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N.Y. Real Property Law Journal

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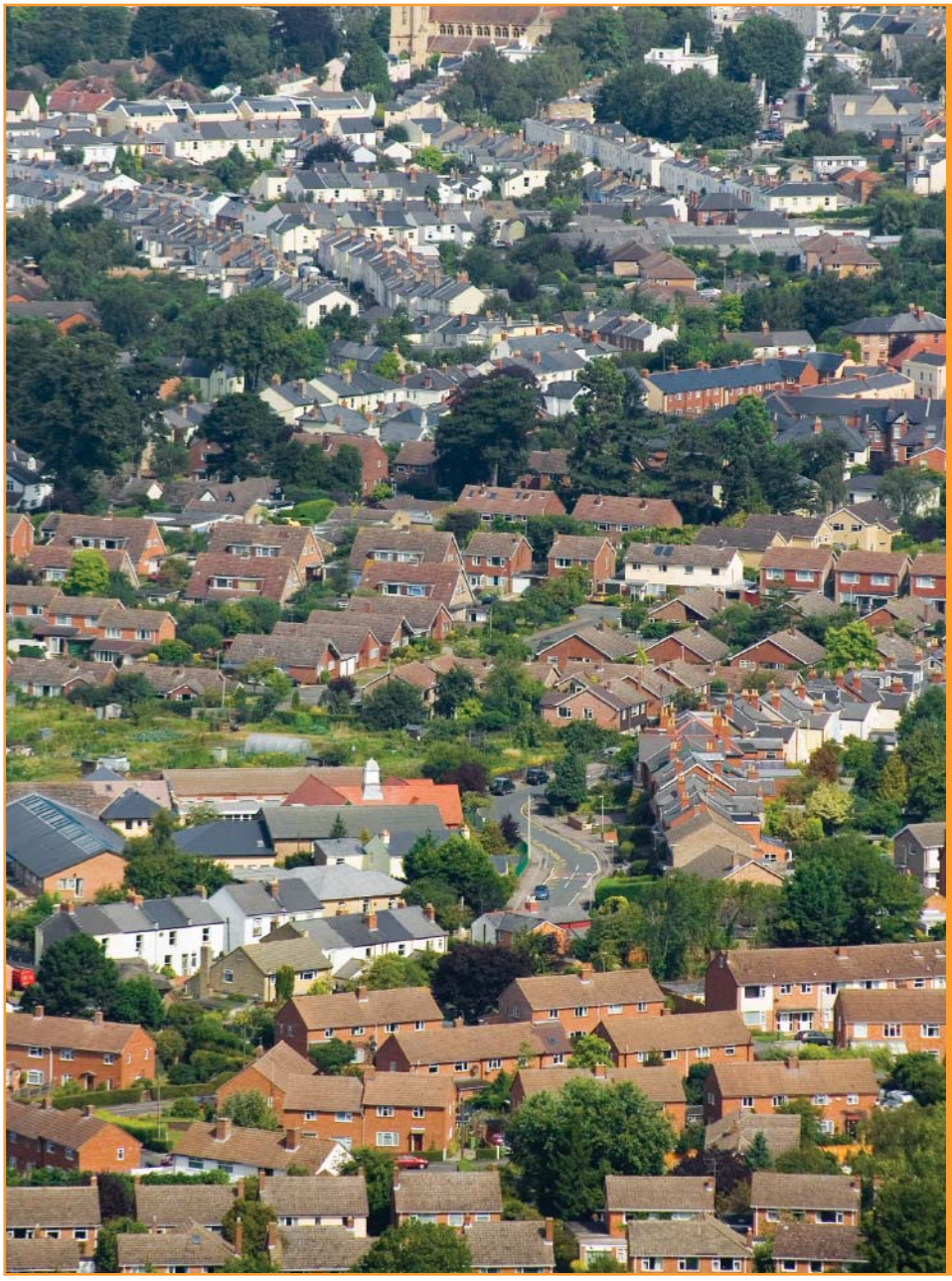

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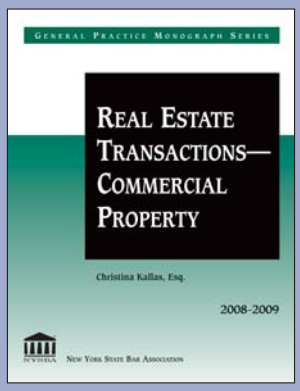
Real Estate Transactions—Commercial Property*



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A must-have for real estate practitioners, this monograph provides an overview of the major issues an attorney needs to address in representing a commercial real estate client and suggests some practical approaches to solving problems that may arise in the context of commercial real estate transactions.

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* The titles included in the **New York Practice Monograph Series** are also available as segments of the *New York Lawyer's Deskbook* and *Formbook*, a five-volume set that covers 27 areas of practice. The list price for all five volumes of the *Deskbook* and *Formbook* is $650.

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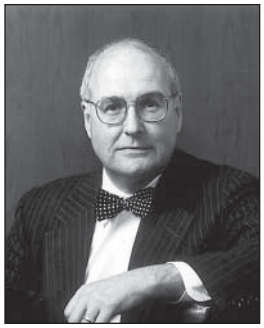
A Message from the Section Chair

Ah, the burdens of being Section Chair! There are, of course, ways of lightening this burden and seeking help with the various tasks including this one. One way is to look to past Chairs' messages and have a past Chair write it for you. I am, as I dictate this, staring at a beautiful picture of Lorraine Power Tharp and am reading her message in the Spring 1999 issue of our *Journal*. On the front page of that *Journal* there is a message noting the passing of another one of the remarkable attorneys who have populated our Section. It is a tribute to Marvin R. Baum and is written by our own Steven J. Baum, his son. Marvin was, of course, as was Lorraine, a past Chair of our Section. Steve notes that "[Marvin] tirelessly gave of his time to both new and experienced attorneys. Anyone could call and ask him a question. They would receive not only an educated response, but possibly one that could not be found in any book." In reading Lorraine's message, I see the following: "My father, William H. Power, Jr., is a lawyer and a retired District Attorney. He had a reputation as an extremely tough and effective District Attorney, yet I know that he dealt with all persons fairly and civilly. My father dispelled the notion, held by some attorneys, that being civil means being weak." Lorraine talks about a meeting at the St. Lawrence County Bar Association at which her father attended and was recognized. She states, "I was very impressed by the collegiality expressed by those attorneys and the respect they clearly had not only for honorees but for one another. Collegiality, respect, civility—they do not preclude one from representing one's client most zealously." Lorraine goes on to conclude this point: "I continued to learn from my dear parents—as we all should from our lifelong mentors—even on issues such as civility in the profession." We are family.



My first remembrance of an association with the Real Property Law Section was a notice I received to attend a meeting at the Annual Meeting of the Title and Transfer Committee. The Title and Transfer Committee was chaired by Edgar Levy, one of the legends of our profession. I did go to the meeting and was treated immediately (I could not have been practicing 10 years) as a respected member of the Bar. Edgar was a true gentleman, as were the lawyers who populated that Committee. I am not going to start naming names—one exception, Jim Pedowitz, and I want to make mention of his beautiful wife, Mary—because I will of course forget someone, but I have learned more from being an active member of that Committee—Title and Transfer—than I have from practically any other activity I have participated in during my practice. Note that Lorraine spoke not only of the State Bar, but also of the St. Lawrence County Bar Association and the collegiality and affection the lawyers of that association found with each other. There are many of you—I suspect most of you—who are receiving this publication and are not actively involved in a Bar Association, particularly those of you who are younger members and starting out in the profession. I have said it before and I believe it with all my heart: When you are looking back at the end of your career, the experience you have had as a lawyer will be enhanced so much by the participation in your local and State Bar associations. We are social animals—we are not meant to be alone. Even a single practitioner—and maybe even most importantly single practitioners—gets so much from our association with one another. I remember participating in a Schenectady County Bar Association luncheon discussion of what we could do to enhance membership in the Association and attract more participants. I suggested we go back to basics—let us schedule an evening meeting once a month, hold it in a tavern and drink. I actually received a very negative comment from one of the attorneys present, but my point is that the function of a Bar Association is to enhance the collegiality that Lorraine spoke of—to get to know leaders such as Marvin Baum, Jim Pedowitz and Lorraine Tharp. Lorraine mentions the importance of mentoring. For those of you who are more established attorneys, membership in the Bar is an opportunity to associate with—and mentor—younger attorneys, many of whom do not have the experience we older attorneys have. (When we started practice almost all of us were able to obtain employment in a law office, so that even if we went out on our own later we had a basic training.)

Lorraine went on to speak of the Annual Meeting and since she is my guide, so do I. Joel Sachs, Program Chair, put together a tremendous program focusing essentially on the State, Federal and title insurance response to the subprime mortgage crisis, with Professor Vincent DeLorenzo from St. John's University, who was so knowledgeable; Kirsten Keefe of the Empire Justice Center, who is probably the recognized authority in the State on this issue, and Melvin Mitzner, one whose name should have been included in the previous listings. The program was up-to-date with PowerPoints, including items obtained within the last day or two. Matthew Leeds chaired a program with David Berkey, Anne Reynolds Copps, Daniel Shlufman, Andrew Brucker, Steven Goldman and Mindy

Stern discussing rights and remedies on defaults in single-family residential contracts of sale. This crew knew what they were talking about and the give-and-take in their discussions on the nuances and subtleties of the various legal aspects of a real estate contract was so enlightening. At lunch, we posthumously gave our Professionalism Award to Lorraine and we are thankful that Russell (her husband) was there and able to speak to us.

Additionally, we had several committee meetings, including a joint meeting of the Real Estate Finance Committee and the Committee on Real Estate Workouts and Bankruptcy, our Title and Transfer Committee, and our Condominium and Cooperative Committee. That one was a sell-out. **Once again, I point out that most of these meetings and almost all meetings have call-in capability. All you have to do, again, is turn to pp. 76-77 of this *Journal*, identify a committee you wish to be involved in, get a hold of the Chair and you will be a member of the committee and get notices of the call-ins. Of course, not everyone can come directly to New York or Albany or Rochester or wherever, but you can get the experience I have spoken of by beginning to participate in the call-in meetings**.

Finally, I want to note that Bernice Leber, our Association President, has aggressively involved the Bar in addressing the current mortgage foreclosure crisis—about which we devoted a significant portion of our program—and has turned to our Real Property Law Section for help. The members of our Section have been outstanding in their response and our efforts have met with some significant success. In that regard, Bernice was so generous in thanking us during the Annual Meeting, and in turn I want to thank Bernice for her generosity.

Lorraine's message was "right on" in another regard. In 1999, we had gone through a significant downturn in the real estate market, although probably not as pervasive as the one we are experiencing now. Lorraine pointed to developments in 1999 which indicated we were coming out of the downturn, but whether we were or not, she remained positive and her final comment is just what we need: "As I write this message, I share one bright note with you—in glancing out my office window at around 5:30 p.m., I see there is still light in the sky. Spring beckons." Thank you, Lorraine, for writing my message.

Peter V. Coffey

New York State Changes Its Priorities in Low-Income Housing

By Harold Babcock-Ellis

The New York State Qualified Allocation Plan

In 2008, New York State implemented new priorities for the distribution of approximately $32 million in low-income tax credits.[1] These tax credits are used to build housing projects throughout New York State with the requirement that the people who rent the new housing be low-income and pay affordable rent. In order for a new housing project to be funded, an application is submitted to the New York State Division of Housing and Community Renewal (DHCR), which then ranks the projects based on its fulfillment of the requirements in the Qualified Allocation Plan (QAP). The new QAP introduces broad changes that range from increased green building requirements to decreased emphasis on a project's readiness to be built.

Section 42 of the Internal Revenue Code allocates each state $1.75 in federal tax credits per person.[2] The states in turn give the tax credits to the highest scoring projects using their own QAP. (Businesses then invest money in the projects in exchange for tax benefits including the tax credits that are used over a 15-year period. Tax credits are attractive to businesses because they lessen the dollar amount of tax paid by a business as opposed to a deduction that lessens the taxable income of a business.) In 2007 there were 93 applications in New York State for tax credits.[3] On average, the projects received 92 cents on the dollar for each tax credit. Of the projects funded, 90% of the applicants were non-profits and 43% of the projects provided housing for the elderly.[4] The Governor's goals for the use of tax credits include "preserving affordable housing, revitalizing upstate communities, encouraging smart growth and energy efficiency and coordinating all available housing resources to maximize their efficiency and benefits."[5]

The tax credits are allocated primarily by the DHCR; however, there are also three sub-allocating agencies.

Credit Allocation Sub-Agencies

One sub-agency, the New York City Department of Housing Preservation and Development, allocates funds to the five boroughs of New York City and has a 10-year $7.5 billion plan to provide housing to half a million New Yorkers by 2013.[6] The second sub-agency is the Development Authority of the North Country. It was created in 1984 to foster development of housing in Jefferson, Lewis, and St. Lawrence counties in response to the U.S. Army moving the 10th Mountain Division to Fort Drum. The 10th Mountain Division consists of 10,000 soldiers, as well as their families, and created a significant need for affordable housing.[7] The third distribution agency, the New York State Housing Finance Agency (HFA), issues taxable bonds to investors.[8] These bonds are then used to fund mortgage loans to housing companies in conjunction with credits and other conventional financing.[9] HFA funds projects throughout New York State and is authorized to fund mortgages to a variety of entities, including limited and non-profit corporations, nursing homes, community development corporations, youth facilities, senior service centers, and many more.[10]

DHCR and each of the three sub-agencies have individual QAPs used to score, rank and then decide which projects are to be funded. This year only the DHCR changed its QAP. The DHCR scores the yearly applicants by first requiring housing projects to meet minimum "threshold eligibility" requirements and then scoring them on a scale of 100 points.[11] For the 2008 funding round, DHCR reevaluated the priorities of the QAP and significantly changed over 50% of the scoring. Most of the changes are found in three sections: "Program Definitions," "Threshold Eligibility Review," and "Scoring and Ranking Criteria."[12] In addition, DHCR now allows applications to be submitted through DHCR's online database.[13]

QAP Definitions and Threshold Eligibility Requirements

In the QAP's "Definitions" section, DHCR added several new terms that exemplify the new priorities. For the first time, "Persons with Special Needs" is defined as people with HIV/AIDS, drug and alcohol addictions, violence victims and other disadvantaged groups.[14] Projects can earn five points if 15% of their units are reserved for these people.[15] "Visitability" standards were also added to the QAP for the first time. Visitability means that a unit is accessible by a disabled neighbor who comes to visit.[16] To fulfill this requirement the unit must have at least one no-step entrance, 36-inch doorways, and at least a half bath on the first floor large enough to be accessed by wheelchair.[17] Visitability was added as a "Threshold Eligibility Criteria," meaning that in order for a project to be minimally eligible to be considered for funding it must meet these construction standards.[18]

DHCR removed the per housing unit $20,000 annual credit limit from the "Threshold Eligibility Requirements."[19] Instead, the QAP states that the amount of per unit credit allocated will be set by DHCR in its "Notice of Credit Availability," which is issued for each funding round.[20] DHCR's decision will allow projects to keep up with rising construction costs and permit projects in expensive areas. For the 2008 funding round, the per housing unit limit will remain $20,000 in annual credits.[21] In addition to the $20,000 in DHCR federal tax credit

funds, a project may request $20,000 in annual credit funding in the form of New York State Low-Income Housing Credits.[22] This is a strategic decision; however, because one of the QAP's scoring criteria is the amount of credit requested per unit (adjusted for unit size), asking for additional money could lower the project's overall score.[23]

Changes in the "Financial Leveraging" section reflect a large priority shift in how projects are to be funded. Previously, the scoring section was called "Efficiency of Credit Use." Projects could earn up to 15 points depending upon the total amount of credit requested, the amount of credit requested per unit adjusted for size, and the proportion of net syndication proceeds raised from the sale of the project's credits. The new QAP gives 13 points if the project has permanent funding from sources other than DHCR or the HTFC, if the land or building was donated, and if the long-term lease amount is nominal. The net syndication proceeds and amount of credit per unit were kept as part of the scoring as a fourth prong.

Going Green

The most noticeable change in the QAP was the addition of "Green Building Measures." Not only is Green a "Threshold Eligibility Criteria,"[24] but it is also worth 10 points.[25] Seven points are given for using sustainable development measures such as a green development plan, smart site location, sidewalks, surface water management, and non-toxic building materials. Three points are given if the project is located on a reused building site, if photovoltaic panels are used for electricity and if the project uses building products and techniques that are beneficial to the environment.

In the previous QAP two points were awarded, under "Energy Efficiency," for the use of Energy Star appliances. This category was increased to five points and the scoring was changed to whether the project participates in either the New York State Energy Research and Development Authority Multifamily Building Performance Program or the New York Energy Star Labeled Homes Program, or if the project will meet comparable energy efficiency standards.[26]

Another "Threshold Eligibility Criteria" that was changed was government approval. Previously, when a funding application was submitted to DHCR, it was required to have obtained all local government approvals necessary to start building. The new QAP loosened this requirement and now only requires that the project has started acquiring approvals and that the application indicates that the project will be eligible.[27]

QAP Scoring

The most points are awarded under the "Housing Needs" section, which has been renamed "Community Impact/Revitalization." The new section awards five points for projects built in areas that have had limited or no subsidized affordable housing in the past 10 years, five points if the area has a strong housing market evidenced by a less than 5% vacancy rate, and five points if the project is part of a community revitalization plan.[28] The previous QAP also awarded five points for a community revitalization plan, but the remaining 15 points were awarded for serving a priority population, using existing housing, addressing housing needs, and the support of infrastructure improvements, real property tax relief and rezoning. Although the 2008 QAP gives fewer points in this section, the wording is less ambiguous and should enable the DHCR to ensure that the tax credits are being used to fulfill an actual need for housing in the areas that most need it. In order to increase the number of points awarded in certain sections, other sections had to lose points. The largest reduction is in the "Project Readiness" section. Previously up to 15 points were awarded based on the proposed time frame for readiness, the status of local approvals, the status of existing environmental conditions, and the status of permanent financing commitments.[29] In the 2008 QAP the points available were reduced to five and the only requirement that remains is the status of financing commitments.[30] The New York State Association for Affordable Housing points out that if readiness becomes less important, then project money could be awarded but then not used within a reasonable time frame. Perhaps DHCR removed this criterion because a final finance commitment would require that local approvals and environmental conditions already be finalized and therefore they are implicit. In any case, readiness should remain an important selection criterion.

The long-term priorities of the QAP were changed as well. In the previous QAP 10 points were awarded if the project proposed to extend the low-income housing beyond the 15 required years by waiver of the right to have a qualified contract to purchase the project. The new scoring provides seven points if the project has an extended use agreement to convey ownership to a non-profit organization to continue to provide low-income housing for a period longer than 30 years.[31] Giving points for extended use beyond 30 years furthers the goal of fulfilling affordable housing needs in New York State.

Disabled accessibility is prominent in the new QAP. Along with the "Visitability" requirement the QAP has a new scoring category of "Fully accessible and adapted, move-in ready units."[32] If at least 5% of units are fully accessible and move-in ready for mobility-impaired people and 2% are fully accessible and move-in ready for hearing- and vision-impaired people, then the project receives three points.[33] If the project increases the percentages to 10% and 4% respectively, then the project becomes eligible for six points.[34] This section also requires that the units must be marketed to households with at least one member who has a disability.[35]

Another new scoring category is "Mixed Income."[36] Three points are

awarded if the project reserves at least 15% of its total units for households with incomes above 60% of median income.[37] DHCR made mixed-income housing a priority because mixed-income housing has been shown to work better than housing for only low or very low-income households.[38] While the QAP provides incentives to provide housing for certain groups of people, it does not provide incentives for other groups that have a need for housing. Ex-convicts, veterans, assisted living and foster parents are a few examples of groups that other states have chosen to provide incentives for but New York has excluded.[39]

Other Sources of Financing

DHCR added an explanation of its "Set-Asides" program to the QAP for the first time.[40] A total of $2 million in set-aside credits has been allocated to supportive housing projects for 2008 and $3 million has been allocated to preservation projects.[41] Previously, in order to qualify as a preservation project, the project had to both avert the loss of affordable housing and be in critical disrepair. For the 2008 funding round a preservation project only has to meet the first condition of averting the loss of critical housing.[42] This will facilitate the preservation of buildings that are in relatively good condition and therefore don't require the heavy time and funding commitment of dilapidated buildings. In addition, DHCR has added in the requirement that high-acquisition projects—those where the cost of acquiring the land and building is greater than 25% of the total cost—must also be preservation projects.

To qualify for the $2 million in supportive housing set-asides, a project must give preference in tenant selection to persons with special needs for at least 25% of the units.[43] In addition, the applicant must document the need for housing and deliver appropriate supportive services through an experienced service provider. The applicant must have a plan to fund the services, as well as provide transportation to the services. Finally, in order to assure that the tenants who require the supportive services can continue to afford the housing, the applicant must have a provision to provide a rental cost subsidy.[44]

Priority Changes Overlooked

Missing from the QAP are any changes to the "Application Process."[45] Some possible changes could include two funding rounds, a rolling application time frame, a two-phase application process so that projects can pre-qualify, and an earlier funding date in order to not lose the spring construction season.[46] In addition, it has been suggested that the QAP's preference for projects with community revitalization plans hurts rural areas that do not have plans in place.[47] In order to help developers obtain fundable projects DHCR could issue a statewide market analysis indicating priority areas for affordable housing. This would eliminate much of the need for community revitalization plans. Although the QAP added six possible points for having fully accessible units, the 10% and 4% of project units standard could be increased. With 43% of all DHCR projects being for the elderly, fully accessible units are in high demand. In contrast, however, the New York State Association for Affordable Housing argues that the "visitability criterion" will make it difficult to build new projects in historic areas and could cause the projects to stand out as low-income housing.[48] Although the NYSAFAH supports visitability, it believes it should not be a threshold eligibility requirement but instead should be used on a project-by-project basis.[49]

Anyone who has ever submitted a project application to DHCR has certainly found the disconnect between QAP scoring and the application materials frustrating. If the QAP existed alone without additional "project instructions" from the DHCR it would appear that it was up to applicants to prove how they have earned the points. In reality, an application must conform to very rigid guidelines. With submission over the Internet, an application is now a long series of filling in blanks with the exhibits attached as "pdf" documents.

Another problem in the QAP is the ambiguity of how many points are awarded for fulfilling certain requirements. For example, the "Financial Leveraging" section is worth 13 points but it then lists five criteria.[50] It is unknown how many points are awarded if the applicant fulfills four out of the five criteria or if one of the criteria is worth more than the others. This opaqueness is found throughout the QAP. In the "Individuals with Children" section five points are "scored on the ratio of bedrooms to units in a project serving households with children." There is no indication if the five points are only awarded where there is a 1-to-1 ratio or if 2-to-1 will earn full points.[51]

DHCR Compared to HFA

The HFA has a separate QAP with different priorities used in determining which projects to fund. The HFA QAP states its purposes in giving out the credits includes preserving and increasing the supply of "decent, safe and affordable housing" for low to moderate-income households as well as the identification and development of resources that might assist in this purpose.[52] In addition, the HFA has implemented its QAP to address the needs of the homeless and others with special needs concerning "shelter, housing, and service(s)."[53]

The DHCR QAP does not outline its goals explicitly, but instead they are understood in the context of the point distribution. One notable difference between the two QAPs is that HFA has no green requirements. As previously mentioned, DHCR gives up to 10 points for everything from close proximity to community services to Energy Star appliances.[54] The closest HFA comes to having any green requirements is awarding points to projects that minimize maintenance and operating costs (implicitly lowering energy use).[55]

The HFA QAP was created in 2001, the same year as the previous QAP. Because of the other substantial similarities between the two QAPs, when HFA updates its version it will likely include green requirements.

The two QAPs share many of the same requirements. Both give scoring points for providing housing to households with children. The new DHCR QAP and the HFA QAP give scoring points for providing mixed-income housing. DHCR specifically states what counts as mixed income (those making above 60% of median income), but the HFA only asks for the promotion of the "economic integration of tenants."[56] Both QAPs give 10 scoring points for "Sponsor Characteristics," which include "experience" or a "track record" of developing affordable housing. HFA goes a step further and awards scoring points for having a development team that includes a "state certified minority business enterprise" or "women owned business enterprise."[57] Both plans award five points if the projects reach people on waiting lists.[58] Finally, both agencies award points for projects that agree to extend the period of low-income use beyond the minimum required by I.R.C. § 42, if the project is part of a community revitalization plan and if it provides handicapped units.[59]

The changes in the QAP reflect DHCR's commitment to using the Federal Low-Income Tax Credits in the most efficient manner possible. For tax credits, efficiency means placing affordable housing where it is most needed. By reserving the right to change the per unit credit maximum, DHCR is allowing for future projects to be built in more expensive areas where low-income housing is harder to find. In the highest scored section, "Community impact/revitalization," DHCR implemented criteria that require the projects to demonstrate a definite need for low-income housing.[60] By forcing the projects to examine the amount of low-income housing available and the vacancy rate of such housing, DHCR can ensure that projects are being put in areas where they will have the largest effect.

After ensuring that low-income projects end up in the right areas, the next step is to ensure that they will remain in operation as long as possible. The QAP's elimination of a contract to buy the project at the end of the 15-year compliance period and the addition of seven points if the project is operated as a low-income housing project for more than 30 years increases the amount of affordable housing available. This makes the value of the government's investment through the use of tax credits that much more valuable.

