UCC Mezzanine Underwriting & Foreclosure

Presented by:
Troy Denunzio: Assistant Vice President
UCC ONE Operations Manager
Jeremy Poetker: Deputy Chief Underwriter

What We Will Cover Today

- Stewart UCC One
- What is Mezzanine Financing
- Equity Pledges
- Security Summary
- Intercreditor Agreement
- Mezz Foreclosure Process
- Risks and Downsides
- Insuring the Title After the Foreclosure Process

Stewart Title UCC ONE

With greater risk comes greater reward, as well as a greater need to have lender interests protected. Stewart Title National Commercial Services' newly re-branded UCC ONE division offers a comprehensive solution that protects the security interest in mezzanine loan transactions:

Our Article 9 Comprehensive Plus lender's policy has protected mezzanine lenders since 2002 by insuring the lender's attachment, perfection and priority of the security interest in the pledged collateral. We also offer additional coverage for certificated security interests to protect the lender under Article 8 of the Uniform Commercial Code (UCC).

Our Mezzanine Endorsement to an Owner's Policy of Title Insurance assigns payments made under the owner's policy to the mezzanine lender. It also provides non-imputation coverage and insures the continuation of coverage should the mezzanine lender decide to foreclose.

No matter the size of the loan, lenders enjoy the benefits of working with the industry's best underwriters, who offer fast turnaround times and help them meet tight deadlines. Our dedicated UCC ONE team gives each transaction the personal attention professionals have come to expect from Stewart Title National Commercial Services.

2024 Title Tenets Webinar Series

UCC / Mezzanine Overview

stewart

NATIONAL COMMERCIAL SERVICES

What is Mezzanine Financing

A mezzanine loan is a loan made to the owner of the equity interests of a single-purpose property owning entity that is a borrower under a mortgage loan.

The mortgage borrower must also be a single-purpose entity with real property as its sole asset. Unlike a mortgage loan that is secured by a lien on the real property itself, a mezzanine loan is secured by a pledge of the mezzanine borrower's 100% equity interests in the mortgage borrower.

Moody's describes it as 'lending to a borrowing entity or group of entities that directly or indirectly own a real property-owning entity, which debt is secured by a perfected first security interest in the mezzanine borrower's pledges ownership interest in the property owner.

What is Mezzanine Financing

These equity interests are personal property; therefore, the pledge is governed by the UCC, rather than real property law.

Upon a default under the mezzanine loan, the mezzanine lender will commence a foreclosure under the UCC. When a mezzanine lender forecloses on its mezzanine loan, the mezzanine lender is foreclosing on the pledged equity interest in the mortgage borrower, and not the real property itself.

Equity Pledges

Equity pledges may also be used as additional security for a regular mortgage loan.

In this scenario, a mortgage lender receives a mortgage on the real estate, plus an additional pledge of equity. The lender now is secured both ways and has two options on how to foreclose and acquire title to the real estate.

This is different from a pure Mezzanine Loan. In a Mezz Loan, there is a separate debt secured by a pledge under the UCC.

However, foreclosure of an equity pledge follows the same process as foreclosure of a mezzanine loan.

UCC Security – Summary

Real Estate Mortgage

- Note / Mortgage / Record Mortgage

UCC Article 9 “General Intangible”

- Note / Pledge and Security Agreement / UCC with SOS

UCC Article 8 “Protected Purchaser”

- Issuer “Opt In” to Article 8 / Certificate / Possession

Comparison – Article 9 Security vs Mortgage Loan

Regular Mortgage Loan:

- Collateral is real property
- Promissory Note, Mortgage
- Mortgage is recorded in real property records

Mezzanine Loan secured via Article 9:

- Collateral is personal property
- Promissory Note, Pledge and Security Agreement
- UCC Financing Statement filed with secretary of state

Organization Chart (typical)

OTHER INVESTORS

JUNIOR MEZZ BORROWER LLC

SENIOR MEZZ BORROWER LLC

PROPERTY OWNER LLC

PROPERTY

Intercreditor Agreement

In a financing transaction that involves both a mezzanine and mortgage loan, the lenders will typically enter into an intercreditor agreement at or around the time of the closing of the loans, which will govern their respective rights and obligations toward each other, including the strict conditions that the mezzanine lender must satisfy to complete a mezzanine loan foreclosure. These conditions include, but may not be limited to the following:

Curing all mortgage loan defaults either before or simultaneously with foreclosure

The equity transferee being a qualified transferee meeting certain financial and experience requirements

Intercreditor Agreement

- The posting of a replacement guarantor (for any nonrecourse carve-out guaranty, environmental indemnity, completion guaranty, carry guaranty, or payment guaranty) and
- The establishment of a hard cash management system

2024 Title Tenets Webinar Series

UCC Mezzanine Foreclosure Process

stewart
NATIONAL
COMMERCIAL SERVICES

UCC Mezzanine Foreclosure Process

A UCC foreclosure of a mezzanine loan indirectly secured by real property could take as little as 10 days but is typically a 45- to 90-day process.

