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## DLA Advisory: General Growth Bankruptcy Decision Weighs in Favor of Debtors

Never underestimate the creativity of a desperate debtor or the sentiments of a bankruptcy judge. General Growth Properties' (GGP) bankruptcy (*In re: General Growth Properties, Inc., et al*) is likely to provide a number of guideposts for real estate developers, investors and lenders as the case progresses and the restructuring envelope gets pushed.

### Score One for the Debtor

Judge Gropper's latest decision, handed down August 11, 2009, which denied a motion by certain special servicers to have their properties and loans removed from GGP's bankruptcy case based on a bad faith filing, proves once again that the best intentions of lenders to devise iron-clad protections of their access to the real estate collateralizing their loans are always going to be tested by public policy and pragmatism.

While bankruptcy judges are bound by the Bankruptcy Code and legal precedent, the court is ultimately a court of equity, in which judges have a certain freedom of discretion to apply the law to specific circumstances but make decisions based on the equities of the specific issues presented. In the case at hand, the lenders, represented by their special servicers, argued a bad faith filing and that their collateral should be excluded from debtor's estate because each property was owned by a special purpose entity ("SPE") and that each was in no immediate danger of defaulting on its mortgage loans. Although the facts supported their position on the debt service question, Judge Gropper denied the bad faith motion pointing out that GGP had established that retaining control over the cash flow from these properties was necessary to support the operations of the entire GGP universe. The judge also noted that a "bankruptcy-remote" entity is not "bankruptcy-proof." Given the fact that public policy leans against denying access to reorganization, it is highly unlikely that lenders will ever achieve that goal.

Perhaps the most effective obstacle against real estate bankruptcy is the inclusion of "springing guarantees," in which the borrower must bring current a contingent liability upon such a filing. However, the GGP decision could undermine even that protection if a judge could rule that the guarantee on one or more individual properties could threaten the chances





of reorganizing the controlling corporate entity. While not at issue in this latest decision, stay tuned for other cases sure to turn up soon.

### Hidden Gems

Beyond the ruling handed down by Judge Gropper, the decision contains some remarkable items of note that will no doubt prove useful to creative borrowers and counsel, including:

- Anticipated Repayment Dates (“ARD”), the date on which a mortgage loan goes into “hyper-amortization,” will be considered by the court to be the equivalent of a loan maturity date for the purpose of establishing the inability of a borrower to repay the loan, either due to lack of alternative financing or the inability to sell the collateral for more than the debt.
- GGP established that it was stymied in its attempts to work with special servicers prior to the bankruptcy filing. Although uncertain, GGP seemed to suggest that the subject loans might have avoided inclusion in the bankruptcy had they been given the opportunity to restructure the debt earlier. Since such out-of-court negotiations are often preferred over drawn out and expensive litigation, the decision suggests that CMBS issuers and regulators may have to rethink the trust provisions that appear to prevent master servicers from transferring a loan to special servicing in the absence of default. Judge Gropper left no doubt about what he thought of the lenders’ arguments against GGP (and no doubt showed some bias toward the debtor) when he concluded that at least this part of the litigation was “a diversion from the parties’ real task, which is to get each of the Subject [SPEs] out of bankruptcy as soon as feasible. The [special servicers] assert talks with them should have begun earlier. It is time that negotiations commence in earnest.”
- A master servicer may determine “that a material and adverse default under the loan is imminent and unlikely to be cured within 60 days,” suggesting that, despite popular belief, a borrower does not have to default before a loan can be transferred to a special servicer and modification discussions can begin.
- An “SPE structure [does] not require that...project-level Debtors be precluded from upstreaming their cash surplus at a time it [is] most needed by the [corporate debtor].” In other words, cash flow from a property owned via an SPE is not restricted to use for the benefit of such collateral, further weakening a lender’s protection in the event of a bankruptcy.





- Judge Gropper also put an end to the fiction that lenders could be protected by an SPE's independent directors, noting that "if [the special servicers and lenders] believed that an 'independent' manager can serve on a board solely for the purpose of voting 'no' to a bankruptcy filing because of the desires of a secured creditor, they were mistaken," at least in the situation where the debtor (the SPE) was solvent, though in the "zone of insolvency," as they were in this case.
- The court appeared to accept, as one basis for filing a petition to reorganize, Debtor's determination that a loan was in distress due to a "high loan-to-value ratio...including a loan-to-value ratio above 70%" (*emphasis added*). The idea, coming off the last several years of real estate financing, that an LTV above 70% places a loan at risk might be considered absurd, but it should count as a warning to lenders that borrowers have quite a bit of leverage if they ever find themselves in front of a judge.
- The court put another final nail in the CMBS coffin when it determined "[t]here was no evidence to counter the Debtors' demonstration that the CMBS market...was 'dead' as of the Petition Date [April 16, 2009], and that no one knows when or if that market will revive" (*emphasis added*). The decision also accepted testimony that "there is no evident means of refinancing billions of dollars of real estate debt coming due in the next several years," a conclusion that will, no doubt provide no joy for both lenders and borrowers.