HFA and DHCR QAPs are substantially similar. The changes to DHCR's QAP are in response to trends in public opinion as well as changes to make the QAP easier to use. The addition of several terms to the "Definitions" section has made it easier to understand and relate to § 42. Applicants can refer to the QAP to determine what "Compliance Period," "Extended Use Period," "High Acquisition Project," and "Person with Special Needs" mean.[61] Even if an applicant was completely unfamiliar with tax credits they could read § 2040.2(s) and learn that qualified low-income housing projects must meet either the 20/50 requirement or the 40/60 requirement.[62] The New York State QAP is complex and therefore the changes are complex. While arguably there are missing provisions, DHCR had to balance the additional priorities with the need to keep the document at a manageable length. The differences between HFA's QAP and DHCR's are insignificant enough to argue that there could be one QAP with cohesive priorities for all of New York State. Most notably, if HFA adopted DHCR's modern green requirements, it would help energy conservation in New York State without disregarding other priorities. This possibility is worth further consideration.

Endnotes

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14. QAP § 2040.2(p).
15. QAP § 2040.3(f)(12).
16. QAP § 2040.2(v).
17. QAP § 2040.2(v).
18. QAP § 2030.3(e)(14).
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25. QAP § 2040.3(f)(4).
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27. QAP § 2040.3(e)(3).
28. QAP § 2040.3(f)(1).
29. QAP 2040.3(f)(11).

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30. *Id*.
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32. QAP § 2030.3(f)(6).
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36. QAP § 2040.3(f)(14).
37. *Id*.
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48. *Id*.
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54. *Supra*, note 26.
55. 21 N.Y.C.R.R. § 2188.6(c).
56. 21 N.Y.C.R.R. § 2188.6(c); *see also* QAP § 2040.2(s).
57. 21 N.Y.C.R.R. § 2188.6(d); *see also* QAP § 2040.2(f)(3).
58. 21 N.Y.C.R.R. § 2188.6(h); *see also* QAP § 2040.3(f)(10).
59. 21 N.Y.C.R.R. § 2188.6; *see also* QAP § 2040.3(f).
60. QAP § 2040.3(f)(1).
61. QAP § 2040.2.
62. QAP § 2040.2(s).

A Fairy Tale

By Marvin N. Bagwell

New Century. Alliance Funding. American Home. Option One. IndyMac. National City. Countrywide.

Title grunts have a confession to make.

Bear Stearns. Fannie Mae. Freddie Mac. Merrill Lynch. WaMu. Wachovia. AIG. Lehman Brothers.

Title grunts—the people who do the actual title work to make sure that transactions close, instruments are recorded, taxes paid and escrow deposits are disbursed—knew that it was coming. From at least 2004 through 2007, closers would return from settlements and deliver closing packages to title offices where other title grunts would go through the packages and take bets on when a mortgage that just closed would go into foreclosure. Would, or better yet, could the borrowers make even the first payment? Odds were they would and could not, and therefore the title grunt would win his or her wager. Title grunts knew that a crash was coming. They just did not know how bad the impact would be. They thought the crash would be localized and merely affect the lender that made the loan. However, title grunts did not know that SIVs (Structured Investment Vehicles), CMOs (Collateralized Mortgage Obligations), CDOs (Collateralized Debt Obligations), and CDSs (Credit Default Swaps), were all in the same family as STDs (Sexually Transmitted Diseases)—that is, toxic to all who touched them. For title grunts, confession may be good for the soul, but who is responsible for the mess we are in? In the best of 19th Century tradition, permit me to weave a tale of woe.

This is a fairy tale. As such, it cannot be true. However, there may be a moral or kernels of truth hidden from deep within.

Once upon a time, there was a legal secretary named Cindy who lived in Queens. Cindy was a single mother with two growing children. Cindy's salary, $40,000 annually, was not a lot but she could make ends meet and buy most of the toys and "stuff" that her children demanded. She could even dine out at Bennigan's once a week with her co-workers—that is, until it all went under. Although Cindy was happy, she was not without wants. Specifically, she hated the tiny apartment in which she and the kids were squeezed. Cindy wanted a house. She wanted a townhouse with a back yard large enough for a small dog for the kids to play with, and a barbeque so that she could entertain her friends. And so, on $40,000 a year, Cindy saved and she prayed.

"Title grunts—the people who do the actual title work to make sure that transactions close, instruments are recorded, taxes paid and escrow deposits are disbursed—knew that [a crash] was coming."

One day her prayers were answered. She saw a flyer on a telephone pole advertising a mortgage broker. The broker claimed that he could get anyone a mortgage. Not only that, the broker was affiliated with a realtor who could find anyone his or her dream home. Cindy took down the phone number from the flyer and made an appointment. Soon she was looking at houses, brand new ones with backyards and room enough for two growing kids. The prices were high, but the broker said he could get her a mortgage and he did. Cindy was able to buy a $600,000 townhouse with a 110% mortgage that covered her closing fees, and no one even verified her income. Best of all, the interest rate on the mortgage was only 1%, or $500 a month. The broker mentioned that her rate would change in a year or so and that it might go up, but he advised Cindy that given the way house prices were increasing, she would certainly be able to refinance into a better loan a year from now. He also said something about "negative amortization," but the concept completely escaped Cindy. Since the entire transaction took place without Cindy ever seeing a lawyer, no one explained what was in all of the papers that she signed at the closing. Cindy was unsure of the situation, as something did not seem right, but she closed anyway and she and her children quickly moved all of their stuff into their new home. As soon as this transaction was complete, the realtor and the broker left the closing with their respective commissions of 6% and 4% and were off to put more Cindys into homes.

Cindy's mortgage came from DependencyMac Bank. Before the ink was dry on Cindy's signature, DependencyMac obtained insurance from Freddie Mac or Fannie Mae (the loan processor was not sure which one) guaranteeing that one of the agencies would pay up if Cindy defaulted on her mortgage payments. In other cases, Freddie or Fannie actually purchased the mortgage from DependencyMac. In either case, Freddie or Fannie charged a fee to DependencyMac and set aside a small amount, a very small amount, of capital just in case Cindy defaulted. Of course, that really was not necessary because everyone knew that Cindy would not default and in the highly unlikely event she did, the U.S. Treasury would not allow the bonds or debt that Fannie or Freddie issued to go

into default. No one considered what would happen to Fannie's or Freddie's stock if the Cindys of the world started to default on their mortgage obligations. Armed with this insurance, DependencyMac then sold or assigned Cindy's mortgage to DeerIntheHeadlights, a huge Wall Street investment banker. DependencyMac received a check from DeerIntheHeadlights, and immediately ran back to use the sales proceeds to "incentivise" other brokers to find more Cindys to whom they could make more mortgage loans. Of course, DependencyMac, DeerIntheHeadlights, Fannie Mae and Freddie Mac took their fees and commissions off the top to pay their workers and, especially, bonuses to the people who occupied their respective executive suites.

DeerIntheHeadlights now owns Cindy's mortgage and not only hers, but also those of thousands of other Cindys. The magic occurs. There is always magic in fairy tales. DeerIntheHeadlights takes all of those thousands of mortgages and re-packages them into one giant mortgage, which it calls a "bond." Can you say "securitization"? This securitization process is not for the faint of heart as the faint of heart do not have a place on Wall Street. The mortgages within the bond are sliced and diced, and divided into segments, or tranches, with differing interest rates depending on the perceived chances that the underling borrowers will default on their mortgage payments. Then the bonds are sold to big bank investors and hedge funds around the world. The slicing and dicing is so efficient that when the bonds emerge, not even the strong of heart will be able to find Cindy's mortgage or pieces of it. But before the bonds are sold, DeerIntheHeadlights makes a few computer runs about who will pay their mortgages, and sends the results to a bond rating agency for its blessing and to a specialty insurance company (one of which is named MGIC) for coverage against losses that might occur if Cindy does not pay her mortgage. The rating agencies and insurance carriers descend from on high, run super-computer calculations of their own, and eventually, eyeing the check that DeerIntheHeadlights is waving in the corner, raise their magic wands, speak the magic words, and spread pixie dust over the bonds, granting them a Triple "A" rating, and float back into their inner sanctums. No one noticed, except Warren Buffet, that if too many Cindys do not make their mortgage payments, all of DeerIntheHeadlights' super-risk calculations would go out of the window. Further, no one, except Warren Buffet, noticed that the insurance carrier's billons of dollars of reserves would not be enough to cover the trillions of dollars of bonds insured by the carrier if too many Cindys defaulted on their mortgages payments. No one, except Warren Buffet and a few other naysayers to whom no one listened, put the insurance policies, some of which are better known as CDSs (credit default swaps), in the same sentence as "weapons of mass destruction." But we digress.

DeerIntheHeadlights now takes the bonds and sells them to banks, governments, hedge funds and investors all over the world, including Cindy's pension fund. But that is not all. The bonds are relatively "solid" in that they are secured or backed by Cindy's house and by Fannie Mae's insurance and by CDSs. It appears as if no one is going to lose here. But wait! There are other ways of making money! How about creating new debt instruments whose underlying value are based upon, or "derived," from the values of the bonds? These "derivatives" can be bought, sold and traded as well. So, DeerIntheHeadlights and its brethren on Wall Street created CDOs (Collateralized Debt Obligations), CMOs (Collateralized Mortgage Obligations) and SIVs (Structured Investment Vehicles) whose values were, to stay the least, speculative. However, DeerIntheHeadlights sold the derivatives to banks, governments, and hedge funds and even to Cindy's pension fund. Of course, all of the middle people between the sellers and the buyers took out fees, substantial fees.

Now, one might ask, where did all of this money to make mortgage loans come from? Well, a great deal of it came from the stuff that the Cindys of the world bought for their children and for themselves. A lot of this stuff—DVDs, plasma TVs, toys, furniture, cars, and, lest we forget, oil—came from places like China, Japan, Russia, Korea, the Middle East and even Brazil. We sent them money to pay for our tschotskes, and they used the money to buy bonds issued by DeerIntheHeadlights, our federal and probably state governments, Freddie and Fannie (who they thought were just as good as our government), thereby sending our money back to this country to finance more mortgages. The only difference was that our money came back to us as debt. We owe what used to be our money to foreign governments and international banks in the form of Treasury, Freddie Mac and Fannie Mae bonds. At every step along the way, someone earned a fee, a substantial fee. The guardians at our gates who were supposed to protect us from our own excesses, the Federal Reserve (dare I mention the sainted Alan Greenspan?) were actually favoring an easy money policy by keeping interest rates low so that the Cindys of the world could buy more and more. More and more came to include more and more homes simply because the money had come back into the country to lend. There was more money to spend, so naturally the prices of homes went up. Home prices were increasing, equity was building, so let's refinance, take the equity out and buy even more stuff! Let the good times roll!

And then cracks began to appear. For the last couple of years, title closers were taking bets on when the mortgages they just closed would go into foreclosure. "Does the borrower know that in one year, the 1% interest rate would reset to 7%?" How can a security guard making $30,000 a year afford a $500,000 mortgage? Doesn't that investment banker who spent his $1 million bonus on a $5 million apartment in Trump Tower know

that his bonus might be minuscule next year? And then there were the frauds. Easy money begat easy thievery. "No document" or "no docs" loans became "no job" loans. "Ninja" (no income, no job, no assets) loans proliferated faster than North Korea's nuclear bombs. And then there was the catch-all category of simply "liar loans." Paying mortgage brokers their entire fee upfront meant that some of them had no incentive to make sure that the mortgages that closed on Friday survived past the weekend. The fact that the DeerIntheHeadlights of the world had moved the paper off their books as quickly as possible should have reminded someone of the P.T. Barnum quote about a sucker being born every minute.

At some point last year, the interest rate on Cindy's mortgage reset. She was already having problems paying the children's medical bills. Push came to shove, and she could no longer afford the house and the mortgage. The mortgage went into foreclosure. She was not alone. Hundreds of thousands of homeowners nationwide headed in the same direction. The economy began a prolonged slide. People began to realize that the home values were not what they used to be. Homeowners went underwater. What that meant was that the mortgages on their homes were greater than the value of the houses. People began to swim away from those homes. One Cindy morphed into thousands. Overnight, a new word came into vogue to describe the once rock solid debt of DependencyMac, DeerIntheHeadlights, and even of Freddie and Fannie, i.e., "toxic." The toxicity was so prevalent that major institutions worldwide lost billions of dollars. The thousands of homes going under the foreclosure hammer depressed prices further. Then the Wall Street wizards (the ones who still had jobs) discovered that their foreclosure rate calculations were thinner than Tinker Bell's gossamer wings. As more and more mortgages went into foreclosure, the values of the bonds and the derivatives based upon them went into freefall. DeerIntheHeadlights and DependencyMac began a race for capital to support their losses. Neither made it. Both effectively became wards of the state, that is, of the taxpayers. Credit markets froze because no one was willing to lend on collateral for which no one knew the value. Banks could not make mortgage loans because they were busy raising capital to support their losses. The most active part of the market is the rumor mills. What Tier 1 lender or hedge fund will be next one deemed by the Treasury Secretary or Chairman Benacke as too big to fail? (At the time that this article was written, Freddie and Fannie had just been placed in conservatorship—whatever that means—and Lehman Brothers is hanging on for dear life.)

"[I]nstitutions deemed too big to fail get to keep their profits made during the fat years, but the government (that is, the taxpayer) gets to cover their losses during the lean years. The philosophical change is profound."

Few have missed the irony that the administration which most touted the ownership society is socializing more lenders than Franklin Roosevelt. Even George Will is complaining about the "moral hazard" of rescuing lenders and thereby privatizing the profits but socializing the losses. Translated, institutions deemed too big to fail get to keep their profits made during the fat years, but the government (that is, the taxpayer) gets to cover their losses during the lean years. The philosophical change is profound. And the bill to the taxpayer may dwarf that of the savings-and-loan crisis of a decade-and-a-half ago.

The nation's economy is in a crisis and it all began because a secretary in Queens who wanted a home for her kids bought one she could not afford. Or did it? There is blame to go around from the sainted Alan Greenspan to people who summer in the Hamptons back to people who clear brush in Texas. To paraphrase one of the most observant social critics of our day, Michael Jackson, the person in the mirror must carry some of the blame. But when everyone is to blame, no one has to take responsibility.

This has been a fairy tale. None of it could possibly be true.

Marvin N. Bagwell is the President, Chief Executive Officer and General Counsel of Bagwell & Associates in New York City. He is a graduate of Harvard College and Harvard Law School. Mr. Bagwell was recently appointed to an at-large seat on the Executive Board of the Real Property Section of the New York Bar Association and serves as an editor of this *Journal*. Mr. Bagwell was recently elected as a Fellow of the American College of Real Estate Lawyers, one of the highest honors accorded to members of his profession.

[**Editor's Note:** The author wrote this article in mid-September, prior to the failure of Lehman Brothers, AIG, and the bailout proposal. In these days, when the front page story in the newspaper is outdated when the paper hits the newsstand, it is tough to keep up with events. Your understanding, if this article seems to be old news, is appreciated.]

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Model Intercreditor Agreement (Among A Lenders, B Lenders, and Swap Counterparty)

By Joshua Stein

Any commercial real estate borrower (a "Borrower"[1]) usually wants to borrow as much money as possible, and as inexpensively as possible. Therefore, when the real estate finance market favors Borrowers, an originator of a commercial real estate loan (a "Loan") will often look for structures to help maximize proceeds for the Borrower. Conversely, when real estate credit is tight and lenders want to try to remove existing Loans from their balance sheet, they may find that a potential buyer would prefer to buy just the "lower risk" or "higher risk" piece of the particular Loan, rather than the entire Loan.

To help accomplish either of these goals, loan originators will sometimes structure a single large mortgage loan (a "Loan") as two smaller loans—an "A" loan, i.e., a senior tranche, and a "B" loan, i.e., a junior tranche or "first loss piece" of the larger Loan. The originator can create these tranches at the inception of the Loan, or after the fact. The originator may sell interests in the A loan and the B loan[2] to various mortgage investors (each, a "Lender"). Each Lender prefers the risk/return combination that its particular interest in the Loan delivers.

The process of severing an individual Loan into separate interests amounts to a mini-securitization of a single Loan.[3] Thus, the Loan originator can deliver more financing at a lower all-in cost to a Borrower than otherwise. Hence the originator can better meet a Borrower's capital needs.[4] The originator may also find that by creating an A/B structure after the fact, the originator can more effectively sell pieces of a Loan that the originator intended to hold.[5]

To define the relative rights and obligations between the two groups of Lenders that hold the A and B pieces of the Loan, the Loan originator will enter into an intercreditor agreement (an "A/B Intercreditor Agreement"), which will bind all Lenders. The model document after these introductory comments (the "Model Agreement") represents the author's attempt to define a "model" A/B Intercreditor Agreement for transactions of this type.

Summary of Issues. An A/B Intercreditor Agreement will raise a short list of issues, the resolution of which somehow often creates more negotiation, verbiage, and redrafts of documents than one might intuitively expect. The issues boil down to these:[6]

- *Cure Rights.* How many times, and how often, may B Lenders "cure" Borrower defaults under the Loan to prevent A Lenders from precipitating a foreclosure?
- *Defaults and Workouts.* If the Loan goes into default, how long and under what conditions can B Lenders control decision-making?
- *Decisions Generally.* What other decisions about the Loan require Lender approval? What percentage vote of the Lenders does each decision require?
- *Option Timing.* Although B Lenders will universally have an option to buy the A Loan, when does the option period start and end?
- *Option Pricing.* If B Lenders exercise their purchase option, does the purchase price include A Lenders' share of any breakage, default interest, late charges, prepayment premium, yield maintenance payment, and similar items that Borrower might need to pay to prevent foreclosure? How will the parties treat non-reimbursable expenses that A Lenders incurred?
- *Out of the Money.* What rights do B Lenders lose if they are "out of the money"—i.e., if a hypothetical liquidation of the collateral securing the Loan (the "Collateral") would leave B Lenders with little or nothing?
- *Transfers.* How freely can Lenders transfer their interests in the Loan? Can they transfer to hedge funds or other categories of investors that might have an agenda different from traditional real estate lenders?

Any A/B Intercreditor Agreement will memorialize the answers to these and other questions. Although the issues in an A/B Intercreditor Agreement are neither monumental nor unwieldy, the process of negotiating them often becomes a grueling ordeal, sometimes even more so than negotiating Loan Documents with Borrower.

An A/B Intercreditor Agreement will often blur the lines between "legal" and "business" issues more than in most other loan documents. Any "legal" issue can become a "business" issue at any time. And the "business" issues in these documents tend to relate to complex confluences of hypotheticals rather than to fundamental economic issues, all of which can typically be expressed in numbers. Moreover, given market pressures, including pressures on timing and costs, business people and lawyers who negotiate A/B Intercreditor Agreements must understand and know how to quickly handle both "business" and "legal" issues. Clients cannot tell their counsel to deal with the legal issues. Conversely, counsel cannot tell clients to deal with the business issues. All become intertwined. Therefore, this Model Agreement represents "recommended reading" not only for lawyers who work in this area, but also for their clients.

Real Estate Finance vs. Other Finance. Multiple-lender structures similar to "A/B loans" also appear in financing markets outside of real estate (e.g., corporate finance), particularly in periods of high liquidity, low interest rates, low default rates, and high optimism, such as the years that preceded late Summer 2007. For example, bank finance transactions often include "B loans," or "junior tranches" similar to the A/B real estate loan described in any A/B Intercreditor Agreement.

The intricacies of multiple-tranche lending transactions vary, however, between real estate finance and corporate finance. In the former market, Borrower owns only a single asset and that asset represents the "main event" (usually the only event) for the Loan. In the latter market, different asset types may support different types of financing on different terms. For example, corporate finance Lenders may analyze, to a varying extent, a Borrower's overall business prospects, as opposed to just the Collateral. In some cases, subordinate lenders will act much more like equity investors, expecting to take equity risks and potentially receive equity rewards.

In typical real estate A/B loans, however, Lenders focus almost exclusively on the Collateral. Intercreditor provisions for these loans therefore do the same.

Corporate finance transactions may establish a wider range of priority structures than real estate lending. For example, corporate finance lenders may agree that the first dollars a Borrower pays will go to pay debt service under a senior tranche—but, after a default, all dollars Borrower pays go to all Lenders *pari passu* across all tranches. Typical real estate lenders would never agree to such a structure, because holders of senior tranches always expect to be paid first after a default. Corporate ownership structures also routinely create more platforms for debt—a property-owning company vs. an operating company vs. a holding company—with structural subordination based on tiers of Borrower's ownership. And Borrowers may own multiple types of asset, each supporting a different type of financing, often in multiple entities.

For those and other reasons, this Model Agreement (for commercial real estate loans) will not necessarily make sense for corporate financing, though some of the same issues will arise in both financial markets.

What's Market? In any multiple-lender financing, the parties often try to resolve issues by asking "what's market?" They assume that if "everyone else does it this way," then they may as well do it the same way. That approach saves time and has merit and logic. But different people will have different views of "what's market," depending on what they've seen in the last deals that crossed their desk. This Model Agreement nevertheless makes a valiant effort to capture "what's market" based on the experience of the author and a handful of other attorneys who reviewed this document in draft.

Over-complexity. Whatever may be the "market" intercreditor relationship between holders of real estate "A" loans and "B" loans, the A/B Intercreditor Agreements that govern such relationships have grown quite verbose and complex, inspired perhaps by the nearly incomprehensible prose and structure of a typical pooling and servicing agreement in a securitization.[7]

The author seeks to respond to that trend by offering this Model Agreement as a template for an A/B Intercreditor Agreement for portfolio loans. This template is both comprehensive and comprehensible, though unfortunately not as compact as one might wish. This Model Agreement collects in one place today's industry expectations (at least as the author and his reviewers perceive them) for the relationship between A Lenders and B Lenders, assuming neither Lender plans to securitize its piece of the Loan.

The introductory notes and footnotes do not seek to address every issue every time it arises, but typically only once, subject to plenty of exceptions and variations. Therefore, anyone seeking to understand the issues this Model Agreement raises should read all the introductory notes and all the footnotes. Those discussions collectively demonstrate, among other things, that any lawyer who practices in this area will benefit by actually reading cases and even a few statutes, an activity that most transactional lawyers regard with dread or at best as a fond but ancient memory.

Starting Point. This Model Agreement assumes as its "base case:" (1) a single substantial commercial real estate Loan, governed by a single loan agreement between a Borrower and the Lender group (the "Loan Agreement") and (2) an administrative agent acting for the Lender group (the "Administrative Agent"), so Borrower never interacts directly with any Lender(s).[8] This Model Agreement assumes the Loan Agreement itself already provides for an A Loan and a B Loan, so Borrower executed and delivered to Administrative Agent separate notes evidencing those two loans, both governed by the single Loan Agreement. If, on the other hand, Borrower never executes two separate, distinguishable notes, then Administrative Agent could, with little trouble, synthetically create the separate A Loan and B Loan within the A/B Intercreditor Agreement. This Model Agreement offers optional language for that purpose.

Bankruptcy Implications of Deal Structure. The common structure in which a single note and a single mortgage evidence the entire Loan—as opposed to having Borrower enter into a separate A Loan and a separate B Loan, each with separate security—creates significant incremental risks and issues in any Borrower bankruptcy.

For example, in one litigated dispute in the bankruptcy of Eastern Airlines,[9] a single set of security documents secured three series of claimants. Each series had different priority rights to the same shared collateral.[10] In essence, a single lien on a single bundle of collateral secured a group of A Lenders, B Lenders, and C Lenders, using today's vocabulary.

The bankruptcy court treated all three series of claimants in the aggregate as a single secured creditor.[11] Then the court concluded that the group as a whole did not have enough collateral to cover all their claims —hence all lenders, considered as a group, were "under-secured."[12] This meant that the group as a whole suffered various bad consequences in the bankruptcy.[13] In contrast, if the court had looked at each series of claimants separately, the A Lenders would have been "oversecured" and would not have suffered the same bad consequences. The court stated:

> [I]f the three Series held separate liens against the Collateral, then the First Series would be oversecured and would be entitled to post-petition interest, but that is not the structure of this transaction. The Debtor granted only one lien, only one secured claim, in favor of all the Certificate holders. How the rights to proceeds of the lien collateral were to be distributed under the Indenture was an intramural matter for the Collateral Trustee and the various series, not the Debtor. Accordingly, the fact that three proofs of claim were filed against the Debtor by the individual Series Trustees cannot change the number of claims that arise out of the single pool of Collateral. Thus, the Indenture provided for one secured claim against Eastern and that claim is undersecured. Eastern is not liable for post-petition interest.[14]

In contrast, if a single lender holds two separate loans clearly documented as two separate loans, the bankruptcy courts will treat them as separate loans. The senior loan can be oversecured or undersecured in its own right, and the courts will view the junior loan separately and independently, as if a third party held it.[15]

The bankruptcy benefits of holding two loans instead of one probably justify the extra expense of documenting the A Loan and the B Loan separately.[16] The separate documentation can directly determine how the two loans get treated in probably the only forum that really matters —bankruptcy court.[17] Nevertheless, the industry does not demand the use of separate sets of loan and security documents. A Lenders and B Lenders routinely buy synthetically created pieces of single Loans. They do all this notwithstanding the bankruptcy problems they might otherwise avoid if they required Borrower to enter into separate loans with separate security documents, sufficient to create two classes of creditors.[18]

In some cases, loan originators have no choice but to have a single set of loan documents memorialize all loans. For example, if the loan originator decides to create an A/B structure only after closing of the Loan, Borrower may have no obligation or inclination to execute new separate loan documents. In other cases, the loan originator may take a hybrid approach, using a single set of loan documents but within those documents setting up the A Loan and the B Loan as separate indebtednesses.[19] The originator might use two notes and (at least for any major Collateral) two mortgages to evidence and secure the two loans, even if a single Loan Agreement (and a single set of all other loan documents) governs both loans.