This can be much faster than a regular mortgage foreclosure in most states.

Example: New York mortgages much be foreclosed judicially; this can take well over a year to complete.

UCC Mezzanine Foreclosure Process

I. TYPES OF FORECLOSURE UNDER ARTICLE 9 OF THE UCC

a. Judicial

b. Strict Foreclosure

c. Foreclosure by Sale Public or Private

Rights of a secured party are found in Part 6 of Article 9

(9-601 to 9-628) of the Uniform Commercial Code as well as by agreement of the parties

UCC Mezzanine Foreclosure Process

II. FORECLOSURE BY SALE (Public sale is most common)

a. Basic Requirements

i. Proper Notice

1. Persons to be notified

2. Timeliness

3. Content and Form

b. Must be COMMERCIALLY REASONABLE (9-610(b))

i. "Every aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be **commercially reasonable**."

-- Fact-based concept

UCC Mezzanine Foreclosure Process

III. “STRICT FORECLOSURE” (9-620)

- debtor consent required
- like “deed in lieu” for real estate

IV. JUDICIAL FORECLOSURE

Mezzanine Loan Foreclosure: Risks and Downsides

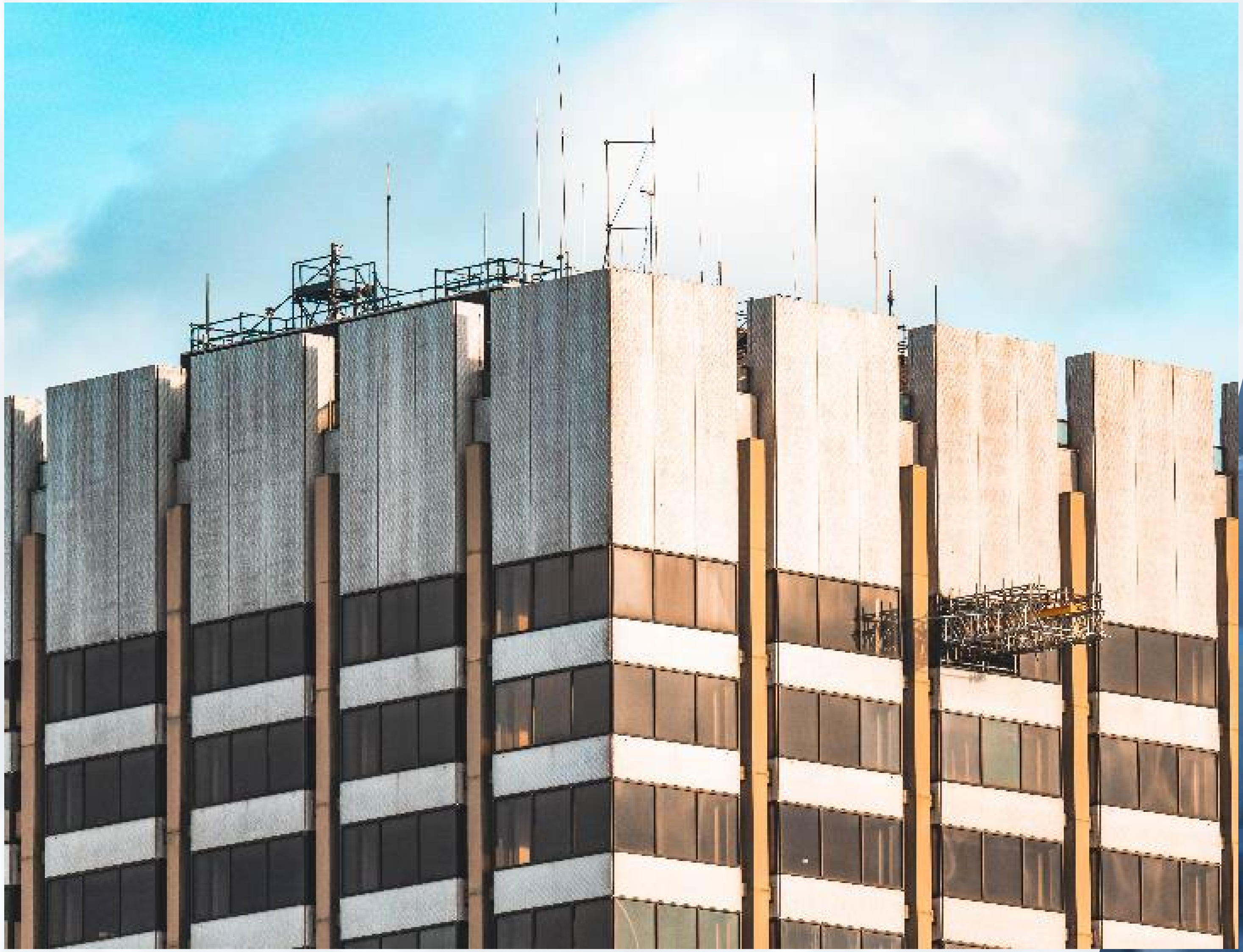
A foreclosing mezz lender obtains control of the real estate SUBJECT TO all liens and encumbrances <u>on the real estate</u>.

