loan facility to a lumber company secured by liens on 90 properties in 21 states

\$160 million debtor-in-possession secured borrowing base revolver and term loan facility to a furniture company

\$140 million commercial mortgage warehousing facility and \$40 million stock acquisition facility

\$275 million secured revolver and term loan facility to finance the acquisition of a Major League baseball franchise

Affiliations

American Bar Association, Massachusetts Bar Association, New York Bar Association, Real Estate Finance Association, Turnaround Management Association

Admissions

Commonwealth of Massachusetts, 1991
U.S. District Court, District of Massachusetts, 1992
State of New York, 2004

Education

Boston University School of Law, J.D., 1991
Duke University, A.B., 1988

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