This deal structure may, however, create its own potential bankruptcy issues—demonstrating once again the range of techniques that bankruptcy offers to attack secured creditors.

If the B Lenders hold a separate loan and separate security (as suggested above), then they will constitute a separate creditor in a Borrower bankruptcy proceeding. A typical subordination agreement will say that in any such proceeding, the senior creditors (*i.e.*, the A Lenders) have authority to exercise voting and other rights of the junior creditors (i.e., B Lenders). An A/B Intercreditor Agreement, in contrast, will not appoint any Lenders as agents for other Lenders; instead, all Lenders will empower Administrative Agent to act on their behalf. The difference may not matter.

A recent bankruptcy case refused to enforce precisely such an "agency appointment" provision in a subordination agreement, at least in the context of voting on a Chapter 11 plan of reorganization.[20] In *In re 203 N. LaSalle St. P'ship*,[21] the court noted that the Section 1126 of the Bankruptcy Code provides that "[t]he holder of a claim" has the right to vote that claim for or against a Chapter 11 plan of reorganization.[22] Applying the plain language of the statute, the court concluded that the junior creditor, and only the junior creditor, met the statutory requirement to vote its claim. Thus, the senior creditor could not vote the junior creditor's claim.[23]

Moreover, the *203 North LaSalle St.* court rejected the senior creditor's argument that it acted as "agent" for the junior creditor. The court reasoned that the senior creditor intended to vote the junior creditor's claim in the senior creditor's own best interests, rather than in the interests of its alleged "principal," hence it could not be considered an "agent."[24]

The result in *203 North LaSalle St.* seems quite hypertechnical and unjustified, an inappropriate and unnecessary extension of bankruptcy

principles and policies into areas where they should not apply. This Model Agreement includes language designed to prevent the result in *203 North LaSalle St*. Among other things, this Model Agreement seeks to make Administrative Agent the holder of all claims, not anyone's agent or designee. This Model Agreement also clarifies that as agent, Administrative Agent acts for all Lenders as a group, not in Administrative Agent's own interest.

Any concern about the result in *203 North LaSalle St.* should be tempered by the fact that the junior creditor in that case was an affiliate of Borrower and not an unaffiliated, third-party holder of debt.[25]

The next cycle of workouts and bankruptcies will teach the real estate finance industry whether it should have worried more about these issues, and how A/B loans might best address them.

Secured Swap Obligations. This Model Agreement assumes Administrative Agent's "swap desk," or conceivably some other derivatives counterparty ("Swap Counterparty"), has entered into with Borrower a swap agreement ("Swap") to allow Borrower to convert a floating interest rate on the Loan into a fixed interest rate.[26] Premature termination of a Swap could require Borrower to make a substantial payment, for example, if interest rates have dropped. Thus, Swap Counterparty will want security for Borrower's contingent obligations under the Swap. But Borrower has no security to offer, except the Collateral for the Loan. Therefore, Swap Counterparty will often share the mortgage that secures the Loan.

To cover that common circumstance, this Model Agreement treats Swap Counterparty as part of the group of "Secured Parties." Swap Counterparty receives a share of the Collateral as if Swap Counterparty held Loan principal in the same amount as Swap Counterparty's claim against Borrower—either an actual claim if the Swap has already terminated or a hypothetical claim[27] equal to what Borrower would owe if Borrower defaulted on the Swap at that moment.

Although such a *pari passu* distribution of Loan proceeds has a ring of fairness to it, the resulting diversion of potential foreclosure sale proceeds to Swap Counterparty will dilute the Lenders' security. As an example, if the Lenders lent $80 against $100 worth of Collateral, they thought they made an 80% loan-to-value loan. But, if the Swap Termination Payment is $10, then the Lenders actually hold something much less attractive: an 8/9 share of a 90% loan-to-value loan.

The real estate finance market nevertheless typically treats the Swap Counterparty on a *pari passu* basis with the Lenders, for at least these reasons:

- The Lender group's dilution of security is hard to explain, hypothetical, pessimistic, and boring. Therefore, many may just ignore it.[28]
- The potential Swap termination payment will typically be a manageable amount and decrease as the Loan matures, hence becoming even more manageable, over time.
- A Swap Counterparty likes to be secured. It may refuse to issue the Swap if its security is weaker than everyone else's (e.g., subordinated).
- Swap Counterparty will usually be an affiliate of Administrative Agent. Administrative Agent will look out for Swap Counterparty. No Lender will walk from the deal as a result.
- An obligation of Borrower to pay a large Swap termination payment will probably correlate with a low interest rate environment, which will also increase the Collateral value and decrease the likelihood of default. Even in a booming real estate market, though, this particular Loan may go into default because of problems unique to its Collateral.

Notwithstanding the author's misgivings about industry standard practice in securing Swaps, this Model Agreement follows the industry standard approach without trying to improve on it.[29] Outside of real estate lending, Lender groups sometimes do consider these concerns, such as by limiting Swap Counterparty's maximum share of foreclosure proceeds or by limiting the maximum term of the secured Swap. This may happen particularly when the Swap relates not to interest rates but instead to some commodity other than use of money.

If Borrower obtains only a rate cap (or no interest rate hedging at all), then the drafter should delete everything in this Model Agreement about any Swap or Swap Counterparty.

Syndicated Lending Provisions. This Model Agreement includes some administrative provisions that would apply not only to A/B loans, but also to ordinary syndicated Loans with a single tranche of Lenders. These provisions include, for example, transfer procedures and delegations of authority. Such provisions change only slightly because of the existence of two tranches of a larger Loan.

This Model Agreement might well have omitted these administrative provisions, leaving them to be added by any particular drafter who considered them necessary.[30] In the interests of completeness and ease of use, however, this Model Agreement does include administrative provisions, written somewhat more clearly than the norm. Some of those provisions raise issues or otherwise merit commentary, which the author has also tried to include, starting with the next paragraph.

Separate Enforcement. This Model Agreement gives Administrative Agent sole authority to "Enforce" the Loan, to the exclusion of individual Lenders. Occasionally, a Lender within a Lender group seeks to enforce

some Loan document separately in a limited way.[31] In *Beal Sav. Bank v. Sommer*, one Lender in a syndicated Lender group wanted itself to sue to enforce one of the ancillary loan documents, even though the Lender group as a whole wanted to forbear entirely.[32] That particular document said, in an offhand way, that it was enforceable by any Lender.[33] No loan document expressly prohibited any individual Lender from enforcing its rights separately. The court nonetheless considered the loan documents as a whole. In the court's view, the documents contemplated "an unequivocal collective design," where the Lenders make decisions together and rely on Administrative Agent to execute them. Separate enforcement would defeat that scheme.[34]

The result in *Beal* conformed to industry expectations, as the author understands them. Given some of the language in the *Beal* loan documents, though, the court perhaps did the lending industry a favor to some degree.

Some market participants believe that even in a Lender group, and notwithstanding *Beal*, an individual Lender should retain the right to sue on the promissory note as an unsecured obligation. The author disagrees, at least in real estate finance. Therefore, this Model Agreement does not allow individual Lenders to proceed separately against Borrower. This approach reflects the author's beliefs that:

- Lenders in the syndicated market do not expect any one Lender to have direct enforcement rights.
- Borrowers do not want to have to deal with individual Lenders that break out of formation and have their own ideas about enforcement.
- The *Beal* court reached the right result, even if one might quibble with how the court got there.
- For typical non-recourse real estate loans, with attendant "one form of action" issues, direct enforcement can be either meaningless or dangerous.
- Direct enforcement could create chaos, hasten bankruptcy, and increase the likelihood of liquidation.

At a minimum, the decision in *Beal* has sensitized the syndicated lending community (not just A/B Lenders) to the issue of separate enforcement rights of Lenders. One should expect to see new provisions on point in syndicated loan agreements and intercreditor agreements to address this issue. Usually, these new provisions will prohibit separate enforcement, except exercise of a right of offset. In rare cases or special circumstances, the parties may conceivably negotiate to allow individual Lenders to conduct certain limited enforcement activities.

Borrower Role. An A/B Intercreditor Agreement (such as this Model Agreement) is typically only signed by Administrative Agent and the Lenders. Borrower is not a party. Borrower cannot directly control what goes into the A/B Intercreditor Agreement.

Might the Lenders ever want Borrower to acknowledge and confirm and consent to the A/B Intercreditor Agreement? Do the Lenders need some Borrower concurrence before the Lenders can freely redistribute among themselves their various claims against Borrower? Can B Lenders obtain rights to receive interests under the A Loan merely by making cure payments to cover unpaid interest under the A Loan? Can B Lenders do this without involving Borrower in any way, and without Borrower's acquiescence?

The author would answer the first two questions in the negative and the last two in the affirmative. Lenders should have the right to make whatever partial assignments they want of their relative interests in the Loan, unless the Loan Agreement provides otherwise.[35]

Conservative Lenders and their counsel may, however, want more comfort. They may fear, for example, that Borrower will claim the benefit of any cure payments B Lenders made under the A/B Intercreditor Agreement. Such Lenders and their counsel may want Borrower to countersign the A/B Intercreditor Agreement to acknowledge and consent to its terms.

Borrower may care a great deal about some of the issues addressed here (such as who can buy into the Loan, decision-making procedures, and any bias toward prompt and expeditious exercise of remedies upon default).[36] If so, Borrower will need to proactively raise those issues in loan document negotiations and try at that stage to control the terms of any possible A/B Intercreditor Agreement and Lender rights. Borrower can negotiate any rights or restrictions it wants in the loan documents. Nothing in any A/B Intercreditor Agreement can dilute those rights and restrictions as they affect Borrower. If Administrative Agent develops the A/B Intercreditor Agreement at the same time as the Borrower loan documents, Borrower may try to pay attention to the intercreditor negotiations and stay involved at least enough to try to prevent problems of the type this paragraph suggests.

Structurally Subordinate A/B Loans. The "typical" A/B Loan will arise from a single first mortgage loan broken into an A Loan and a B Loan. In some cases, however, the combined A/B Loan might be structurally subordinate to some other loan. For example, if the A/B loan is in itself a mezzanine loan, it will be structurally subordinate to a mortgage loan that encumbers the underlying real property. Or the Collateral for the A/B loan might consist of a majority of the shares (and proprietary leases) of a cooperative building, structurally subordinate to an "underlying" first mortgage loan on the same building. These "oddball" cases do sometimes occur. The endless ingenuity of the real estate industry—and the ever-

increasing complexity and layering of real estate finance transactions—may produce other structures where the A/B loan somehow encumbers collateral that is itself subordinate to another loan.

If Borrower closes the senior loan simultaneously with the subordinated A/B Loan, the same originator will probably originate both loans at once. That originator may also conceivably plan to hold the senior loan while acting as Administrative Agent for the subordinate A/B Loan. Those facts create a genuine conflict of interest[37] that should concern both "A" loan purchasers and "B" loan purchasers. This conflict should, above all else, concern the originator, which will face endless and boundless claims of breach of duties it didn't know it owed (and couldn't even have imagined) if the documents do not address the conflict and the transaction suffers any distress.

Because these facts arise rarely, this Model Agreement does not address them. But because these facts can and do sometimes arise, the author has prepared a set of optional provisions for possible use when an A/B Loan is "structurally subordinate" to some other loan. Most of those provisions apply whether or not the originator has a conflict of interest. A few focus on any such possible conflict. They are available from the author by request.

Plain English. This Model Agreement seeks to use ordinary English prose, liberating the reader from the legalese that makes so many intercreditor and other agreements incomprehensible. To do that, the author has tried to follow the principles he has expressed in several articles on legal writing,[38] which can be boiled down as follows. Keep sentences short. Use the active voice and ordinary language. Eliminate section cross-references. Establish and consistently use an intuitive set of defined terms.

Review Process. In preparing and editing this Model Agreement, the author requested comments from a number of commercial real estate and other finance lawyers. This document reflects many of their comments. The author wishes to thank these individuals (and a few reviewers who asked to remain anonymous) for their contributions: Christopher J. Carolan, Esq., of Brown Rudnick Berlack Israels LLP; Paul M. Fried, Esq., of AFC Realty Capital; Robert G. Harvey, Esq., formerly of McKee Nelson LLP; Andrew L. Herz, Esq., of Patterson Belknap Webb & Tyler LLP; Alfredo R. Lagamon, Jr., Esq., formerly of Baker & McKenzie LLP; K.C. McDaniel, Esq. of K.C. McDaniel PLLC; John C. Murray, Esq., of First American Title Insurance Company; and Michael Weinberger of Cleary Gottlieb Steen & Hamilton LLP. None of these individuals should be blamed for any mistakes or misjudgments in this document. None has "approved" this document.

Further Comments. Anyone who uses this document is encouraged to submit comments to the author through his Web site, www.real-estate-law.com. If enough improvements are suggested to justify a second edition, the author will produce one. Anyone who would like to receive a copy of any second edition should please notify the author through his Web site.

Caveats. Because we live in an era of caveats, disclosures and risk management, no model document would be complete without a reminder of the following rather intuitively obvious propositions. This Model Agreement comes with no guarantee or warranty and is offered "as is." No representation is made that this document complies with law or is enforceable. It may or may not work for any particular transaction. It may omit important provisions or contain bad provisions or mistakes. Every transaction, however "routine," can and usually does raise its own unique issues, which may require extensive tailoring and thought, going beyond mere shoveling of words from one word pile to another. Anyone using a model document must read and consider every word of it to decide what works and what doesn't. In the case of this particular Model Agreement, the drafter must also consider how this Model Agreement interacts with the Loan documents, and correct any anomalies or inconsistencies. This Model Agreement should be used only by a competent lawyer with substantial relevant experience admitted to practice in the state whose law applies. Any nonlawyer should not use this Model Agreement in any transaction. Nothing in these introductory notes or in this Model Agreement reflects the positions or policies of, or has been approved by, any organization or anyone else. The author and his colleagues reserve the right, at any time, to take positions inconsistent with those in this article and accompanying Model Agreement. So do the individuals who reviewed this Model Agreement in draft. Don't believe everything you read, even less of what you hear. Look both ways before you cross the street; if you don't, you might get run over by a bus. If it's cold, wear a jacket. If you think it might rain, also bring along an umbrella.

INTERCREDITOR AGREEMENT (AMONG A LENDERS, B LENDERS, AND SWAP COUNTERPARTY)
(the "Agreement")
For Obligations Secured by Real Property at:
_____
_____
(as "Sole Lead Arranger" and "Administrative Agent")
Dated _____ (the "Effective Date")

Latham & Watkins LLP
885 Third Avenue
New York, New York 10022-4802
Attention: Joshua Stein, Esq.

Intercreditor Agreement (Among A Lenders, B Lenders, and Swap Counterparty)

This **INTERCREDITOR AGREEMENT (AMONG A LENDERS, B LENDERS, AND SWAP COUNTERPARTY**) (this "Agreement") is made as of _____ (the "Effective Date") by and among these parties:

Administrative Agent. _____ _____, with an address at _____ (as Administrative Agent under this Agreement, with any successor or replacement in that capacity, "Administrative Agent");

Initial A Lenders. The party(ies) identified on the signature pages of this Agreement as acquiring interests in the A Loan ("A Lenders"), and if this Agreement does not identify any such A Lender(s), then "A Lender(s)" means Administrative Agent unless and until (and except to the extent that) Administrative Agent has assigned interests in the A Loan to other A Lender(s);

Initial B Lenders. The party(ies) identified on the signature pages of this Agreement as acquiring interests in the B Loan ("B Lenders"), and if this Agreement does not identify any such B Lender(s), then "B Lender(s)" means Administrative Agent unless and until (and except to the extent that) Administrative Agent has assigned interests in the B Loan to other B Lender(s); and

Swap Counterparty _____,___ with an address at _____, as Swap Counterparty (with its permitted successors and assigns, "Swap Counterparty").

This Agreement is entered into based on these facts, and may use capitalized terms before defining them.

A. Administrative Agent and _____ ("Borrower") entered into a [Loan and Security] Agreement (the "Loan Agreement") dated as of _____ (the "Loan Date").

B. Under the Loan Agreement, Administrative Agent made on behalf of the A Lenders and the B Lenders (together, "Lenders") to Borrower two separate loans (together, the "Loan"), consisting of the A Loan and the B Loan, each a separate obligation and secured in part by separate liens and security interests encumbering the Collateral.[39]

C. Swap Counterparty and Borrower entered into the Swap for the Loan, and agreed to pay Swap Payments to one another.

D. In accordance with the Loan Documents,[40] the Security Documents (encumbering the Collateral) secure the Loan and Borrower's obligations under the Swap[41] (the "Secured Obligations"). Each reference to the "Secured Obligations" also includes a reference to the right to Enforce all Loan Documents, including the Credit Parties' obligations to reimburse any Borrower-Reimbursable Expenses.

E. On or about the Effective Date,[42] Administrative Agent and the Lenders are executing and delivering one or more Assignment and Acceptance Agreement(s) substantially in the form of Exhibit A[43] or otherwise in form and substance acceptable to Administrative Agent[44] (each, an "Assignment") by which Administrative Agent assigns the A Loan, in whole or in part, to A Lender(s), and the B Loan, in whole or in part, to B Lender(s), excluding such part(s) of the Loans (if any) as Administrative Agent retains as a Lender.

F. After the Effective Date, additional A Lender(s) and B Lender(s) may acquire interests in the Loan from Administrative Agent or from Lender(s), or may dispose of interests in the Loan.

G. The parties intend that Administrative Agent shall, subject to this Agreement, hold and exercise certain rights of the Lenders and Swap Counterparty (the "Secured Parties").[45]

NOW, THEREFORE, for good and valuable consideration, Secured Parties and Administrative Agent agree:

1. Definitions

Any definitions in the Loan Agreement also apply here, except where this Agreement provides some other definition for a term.[46] Within this Agreement, these terms shall have these meanings,[47] disregarding any Modification of any Borrower obligation(s) or any Loan Document(s) through any Insolvency Proceeding. Without limiting the previous sentence, the parties intend that interest of any kind (including Default Interest) shall continue to accrue before, during, and after any Insolvency Proceeding and shall therefore include post-petition interest.[48]

"**A Expense**" means any Expense of A Lenders.

"**A Interest**" means, for any period, interest on A Principal at the A Rate. To the extent B Lenders make Cure Payments for A Interest, such payments shall reduce A Interest (and increase the outstanding balance of Cure Payments) as among the Lenders and for purposes of this Agreement, with no effect on Borrower.

"**A Loan**" means the rights to receive A Principal, A Interest, Borrower-Reimbursable A Expenses, and Add-Ons based on the foregoing, and all related rights under the Loan Documents. To the extent Borrower defaulted in paying, but B Lenders made timely Cure Payments to A Lenders for, any such sums, the B Loan shall (and the A Loan shall not) include the right to receive such sums (as reimbursement of Cure Payments for purposes of this Agreement), with related Add-Ons.[49]

"**A Principal**" means the principal amount of the A Loan.[50] On the Effective Date, A Principal equals $_____. A Principal shall decrease by any payments (including Cure Payments, without thereby affecting Borrower) applied to A Principal under this Agreement.[51]

"**A Rate**" means, for any period, an annual rate of interest equal to the Loan Interest Rate less ___ percent per annum.[52]

"**Add-Ons**" means Breakage Costs, Default Interest, late charges, and Prepayment Premiums, to the extent the Loan Documents require any of them.[53]

"**Administrative Agent's knowledge**," "**actual knowledge**," and "**knowledge**" (and terms of similar meaning) mean the actual knowledge (with no duty to investigate and no constructive or implied knowledge) of Administrative Agent's personnel who currently, actually, and directly service the Loan.[54]

"**Appraisal**" means an MAI appraisal obtained by Administrative Agent and prepared in accordance with Appraisal Institute standards by an independent appraiser (unaffiliated with any Lender) that is a member of the Appraisal Institute, with at least five years of experience appraising real property similar to the Collateral. Administrative Agent shall select the appraiser, subject to reasonable approval by a Majority of B Lenders. Administrative Agent may from time to time require a Majority of B Lenders to pre-approve up to four potential appraisers. Any such pre-approval shall remain effective unless and until a Majority of B Lenders reasonably revoke it by Notice to Administrative Agent, provided that they: (a) nominate a reasonable replacement for each appraiser disapproved; and (b) within the preceding 180 days, neither (i) gave a similar Notice; nor (ii) received a Substantial Impairment Notice.[55]

"**B Decision Period**" means a period determined as follows:[56]

1. **Commencement**. Any B Decision Period begins on the first day of a Default Period. If, however, a previous B Decision Period ended within __[57] days before the first day of a Default Period, then no new B Decision Period shall commence on account of that Default Period.
2. **Maximum Number**. If a total of _____[58] B Decision Periods have previously occurred, then no more B Decision Periods shall ever occur.
3. **Termination**. Any B Decision Period ends on the earliest of: (a) ___[59] days after it began; (b) B Lender(s)' material default under the B Option; and (c) a Borrower Cure Date.
4. **Conditions**. As conditions to continuation of any B Decision Period: (a) B Lenders shall reimburse A Lenders, Swap Counterparty, and Administrative Agent for all Expenses they paid (excluding any interest component of such Expenses, but any such unpaid interest shall remain payable under the Waterfall); (b) B Lenders shall make Cure Payments to cure all Defaults that affect the A Loan; and (c) the B Loan shall not be Substantially Impaired. B Lenders shall have _____ Business Days[60] after demand to satisfy these conditions. During that time, B Lenders need not satisfy such conditions in order to maintain a B Decision Period.
5. **B Option**. If, at any time, any B Lender(s) have validly exercised the B Option, then notwithstanding anything to the contrary in the preceding definition of "B Decision Period," the B Decision Period shall include the time from such exercise until the first to occur of the B Option Closing Date and any B Lender(s)' material default under the B Option.

"**B Expense**" means any Expense of B Lenders.

"**B Interest**" means, for any period, interest on B Principal at the B Rate.

"**B Loan**" means the rights to receive B Principal, B Interest, Borrower-Reimbursable B Expenses, and Add-Ons based on the foregoing, and all related rights under the Loan Documents. To the extent Borrower defaulted in paying, but B Lenders made timely Cure Payments to A

Lenders for, any sums payable on account of the A Loan, the A Loan shall not (and the B Loan shall) include the right to receive such sums, to the extent not previously paid or reimbursed, and related Add-Ons.[61]

"**B Option Closing Date**" means the next Interest Payment Date that is more than five Business Days after exercise of the B Option, or as the parties agree. The B Option Closing Date need not fall within the B Option Period.

"**B Option Period**" means a period that begins when any Default Period begins and continues, whether or not a B Decision Period exists, until either: (a) a Borrower Cure Date has occurred; or (b) Enforcement has divested Borrower of all or substantially all Collateral.[62]

"**B Option Price**" means the sum of the following, without duplication, excluding Add-Ons:[63] (a) A Principal; (b) A Interest accrued and unpaid through the date of determination; (c) A Expenses; and (d) Swap Payments then due from Borrower to Swap Counterparty. Item "d" shall be payable to Swap Counterparty. All other items shall be payable to A Lender.

"**B Principal**" means the principal amount of the B Loan.[64] On the Effective Date, B Principal equals $_____. B Principal shall: (a) decrease by any payments applied to B Principal under this Agreement and (b) to the extent Law allows, rise by any Cure Payments made on account of A Principal. On the Effective Date, B Lender is fully funding $_____ on account of B Principal to close the Loans.

"**B Rate**" means, for any period, an annual rate of interest equal to the Loan Interest Rate plus ___ percent per annum.[65]

"**Borrower Cure Date**" means the date when, in Administrative Agent's reasonable determination, Credit Parties have cured all Event(s) of Default and Defaults under the Loan. Cure Payments shall not cause a Borrower Cure Date unless and until Credit Parties have cured all Event(s) of Default and Defaults under the Loan Documents that gave rise to such Cure Payments and fully performed their corresponding obligations under the Loan Documents then due or past due.

"**Borrower-Reimbursable**" means, for any Expense, that the Loan Documents require Borrower to pay or reimburse such Expense, whether or not Borrower has.

"**Bucket**" means each numbered paragraph in the Waterfall.

"**Business Day**" means any day except Saturday, Sunday, or any other day when commercial banks in New York City must or legally may close.

"**CDO**" means collateralized debt obligation(s).

"**Cure Payment**" means any amount (except Expense reimbursements) that B Lender(s) pay to Administrative Agent (to be disbursed to A Lenders through the Waterfall) or directly to A Lenders to cure (or to protect A Lenders from delay or lost payments as a result of) any Default, to the extent such Default impairs the A Loan or defers A Lenders' receipt of any sums A Lenders would have received if the Default had not occurred. B Lenders' making of any Cure Payment(s) shall affect only the Lenders' rights among themselves. As against Credit Parties only, it shall not cause a Borrower Cure Date or reduce any Borrower Obligations.[66]

"**Decision Rules**" means the Default Decision Rules and the Non-Default Decision Rules.