As the collateral is the ownership and control of the mortgage borrower, the mezzanine lender not only becomes the 100% owner of the mortgage borrower, it also effectively becomes the owner of the underlying real property.

The underlying real property will remain subject to all liens and encumbrances (including the mortgage loan itself), which, by contrast, would have been extinguished in a mortgage loan foreclosure process.

Legal Vulnerabilities of Mezz Foreclosure

- “Commercially Reasonable” and “Good Faith” is difficult to nail down
- Conflicting law – UCC or real estate?
- “Clogging of Equity of Redemption” defense
- Bankruptcy defenses – Fraudulent Transfer, Preference



2024 Title Tenets Webinar Series

UCC Mezzanine Insuring Title After the Foreclosure Process

stewart
NATIONAL
COMMERCIAL SERVICES

Can we insure title to real estate after a Mezz foreclosure?

- It depends
- Fact-dependent
- We are concerned about litigation
- There could be multiple legal avenues where a disgruntled borrower could challenge a mezz foreclosure

UCC ONE Mezz Foreclosure Requirements to Insure

This is a non-binding list of requirements to review and, if acceptable, to issue an owner's policy. This list assumes a policy is being issued to the foreclosing entity. Additional requirements would be necessary for a third party "bidder" to be insured. Underwriting Discretion may limit or eliminate our ability to provide coverage.

A. Review of full title search/report

1. Policy subject to land mortgages and title issues?

B. Review of Mezz Loan documentation and foreclosure proceeding:

a. Mezzanine Loan Agreement and any amendments/modifications
b. Organizational documents of Mezz debtor and issuer, showing opting into Article 8.
c. Original Pledge Agreement and any amendments/modifications
d. Original Promissory Note(s)

UCC ONE Mezz Foreclosure Requirements to Insure

e. UCC Financing Statements filed against all Debtors in Debtors state of formation and any continuations amendments thereto: (Filing cancelations may be necessary).

f. Current UCC search against the debtors.

g. If certificated under Article 8: Does secured party have possession of the original certificates? Do certificates contain Article 8 language? Do we know that there are no other pledges of certificates?

h. UCC Policy (if any) issued to the Mezz lender

i. Copies of all default notices sent to all parties as required in the loan agreement/pledge agreement.

j. All correspondence between the Debtor and lender relating to the default.

k. If a strict foreclosure is contemplated under 9-620 of the UCC, a copy of the agreement sent to the Debtor and accepted by the Debtor. Proof of authority of Debtor to consent

UCC ONE Mezz Foreclosure Requirements to Insure

m. Documentation from the UCC foreclosure: how was the sale conducted, advertised, noticed, transcript of the bidding process

n. Notice of the sale given to all interested parties – personal service is the preferred method

o. Opinion of counsel from the attorney that conducted the UCC foreclosure for the lender

p. Possession: demonstrated actual ownership of the property by the Mezz lender: for example, Mezz lender has taken the keys, has entered into management agreements, is dealing with tenants, performing maintenance, paying taxes, obtaining insurance, etc.

q. Other agreements, estoppel certificates

What are we looking for:

Risks of litigation

Challenge to the foreclosure

Control of the entity

UCC ONE

Thank you. Questions?

Stewart Title Guaranty Company
National Commercial Services
stewart.com/commercial

Troy Denunzio
Assistant Vice President
UCC ONE Operations Manager
troy.denunzio@stewart.com

Jeremy Poetker
Deputy Chief Underwriter
jeremy.poetker@stewart.com