"**Default Interest**" means interest payable under the Loan Agreement at the Default Rate, to the extent it exceeds the Loan Interest Rate. The annual rate of Default Interest for A Lender and B Lender (as applied over and above the A Rate and the B Rate) shall be the same.[67]

"**Default Period**" means a period that begins when an Event of Default occurs under the Loan (even if governing law prevents Enforcement) and ends on a Borrower Cure Date or a Final Recovery Determination.[68]

"**Discretionary Action**" means any Modification of, approval or consent under, or other discretionary action under or relating to any Loan Document, or material decision or action in any Borrower Insolvency Proceeding, unless required by the Loan Document(s) or Law.

"**Dispute**" means any action, suit, or other legal proceeding arising out of or relating to this Agreement, any Assignment, or the relationship between or among any of the parties regarding any Secured Obligations or Collateral.

"**Emergency Expense**" means any Expense that Administrative Agent reasonably determines is reasonably necessary to prevent imminent risk of death, injury, or significant property damage or loss to the Collateral.

"**Enforce**" means the exercise of any or all rights and remedies under the Secured Obligations (including the A Loan, the B Loan, and the Swap), the Loan Documents, and applicable law, including: give notice(s) of default; accelerate the Loan; collect or sue for payment; foreclose upon or take possession of Collateral; exercise any other rights against the Collateral; bid at any foreclosure or other auction of Collateral; initiate, join in, or object to motions or other actions in any Insolvency Proceeding; file proof(s) of claim in any Insolvency Proceeding; vote such claims; take any other actions in any Insolvency Proceeding (including purchase claims of other creditors);[69] receive Swap Payments (although Borrower may pay Regular Swap Payments directly to Swap Counterparty); enforce the Swap against Swap Counterparty; accept a Transfer of Collateral in lieu of foreclosure; sell, dispose of, hold, operate, or otherwise deal with Collateral; and (subject to the restrictions in this Agreement) incur Expenses related to any of the foregoing.

"**Enforcement**" means the act or process of Enforcing.

"**Expense Approval Threshold**" means: (a) for any individual Expense, $_____; and (b) over a calendar year, Expenses aggregating $_____ (disregarding Expenses the Lenders approved under this Agreement).[70]

"**Expenses**" means, subject to the Decision Rules, any out-of-pocket expenses or advances (including Legal Costs)[71] Administrative Agent has actually and reasonably incurred (or proposes to actually and reasonably incur) in administering, Enforcing, holding, preserving, and protecting the Secured Obligations, the Collateral, or any REO,[72] excluding any such expenses that:

1. **Not Otherwise Incurred.** Administrative Agent would not reasonably have incurred if it held the entire Loan for its own account, except any expenses incurred to comply with this Agreement;
2. **Material Breach, Etc.** Result from Administrative Agent's willful misconduct, gross negligence, or material breach of any Loan Document or this Agreement; or
3. **Overhead.** Constitute Administrative Agent's normal overhead, including staffing and other ordinary operating expenses.

Subject to the preceding exclusions and the Decision Rules, Expenses shall include Borrower-Reimbursable Expenses, Non-Borrower-Reimbursable Expenses, and any sums paid to cure any Borrower's default, to Enforce the Secured Obligations, or to protect any Collateral or REO (including environmental remediation).[73]

To the extent that any Person reimburses any other Person for any Expense: (a) the reimbursing Person shall be treated as if it had paid an Expense equal to such reimbursement; and (b) the Person reimbursed shall no longer be deemed to have incurred that Expense.

Except where this Agreement states otherwise, unpaid Expenses shall bear interest (excluding Default Interest)[74] at the A Rate (for A Expenses) or B Rate (for B Expenses or Administrative Agent's unreimbursed Expenses).

"**Final Recovery Determination**" means Administrative Agent's reasonable determination, in accordance with the Servicing Standard, that Administrative Agent and the Secured Parties have recovered all Loan Proceeds they will likely ever recover.[75]

"**Indemnify**" means that the Person (the "**Indemnitor**") that agrees to Indemnify another Person (the "**Indemnitee**") regarding a matter (the "**Indemnified Risk**") shall indemnify, defend, and hold harmless the Indemnitee from and against every action, claim, cost, damage, demand, disbursement, expense, judgment, liability, loss, obligation, penalty, and suit (including reasonable attorneys' fees and charges) of any kind or nature whatsoever (excluding consequential damages) that may be imposed on, incurred by, or asserted against Indemnitee in any way relating to or arising from the Indemnified Risk.

"**Lender**" means each A Lender and each B Lender.

"**Loan Interest Rate**" means, for any period, the aggregate average interest rate under the Loan Agreement, disregarding Default Interest, as reasonably calculated by Administrative Agent.

"**Loan Proceeds**" means all sums Administrative Agent receives from any source on account of the Secured Obligations, the Collateral, or any REO. Loan Proceeds include principal, interest, Add-Ons, Cure Payments, Swap Payments whether payable by Borrower (except Swap Regular Payments due Swap Counterparty) or by Swap Counterparty, funds from any lockbox or cash management arrangements for the Collateral, application of reserves or other cash collateral, Loss Proceeds, and Enforcement proceeds, whether from or on account of any Credit Party, from REO operations, or from any Transfer of REO. Loan Proceeds also include any funds Administrative Agent obtains by drawing upon or applying Substantial Impairment Prevention Collateral

"**Majority**" means Lenders whose aggregate Pro Rata Share exceeds 50%, except as follows:

1. **Majority in Group**. For any group (less than all) of the Lenders, a "**Majority**" means Lenders that collectively hold more than 50% of the aggregate Pro Rata Share of all Lenders in the group. For example, if the B Lenders' aggregate Pro Rata Share were 40%, then a Majority of B Lenders would mean B Lenders collectively holding more than a 20% Pro Rata Share.
2. **Nonvoting Lenders**. Any "**Majority**" calculation shall disregard the Pro Rata Share of each Nonvoting Lender, for both numerator and denominator.

"**Majority Decision**" means any Discretionary Action that would:[76]

1. **Additional Debt.** Allow Borrower to incur additional debt (or allow any beneficial owner of Borrower to enter into any mezzanine financing arrangement);
2. **Default Interest.** Waive any Default Interest;
3. **Expenses.** Incur any Expense, except an Emergency Expense, if Administrative Agent reasonably estimates it will exceed the Expense Approval Threshold;
4. **Lease Approvals.** Approve any Major Lease or Modification of an existing Major Lease;[77]
5. **Property Management.** Consent to (i) replacement or termination of any property manager or (ii) execution or material Modification of any property management agreement;[78]

6. **Reserve Accounts.** Modify any requirement of the Loan Agreement about any required deposit in, or material condition(s) to release(s) of any amount from, the _____ Reserve Account, any _____ Escrow Account, or any Restoration Fund;[79]

7. **Swap.** Consent to any material modification of Borrower's interest in the Swap; or

8. **Other.** Diminish or waive Borrower's material obligations under the Loan Documents in any material respect,[80] but any waivers affecting these matters are not Majority Decisions and are within Administrative Agent's sole authority: (a) late charges; (b) deliveries of documents to satisfy any Extension Condition or Release Condition, provided that Administrative Agent reasonably determines that Borrower has satisfied all substantive Extension Conditions or Release Conditions, as the case may be; (c) any insurance-related waiver, provided that after such waiver Borrower's insurance program, considered as a whole, is in Administrative Agent's reasonable judgment commercially reasonable; and (d) the grant of other immaterial waivers (including any waiver or consent that the Loan Agreement expressly states Administrative Agent can grant) and extensions, provided that Administrative Agent determines in accordance with the Servicing Standard that any such waiver or extension would not materially impair Loan collectability.

"**Modify**" means from time to time abandon, amend, cancel, consolidate, discharge, extend, increase, modify, refinance, reject, renew, replace, restate, split, spread, subordinate (except in accordance with this Agreement), substitute, supplement, surrender, terminate, or waive a specified agreement or document, or any of its terms or provisions, or accept, agree to, cause, make, or permit any of the foregoing. "**Modification**" has a corresponding meaning.

"**Non-Borrower-Reimbursable**" means, for any Expense, that it is not Borrower-Reimbursable. Non-Borrower-Reimbursable Expenses would include these Expenses except to the extent, if any, they constitute Borrower-Reimbursable Expenses: Expenses incurred in the ordinary course of servicing commercial real estate loans that are not in default, such as costs of reasonable additional appraisals, tax searches, and collateral audits; maintaining mortgage impairment insurance; receiving, reviewing, and distributing copies of documents and information; reasonable consultants, advisors, and counsel to benefit the Secured Parties as a group; and Expenses of any litigation for which this Agreement requires the Secured Parties (but the Loan Agreement does not require Borrower) to Indemnify Administrative Agent.

"**Nonvoting Lender**" means any Lender that is: (1) in default under this Agreement; (2) an Affiliate of any Borrower; or (3) a B Lender when the B Loan is Substantially Impaired. Administrative Agent shall be a Nonvoting Lender for any vote on whether to: (a) Notify Administrative Agent that it is in default; or (b) remove or replace Administrative Agent.

"**Payment Cap**" means $_____[81] per calendar year (or in each B Decision Period, in the case of B Expenses in a B Decision Period). A separate Payment Cap applies to each of: (a) Cure Payments by B Lenders per calendar year; (b) Administrative Agent's Non-Borrower-Reimbursable Expenses per calendar year; and (c) aggregate B Expenses in each B Decision Period.

"**Permitted Holder**" means Administrative Agent, any Person that acquires an interest in the Loan directly from Administrative Agent, or any Person that is (a) a "qualified institutional buyer" or institutional "accredited investor" within the meaning of Securities Act Regulation D; (b) not Borrower or its Affiliate; and (c) one or more of these, provided that any Person that is otherwise a Permitted Holder (under any element of this definition) must meet the financial test at the end of this definition:[82]

1. **Financial Institutions.** A bank, commercial credit corporation, governmental entity, insurance company, investment bank, mutual fund, pension fund, pension fund advisory firm, pension plan, real estate advisory firm, real estate investment trust, savings and loan association, or trust company, or an Affiliate[83] of any of the foregoing Persons;[84]

2. **Institutional Investors.** An investment company or money management firm that is a Real Estate Lender;

3. **Securitization Vehicles.** Any Securitization Vehicle; or

4. **Similar Entities.** Any Real Estate Lender that is substantially similar to any of the foregoing.

Regardless of its categorization or characterization above,[85] a Person cannot constitute a Permitted Holder unless it has at least: (a) $250,000,000 in capital/statutory surplus or shareholders' equity (unless a pension advisory firm or similar fiduciary or a governmental entity)[86] and (b) $650,000,000 in total assets (in its name or under management).

"**Prepayment Premium**" means all sums payable by Borrower on account of any prepayment premium, extra charge, spread maintenance premium, yield maintenance premium, or similar fee under any Loan Document, except a Swap Termination Payment.

"**Principal**" means: (a) for A Lenders, A Principal; and (b) for B Lenders, B Principal.

"**Pro Rata Share**" means, for each Lender, its then Principal divided by the Lenders' then total Principal,[87] subject to the further provisions of this paragraph. For voting, Swap Counterparty's Pro Rata Share shall always equal 0%. For any other

purpose (including Expenses, Loan Proceeds, Waterfall, and other financial rights and obligations), Administrative Agent shall calculate Swap Counterparty's Pro Rata Share as if any Swap Termination Payment Borrower owes (or would hypothetically owe if a Swap Termination had just occurred) were additional Principal. Except for voting, the other Lenders' Pro Rata Shares shall drop to reflect Swap Counterparty's Pro Rata Share under the previous sentence.

"**Rating Agency**" means Fitch, Inc.; Fitch Ratings Ltd.; Moody's Investors Service, Inc.; their Affiliates and successors; and S&P.

"**Real Estate Lender**" means any Person regularly engaged in the business of making or owning (or advising makers or owners of) mezzanine loans, B loans, loan participations, and non-investment grade tranches in securitizations, in each case secured or backed by interests in commercial real property in the United States.

"**REO**" means Collateral (except cash and equivalents) acquired through Enforcement.

"**Representative**" of Administrative Agent means any agent, Affiliate, attorney-in-fact, or servicer of Administrative Agent.

"**S&P**" means Standard & Poor's Rating Group and its Affiliates and successors.

"**Securities Act**" means the Securities Act of 1933, as amended.

"**Securitization Vehicle**" means a trustee (or in the case of a CDO, a single-purpose bankruptcy-remote entity that at the same time pledges its interest in the Loan to a trustee) in connection with (a) a securitization of, (b) creation of a CDO secured by, or (c) financing through an "owner trust" of, any interest in the Loan, provided that either:

1. **Securities.** Such Securitization Vehicle has issued at least one class of securities that at least one Rating Agency has initially rated at least investment grade;
2. **Special Servicer.** If the Securitization Vehicle is not a CDO, then its special servicer must: (a) be identified as an "approved servicer" by one or more Rating Agencies and (b) comply with a specified servicing standard, notwithstanding any contrary direction or instruction from any other Person; or
3. **CDO.** If the Securitization Vehicle is a CDO, then its asset manager is a Permitted Holder not itself a Securitization Vehicle.

"**Separate Swap Collateral**" means security (or collateral or credit support) for the Swap that does not also constitute Collateral for the Loan.[88]

"**Servicing Standard**"[89] means to administer, Enforce, and service the Secured Obligations on behalf of, and for the benefit of the Secured Parties as a collective whole (as Administrative Agent determines in its good faith and commercially reasonable judgment), consistent with Law, this Agreement, and the Loan Documents. Consistent with the previous sentence, the Servicing Standard also requires Administrative Agent to administer, Enforce, and service the Secured Obligations:

1. **Standards.** With such care, skill, and diligence as is customary in its mortgage servicing and REO management for third parties or for itself, whichever is higher, for secured loans similar to the Loan and REO similar to the Collateral;
2. **Collection.** With a view, in any Default Period, to: (x) timely collecting all scheduled principal and interest payments; and (y) if, in Administrative Agent's judgment, no satisfactory arrangements can be made to collect all delinquent payments, then maximizing recovery of the Secured Obligations (as a collective whole) on a net present value basis (discounted at such rate as Administrative Agent determines, but at a rate no lower than the Loan Interest Rate); and
3. **Conflicts.** Disregarding: (a) Administrative Agent's (or its Affiliate's) ownership of any interest in the A Loan, the B Loan, any other loan, or the Swap; (b) the sufficiency of Administrative Agent's compensation (if any) for acting as such;[90] and (c) any Person's right or obligation to purchase the Secured Obligations or any interest in the Secured Obligations.[91]

"**Substantial Impairment Prevention Collateral**" means, collectively, the following, all in form and substance reasonably satisfactory to Administrative Agent: (a) cash, United States Treasury obligations with a remaining term of up to 90 days, a letter of credit from a bank or other financial institution whose long-term unsecured debt obligations are rated at least "AA" by S&P or whose short-term obligations are rated at least "A-1" by S&P, or other investment-grade collateral or assurance of payment; and (b) such security interests, security agreements, pledges, filings, and agreements as Administrative Agent reasonably requires to give Administrative Agent a first priority security interest (where applicable) and right to draw upon and apply (in accordance with this Agreement) the item(s) referred to above in clause (a).

"**Substantially Impaired**" or "**Substantial Impairment**"[92] means a hypothetical status of the B Loan that Administrative Agent shall determine as follows. Administrative Agent shall hypothetically sell all Collateral (including all Substantial Impairment Prevention Collateral timely delivered to Administrative Agent) at its fair market value.[93] For that purpose, Administrative Agent shall value: (a) Substantial Impairment Prevention Collateral in any commercially reasonable manner; and (b) all other Collateral based on an Appraisal. Administrative Agent shall hypothetically disburse all resulting Loan Proceeds through the Waterfall.

Administrative Agent shall then measure the total Loan Proceeds that B Lenders would receive through such hypothetical disbursement. Only if that total is 25% or less of B Principal, then the B Loan is Substantially Impaired. Notwithstanding anything to the contrary in this definition, the B Loan is not Substantially Impaired so long as any B Lender(s) have exercised, and no B Lender is in material default under, the B Option.

"**Supermajority**" means Lenders whose aggregate Pro Rata Share exceeds 66 2/3%, except as follows:

1. **Supermajority in Group**. For any group (less than all) of the Lenders, a "**Supermajority**" means Lenders that collectively hold more than 66 2/3% of the aggregate Pro Rata Share of all Lenders in the group. For example, if A Lenders' aggregate Pro Rata Share were 40%, then a Supermajority of A Lenders would mean A Lenders collectively holding more than a 26 2/3% Pro Rata Share.
2. **Nonvoting Lenders**. Any "**Supermajority**" calculation shall disregard the Pro Rata Share of each Nonvoting Lender, for both numerator and denominator.

"**Supermajority Decision**" means any Discretionary Action to consent to (or waive acceleration on) any Transfer or Change of Control.

"**Swap**" means any swap that Swap Counterparty enters into from time to time with Borrower, provided that: (a) it complies with the Loan Agreement; and (b) Borrower has, in compliance with the Loan Agreement, pledged Borrower's rights under such swap to Administrative Agent for the Lenders. At the Effective Date, the Swap consists of Master Agreement (Reference No. ___), between Swap Counterparty and Borrower, dated as of _____, supplemented only by Confirmation(s) issued under Swap Counterparty's Reference No. _____, dated as of _____.[94]

"**Swap Payment**" means any Swap Regular Payment or Swap Termination Payment.

"**Swap Regular Payment**" means any payment that the Swap requires any Swap party to pay the other (including periodic payments), unless accrued and unpaid at Swap Termination.

"**Swap Termination**" means any termination, including early termination, of a Swap.

"**Swap Termination Payment**" means any payment that any Swap requires any Person to pay upon Swap Termination, including: (a) Swap breakage (not Breakage Costs under the Loan Agreement); (b) any sums due and payable under the Swap, but not paid, at Swap Termination; and (c) any Borrower-Reimbursable Expenses owed to Swap Counterparty.[95]

"**Transfer**" any property means assign, convey, encumber, hypothecate, mortgage, participate, pledge, sell, sub-participate, transfer, or in any other way dispose of such property or any interest in it, or agree to do any of the foregoing, including the granting of an option to do any of the foregoing. "Transferee" and "Transferor" have corresponding meanings.

"**Unanimous Approval**" means approval of all Lenders (or those in any group whose Unanimous Approval is required), except Nonvoting Lenders.

"**Unanimous Decision**" means any Discretionary Action that would:

1. **Fundamental Financial Terms.** Defer, reduce, increase, or decrease any payment of principal or interest; or
2. **Release.** Release any material Collateral or any Credit Party's obligations.

"**Waterfall**" means application of Loan Proceeds in this order of priority of payment until exhausted:[96]

1. **Swap Regular Payments.** So long as no Swap Termination[97] has occurred, to Swap Counterparty all Swap Regular Payments not paid directly;
2. **Swap Termination Payments.** If a Swap Termination has occurred (except a Wrongful Swap Termination), then to Swap Counterparty its Pro Rata Share of such Loan Proceeds, to be applied against any Swap Termination Payment due Swap Counterparty until fully paid;[98]
3. **A Interest.** To A Lenders, accrued unpaid A Interest;
4. **A Expenses.** To A Lenders, A Expenses,[99] with interest at the A Rate;
5. **A Principal.** To A Lenders, their Pro Rata Shares (as among the Lenders) of principal repayments;[100]
6. **Additional A Principal.** In any Default Period (even if B Lenders have made and are making Cure Payments),[101] to A Lenders, A Principal until fully repaid;[102]
7. **Cure Payments.** To B Lenders, to reimburse Cure Payments B Lenders actually paid, with interest at the B Rate;
8. **B Interest.** To B Lenders, accrued unpaid B Interest;
9. **B Expenses.** To B Lenders, B Expenses, with interest at the B Rate;
10. **B Principal.** To B Lenders, their Pro Rata Shares (as among the Lenders) of principal repayments;
11. **Additional B Principal.** In any Default Period, to B Lenders, B Principal until fully repaid;
12. **Excess Interest.** To Administrative Agent, as additional consideration for originating the Loan and entering into this Agreement, any interest (except Default Interest) Borrower has paid on account of the Loan, in excess of interest (except Default Interest) due and payable to the

Lenders for the period such payment covered;[103]

13. **Lenders' Additional Amounts.** To each Lender, its Pro Rata Share of all other payments under the Loan Documents (including Add-Ons),[104] until the Loan has been fully repaid;

14. **Subordinated Swap Payments.** If a Wrongful Swap Termination occurred, then to Swap Counterparty until all Swap Termination Payments then due and owing to Swap Counterparty have been fully paid; and

15. **Residual Sums.** To each Lender, its relative Pro Rata Share (as measured based on the maximum aggregate Principal of each Lender's interest in the Loan, including that of its predecessor(s) in interest, that was outstanding at any time after the Effective Date, even though no Principal remains outstanding at the date of determination) of any sums remaining.

"**Wire Address**" of each Lender means such Lender's account identified on the signature page for such Lender, as such Lender may change it by Notice.

"**Workout**" means during (and as a means of concluding) any Default Period, any of these for the Loan: (a) Modification, (b) discounted payoff, (c) conveyance of Collateral, or (d) other negotiated or consensual resolution.

"**Wrongful Swap Termination**" means a Swap Termination that results from Swap Counterparty's breach or default.

2. Administrative Agent

2.1 Appointment. Each Lender appoints and designates Administrative Agent as such Lender's sole and exclusive agent to hold and Enforce such Lender's entire interest in the Loan. Swap Counterparty appoints and designates Administrative Agent as Swap Counterparty's sole and exclusive agent to hold and Enforce Swap Counterparty's interest in the Collateral. In furtherance of those appointments and designations, each Secured Party designates and appoints Administrative Agent as its agent for all the foregoing matters; to take such action on its behalf as Lender or any payee, mortgagee, assignee, or beneficiary may take under any Loan Document; and to Enforce the Secured Obligations. Administrative Agent shall also have all powers reasonably incidental to the foregoing, on the terms of this Agreement and the Loan Documents.

2.2 Duties. Administrative Agent shall have no duty or responsibility except as this Agreement and the Loan Documents expressly state. No implied covenant, duty, function, liability, obligation, or responsibility of Administrative Agent shall be construed to exist. Administrative Agent shall administer and Enforce the Secured Obligations and the Loan Documents (and exercise its rights and authority and perform its obligations under this Agreement) in accordance with the Servicing Standard. Administrative Agent shall have no duty to inspect the Collateral or to ascertain or inquire into or verify performance or observance of any covenant or agreement or satisfaction of any condition. Administrative Agent shall not be liable for any undertaking of Borrower, Swap Counterparty (as Swap Counterparty), or any other Person or for any error of judgment or any action taken or omitted to be taken by Administrative Agent except Administrative Agent's willful misconduct, gross negligence, or intentional and material breach of this Agreement. Administrative Agent shall have no fiduciary or trustee relationship with any Secured Party. This Agreement defines Administrative Agent's obligations to and relationship with Secured Parties. No such obligations or relationship shall be inferred beyond the words of this Agreement.

2.3 Reliance. Administrative Agent may rely (and shall be protected in relying) on: (a) any written communication (including email) that Administrative Agent reasonably believes to be genuine and correct and to have been given by the proper Person; and (b) advice of counsel (including counsel for Borrower), accountants, engineers, architects, and other experts Administrative Agent selects.

2.4 Delegation. Administrative Agent may execute any duties under this Agreement, as Administrative Agent, or as an assignee, beneficiary, mortgagee, party, or payee under any Loan Document, by or through a Representative. Any such arrangement shall be at Administrative Agent's sole cost and expense and shall not change Administrative Agent's obligations. Administrative Agent shall be responsible for its Representative's acts or omissions.[105]

2.5 Administrative Agent's Interests. For purposes of Administrative Agent's interest in the Secured Obligations as a Secured Party, Administrative Agent may exercise its rights and authority under this Agreement, including its voting rights, as if it were not Administrative Agent.

2.6 Indemnification. Secured Parties shall Indemnify Administrative Agent (to the extent Administrative Agent is not otherwise reimbursed under this Agreement or under the Loan Documents), severally in proportion to their Pro Rata Shares, regarding this Agreement, the Loan Documents, Enforcement, any litigation with Borrower, and Administrative Agent's actions or omissions under this Agreement and the Loan Documents, except as follows. Whenever the Default Decision Rules entitle any group of Lender(s) to direct Administrative Agent regarding Enforcement, only such directing Lender(s) (and no other Secured Party(ies)) shall Indemnify Administrative Agent regarding any actions Administrative Agent takes in furtherance of such directing Lenders' directions. (For example, if a Majority of B Lenders direct Administrative Agent to take some action, then only the B Lenders

constituting such Majority shall Indemnify Administrative Agent.) Administrative Agent's certificate of the amount of any indemnity payable under this paragraph shall be *prima facie* evidence of such amount absent manifest error. Such indemnity obligations shall survive the termination of this Agreement and the Loan Documents. Unless Indemnified to Administrative Agent's reasonable satisfaction regarding such matters, Administrative Agent may not be compelled to perform any act under this Agreement or the Loan Documents or take any action toward the execution or enforcement of the powers thereby created or to prosecute or defend any suit with respect to the Loan Documents. In no event, however, shall Administrative Agent be required to take any action that Administrative Agent determines could expose Administrative Agent to criminal or material civil liability. Notwithstanding the foregoing, no Person shall be required to Indemnify: (a) Administrative Agent for its willful misconduct, gross negligence, or intentional and material breach of any Loan Document or this Agreement; or (b) Swap Counterparty for its obligations as Swap Counterparty.

2.7 Replacement. If (i) Administrative Agent is negligent or otherwise defaults in performing its duties or obligations under this Agreement or the Loan Documents and fails to cure such negligence or default within ten Business Days (or, if it cannot reasonably be cured within such time, then a reasonable time under the circumstances) after Notice from a Supermajority of the Lenders,[106] or (ii) Administrative Agent fails to Enforce the Secured Obligations in compliance with the Default Decision Rules during the B Decision Period (and does not cure such failure within ten Business Days after Notice from a Supermajority of B Lenders, or if such failure cannot reasonably be cured within such time, then Administrative Agent fails to cure it within a reasonable time[107] under the circumstances after such Notice), then a Supermajority of the Lenders (or of the B Lenders, in the case of clause (ii)) may, in its sole and absolute discretion, replace Administrative Agent. The replacement Administrative Agent shall have all rights and obligations of Administrative Agent under this Agreement. Any replaced Administrative Agent shall cooperate to Transfer all Security Documents to its replacement.

2.8 No Separate Authority. Administrative Agent shall have sole and exclusive authority to deal and communicate with every Credit Party and any other Person about the Secured Obligations, the Loan Documents, the Collateral, and any REO on behalf of the Secured Parties. No Secured Party shall communicate directly with any of the foregoing parties about such matters on behalf of any Secured Party(ies), Enforce any Loan Document or Swap Counterparty's rights in the Collateral, or have any power or authority to directly Enforce any Loan Document or Swap Counterparty's rights in the Collateral. Although each Lender (as a direct Lender under the Loan Agreement, and not a participant) is in direct privity with Borrower (and Swap Counterparty has direct rights against the Collateral and is in direct privity with Borrower regarding the Collateral), all such privity (and rights) shall be exercised exclusively through Administrative Agent. Except during a Default Period, nothing in this paragraph prevents any Secured Party from communicating directly with any of the foregoing parties to request information and for marketing and client relations. Nothing in this paragraph prevents any Secured Party from exercising a right of offset against any Credit Party, subject to the Loan Agreement and governing law, provided that: (a) in the case of Swap Counterparty, Swap Counterparty would otherwise remit Swap Payments directly to Borrower and not to Administrative Agent; and (b) such Secured Party remits to Administrative Agent (as Loan Proceeds) the entire amount it realizes through such offset.[108]

2.9 Documents. Administrative Agent shall hold the original Loan Documents (except any promissory note(s) evidencing any other Lenders' interest in the Loan) for the benefit of the Secured Parties. Administrative Agent shall exercise reasonable care regarding the Loan Documents. If Administrative Agent misplaces or destroys any Loan Documents, then Administrative Agent may in place of delivering such original Loan Documents issue a customary lost document affidavit and indemnity.

2.10 Ownership and Administration of REO. Administrative Agent may require that any REO be held by: (a) Administrative Agent, subject to this Agreement; (b) a newly formed single purpose entity owned by the Secured Parties in a manner consistent with their relative rights under this Agreement; or (c) a wholly owned subsidiary of Administrative Agent. In each case, this Agreement shall govern all decisions and actions regarding the REO, and the distribution of any Loan Proceeds that arise from the REO. All documentation to implement the provisions of this paragraph must be reasonably satisfactory to Administrative Agent.

3. Secured Parties

3.1 Obligations. Each Lender joins in, assumes, and shall perform, in proportion to its Pro Rata Share, all obligations of a Lender under the Loan Agreement. The Loan Agreement shall bind each Lender.

3.2 Funding. Each Lender shall fund its Principal to Administrative Agent substantially when Administrative Agent assigns to such Lender its Pro Rata Share of the Loan.[109]

3.3 Initial Advance. On the Effective Date, each Lender shall fund its Principal (less any applicable origination fee), in accordance with written (including emailed) instructions of Administrative Agent's counsel. Administrative Agent or its counsel shall close the Loan when Administrative Agent has determined that all material closing condi-

tions have been satisfied or waived, with no need to obtain any Lender's approval.[110]

3.4 Additional Advances. A Lender shall fund all Additional Advances. A Principal shall increase to the extent of each Additional Advance when made. Administrative Agent shall administer the Additional Advance process, including reviewing and approving documents and, in Administrative Agent's discretion, Modifying any Additional Advance conditions.[111]

3.5 Swap Counterparty. To the extent that a Lender or its Affiliate is Swap Counterparty, it may exercise all rights and remedies (including its rights and remedies as an unsecured creditor of Borrower unless doing so may impair any Collateral or any Lender's rights) as Swap Counterparty (except regarding Collateral or Insolvency Proceedings) as if it were not a party to this Agreement or any Loan Document. This does not limit: (a) Swap Counterparty's rights and obligations under this Agreement; or (b) Administrative Agent's authority under this Agreement to act for Swap Counterparty as to the Collateral. If Swap Counterparty obtains a judgment against Borrower, Swap Counterparty shall: (a) comply with Administrative Agent's instructions on enforcement (or non-enforcement) of such judgment against the Collateral; and (b) promptly remit to Administrative Agent any proceeds of any such enforcement. If the Swap requires Borrower or its Affiliate to give Swap Counterparty any Separate Swap Collateral,[112] then: (a) Swap Counterparty may act against the Separate Swap Collateral as if this Agreement did not exist, unless such action limits or impairs any Enforcement of any Secured Obligation (for example, because of one form of action or anti-deficiency rules) or any Loan Document or relates to initiation of an Insolvency Proceeding; and (b) no Lender shall have any interest in any Separate Swap Collateral or its proceeds. If Administrative Agent so directs, Swap Counterparty shall act against (and apply proceeds of) its Separate Swap Collateral for Swap Counterparty's benefit before Administrative Agent acts against the Collateral under this Agreement.

3.6 Insolvency Proceedings. No Secured Party shall commence, file, institute, petition (either by itself or in conjunction with any other Person), or join any Person in the foregoing, or otherwise initiate or cause any other Person to initiate, or facilitate or acquiesce in commencement of, or file any motion or objection or other papers in, any Insolvency Proceeding affecting Borrower, unless Administrative Agent requests such Secured Party to do so consistently with this Agreement. Each Secured Party shall, on Administrative Agent's request, execute, verify, deliver, and file in a prompt and timely manner any proofs of claim, consents, assignments, or other acts or documents necessary or appropriate for Enforcement. By signing this Agreement, each Secured Party irrevocably assigns to Administrative Agent all claims and rights of such Secured Party in any Borrower Insolvency Proceeding, and authorizes Secured Party to exercise such claims and rights (to the exclusion of the assignor) in accordance with this Agreement. All Secured Parties acknowledge that such assignment, and the terms of this Agreement, benefit all Secured Parties, including each assignor. If any Secured Party seeks to exercise individually any claim or right in any Borrower Insolvency Proceeding (except in accordance with Administrative Agent's directions), or otherwise violates this paragraph, then such Secured Party shall Indemnify all other Secured Parties regarding any loss they suffer as a result of such Secured Party's actions.[113] The fact that any court authorizes an individual Secured Party's actions shall not excuse such Secured Party from the foregoing Indemnity obligations.

3.7 Subagents. Administrative Agent may at any time require A Lenders as a group or B Lenders as a group to appoint, by a Majority of either such group, a "sub-agent" to act for all A Lenders or all B Lenders, as applicable.[114] The relationship between each group of Lenders and its subagent shall be governed by this Agreement, to the extent reasonably applicable to such relationship (replacing references to Administrative Agent as it relates to such group with references to the subagent for such group), as Modified by agreement of Lenders within such group. Administrative Agent need thereafter deal only with such subagent(s) and need not deal with individual Lender(s) within each group.

4. Communications

4.1 Changes in Interest Rate. Administrative Agent shall promptly notify Lenders in writing of each election notice Administrative Agent receives from Borrower on interest rate calculations.

4.2 Requests for Instructions. Subject to the Decision Rules, Administrative Agent may at any time (even if this Agreement does not require it) request instructions from Majority Lenders on any Discretionary Action. Administrative Agent may refrain from taking (and may withhold) any Discretionary Action (and shall incur no liability to any Person for doing so) until Administrative Agent has received such instructions.

4.3 Reporting. Administrative Agent shall periodically give the Secured Parties copies of all material financial information and notices Administrative Agent has given or received under the Loan Agreement. Administrative Agent shall: (a) promptly give the Secured Parties copies of any written communications between Borrower and Administrative Agent about any actual or alleged (Event of) Default; and (b) otherwise keep the Secured Parties reasonably informed of the status of any such actual or alleged (Event of) Default. Administrative Agent shall upon reasonable request from a Lender give such Lender cop-

ies of any other material information in Administrative Agent's possession about the Collateral or Loan.

4.4 Publicity. In accordance with its customary procedures, Administrative Agent shall use reasonable precautions to avoid disclosing the identity or involvement of any Secured Party in connection with the Secured Obligations in any of its advertising or other publicity materials, without such Secured Party's prior written consent.[115]

5. Decisions and Approvals

5.1 Administrative Agent's Authority. Subject only to the Decision Rules[116] and the Servicing Standard, Administrative Agent may, in its sole discretion, in each instance without prior notice to any Secured Party (and even if any such action adversely affects a Secured Party), and to the exclusion of the Secured Parties: (i) exercise or refrain from exercising any power or right of Administrative Agent or any Lender under any Loan Document or against any Collateral; (ii) Enforce or not Enforce the Secured Obligations; (iii) grant or withhold any consent, approval, or waiver, and make any determination, under any Loan Document; (iv) Modify any Loan Document; (v) accept additional security or release any Collateral; (vi) collect the Obligations; and (vii) exercise or determine not to exercise any or all powers incidental to any of the foregoing. No Lender shall have any authority to take any action within Administrative Agent's authority under the previous sentence or otherwise, except to the limited extent that this Agreement allows Swap Counterparty to enforce the Swap against Borrower. No Lender shall have any right to Enforce the Loan (and Swap Counterparty shall have no rights to proceed against any Collateral) directly,[117] and presently and irrevocably assigns, conveys, and delegates to Administrative Agent all rights to Enforce the Secured Obligations (and proceed against any Collateral). Nothing in any Decision Rule gives Swap Counterparty any rights.[118]

5.2 Non-Default Decision Rules. Notwithstanding anything to the contrary in this Agreement but subject to the Default Decision Rules, Administrative Agent must obtain the following approval (or deemed approval) of these Lenders for only these decisions (such approval requirements, collectively, the "Non-default Decision Rules"):[119]

If a Decision Constitutes:	Then it needs approval (or deemed approval) by these Lenders, except Nonvoting Lenders:
Unanimous Decision	Unanimous Approval
Supermajority Decision	Majority of A Lenders; Majority of B Lenders; and Supermajority of all Lenders
Majority Decision	Majority of A Lenders; and Majority of B Lenders

5.3 Default Decision Rules. In any Default Period, Administrative Agent's Enforcement shall be subject to the Non-default Decision Rules and these limits (the "Default Decision Rules"), subject always to Administrative Agent's indemnity rights under this Agreement. The Default Decision Rules shall supersede the Non-default Decision Rules where inconsistent.[120]

5.3.1 B Decision Period. In any B Decision Period,[121] Administrative Agent shall follow (i) a Majority of B Lenders' directions on when and how to Enforce the Secured Obligations and (ii) the direction of the Majority of B Lenders to agree to a Workout of the Loan,[122] provided that (in the case of (i) or (ii)):

5.3.1.1 Servicing Standard. Administrative Agent reasonably determines such Enforcement or Workout meets the Servicing Standard;

5.3.1.2 Conditions. B Lenders continue to meet all conditions to the existence and continuation of a B Decision Period**;**

5.3.1.3 Projection. Except with their Unanimous Approval, all A Lenders receive and reasonably project that they shall continue at all times to receive (including after Enforcement or Workout), when and as (or before) otherwise required (whether from Credit Party(ies), any other Person, or Cure Payments), all Loan Proceeds (including Expense reimbursements and Add-Ons) that A Lenders (and Swap Counterparty receives all Swap Payments that Swap Counterparty) would have received if: (i) no Default Period existed; (ii) a Borrower Cure Date had occurred; (iii) the Loan had not been accelerated; and (iv) no Workout, Enforcement, or Swap Termination had occurred. In making that projection, A Lenders shall recognize that B Lenders have no obligation to make Cure Payments except as they expressly agree in writing; and

5.3.1.4 Effect of Loss. Any loss resulting from the Enforcement or Workout, as the case may be, does not otherwise materially adversely affect A Lenders.

5.3.2 Disputes on Enforcement or Workout. If Administrative Agent reasonably determines that A Lenders or B Lenders have instructed Administrative Agent to act (or fail to act) in a manner that does not satisfy this Agreement, Administrative Agent shall promptly Notify all Lenders of such determination and, in reasonable detail, its basis, and specific changes that, in Administrative Agent's view, would cause the applicable Lenders' instructions to satisfy this Agreement. The parties shall diligently and in good faith seek to resolve any such impasse. Its existence shall not limit B Lenders' right to exercise the B Option at any time during the B Option Period.

5.3.3 Outside B Decision Period. During any Default Period (except

when either: (a) B Lenders can still timely satisfy the conditions to a B Decision Period; or (b) a B Decision Period exists), Administrative Agent shall follow the directions of a Majority of A Lenders on when and how to Enforce the Loan; obtain approval from a Majority of A Lenders for any Workout;[123] and give B Lenders at least five Business Days notice before agreeing to any Workout. In acting under the previous sentence, A Lenders need not consider B Lenders' interests in any way; shall have no obligations except as stated in clause (c) (and shall therefore have no obligations of "good faith" or obligations to comply with the Servicing Standard)[124] to B Lenders; and a Majority of A Lenders may Modify the B Loan with no limits of any kind. B Lenders acknowledge that this Agreement gives them sufficient contractual rights to protect their interests. If B Lenders do not exercise such rights, then A Lenders shall have no obligation to protect B Lenders in any way.[125]

5.3.4 Failure to Act. Notwithstanding anything to the contrary in the preceding Default Decision Rules, if at any time (a) the Lenders (as applicable) have not directed Administrative Agent to Enforce the Secured Obligations in any way and (b) have not remedied such failure within ten Business Days after Notice (given in accordance with the "Deemed Consents" paragraph below), then Administrative Agent may (but shall have no obligation to) take only such actions to Enforce the Secured Obligations as Administrative Agent reasonably determines necessary to protect and preserve the Collateral and prevent any material impairment of the Secured Parties' interests, such as filing a proof of claim and paying unpaid Priority Expenses. In addition, if any Default Period has continued for 60 days and the Lenders have not directed Administrative Agent on whether and how to Enforce the Loan, then Administrative Agent may (but shall have no obligation to), seek to Enforce the Secured Obligations consistent with the Servicing Standard and with achieving a reasonably prompt Transfer of the Collateral from Borrower.

5.4 Consent Procedural Matters. If Administrative Agent or any Lender requests any Lender's consent to any matter requiring such Lender's consent (in its capacity as a Lender) under this Agreement, such request may contain a statement substantially to this effect, in boldface and/or capital letters: "IF YOU DO NOT RESPOND TO THIS REQUEST FOR CONSENT WITHIN TEN BUSINESS DAYS OF RECEIPT, THEN YOUR CONSENT SHALL BE DEEMED GRANTED." If a request for consent complies with this grammatical paragraph and the sender does not receive the recipient's written response within ten Business Days after the recipient receives such request, the recipient shall be deemed for all purposes of this Agreement (including any Lender approval requirements) to have consented to such request. If any Lender has consented or been deemed to have consented to any matter, then such Lender may not withdraw such consent without Administrative Agent's Consent.

5.5 Dissenters. If any Lender opposes any recommendation from Administrative Agent on any Discretionary Action and does not irrevocably withdraw its opposition within five Business Days after Administrative Agent's written request (a "Dissenter"), then Administrative Agent may, at its option, acquire such Dissenter's entire interest in the Loan either for its own account or for the account of others, disclosed or undisclosed. The purchase price shall equal the amount Dissenter would receive if Borrower paid all Obligations (except Add-Ons)[126] and Administrative Agent distributed the resulting Loan Proceeds through the Waterfall. In all other respects, the provisions of this Agreement on the B Option shall govern the purchase and sale of Dissenter's interest in the Loan.[127]

6. Expenses

6.1 Decision Process. If Administrative Agent desires to incur any Expense, then Administrative Agent shall proceed as follows. In any B Decision Period, the Default Decision Rules and the definition of B Decision Period shall govern any decision to incur an Expense. The B Lenders shall have the same rights and obligations for approval and payment of any such Expense that they do for Cure Payments. At any other time, if Administrative Agent reasonably determines that any Expense (or a series of related Expenses) is reasonably likely to exceed the Expense Approval Threshold, Administrative Agent shall obtain approval from the Lenders under the Non-default Decision Rules. Administrative Agent may, however, incur any Emergency Expense at any time (even during a Default Period or a B Decision Period) without seeking or obtaining approval of any Lenders. Administrative Agent shall reasonably endeavor to minimize, and shall with reasonable promptness notify the Lenders of, any Emergency Expense. To the extent that Administrative Agent satisfies the conditions under this paragraph for incurring Expenses, Administrative Agent may incur such Expense itself and request reimbursement as more fully described below or may request that Secured Parties contribute to such Expense, when incurred, in accordance with the further provisions of this paragraph. For any Expense arising outside a B Decision Period:

6.1.1 Administrative Agent Request. Administrative Agent may request (but not require, except as this Agreement otherwise expressly provides) that Secured Parties incur such Expense.

6.1.2 B Lenders' Rights. B Lenders' right to incur any such Expense shall supersede A Lenders' and Swap Counterparty's right to do so.

6.1.3 Sharing. If multiple Secured Parties desire to incur any such Expense, then they shall do so in pro-

portion to their Pro Rata Shares or as they otherwise agree.

6.1.4 Borrower-Reimbursable Expense(s). Any Borrower-Reimbursable Expense(s) shall be added to the Secured Obligations (or part of the Secured Obligations) held by whichever Secured Party(ies) incurred such Borrower-Reimbursable Expense(s); shall not become part of any Lender's Principal; shall therefore not affect Pro Rata Shares; and shall be repaid in accordance with the Waterfall (or as the definition of "B Decision Period" provides).

6.1.5 Non-Borrower-Reimbursable Expense(s). To the extent that Non-Borrower/Reimbursable Expenses were approved in accordance with the Non-default Decision Rules and do not (except in the case of Emergency Expenses) exceed the Payment Cap, each Secured Party shall promptly upon demand pay its Pro Rata Share of such Non-Borrower-Reimbursable Expenses.

6.1.6 No Lender Obligation. Except as the previous subparagraph provides, no Secured Party shall ever be obligated to make a payment to contribute to any Expense.

6.2 Reporting. Administrative Agent shall give the Secured Parties a monthly statement of Expenses. If any Lender so requests within 60 days after receiving the first monthly report of a particular Expense, Administrative Agent shall give the Secured Parties reasonable additional documentation for that Expense.

7. Cure Rights and Purchase Option

7.1 Defaults. In any Default Period, a Majority of B Lenders may determine that B Lenders shall make Cure Payments.[128] To the extent that total Cure Payments in any calendar year do not exceed the Payment Cap, all B Lenders shall make such Cure Payments (as determined by a Majority of B Lenders) in proportion to their Pro Rata Shares within three Business Days after the Majority of B Lenders vote to make such Cure Payments. After total Cure Payments in any given calendar year have equaled the Payment Cap, thereafter in such calendar year any B Lender that has voted against making Cure Payments need not contribute to such Cure Payments. The other B Lenders shall, in proportion to their relative Pro Rata Shares, cover the resulting Cure Payment shortfall (simultaneously with the funding of such Cure Payments by the Majority of B Lenders).[129] If B Lenders make Cure Payments at any time outside a B Decision Period, A Lenders may (by a Majority vote) reject them. Nothing in this paragraph limits the number or amount of any Cure Payments. No Cure Payment limits Borrower's obligations to any Lender. To the extent those obligations run to the A Lender(s), but B Lender(s) paid Cure Payment(s) to A Lender(s) on account of such obligations, A Lender(s) by signing this Agreement, assign to B Lender(s) all rights to receive such payments from Borrower, subject to the Waterfall.

7.2 B Option. In any B Option Period, B Lenders shall have the right (the "B Option"), but not the obligation, to elect to purchase the A Loan from A Lenders, and the Swap (including Swap Counterparty's entire interest in the Collateral and any Separate Swap Collateral) from Swap Counterparty, on the B Option Closing Date, for the B Option Price. If at the B Option Closing Date no Swap Termination has already occurred, then a Swap Termination shall be deemed to occur immediately before the B Option Closing Date. B Lenders may exercise the B Option by giving A Lenders and Swap Counterparty Notice of exercise. The transfer of the A Loan, the Swap, and Swap Counterparty's entire interest in the Collateral and any Separate Swap Collateral shall occur on the B Option Closing Date. Such transfer shall be effectuated under an agreement in industry standard form, with such modifications as Secured Parties reasonably agree are necessary to reflect the terms and attendant circumstances of such transfer. Any such agreement shall not require A Lenders or Swap Counterparty to make any representations or warranties, or be subject to any recourse, except that each shall represent and warrant that it has not otherwise transferred its interest in the A Loan or the Swap.[130] On the B Option Closing Date, the B Lenders shall assume (and shall cause Swap Counterparty to be released from) all of Swap Counterparty's obligations under the Swap.

7.3 Decision Process. Any B Lender (or group of B Lenders) may request B Lenders as a whole, by Notice to B Lenders, to exercise the B Option when B Lenders have the right to do so. Within five Business Days, any B Lender that receives such Notice may elect (by Notice to all B Lenders) not to participate in the exercise of such B Option. If any B Lender(s) give Notice that they do not wish to participate in such exercise, then the B Lender(s) that proposed such exercise may withdraw such proposal.

7.4 Effect of Exercise. The B Lender(s) that exercise the B Option shall acquire the A Loan in proportion to their relative Pro Rata Shares. They shall succeed to all rights and obligations of A Lenders, including those under this Agreement. If Administrative Agent is not a B Lender, then on the B Option Closing Date, a Majority of B Lenders shall designate a replacement Administrative Agent.

8. Distributions

8.1 Loan Proceeds. Administrative Agent shall distribute all Loan Proceeds to Secured Parties under the Waterfall, in proportion to the claims of multiple claimants within each Bucket. Administrative Agent may apply any amounts payable to any Secured Party first to reimburse Administrative Agent for such Secured Party's Pro Rata Share of any Expenses and Indemnity obligations for which any such Secured Party did not already contribute or pay its Pro Rata Share, even if this Agreement did not require such Secured Party to pay such Pro Rata Share of such

Expenses and Indemnity obligations in the first instance.[131] In calculating interest due the Lenders, Administrative Agent shall allocate each Advance between A Loan and B Loan based on Pro Rata Shares.

8.2 Timing. If Administrative Agent receives Loan Proceeds by 11 a.m. New York City time on a Business Day, Administrative Agent shall disburse them on that Business Day. If Administrative Agent receives Loan Proceeds at any other time, Administrative Agent shall disburse them on the next Business Day. Administrative Agent shall disburse Loan Proceeds by wire transfer of immediately available funds to the recipient's Wire Address.

8.3 Sharing. If a Lender obtains any payment (voluntary, involuntary, or otherwise) on account of such Lender's interest in the Secured Obligations, including through any rights of setoff (including any setoff a Lender asserts against its obligation as Swap Counterparty, if applicable), such Lender shall immediately pay over such payment to Administrative Agent, to be applied as Loan Proceeds under this Agreement. This Section does not apply in any way to: (a) so long as no Swap Termination has occurred, any Swap Regular Payments from Borrower to Swap Counterparty; or (b) any payments Swap Counterparty receives from any Separate Swap Collateral. If, however, Swap Counterparty receives from Borrower any Swap Payment (or any recovery on account of a Swap Payment) simultaneously with or after a Swap Termination, Swap Counterparty shall remit it to Administrative Agent, to be applied as Loan Proceeds, except to the extent it arises from Separate Swap Collateral.

8.4 Disgorgement. If any Insolvency Proceeding or court order requires Administrative Agent to disgorge or return any Loan Proceeds, or if Administrative Agent remits to any Secured Party any Loan Proceeds in error, then each Secured Party shall, on request, promptly pay Administrative Agent: (a) any such Loan Proceeds that such Secured Party received (as reasonably calculated by Administrative Agent); (b) such Secured Party's proportionate share of any interest or other amount Administrative Agent pays or is required to pay on account of such Loan Proceeds; and (c) interest at the federal funds rate on any amount in (a) or (b) above, unless such Secured Party pays such amount within one Business Day after the request for payment.

8.5 Liability. If, in Administrative Agent's reasonable opinion, distribution of any Loan Proceeds might produce any liability to Administrative Agent, it may refrain from making distribution until its right to do so has been determined by a court of competent jurisdiction or has been resolved by agreement of all Secured Parties. In addition, Administrative Agent may require Secured Parties to Indemnify Administrative Agent against any such liability, before making any such distribution.

8.6 Taxes. Administrative Agent shall remit Loan Proceeds to any Secured Party without deduction for taxes, charges, levies, or withholdings, except to the extent, if any, that Law, the Loan Documents, or this Agreement requires Administrative Agent to withhold such amounts. Each Secured Party promptly shall deliver such withholding exemption forms as Administrative Agent reasonably requests.

9. Transfers

No Secured Party shall Transfer its interest (or any part of its interest) in the Secured Obligations, without Administrative Agent's prior consent, which Administrative Agent may withhold in its sole and absolute discretion except as stated below.[132] Secured Parties further agree as follows, superseding the preceding sentence, regarding Transfers:

9.1 Borrower. No Secured Party shall Transfer any interest in any Secured Obligation to Borrower or its Affiliate.

9.2 Cross-Holdings. Any Lender may hold interest(s) in both the A Loan and the B Loan. As among the Secured Parties, no A Lender shall have any obligation to act in any particular manner because of its interest(s) in the B Loan, and vice versa. Each Lender may vote any part of its interest in the Loan on any matter (including exercise or non-exercise of the B Option, in the case of a B Lender) in accordance with its own determination of its best interests, including its interests as holder of other interest(s) in the Loan. Nothing in this paragraph shall cause the A Loan and the B Loan to constitute a single indebtedness of Borrower. To the contrary, the A Loan and the B Loan remain entirely separate obligations subject to the possibility of overlapping ownership.

9.3 Loan Agreement. No Lender shall cause or permit any Transfer that would violate the Loan Agreement, even if Administrative Agent consents to it.

9.4 Minimum Hold. If, after any Transfer, any Lender would hold less than $_____ in principal of the Loan, then simultaneously with such Transfer such Lender shall Transfer its entire interest in the Loan to the same Transferee.[133]

9.5 Permitted Transfers. Administrative Agent's consent shall not be required for: (a) a Secured Party's Transfer of its interest in the Secured Obligations or under this Agreement to its Affiliate or a Federal Reserve Bank; (b) any Transfer to a Permitted Holder; or (c) a Lender's grant of a participation interest to any Permitted Holder, provided that such Lender's agreement with its participant (a copy of which such Lender shall have delivered to Administrative Agent) gives the participant no consent or approval rights on any Discretionary Action, except Unanimous Decisions. Administrative Agent and Borrower shall have no obligations of any kind to any participant.

9.6 Pledge. Any Lender (a "Pledgor") may pledge its interest in the Loan (a "Pledge") to any entity that has extended a credit facility (or may "sell" its interest in the Loan to, and "repurchase" it from, the provider of a so-called "repurchase" facility) to such Lender (a "Pledgee"), on the terms and conditions of this paragraph, provided that such Pledgee is: (x) a Permitted Holder; (y) a financial institution whose long-term unsecured debt is rated at least "A" (or its equivalent) or better by each Rating Agency; or (z) Deutsche Bank AG, New York Branch; RBS Greenwich Capital Markets, Inc.; Goldman Sachs Mortgage Company; Bank of America N.A.; or their successor institutions.[134] The parties further agree as follows regarding any Pledge:

9.6.1 Effect of Notice. If a Lender Notifies Administrative Agent that such Lender has made a Pledge (which Notice shall give Pledgee's name and address within the United States), then Administrative Agent shall promptly acknowledge receipt. Thereafter, Administrative Agent shall: (a) give Notice to Pledgee of any default under this Agreement by Pledgor of which default Administrative Agent has actual knowledge; and (b) allow such Pledgee ten Business Days Business Days to cure such default. Pledgee need not cure any such default. In addition, from and after Administrative Agent's receipt of Notice of a Pledgee: (a) no Modification of this Agreement that would require Pledgor's consent shall be effective against such Pledgee without its written consent, not to be unreasonably withheld, conditioned, or delayed and deemed granted[135] if Pledgee fails to respond to any request for consent within ten Business Days after written request; and (b) if Pledgee gives Notice (a "Redirection Notice") to Administrative Agent that Pledgor is in default, beyond applicable cure periods, under Pledgor's obligations to Pledgee (which Notice need not be joined in or confirmed by Pledgor), and until Pledgee withdraws or rescinds its Redirection Notice, Administrative Agent shall remit to Pledgee any payments that this Agreement would otherwise require Administrative Agent to remit to Pledgor from time to time. Any Pledgor unconditionally and absolutely releases Administrative Agent from any liability to Pledgor for complying with any Redirection Notice.

9.6.2 Pledgee's Rights and Remedies. Pledgee may fully exercise its rights and remedies against Pledgor, and cause a Transfer of any and all collateral granted by Pledgor to such Pledgee, in accordance with applicable law and this Agreement. In such event, Administrative Agent shall recognize such Pledgee (and any transferee of such collateral that is also a Permitted Holder), and its successors and assigns, as the successor to Pledgor's rights, remedies, and obligations under this Agreement. Any such transferee shall assume in writing Pledgor's obligations accruing from and after such Transfer (i.e., such Pledgee's realization upon its collateral) and shall agree to be bound by this Agreement.

9.6.3 Termination of Pledgee's Rights. Any Pledgee's rights under this paragraph shall continue unless and until such Pledgee has Notified Administrative Agent that the Pledge has terminated.

9.7 Prohibited Transfers. If any Secured Party Transfers its interest in the Secured Obligations in violation of this Agreement, then the Transfer shall be void *ab initio*. Without limiting the previous sentence, Administrative Agent shall not make any payments to such Transferees.

9.8 Required Deliveries. A Lender that makes any Transfer (except: (a) to a Federal Reserve Bank or (b) a Pledge to a Pledgee as this Agreement expressly allows) shall deliver to Administrative Agent: (i) a certificate of a senior officer of the Transferor or Transferee certifying that Transferee is a Permitted Holder; (ii) an original fully executed Assignment from Transferor to Transferee; (iii) copies of all other documents for such Transfer; and (iv) a Transfer fee of $3,500.[136]

10. Substantial Impairment[137]

10.1 Substantial Impairment Notice. If at any time Administrative Agent believes the B Loan is Substantially Impaired,[138] then Administrative Agent may at its option so Notify B Lenders (a "Substantial Impairment Notice"). With or before any Substantial Impairment Notice, Administrative Agent shall give B Lenders a copy of an Appraisal and Administrative Agent's calculations demonstrating such Substantial Impairment. If a Majority of A Lenders request Administrative Agent to obtain an Appraisal (and agree to pay for such Appraisal as an Expense with no effect on future application of any Expense Approval Threshold) to determine whether the B Loan is Substantially Impaired, then Administrative Agent shall promptly comply with such request, provided that the Majority of A Lenders made no similar request within the preceding 180 days. If the resulting Appraisal demonstrates the B Loan is Substantially Impaired, then Administrative Agent shall not unreasonably refuse to give B Lenders a Substantial Impairment Notice.[139]

10.2 Delivery of Substantial Impairment Prevention Collateral. Within ten Business Days after any Substantial Impairment Notice, any B Lender(s) may in their sole and absolute discretion notify Administrative Agent that they unconditionally and irrevocably agree and commit to deliver to Administrative Agent Substantial Impairment Prevention Collateral sufficient to prevent Substantial Impairment of the B Loan. If any B Lender(s) give(s) such Notice to Administrative Agent, then such B Lender(s) shall, within ten days after committing to do so, deliver to Administrative Agent Substantial Impairment Prevention Collateral in such amount. So long as B Lender(s) timely perform under this paragraph, the B Loan shall not be deemed Substantially Impaired.[140]

10.3 Use of Substantial Impairment Prevention Collateral.

If any B Lender(s) deliver to Administrative Agent any Substantial Impairment Prevention Collateral, then only if Administrative Agent has made a Final Recovery Determination and applied all other Loan Proceeds through the Waterfall, Administrative Agent may draw upon and apply through the Waterfall (as Loan Proceeds) all such Substantial Impairment Prevention Collateral. Until then, the B Lender(s) that delivered Substantial Impairment Prevention Collateral shall preserve and maintain it. Unless and until the A Loan has been unconditionally, irrevocably, and finally paid in full from Loan Proceeds, B Lenders unconditionally and irrevocably waive any rights of contribution, indemnity, reimbursement, or subrogation from Credit Parties or their Affiliates on account of Administrative Agent's application, drawing, or use of Substantial Impairment Prevention Collateral. Delivery of Substantial Impairment Prevention Collateral does not in itself (unless and until applied as Loan Proceeds) affect the amount of the B Loan.

10.4 Release of Substantial Impairment Prevention Collateral. Administrative Agent shall promptly release all undrawn and unapplied Substantial Impairment Prevention Collateral to the B Lender(s) that delivered it if and when any of the following has occurred:

10.4.1 Appraisal. Administrative Agent has, in accordance with the Servicing Standard and at B Lenders' request (which request they may make no more than once every 180 days) and expense, obtained an updated Appraisal showing that even without the Substantial Impairment Prevention Collateral, the B Loan is no longer Substantially Impaired;

10.4.2 B Option. B Lenders have exercised the B Option;[141]

10.4.3 Discretionary Approval. A Lenders, by Unanimous Approval (in their sole and absolute discretion), have directed Administrative Agent to release the Substantial Impairment Prevention Collateral; or

10.4.4 Repayment. A Lenders and Swap Counterparty have received unconditional (re)payment of an amount equal to the B Option Price;

11. Representations, Warranties, and Acknowledgments

11.1 All Parties. Administrative Agent and each Lender each represents and warrants to all other parties to this Agreement that: (a) it is a Permitted Holder and legally authorized to enter into this Agreement, any Assignment to which it is a party, and, in the case of Administrative Agent only, any Loan Documents to which it is party (the "Documents"); (b) it has duly executed and delivered the Documents; (c) the Documents do not violate any agreement or Law that binds it, and are its legal, valid, binding, and enforceable obligation; (d) it has dealt with no agent, broker, consultant, investment banker, or other Person that may be entitled to any commission or compensation as a result of any transaction this Agreement describes; and (e) it is sophisticated about (and experienced in making) decisions to acquire assets such as its interest(s) in the Secured Obligations. Swap Counterparty, in its capacity as Swap Counterparty, makes to all other parties to this Agreement the representations and warranties in clauses (a) through (d) above.

11.2 Secured Parties. Each Secured Party agrees, acknowledges, represents, and warrants to all other parties that:

11.2.1 Decisions. It will, independently and without reliance on any other Person, based on such documents and information as it deems appropriate at the time, make and continue to make its own credit decisions about Credit Parties and the Secured Obligations. It has previously, in the same way, made its own credit decision to acquire its interest(s) in the Secured Obligations.

11.2.2 No Responsibility. No party to this Agreement: (a) shall be responsible to any other party for the collectability, enforceability, execution, genuineness, legality, sufficiency, or validity of any Loan Document or other instrument or document furnished under the Loan Documents or relating to the Obligations; or (b) has made or shall be deemed to have made any warranty or representation to another or be responsible to another for any statement, warranty, or representation (written or otherwise) made in or in connection with the Secured Obligations or the Loan Documents or for the financial condition of any Person or for any Collateral (but this does not limit any Person's express representations and warranties under this Agreement).

11.2.3 Review and Approval. It has: (a) reviewed and accepted the Loan Documents as they exist on the Effective Date and the closing deliveries (or waivers of closing requirements) under the Loan Agreement as of the Effective Date; (b) received all relevant financial information as it has deemed appropriate to make its own credit analysis and decision to acquire its interest in the Secured Obligations; and (c) used the information it has received about the Secured Obligations solely to evaluate the Secured Obligations and will keep such information confidential (except as Law or judicial process requires) and not use it for any other purpose.

11.2.4 Securities Compliance. It acquires its interest in the Secured Obligations for its own account and not with a view to or for sale in connection with any distribution of any evidence of indebtedness.

11.3 Administrative Agent. Administrative Agent represents and warrants to each Secured Party as follows, as of the Effective Date, subject to any matters that any Loan Document or Exhibit B discloses:[142]

11.3.1 Actions and Proceedings. Administrative Agent has received no notice of any pending action, suit, proceeding, arbitration, or governmental investigation against any Credit Party or the Collateral, an adverse outcome of which, to Administrative Agent's knowledge,

would materially and adversely affect any Credit Party's ability to perform under the Loan Documents or the value or use of the Collateral. To Administrative Agent's knowledge: (a) no proceeding exists to condemn any Collateral; and (b) no Credit Party is a debtor in any Insolvency Proceeding.

11.3.2 Engineering and Environmental. Administrative Agent has delivered to each Lender true and complete copies of (i) the engineering report or update prepared by _____ dated _____; (ii) the letter from _____ to Administrative Agent, dated as of _____about _____; and (iii) the Phase I environmental report prepared by _____ and dated _____. Administrative Agent has received no other written reports about any physical or environmental issues that materially adversely affect any Collateral.

11.3.3 Full Disbursement. The Loan has been fully disbursed except _____.

11.3.4 Insurance. To Administrative Agent's knowledge, all insurance the Loan Documents require is in full force and effect in all material respects subject only to waivers that satisfy the Servicing Standard.

11.3.5 Loan Defaults. Administrative Agent has delivered no Notice of any uncured (Event of) Default to Borrower. Administrative Agent has no knowledge of any basis for such a Notice. The Loan is not, and has never been, delinquent for 30 or more days, in any sum(s) due Administrative Agent or any Lender.[143]

11.3.6 Loan Documents. Administrative Agent has delivered to the Lenders true and complete copies of each Loan Document listed in Exhibit B. Those Loan Documents constitute all material agreements about, and all material documents evidencing or securing, the Loan.

11.3.7 Loan Status. Administrative Agent has not: (a) Modified in writing any material provision of the Loan; (b) released any material Collateral; or (c) to Administrative Agent's knowledge, released any Credit Party from any material Obligation.

11.3.8 No Equity Participation. Except as the Loan Agreement discloses, Administrative Agent does not (and has no right to) own any equity participation or preferred equity interest in any Credit Party or its Affiliate.[144]

11.3.9 No Sweep Event. Administrative Agent has not Notified Borrower of a Sweep Event.[145]

11.3.10 Opinions. Administrative Agent has delivered to each Lender true and correct copies of the legal opinions Administrative Agent received for the Loan. Administrative Agent has received no Notice (and has no reason to believe) that any such opinion is materially incorrect.

11.3.11 Other Loans. To Administrative Agent's knowledge, (a) no subordinate mortgage or lien encumbers any Collateral, and (b) there is no mezzanine debt related to the Collateral or Borrower.

11.3.12 Permits. Administrative Agent has no reason to believe any representations and warranties in the Loan Agreement about Permits are materially false.

11.3.13 Reserves and Escrows. Administrative Agent or its Representative holds or controls all escrows and reserves the Loan Documents require.

11.3.14 Servicing. Administrative Agent has complied with the Servicing Standard in all material respects since the Loan Date.

11.3.15 Status. Administrative Agent: (a) is a branch, licensed in New York, of a banking corporation duly organized under the laws of _____; (b) has entered into no intercreditor, participation, co-lender, or similar agreement for any Secured Obligations except this Agreement or as the Loan Agreement discloses; and (c) except as disclosed to the Lenders in writing, possesses all original material Loan Documents (except individual Lenders' separate promissory notes, if any, and any Loan Documents delivered to appropriate third parties for recording or filing).

11.3.16 Swap. The Swap is in full force and effect. Swap Counterparty (and, to Administrative Agent's knowledge, Borrower) is not in default under the Swap.[146]

11.3.17 Title Policy. Administrative Agent has received no Notice (and has no knowledge or reason to believe) the Title Policy is not in full force and effect. Administrative Agent has not made (and knows of nothing that might support) any claim under the Title Policy. Administrative Agent has no actual knowledge of anything that would impair or diminish the Title Policy.

11.4 Conflict. All Secured Parties acknowledge: (a) Administrative Agent has fully disclosed that Administrative Agent, Swap Counterparty, Administrative Agent as an A Lender (if applicable), and Administrative Agent as a B Lender (if applicable) (all the foregoing, the "Conflicted Parties") are the same Person or different departments of the same Person; (b) Conflicted Parties have been represented by the same counsel in negotiating and closing all legal relationships referred to in this Agreement to which any of them are party, and this Agreement; (c) this Agreement satisfactorily addresses any conflict of interest that may result from the matters in clauses (a) and (b); (d) each Lender has had ample opportunity to have its own counsel review and approve this Agreement and all other documents as to which the Conflicted Parties have any actual or potential conflict of interest; (e) this Agreement fully defines the duties of Administrative Agent, including such duties as they relate to Administrative Agent's conflict of interest (if any) in dealing with any other Conflicted Party; and (f) Administrative Agent shall not be deemed to have any fiduciary du-

ties or implied obligations as a result of any such conflict or otherwise. This does not limit Administrative Agent's express obligations under this Agreement.

12. Miscellaneous

12.1 Certain Claims. Each party waives any right to recover consequential or speculative damages of any kind in the event of any Dispute.

12.2 Characterization. This Agreement, the Assignments, and the Loan Documents create no partnership, joint venture, or fiduciary obligations among the parties. No interest of any Lender in any Loan, and no rights of any Person under this Agreement, are a security under the Securities Act or any other securities law.

12.3 Counterparts. This Agreement may be executed in any number of counterparts, as if all parties had signed the same document. All counterparts shall be construed together. They constitute one agreement.

12.4 Further Assurances. Each party shall, from time to time, execute such documents as Administrative Agent reasonably requires to evidence Administrative Agent's authority, and to further effectuate the parties' intentions, under this Agreement. If any Lender determines that it desires to securitize its interest in the Loan, then the other parties shall not unreasonably refuse to agree to any amendments of this Agreement necessary or appropriate to achieve such securitization, provided that any such amendment does not: (a) defer or reduce any payment; (b) impair the rights of the signing party in any material respect; or (c) in any other way materially adversely affect any Lender.[147]

12.5 Governing Law, Disputes. This Agreement and any Dispute shall be governed by, and construed under, New York law. The parties irrevocably: (a) agree that any Dispute may be brought in any state or federal court in New York County having subject matter jurisdiction;[148] (b) consent to jurisdiction of each such court in any Dispute; (c) waive any objection to venue of any Dispute in any such court and any claim that any Dispute has been brought in an inconvenient forum; and (d) consent to service of process in any Dispute by service of copies at its notice address, with simultaneous service of copies on all its copy recipients, under this Agreement.[149] Nothing in this paragraph limits any Person's right to serve legal process in any manner Law allows or Administrative Agent's right to initiate any Dispute with Borrower anywhere. THE PARTIES WAIVE JURY TRIAL IN ANY DISPUTE.

12.6 Interpretation. "Include" and its variants shall be interpreted as if followed by: "without limitation." If any provision(s) of this Agreement are held illegal, invalid, or unenforceable in any respect, that shall not limit the enforceability, legality, or validity of the remainder.

12.7 Merger. This Agreement and the Assignment(s) embody the entire agreement among the parties about the Secured Obligations and the Collateral, superseding all prior agreements and understandings about such matters.

12.8 Modifications. Nothing in this Agreement may be Modified except by a written instrument signed by the party to be charged.

12.9 Notices and Payment Instructions. Any Notice under this Agreement shall comply (and become effective in accordance) with the Notice procedures in the Loan Agreement, but shall be dispatched to the address or fax numbers (and to the copy recipients) specified below each party's signature to this Agreement. Each party may change its address or copy recipient(s) by such Notice. Notice of any matter except a default (or exercise of remedies) under this Agreement may be given by email.

12.10 Obligations Absolute. Each party's obligations under this Agreement are absolute and unconditional. They shall not be affected by any circumstance whatsoever, including any Person's breach of obligations, lack of validity or enforceability of any Loan Document, Default Period, or failure to satisfy any term or condition of any Loan Document. Any payment this Agreement requires shall be made with no abatement, offset, reduction, or withholding whatsoever, except required withholdings.

12.11 Other Transactions. Each party to this Agreement and its Affiliates: (a) may accept deposits from, lend money to, act as trustee under indentures of, and generally engage in any business with, Borrower, its Affiliates, and any Person that may do business with any of the foregoing, with no duty to account to one another; but (b) shall acquire no direct or indirect ownership interest in Borrower or its Affiliates.

12.12 Streit Act. If any Secured Obligation, this Agreement, or the interest of any Secured Party under this Agreement constitutes or is deemed to constitute a "mortgage investment" under New York Real Property Law § 125, then Administrative Agent shall have all powers, shall perform all obligations, and shall be bound by all restrictions and requirements, that apply to a trustee under New York Real Property Law § 126.[150]

12.13 Successors and Assigns. Subject to the Transfer restrictions in this Agreement, the parties' obligations and rights in this Agreement shall bind and benefit their successors and assigns. This Agreement does not benefit Borrower or any third party. Nothing in this Agreement, or any rights, obligations or payments among the parties to this Agreement, diminishes Borrower's obligations under the Loan Documents. By entering into and performing under this Agreement, Secured Parties merely assign among themselves various partial interests in the Loan and the Collateral, in exchange for various payments, without benefiting Borrower in any way.

IN WITNESS WHEREOF, Administrative Agent and the Secured Parties have duly executed this Agreement as of the Effective Date.

ADMINISTRATIVE AGENT AND SWAP COUNTERPARTY:[151]

By:_____
Name:
Title:

By:_____ [152]
Name:
Title:

Notice Address and Wire Transfer Address: _____ _____ Attention: _____ Fax No.: _____ Wire Transfer Address: _____ _____	Copy Recipient for Notice(s): Latham & Watkins LLP 885 Third Avenue New York, New York 10022 Attention: Joshua Stein, Esq.

[INITIAL LENDERS' SIGNATURE PAGE TO INTERCREDITOR AGREEMENT (AMONG A LENDERS, B LENDERS, AND SWAP COUNTERPARTY) DATED AS OF _____, 200__.]

PARTY
NAME OF PARTY, a _____

By: _____
Name: _____
Title: _____

By: _____
Name: _____
Title: _____

Notice Address: _____ _____ Attention: _____ Fax No.: _____ Wire Transfer Address: _____ _____	Copy Recipient for Notice(s): _____ _____ _____

The above Lender is acquiring the following interest in the following Loan(s):

Loan	Principal Amount	Pro Rata Share (Disregarding Swap Counterparty's Interest)
A Loan	$	_____%
B Loan	$	_____%

[Copy as Appropriate]

Endnotes

1. Definitions in the following Model Agreement apply both in these introductory comments and in all footnotes. For convenience, the introductory comments repeat many definitions.
2. An originator can also create a "C" loan and other subordinate tranches as well, typically in connection with securitizing the "A" loan or conceivably other senior tranches. The securitization market insists, however, that the various levels of Lenders make decisions and take actions quickly. This means the "first loss" position (*i.e.*, the most subordinate tranche) will often call the shots to the exclusion of more senior tranches. Although this reallocation of control is "market standard" in securitizationland, portfolio lenders buying the affected intermediate tranches (*e.g.*, the "C" tranche where the "J" tranche controls decisions) must accept the resulting loss of control. Under these circumstances, an investment in an intermediate tranche of a larger Loan becomes very different from a direct investment in a single Loan, hence very different from the investments these portfolio lenders usually make. The demands of the securitization market seem less likely than in the past to drive any of these issues, however.
3. Unlike the typical/historical case in a securitization, however: (1) the value of the parts will usually equal the value of the whole; and (b) the outcome of the transaction will depend entirely on the performance of a single loan, without the diversity of credit risks built into a typical securitization.
4. Once upon a time borrowers could achieve the same result by closing multiple mortgages secured by the same real property. That technique has fallen out of favor for many good reasons. *See, e.g.,* Joshua Stein, *Subordinate Mortgage Financing: The Perils of the Senior Lender*, Real Estate Review, Fall 1997, at 3 (reprinted at www.real-estate-law.com, under "Lending"). If, however, a borrower closes a senior and a junior mortgage and the two mortgagees enter into an intercreditor agreement like the one offered here (sufficient to fully supplant whatever legal principles, issues, and theories would otherwise govern and complicate the intercreditor relationship), then the arrangement becomes just like a typical A/B lending structure and perfectly benign, at least in the author's opinion. The arrangement would need to include appointment of a single agent to enforce both mortgages; otherwise, enforcement of the first mortgage could be deemed a violation of the "automatic stay" if the holder of the second mortgage had itself filed bankruptcy (transfer restrictions could mitigate that risk). How the rating agencies might feel about a two-mortgage structure—even with a strong intercreditor agreement—lies outside the scope of this paper. As another cousin to A/B loans, an originator can simultaneously originate a "mezzanine" loan secured by a pledge of direct or indirect equity interests in Borrower or backed by preferred equity within a Borrower constituent entity. Those arrangements also require intercreditor agreements, raising many issues like those in this Model Agreement, but with a different flavor because the two lenders do not share collateral. That particular intercreditor relationship will usually be documented by a variation on the industry standard mortgage/mezzanine intercreditor agreement, *available at* www.cmbs.org/standards/Intercreditor_Agreement. pdf . This "industry standard" agreement lacks a jury trial waiver, perhaps the most important "boilerplate" paragraph in any document. No one has ever added one to the model in the years since the model was promulgated. Therefore, anyone using that model in a transaction should repair the omission. This industry standard mortgage/mezzanine intercreditor agreement sometimes provides a starting point for an A/B intercreditor agreement, particularly if the originator intends to securitize the A Loan. This Model Agreement started from a different point.
5. This assumes, of course, the existence of a marketplace for purchases of existing real estate loans. For that to exist, buyers need to have cash (or financing) and the inclination to buy real estate loans at a price level that sellers will accept. At the time of writing, none of this seems to exist, but markets go up and markets go down, a fact that many real estate and other investors forgot from 2002 through mid-2007 or so.
6. Some of these issues also arise in any syndicated or other multiple-lender loan. Outside of real estate, any intercreditor discussion might also raise a few more questions, such as these. Which Collateral secures which Lender? (In real estate financing, all Collateral typically secures all Lenders.) Who gets paid first under which circumstances? (In real estate financing, the Waterfall in this Model Agreement is widely accepted and requires little negotiation except to the limited extent suggested in the definition of "Waterfall.")
7. If the originator intends to securitize the A Loan, the pooling and servicing agreement for the securitization will govern many important pieces of the relationship between A Lender and B Lender, all with an eye toward assuring the best possible execution of the A Loan's securitization. These agreements cover an ever-increasing and never-decreasing range of hypothetical eventualities, typically as complicatedly as possible, often defying comprehension by mere mortals. Of course, the rules of entropy dictate that the facts will unfold in whatever way the parties never imagined, thus producing a longer document next time (or the demise of securitization for the time being). When A and B Lenders intend to maintain their "A" and "B" loans in their portfolio, they worry less (or not at all) about much of the "securitization agenda." They can craft a reasonable business deal between themselves, using the ordinary language of mere mortals. This Model Agreement considers only the latter type of A/B intercreditor relationship.
8. The Administrative Agent will typically but not necessarily originate the entire transaction and "sell down" the various pieces either at closing or soon after. The Lender group may have the right to replace Administrative Agent in some circumstances. Lenders will sometimes fear, for example, that Administrative Agent has too chummy a relationship with Borrower, and may not act aggressively in a default. This concern can also arise in any syndicated credit, not just an A/B Loan.
9. *In re Ionosphere Clubs, Inc.*, 134 B.R. 528, 529 (Bankr. S.D.N.Y. 1991).
10. *Id*.
11. *Id.* at 532.
12. *Id*.
13. *Id*. Correspondingly, other parties in the bankruptcy benefited. Thus, the bankruptcy court helped achieve its usual goal of making everyone, particularly the secured creditors, "share the pain," at least where any possible opportunity exists to do so. Secured creditors and their counsel usually try to deny the bankruptcy courts such opportunities.
14. *Id*.
15. *See, e.g., In re Midway Partners*, 995 F.2d 490, 495 (4th Cir. 1993). The use of separate liens (thus creating separate classes of creditors) also creates strategic opportunities in any Borrower bankruptcy, such as the alternatives and possibilities available to the various classes under 11 U.S.C. § 1111(b) (2005). The alternatives and possibilities will vary depending on the full range of possible Collateral values. This flexibility should in general only help, and not hurt, the Lenders as a group, subject perhaps to a few anomalous exceptions.
16. As of mid-2007, when the real estate credit market crested, Borrowers typically had enough leverage to force the Administrative Agent to close a single Loan and create the A and B Loans synthetically, regardless of the possible bankruptcy benefits of having two separate loans. When real estate credit revives, Administrative Agent will probably have the upper hand in this

discussion (at least until the next lending boom gets ready to crest).

17. The importance of bankruptcy court for single-asset real estate cases has probably much diminished since the last down cycle, thanks to the 2005 amendments to 11 U.S.C. § 101(51B) (2005) and 11 U.S.C. § 362(d)(3) (2005) (eliminating $4 million cap for "single asset real estate" debtors). If those amendments remove most single-asset real estate cases from the bankruptcy system as seems likely, and if the state courts enforce real estate finance remedies and documents as written, then Lenders and Borrowers may find the entire process vastly simplified and many traps, minefields, and spurious issues removed. Of course, since 2005 none of this has been tested much, although this will change soon. Borrowers and bankruptcy judges may yet figure out how to keep using bankruptcy to torment and delay real estate Lenders, particularly for Collateral that involves some business operations, such as a hotel, golf course, marina, or storage facility. The "magic key" to bankruptcy court for Borrowers may lie in their potential ability to treat trade creditors' and Lenders' deficiency claims as separate classes for purposes of "cramming down" a plan of reorganization under 11 U.S.C. § 1129(a)(7)(A)(i) (2005). Lenders shouldn't start deleting their "bankruptcy recourse" carveout guaranties just yet.

18. The Loan documents might require Borrower to cooperate to sever one Loan into two separate loans (*i.e.*, an A Loan and a B Loan) if Administrative Agent ever asked. If the Loan ever went into default, the only time that really matters, would Borrower likely perform that obligation? Would a bankruptcy court enforce it? Administrative Agent might try to address these concerns by figuring out a way to make the future bifurcation of the Loan self-executing so it requires no Borrower action or cooperation of any kind—perhaps just Administrative Agent's issuance of a "bifurcation certificate." Administrative Agent might also try to structure the bifurcation procedure so it constitutes part of a "subordination agreement," which the Bankruptcy Code says is enforceable in bankruptcy to the extent it is enforceable under state law. 11 U.S.C. § 510(a) (2005). The efficacy of any of these measures represents an issue beyond this article.

19. The rating agencies may not like this arrangement even if it were subject to a restrictive intercreditor agreement.

20. *See In re 203 N. LaSalle St. P'ship*, 246 B.R. 325 (Bankr. N.D. Ill. 2000).

21. 246 B.R. 325 (Bankr. N.D. Ill. 2000).

22. *Id*. at 331.

23. *Id*. at 332.

24. *Id*. at 331–32.

25. As the larger lesson, perhaps, no matter how hard a senior creditor tries to "subordinate" a creditor that is a Borrower affiliate, "there's always something" that will get in the way. The senior creditor might try to solve the problem through nonrecourse carveouts, but if the principals have already incurred personal liability as the result of the bankruptcy filing itself, they probably won't care much about any incremental personal liability they might suffer by misbehaving under a subordination agreement.

26. Borrowers and Lenders often insist on such arrangements because interest rates fluctuate far more than net operating income of real estate. Swaps are not at all unique to A/B loans. They can arise in any substantial commercial mortgage loan, and raise all the same issues discussed here. For more on how swaps work and the risks they create for real estate borrowers and lenders, *see* Joshua Stein, Stein on New York Commercial Mortgage Transactions § 6.14 (2006).

27. This hypothetical claim will vary as interest rates shift. It seems an imperfect measure of Swap Counterparty's relative interest in the Collateral. That imperfection may create inconsistencies and anomalies over time. Other formulas might make more sense. Multi-lender security structures that involve Swap Counterparties typically don't consider these details at all. They just say Swap Counterparty has the benefit of the Collateral on a *pari passu* basis.

28. They also often ignore the entire intercreditor relationship between Swap Counterparty and the Lenders, stating simply that the Collateral also backs Borrower's obligations to Swap Counterparty.

29. Improvements could include these: treating the Swap as entirely junior to the Loan (including both A Loan and B Loan); sandwiching the Swap's priority between the A Loan and the B Loan; or making the Swap *pari passu* with just the A Loan or just the B Loan. Whatever the A Lenders and B Lenders gain in this trade, the Swap Counterparty loses. Conceivably, the Swap Counterparty could limit itself to a lien on Borrower's equity, a structure the author has never seen in the context of Swap security.

30. In many cases they won't be necessary at all, because the underlying Loan Agreement already includes them. They are rather common and generic. If Administrative Agent anticipates selling interests in the Loan to foreign Lenders, the syndication provisions should also require Administrative Agent, on Borrower's behalf, to maintain a register of Lenders. This will mitigate exposure to U.S. income withholding tax requirements.

31. *See, e.g., Beal Sav. Bank v. Sommer*, 8 N.Y.3d 318 (2007).

32. *Id*. at 322–24.

33. *Id*. at 323.

34. *Id*. at 326.

35. More typically, the Loan Agreement will expressly permit Administrative Agent and any Lenders to make all kinds of assignments and partial assignments.

36. Ultimately, however, Borrower cannot control what the Lenders do, even if the decision-making procedures for Loan enforcement are exquisitely complex and slow, and the Loan Agreement allows only the sweetest and most patient Lenders to buy into the Loan. If the Loan goes into default, nice Lenders may stop being nice. Sooner or later, Borrower may lose the Collateral. In any event Borrower cannot control the situation.

37. The originator might instead plan to securitize the senior loan while continuing to administer the A/B loan. A quick securitization with a third-party servicer can eliminate the conflict of interest. Even so: (1) the risks of being "structurally subordinate" to the senior loan remain; and (2) the "conflict of interest" problem remains if for any reason the originator cannot quickly securitize the senior loan (for example, because the markets freeze up between origination and securitization).

38. To see those articles, including publication details, *see* http:// www.real-estate-law.com and click on "Better Documents."

39. As an alternative, if Borrower entered into only a single Loan, this paragraph could read as follows:

    Under the Loan Agreement, Administrative Agent made to Borrower a single loan secured by all Collateral (the "Loan"), which Administrative Agent and the Lenders intend to break into the A Loan and the B Loan (each constituting part of the Loan) as this Agreement more fully describes.

40. The obligations under the Loan (and secured by the Security Documents) would typically include, as additional interest, Borrower's obligation to pay Swap Payments due Swap Counterparty from time to time. In New York, calling the Swap Payments "additional interest" is believed to mitigate mortgage recording tax. This belief is not necessarily correct.

41. A question arises, though. If at some point Swap Counterparty is no longer an Affiliate of any Lender, should Swap Counterparty lose the benefit of the Collateral?

42. Adjust description of timing as appropriate.

43. If the Loan Agreement contains an adequate Assignment form, use and refer to it instead, eliminating this exhibit.

44. Some Lenders might not want to give Administrative Agent this flexibility, but it seems reasonable.

45. If no Swap Counterparty exists, then all references to "Secured Parties" can simply refer to the Lenders instead.

46. This Model Agreement assumes the Loan Agreement already defines these terms: Accounts, Additional Advances, Advance, Affiliate, Approved Bank, Breakage Costs, Collateral, Consent, Control, Credit Party(ies), Default, Default Rate, Escrow Account, Event of Default, Exit Fee, Extension Condition, Insolvency Proceeding, Interest Payment Date, Law, Legal Costs, Loan Documents, Loss Proceeds, Major Lease, Maturity Date, Notice, Notify, Obligations, Person, Priority Expenses, Release Condition, Reserve Account, Restoration Fund, Security Documents, Sweep Event, and Title Policy. Any drafter should confirm each such assumption, and edit as appropriate. Even when the assumption checks out, the drafter should check that the definitions in the Loan Agreement work in this Model Agreement. As an example of how a Loan Agreement definition might not work here, the Loan Agreement might define "Loan Documents" to include documents for three separate loans, only one subject to this Model Agreement. In that case, the drafter should not invite mistakes and confusion. The term "Loan Documents" should not be used in this Model Agreement at all. Instead, this Model Agreement should use some other term, defined strictly within this Model Agreement.

47. Drafters should tailor definitions to reflect document structure for their particular transaction.

48. Ancient bankruptcy principles sometimes denied a senior creditor the right to recover post-petition interest as a priority claim, unless the subordination agreement expressly gave the senior creditor priority for post-petition interest. The courts reasoned (not necessarily the correct verb choice) that because ordinary bankruptcy principles cut off the accrual of interest at the time of filing, senior creditors needed to be extremely "explicit" if they wanted to overrule this result in subordination agreements. In other words, the subordination agreement needed to "clearly show that the general rule . . . is to be suspended, at least vis-à-vis these parties." *See, e.g.*, *In re Time Sales Fin. Corp.*, 491 F.2d 841, 844 (3d Cir. 1974). Silence must have meant that the senior creditors accepted the general bankruptcy rule, as opposed to ordinary principles of contract law. That proposition is, of course, absurd. Counterintuitive rules like these are informally known as "gotchas." They lead to ever-longer documents of all kinds, although they also further justify the use of (and payment of substantial legal fees for) competent and experienced counsel in any transaction. Section 510(a) of the Bankruptcy Code, which expressly provides for enforcement of subordination agreements, may supersede the so-called Rule of Explicitness.

49. If the parties synthetically create the A Loan under this Model Agreement, then add: "The A Loan constitutes part of the Loan, which part shall have the characteristics this Agreement describes. The A Loan is not separately documented except through this Agreement."

50. If the parties synthetically create the A Loan under this Model Agreement, then the drafter might add: "A Principal constitutes part of the principal of the Loan, which part shall have the characteristics this Agreement describes. A Principal is not separately documented except through this Agreement."

51. Adjust to reflect treatment of any additional advances. For example, may wish to say A Principal shall "increase on account of any Additional Advances that A Lender funded."

52. A drafter could also express the A Rate as an index plus a spread.

53. "Add-Ons" receive unfavorable treatment, at least from an A Lender's viewpoint. B Lenders can receive payment in a Default Period even if some Add-Ons remain unpaid to A Lenders. In contrast, if separate mortgages secured two loans, everything due A Lenders would need to be paid first to preserve B Loan's security. B Lenders will want to keep the list of "Add-Ons" short, such as by omitting late charges. If the Loan includes an exit fee, A Lenders will want to add it to the list.

54. Administrative Agent may want to identify those personnel by name. The Lenders should then seek assurance that the named individuals are the correct individuals to name.

55. Much of this definition might be substantive enough to go in the text of the Agreement. Other definitions of that type: Majority Decision; Permitted Holder; Supermajority Decision; and Unanimous Decision.

56. This definition gives B Lenders the "first crack" at solving the problem. Some intercreditor relationships outside of real estate finance, in contrast, may give the senior creditor "first crack" for a certain period, while the junior creditor must "stand still." This does not seem to be the norm in real estate A/B Loans.

57. The parties would typically agree to some number of days between 30 and 90. This prevents the B Lenders from achieving chronic and long-term control based on a series of B Decision Periods. Instead, this Model Agreement effectively forces them to exercise the B Option, although they often face little time pressure to do so. B Lenders may object to this paragraph entirely, insisting on the possibility of multiple "back to back" B Decision Periods.

58. The drafter should fill in the blank as negotiated, probably between three and five. B Lenders will try to argue that the numerical cap on B Decision Periods justifies eliminating or reducing the number of days between B Decision Periods.

59. The usual range is 120 to 180 days.

60. This period might range from three to ten Business Days.

61. If the parties synthetically create the B Loan under this Model Agreement, then the drafter might add: "The B Loan constitutes part of the Loan, which part shall have the characteristics this Agreement describes. The B Loan is not separately documented except through this Agreement."

62. The B Option Period is very long. The drafter should consider whether to shorten it. As of 2007, real estate industry trends have dictated a long B Option Period, as suggested here. In corporate finance intercreditor agreements, however, the junior class often has only ten days to exercise a buyout option.

63. A Lenders would prefer to exclude Add-Ons, but usually drop the point. They recognize that exercise of the B Option can easily extricate them rather painlessly from a problem Loan. Under those circumstances, they don't need to hold out for the last penny.

64. If the parties synthetically create the B Loan under this Model Agreement, then the drafter might add: "B Principal constitutes part of the principal of the Loan, which part shall have the characteristics this Agreement describes. B Principal is not separately documented except through this Agreement."

65. Adjust as appropriate, taking into account the mathematics and deal terms of the transaction. The spread added to the B Loan Interest Rate to derive B Rate will not necessarily equal the spread subtracted from the Loan Interest Rate to derive A Rate. Those spreads will be the same only if A Principal equals B Principal and Administrative Agent receives no "skim" or "strip."

66. This definition says nothing about Swap Counterparty receiving anything.

67. If the Loan Agreement provides otherwise, the drafter should edit as appropriate.

68. Under this definition, a Swap Termination would not trigger a Default Period. If the parties desire such a trigger, they can define Event of Default accordingly in the Loan Agreement.

69. The restrictions on Expenses in this Model Agreement would make such purchases rather difficult.

70. The author would suggest $25,000 and $100,000. These numbers are rather low, but they track industry expectations. The drafter can consider raising them.

71. Loan Documents always obligate Borrower to reimburse Lenders' Legal Costs, because otherwise "costs of collection" (or similar terms) do not typically include Legal Costs—even though it might be "intuitively obvious" that Legal Costs should be entitled to the same treatment as any other costs of collection. As a result of this principle, any obligation to reimburse another party's expenses always expressly mentions Legal Costs. Is that truly necessary? Or does the exclusion of Legal Costs really apply only to an obligation to reimburse costs of collection? The answers to these questions lie outside the scope of this article, which takes the traditional approach of expressly mentioning Legal Costs.

72. B Lenders' Cure Payments would not constitute Expenses. This Model Agreement handles them separately, with separate rights, obligations, and priorities in the Waterfall.

73. Some A/B Intercreditor Agreements create special decision procedures to deal with environmental problems. Such problems are, however, functionally no different from any other issue or problem with the Collateral. They require no special treatment. Similarly, many Loan Document drafts contain extensive covenants on environmental matters. A well-represented Borrower will, however, often negotiate its environmental covenants to consist of nothing more than an obligation to comply with environmental law and to Indemnify against failure to comply. In that case, the generic obligation to comply with Law (and to Indemnify against any failure to comply) should suffice. Any additional provisions specific to environmental law therefore serve no additional purpose. But "fear of environmental liability" drove a tremendous expansion of loan documents in the 1980's. Even with two decades of experience the industry does not yet have enough comfort to cut back the environmental verbiage. Again, loan documents only grow and never shrink.

74. If the A Loan and B Loan were senior and junior mortgages, the junior mortgagee (*i.e.*, holder of the B Loan) would need to pay whatever the senior loan required Borrower to pay, at whatever rate applied to Borrower. In an A/B loan, the B Lender typically negotiates a "better" deal than that, such as having no obligation to pay default interest to preserve its position or cure payment defaults on the A Loan. In that respect, A/B loans follow the "securitization" model (where the various tranches share seats on a leaky boat, and all share an interest in plugging the leaks) rather than the "junior/senior mortgage" model (where Borrower creates the junior mortgagee's position strictly out of Borrower's equity, subject entirely to the senior mortgage).

75. The parties may want to give the Lenders some right to approve a Final Recovery Determination, but it seems unnecessary.

76. Administrative Agent may want to shorten this list, starting with any items except "Additional Debt" and "Expenses." Everything else could go either way. And the parties may want to lengthen the list to reflect Loan-specific decisions such as approval of a replacement general contractor in a construction loan.

77. This Majority Decision will vary among transactions and may affect only certain Major Leases. Borrower will want to minimize Lender involvement and discretion, but will probably need to cover the issue in the Loan Agreement, not in an A/B Intercreditor Agreement. Because this particular approval right can severely interfere with Borrower's execution of its most fundamental task as an owner of real estate, Borrower and Administrative Agent may want to have the right to seek approvals based on term sheets or letters of intent rather than final signed Leases. Lease approvals will also very commonly be deemed granted if not withheld, even if similar "deemed consent" language does not otherwise apply to Lender decisions. And Borrowers may sometimes suggest eliminating approval requirements for any Lease that meets agreed-upon leasing guidelines. The problem then becomes defining those standards. To the extent Borrower argues for low rent thresholds in the leasing guidelines, Borrower undercuts its valuation theory for the whole Loan.

78. Administrative Agent or Borrower may want to pre-approve certain potential management changes.

79. Limit to refer only to particularly important Accounts, taking into account the terms of the Loan.

80. This item is less standard than others in the list of Majority Decisions, because it is rather broad and murky. Administrative Agent may prefer to delete it.

81. This number might fall between $25,000 and $100,000, even for large loans. Although that number may seem rather low, it tracks market expectations. One might express the number as a multiple of the then-current monthly payment on the Loan, but this raises all kinds of interesting calculational questions.

82. Some of these paragraphs could include hedge funds, a category that some fear or dislike, because some market professionals view them as short-term opportunists (part of the "loan to own" gang) rather than long-term real estate investors. The Loan Agreement may already define who may hold the Loan. In such cases, drafters should try to cross-reference the Loan Agreement restrictions rather than repeat them, though the parties could add more restrictions in this Model Agreement. Any such restrictions may raise other questions. Would any such additional restrictions require Borrower concurrence? Does Borrower have any right to prevent the Lenders from agreeing among themselves on anything they want among themselves?

83. Only certain Permitted Holders —financial institutions —can act through Affiliates. Others don't have that option. Any definition of "Permitted Holder" will often automatically include Affiliates of any Person that otherwise appears anywhere on the list. The broader the list, the less sense "Affiliates" will make. The list offered here is relatively broad.

84. Although this language is fairly typical, not all of these "Financial Institutions" are really financial institutions. Borrower and Administrative Agent may prefer to exclude some of them from the list.

85. The drafter may prefer to apply the financial test only for certain types of Permitted Holder, not all of them.

86. The drafter may consider deleting the previous parenthetical.

87. If unfunded commitments exist, the drafter should adjust as necessary, at least for voting.

88. Given Borrower's penury (except its ownership of the Collateral for the Loan), the notion of Separate Swap Collateral seems rather unlikely, though a Borrower Affiliate might conceivably provide it. In that case, Administrative Agent must consider possible complexity resulting from the Affiliate's demands for reimbursement and subrogation rights.

89. This concept comes from securitized loans. In syndications of portfolio loans, the documents often impose no particular performance standard beyond perhaps subparagraph "1." The notion of a Servicing Standard seems appropriate. The parties may, of course, want to negotiate the standard. Expectations may change as industry standards and requirements develop over time, prodded perhaps by governmental authorities. The author anticipates that these changes will take place first in securitizationland, then gradually spill over to portfolioland. Any Servicing Standard will create difficult factual issues in any dispute. How can anyone ever prove or disprove Administrative Agent's compliance or noncompliance with most of the qualitative standards embodied in any Servicing Standard? The parties may want to establish an expedited dispute resolution system to resolve any disagreements about the Servicing Standard, but that does not seem common practice. Few issues seem to have arisen about Administrative Agents' standard of performance, except occasional "conflict" issues. Ultimately, Administrative Agent may just say "trust me." Many Lenders may go along. This seems more likely in ordinary single-

tranche syndicated loans than in A/B loans, where Administrative Agent may hold differing interests in the two tranches.

90. This Model Agreement provides for no compensation. The Loan Agreement may require Borrower to pay Administrative Agent an administrative fee, typically between $24,000 and $50,000 a year.

91. To address their overall fear about Administrative Agent's servicing, Lenders might also want to say that Administrative Agent must also disregard: "any other actual or potential transactions or relationships between Administrative Agent (or its Affiliates) and Borrower (or its Affiliates or principals)."

92. Most intercreditor agreements that provide for a concept like this use the defined term "Control Appraisal Event." The defined term used in this Model Agreement, in contrast, seems more helpful, as it reminds the reader of what it means.

93. This assumption seems rather optimistic. Some A/B Intercreditor Agreements assume a sale at 90% of value. Though this assumption seems reasonable, the definition of Substantially Impaired already contemplates a huge degree of collateral failure. Also, Lenders often forget that mortgages are illiquid assets. Sometimes markets seize up or even "fail," and no one wants to buy particular types of mortgages because of a temporary panic or change in marketplace tastes (*e.g.*, "subprime" mortgages in late summer 2007). How should Administrative Agent deal with such circumstances? Does the concept of "Substantial Impairment" work if the entire relevant marketplace has been "Substantially Impaired"?

94. Swap desks often believe "less is more" and may skip the Master Agreement. Drafters should revise this Model Agreement accordingly.

95. Swap Counterparty may prefer to treat these previously accrued sums (in clauses (b) and (c)) as Swap Regular Payments. That could give a Swap Counterparty priority for those payments, probably unwarranted in a meltdown.

96. Many intercreditor agreements define separate Waterfalls pre- and post-Default. This approach takes more space and requires conforming changes if the parties negotiate the Waterfall in any way, thus increasing the risk of inconsistencies and mistakes. It seems quite unnecessary given the minimal changes in the Waterfall that any Default Period actually engenders. This Model Agreement therefore uses a single Waterfall with only a few pinpointed changes during a Default Period. Those who prefer duplication, extra risk of mistakes, more cross-references that can go wrong, longer documents, and extra excitement can create two Waterfalls.

97. Typically a Loan Event of Default automatically triggers a Swap Termination. If it does not, then the Lenders may want to provide for that result. Otherwise, Swap Counterparty may continue to receive Swap Regular Payments as a first-priority claim, even during a Default Period.

98. This Bucket in the Waterfall diverts some percentage of the water away from the main Waterfall even before the Lender group starts to receive the first drop. If Borrower pays a dollar of Loan principal after default, the Lenders won't see all of it, because Swap Counterparty will receive some part of it. That will, among other things, produce a disconnect between the "principal" that Borrower thinks it owes and the aggregate "principal" that the Lenders think they are owed. Once the Swap Counterparty becomes "*pari passu*," however, that disconnect cannot be avoided. Eliminating it would eliminate the Swap Counterparty's "*pari passu*" participation in the security. The author would favor that result, preferring instead to treat the Swap Counterparty as a subordinate participant (behind both the A Loan and the B Loan). As noted in the introductory comments, however, no one else seems to agree.

99. This would include both Borrower-Reimbursable Expenses and Non-Borrower-Reimbursable Expenses. B Lenders may feel otherwise. If B Lenders prevail, the drafter should edit the Waterfall to cover Non-Borrower-Reimbursable Expenses later.

100. Conceivably, principal prepayments might go first to one Lender until that Lender has been fully repaid. In that case, if Borrower has signed two separate sets of loan documents (or a single set of loan documents that builds in the A Loan and the B Loan, with varying interest rates), the balance of one Loan will drop faster than the balance of the other Loan, and Borrower's all-in interest rate will increase or decrease—so-called "rate creep." To prevent "rate creep," prepayments should be applied to A Loan and B Loan pro rata. If Borrower doesn't "see" the A/B structure at all, then Borrower also doesn't "see" the "rate creep" issue. Whether or not Borrower "sees" the rate creep issue, accelerated repayment of the A Loan could turn the entire arrangement into a "taxable mortgage pool"—essentially a failed and hence taxable REMIC. *See* 26 U.S.C. § 7701(i)(2)(A)(ii) (defining a taxable mortgage pool in part as any arrangement that involves mortgage-backed "debt obligations with 2 or more maturities" that fails to qualify as a REMIC). This could unintentionally create a significant tax headache. Would the same problem of "2 or more maturities" arise merely as the result of the A Lenders' priority under the Waterfall during any Default Period? And just how bad a tax headache would a "taxable mortgage pool" actually create? The answers to those questions lie outside the scope of this article.

101. B Lenders may argue that as long as they have cured the Event of Default, the payments should not stop here.

102. This is one of only two ways the Waterfall changes during a Default Period. The other change relates to "Additional B Principal."

103. This Bucket gives Administrative Agent a "skim" or a "strip" arising because Borrower is willing to pay more interest than the Lenders collectively demand (the same arbitrage that drives securitization). It is, however, rather deeply subordinated in a Default Period, which seems appropriate. In the syndicated lending market, any such "skim" or "strip" is quite unusual. Even though loan purchaser demand might enable Administrative Agent to extract a couple of extra dollars this way, Administrative Agent knows that on the "next deal," it may be a buyer instead of a seller; may end up on the losing end of a "skim" or a "strip"; and doesn't relish the prospect.

104. A Lenders might expect higher priority for their Add-Ons, because if A Lenders and B Lenders each had their own mortgage, A Lenders would receive everything due them before B Lenders received a penny. A/B Lenders seem to have a different view of the world, perhaps by analogy to a securitization.

105. The concept of blaming Administrative Agent for Representative's actions seems reasonable. Administrative Agent may, however, prefer to negate any such liability unless Administrative Agent chose Representative negligently.

106. If only one Lender exists beyond Administrative Agent and its Affiliates, this concept might not work. Even more generally, Administrative Agent may think it's too easy for the Lenders. On the other hand, the Lenders may argue that any Lender should have the right to give Notice of default, because removal still requires an actual Lender vote, and that requirement adequately protects Administrative Agent.

107. The Lenders may prefer to cut off this open-ended cure period, for example at 60 days.

108. The Swap would typically address offsets. It should expressly allow Swap Counterparty to offset for sums due Swap Counterparty as a Lender, at least if Swap Counterparty would otherwise make Swap Payments to Borrower (not Administrative Agent).

109. Optional. The drafter may edit this and the next two paragraphs as appropriate.

110. The drafter may delete if Lenders will buy in after closing.

111. The drafter may edit based on treatment of Additional Advances. Conform all references to Additional Advances. Check definitions in Loan Agreement.

112. Administrative Agent and Lenders may want to assure that any Separate Swap Collateral comes from Borrower's Affiliates rather than Borrower, to satisfy "single purpose entity" principles as they relate to Borrower. Administrative Agent would also want to limit the Affiliate's rights of indemnity, reimbursement, or subrogation. Borrower's delivery of Separate Swap Collateral may complicate Borrower's affairs and increase the likelihood and complexity of an Insolvency Proceeding. The typical transaction will not involve Separate Swap Collateral, so the drafter can delete all provisions that address it.

113. These Indemnity claims will not be easy to measure. Therefore, it may make more sense to give the other Secured Parties a right to "put" their interest in the Loan, at par, to whatever Secured Party violates this paragraph.

114. The drafter may consider adding this statement: "Unless a Majority of either such group determines otherwise, the sub-agent of each group shall be whichever Lender holds the largest Pro Rata Share within such group."

115. Tailor as appropriate to reflect understandings on publicity.

116. The Decision Rules generally give B Lenders substantial controls over many important decisions. In contrast, in a corporate loan, the more senior class of Lenders and Administrative Agent would probably take a very different approach and instead want the more junior class to "go along" with almost anything the senior Lenders wanted to do. For example, if the senior Lenders wanted to release certain Collateral, the intercreditor agreement would require the junior Lenders to do the same thing. The junior Lenders might also agree to acquiesce in any increase in the senior debt principal or interest, or any future waivers granted to Borrower.

117. This language responds to *Beal Sav. Bank v. Sommer*, 8 N.Y.3d 318 (2007), as discussed in the introductory notes.

118. Swap Counterparty might seek the right to approve at least Supermajority Decisions or Unanimous Decisions. This Model Agreement gives Swap Counterparty no decision rights, on the theory that Swap Counterparty amounts to a bit of an interloper, merely piggybacking on the Lenders' security, and should not have a seat at the decision table. Swap Counterparty would argue that "taxation without representation" violates fundamental fairness.

119. These approval requirements and related agency/bank group issues mostly conform to the approval requirements and related agency/bank group issues in a typical syndicated credit, with nuances because of two tranches. The checklist of decisions requiring approval has become extremely standard, but the parties may still want to expand or shrink the decision lists, or re-categorize decisions, in particular cases. All the Decision Rules disenfranchise Swap Counterparty entirely. To the extent that Borrower participates in negotiating this Model Agreement, Borrower will focus first on these approval requirements as well as the related approval procedures, such as deemed consents.

120. A "Default Period" would include the duration of any Borrower Insolvency Proceeding. Do the fairly typical Default Decision Rules in this Model Agreement provide a reasonable structure, and enough flexibility, to deal with a Borrower Insolvency Proceeding? Some might suggest that the A Lenders should control everything during a Borrower Insolvency Proceeding, with B Lenders relegated to their B Option. The market does not seem to agree, but the market could be wrong.

121. The B Decision Period arises at the beginning of a Default Period. During the B Decision Period, the A Lenders must stand still. In contrast, if the loan structure were not an A/B structure, and instead a "junior" tranche of lenders held separate collateral, that junior tranche would probably have to stand still for some period while the more senior lenders decided whether to enforce their collateral.

122. B Lenders may want to require a greater vote.

123. A Lenders may want to require a greater vote.

124. B Lenders may want to negotiate that the Servicing Standard continues to apply in these circumstances. A Lenders would probably insist that in a meltdown, B Lenders must rely on exercising the B Option rather than theorizing about what the Servicing Standard really requires.

125. This paragraph seems rather harsh, but it reflects reality. B Lenders should not purchase interests in B Loans unless they can and will (if appropriate) buy out the A Loan to preserve their position if the Loan encounters stress. That's the added risk of a B Loan, justifying its added return. The financing market has until recently tended to ignore such risks. This has produced shock and outrage when market players have learned that risk actually exists and deals can go bad. In other words, subordinate lenders may actually at some point need to write big checks (beyond mere Cure Payments for missed interest) or else abandon their investment. They don't necessarily have the option to go to court seeking relief based on theories of "preventing forfeitures" or "doing equity."

126. Dissenter will want to receive its share of Add-Ons as well.

127. A "yank a bank" clause like this one sounds great. As a practical matter, though, it probably gives Administrative Agent nothing more than it already has —the ability to buy out a Lender that doesn't want to stay in the Loan. To have teeth, a "yank a bank" clause should value Dissenter's interest in the Loan taking into account the liquidation value of the Collateral, much like the formula for testing Substantial Impairment of the B Loan. Otherwise, the pricing seems overly generous in the only circumstance where it might ever matter —the Loan has gotten into trouble and Dissenter misbehaves to try to get bought out. But "yank a bank" clauses rarely establish a value-based formula, and are very far from universal to begin with, probably for the reasons this footnote suggests. They may be somewhat more common as a Borrower's technique to remove particularly expensive or uncooperative Lenders. The entire clause constitutes an early candidate for deletion.

128. A Lenders might want the right to "reject" Cure Payments if they represent only a "temporary fix" to a problem or otherwise merely delay the inevitable. This Model Agreement does not give A Lenders that right, at least during a B Decision Period. The author believes that giving A Lenders a rejection right would introduce low-value factual and judgmental issues into the discussion, with little benefit to anyone. In exchange, B Lenders have strict limits on their cure rights. In a particular transaction, A Lenders could certainly take a more aggressive view.

129. The B Lenders that choose to write checks may want the right to "dilute" the other B Lenders through a squeeze-down mechanism similar to that which applies when partners fail to meet capital calls. Such dilution would erode the optionality of most Cure Payments; hence this Model Agreement does not provide for it. In some circumstances, though, it may make sense.

130. This paragraph offers only a minimalistic description of the contract and closing mechanics for the B Option. Under some circumstances, the parties may want to add provisions of the types found in a loan purchase agreement, such as a deposit, a financing contingency (very unusual), a specific executory interval, rights and remedies for default, and other provisions. The author would submit, however, that the B Option represents a very simple purchase and sale transaction, requiring no further detail.

131. The previous sentence reflects two important decisions, either of which could go either way. First, all Secured Parties must bear their Pro Rata Shares of all Expenses. One could argue that

the B Lenders and not the A Lenders should bear all Expenses (such as by reimbursing Expenses as the first Bucket of the Waterfall or after payments to A Lenders only). Second, Administrative Agent can almost never require a Secured Party to write a check for an Expense. Instead, Administrative Agent must wait for repayment through diversion of funds otherwise payable to Lenders. One could argue that the Lenders should "pay up" sooner. If any Lender refused to "pay up," Administrative Agent could then reimburse itself for Expenses out of any amounts otherwise payable to that Lender. If a reimbursement exceeded a certain level, Administrative Agent might agree to payment over time. An Administrative Agent could certainly take a more aggressive position.

132. As in syndicated loans, Transfers may also require Borrower approval (so long as no Event of Default exists under the Loan). This assumes Borrower will participate in structuring and negotiating the A/B Loan. If that process occurs after closing or independently of Borrower, Borrower will need to address the issue in the Loan Agreement, and Administrative Agent will need to remember to comply with the Loan Agreement in administering Transfers.

133. Borrower or Lenders may also negotiate a minimum hold requirement for Administrative Agent. If Administrative Agent wants to go below that minimum, then Administrative Agent would need to offer to resign as Administrative Agent.

134. These institutions are the "usual suspects" as warehouse (repo) lenders. Therefore, Pledge clauses often identify them by name. But the world can change. The parties may therefore prefer to rely on objective criteria (which these "usual suspects" will usually satisfy anyway, at least at the time of writing) rather than to "hard-wire" anyone into the document.

135. Pledgee's "deemed approval" procedures are less protective than those for Lenders.

136. This fee is almost universally $3,500. It varies less than almost anything else in this Model Agreement. Some agent banks have eliminated this fee, but that does not seem to be the trend.

137. This Model Agreement uses the term "Substantial Impairment" to refer to the circumstance where B Lenders are "out of the money" by at least 75% of their outstanding principal balance. Other A/B Intercreditor Agreements call this circumstance a "Control Appraisal Event," a term that does not seem particularly intuitive. Whatever the parties call it, the mechanism achieved more popularity a few years ago than today, but sometimes still appears. Any user of this Model Agreement should regard the concept as optional.

138. The entire concept of Substantial Impairment assumes Administrative Agent can order up a reliable Appraisal of the Collateral at any time. That may not make sense at all for certain types of Loans, such as construction loans, and may not be practical during market meltdowns (perhaps the only time it will matter). The process may also take time and invite flyspecking of the Appraisal.

139. The notion of allowing the A Lenders to initiate this process is nonstandard but reasonable.

140. If B Lenders are creditworthy, it might suffice for them to deliver an undertaking (as if they issued a letter of credit themselves) in place of actual Collateral.

141. Administrative Agent may prefer to wait until the closing under the B Option. This paragraph assumes Administrative Agent will rely on B Lenders' credit once they elect to purchase. That concept is somewhat inconsistent with requiring Substantial Impairment Prevention Collateral (instead of a mere undertaking) from B Lenders in the first instance.

142. An Administrative Agent would typically not make all these representations and warranties. Each, however, relates to disclosure of matters actually known to Administrative Agent rather than to objective guaranties of Loan quality. Thus, Administrative Agent should find them tolerable. Any Administrative Agent may still prefer to trim them back in any number of rather obvious ways.

143. This sentence would not cover monetary defaults relating to third-party payments, such as real estate taxes.

144. This assurance may be tricky if the Loan originator provided, or may later provide, some form of mezzanine financing. The drafter should edit as appropriate or delete.

145. The drafter should tailor this provision to refer to particular "bad" events that could have occurred under the Loan Agreement.

146. This paragraph assumes Administrative Agent also acts as Swap Counterparty.

147. Lenders often say they will never securitize. Then, in the next reorganization of their institution, they decide they must securitize. This language accommodates that possibility. Other Lenders (and, particularly, Borrower) may argue that securitizing any interest in the Loan is fundamentally incompatible with the transaction as originally contemplated.

148. This language allows New York jurisdiction but does not limit jurisdiction to New York. Should the parties provide for exclusive jurisdiction in New York? The author sees no reason to tie Administrative Agent's hands.

149. For foreign Lenders, Administrative Agent may want to consider requiring designation of an agent for service of process.

150. New York's ancient and largely unknown and ignored "Streit Act" imposes certain investor protection requirements for a "mortgage investment," defined more or less as a mortgage in which multiple persons hold an interest. The Streit Act applies whenever the underlying real property is located within New York. Also, in a moment of jurisdictional exuberance, the legislature decided the Streit Act protections should also apply for any real property anywhere, whenever the "trustee" under such an investment has an office in New York or is authorized to do business in New York. Therefore, this paragraph will typically apply for the majority of substantial commercial mortgage loans encumbering real property anywhere in the United States or perhaps the entire world and even Mars. The Streit Act lies in wait as cannon fodder for litigators in the next downturn.

151. If Administrative Agent does not also act as Swap Counterparty, then add a separate signature for Swap Counterparty.

152. Many banks (and all German banks) active in syndicated lending follow a "four eyes" rule, requiring two signatures for any document. For any bank that requires only one signature, delete the second signer. The same comment applies to all other signatures in this Model Agreement and any Assignment.

Joshua Stein, a commercial real estate and finance partner with Latham & Watkins LLP, has published extensively on a wide range of topics in commercial real estate law and practice. To contact the author, read some of his other articles, learn about his books, or request an editable version of this model document, visit http://www.real-estate-law.com. ***The Bloomberg Corporate Law Journal*** **(Bloomberg Finance L.P.) published an earlier version of this article and model document in Fall 2007.**

Exhibit A

ASSIGNMENT AND ACCEPTANCE AGREEMENT, FORM OF

This ASSIGNMENT AND ACCEPTANCE AGREEMENT (this "Assignment") is made as of _____ (the "Assignment Date"), by and between _____ ("Assignor") and _____ ("Assignee"), based on these facts:

A. Assignor, Assignee, and _____, as Administrative Agent ("Administrative Agent"), entered into an Intercreditor Agreement dated as of _____ (the "Agreement"). The Agreement contemplates Assignor and Assignee may enter into this Assignment. All definitions in the Agreement apply here.

B. Assignor wishes to assign to Assignee (part of) Assignor's rights and obligations regarding the Loans, including (part of) Assignor's interest as Lender (A Lender or B Lender or both) in and to the Loans.

C. As a condition to the release of Assignor from its rights and obligations as a Lender arising after the Assignment Date under the assigned interest in the Loan, the Loan Agreement requires the parties to execute and deliver this Assignment.

NOW, THEREFORE, Assignor and Assignee agree:

1. Purchase Price and Assignment. On the Assignment Date, Assignee shall pay to Assignor's account specified beneath Assignor's signature below, the dollar amount specified below Assignee's signature. That sum constitutes the purchase price (the "Purchase Price") for Assignor's assignment to Assignee of the Pro Rata Share of the A Loan, the B Loan, or both (disregarding any interest of Swap Counterparty) stated below Assignee's signature. Assignee is acquiring only the interest (if any) in the A Loan and the interest (if any) in the B Loan stated below Assignee's signature. Effective on Assignor's receipt of the Purchase Price, Assignor shall be deemed to have assigned, granted, and transferred to Assignee, and Assignee shall have assumed and received, such Pro Rata Share of such Loan(s) (consisting of (portions of) the A Loan, the B Loan, or both) in accordance with the Agreement, this Assignment, and the Loan Agreement. The Purchase Price includes accrued interest payable by Borrower through the Assignment Date.[1]

2. Administrative Agent Authority. Assignee acknowledges and agrees that (i) Administrative Agent, in its capacity as "Administrative Agent" shall act, to the exclusion of Assignee, for and on behalf of Assignee as the Agreement provides; and (ii) such Administrative Agent shall remain the sole Administrative Agent as provided in and subject to the Agreement.

3. Lender Obligations. Assignee assumes all obligations (and makes all representations and warranties) of an A Lender, B Lender, or both (depending on the interest(s) Assignee is acquiring in which Loan(s), as indicated under Assignee's signature) under the Agreement. By signing this Assignment, Assignee joins in the Agreement as such Lender(s). This Assignment is subject to the Agreement and the Loan Documents.

4. Disputes. Any Dispute under this Assignment shall be subject to the same choice of law and other Dispute-related provisions (including the jury trial waiver) as any Dispute under the Agreement.

5. Notices. Any Notice under this Assignment shall be given in accordance with the Agreement.

6. Miscellaneous. Nothing in this Assignment may be Modified except by an instrument in writing executed by the party to be charged. This Assignment is for the sole benefit of Assignor and Assignee and no third party, except Administrative Agent, shall be a third party beneficiary of all provisions in this Assignment that benefit Administrative Agent. If anything in this Assignment should be held invalid, illegal or unenforceable in any respect, the validity, legality, and enforceability of the remaining provisions in this Assignment shall not in any way be affected or impaired thereby. This Assignment may be executed in any number of counterparts, with the same effect as if all of the parties had signed the same document. All counterparts shall be construed together. All constitute one agreement. This Assignment and the Agreement embody the entire agreement between the parties about assignment of interests in the A Loan, the B Loan, or both, superseding all prior agreements and understandings.

IN WITNESS WHEREOF, Assignor and Assignee have executed this Assignment as of the Assignment Date.

ASSIGNOR

NAME OF ASSIGNOR, a _____

By: _____ By: _____

Name: _____ Name: _____

Title: _____ Title: _____

Notice Address:	Copy Recipient for Notice(s):
_____ _____ Attention: _____ Fax No.: _____ Wire Transfer Address: _____ _____	_____ _____ _____

ASSIGNEE

NAME OF ASSIGNEE, a _____

By: _____ By: _____

Name: _____ Name: _____

Title: _____ Title: _____

Notice Address:	Copy Recipient for Notice(s):
_____ _____ Attention: _____ Fax No.: _____ Wire Transfer Address: _____ _____	_____ _____ _____

The above Assignee is acquiring the following interest in the following Loan(s):

Loan	Principal Amount	Pro Rata Share (Disregarding Swap Counterparty's Interest)
A Loan	$	_____%
B Loan	$	_____%

Endnote

1. As an alternative: "The Purchase Price includes interest only through the last Interest Payment Date before the Assignment Date. Assignee shall promptly remit Assignor's share of the next interest payment (based on a *per diem* allocation) when and as received.

Exhibit B

DISCLOSURE SCHEDULE

Whatever Happened to Article 78?

By Adam Leitman Bailey and Dov Treiman

The courts hearing cases challenging administrative agencies stand accused of rubber stamping the most vacuous statements paraded before them as findings of fact.[1] Indeed, an analysis of landlord-tenant cases over the past 10 years arising from the First and Second Judicial Departments[2] reveals some amazing patterns, sustaining the overall impression common in the landlord-tenant bench and Bar that Article 78 so rarely results in a victory for the petitioner that pursuing it has become nearly futile.

CPLR Article 78 gathers together the old writs used by the common law courts to review the work of administrative agencies. Section 7803 limits the questions that can be raised in such proceedings to whether the agency failed to perform its duty, acted in excess of jurisdiction, violated lawful procedure, was affected by an error of law, was arbitrary and capricious, abused discretion, or acted in the absence of substantial evidence. Of these, the question that has come to dominate all the others is whether the agency was arbitrary and capricious.

The question that demanded answering is whether a raw count of the numbers of times courts affirm the agencies sustains the accusation of "rubber-stamping."

Meaningful research must focus on the work of three courts: The Court of Appeals and the Appellate Divisions for the First and Second Departments. There are four possible substantive outcomes to an Article 78 proceeding: affirming the decision of the agency (*"Aff'd),"* affirming it as modified (*"Mod"*),[3] reversing it (*"Rev'd"*), and remanding the matter to the agency for further processing (*"Rem"*).[4] In order for an analysis of judicial decisions to have any meaning, one must navigate between the necessity for enough decisions to display a statistical trend and having the decisions close enough to each other in time to show then "current" thinking. In order to achieve both goals, we present our data in 10-, five-, and three-year chunks.[5]

"[T]he overall impression common in the landlord-tenant bench and Bar [is] that Article 78 so rarely results in a victory for the petitioner that pursuing it has become nearly futile."

In examining the record of cases decided over the past 10 years by these courts, we examined numbers of cases on landlord-tenant matters as follows:

Courts	3 yrs	5 yrs	10 yrs
All	68	137	334
Court of Appeals ("CoA")	2	6	13
App. Div. 1st Dep't ("1st")	41	87	230
App. Div. 2d Dep't ("2d")	24	44	91

The chart below gives the percentages of each of affirmances, reversals, modifications, and remands in ten ("10"), five ("5"), and three ("3") year study periods.[6]

Certain additional facts emerge from a study of the data. For example, in 1999 and almost all of 2000, 100% of landlord-tenant based Article 78 proceedings before the Second Department sustained the agency's rulings. In the past five years, the Court of Appeals has never reversed an agency on a landlord-tenant matter. Unlike past practice, these courts have not modified any landlord-tenant agency decisions for the past three years. For the First Department that handled 69% of the cases in the study,[7] it has been nearly a decade since it modified an agency decision.

We find that for the entire study period, the Appellate Divisions tend to sustain the agency outright roughly 85% of the time, but the Court of Appeals only sustains the agencies roughly half the time. Those data would at least suggest that the Appellate Divisions are misreading the will of the Court of Appeals. However, given the fact the high court has only been averaging slightly more than one landlord-tenant related Article 78 proceeding a year, there is limited validity to any statement made on statistics alone.[8] The remands to the agency reinforce this idea that the Appellate Divisions are not following the Court of Appeals' lead. While the Appellate Divisions remand to the agency in roughly 10% of cases, the Court of Appeals does so in the 30%-50% range.[9]

Independent of the statistics, both practitioners and some few judges are complaining increasingly loudly that Article 78 has become a mere "rubber stamp" for agency action. As Justice

Courts	Aff'd 10	Aff'd 5	Aff'd 3	Rev'd 10	Rev'd 5	Rev'd 3	Mod 10	Mod 5	Mod 3	Rem 10	Rem 5	Rem 3
All	84%	82%	84%	4%	16%	3%	2%	2%	0%	10%	4%	12%
CoA	54%	50%	50%	8%	0%	0%	8%	17%	0%	30%	33%	50%
1st	86%	90%	88%	3%	2%	2%	2%	0%	0%	9%	8%	10%
2d	85%	73%	83%	5%	9%	4%	2%	5%	0%	8%	14%	13%

Marlow wrote in his stinging dissent in *333 East 49th Assocs., LP v. DHCR*,[10]

> While I agree with the majority's statement of law that "[t]he administrative agency charged with enforcing a statutory mandate has broad discretion in evaluating pertinent factual data and inferences to be drawn therefrom, and its interpretation will be upheld so long as not irrational and unreasonable," I respectfully disagree that this record meets even that modest standard.
>
> Instead, I believe that a reviewing court must be presented with a record containing factually meaningful findings so as to enable appellate judges to draw those rational inferences to support, and thus affirm, a result that affects parties' legitimate and significant rights. Otherwise, this Court's mandate —intended to be a conscientious review power over governmental action—will be transformed into a superficial habit of "rubber stamping" the most vacuous statements paraded before us as findings of fact.

The key phrase in the *333* dissent is "conscientious review power over governmental action." Intriguingly, Justice Marlow cites to nothing to back up his assertion that Article 78 should be "conscientious" and there is much in the literature to suggest to the contrary.

The problems originate in the statute itself, CPLR 7803(3), that directs the Supreme Court to consider whether the agency's actions were "arbitrary and capricious." Occasional decisions directly proceed under the "arbitrary and capricious" standard, but the overwhelming bulk of decisions hold that "arbitrary and capricious" means "irrational."[11] The problem with "irrational" is that it means a range of things: illogical, unreasonable, foolish, crazy, ridiculous, absurd, silly, unfounded, or groundless. Noting the range of nuance in these terms, we see it is a vastly different thing to say that a court may reverse an administrative decision because it is merely "unfounded" than to say that the administrator was "crazy." In truth, the "irrational" standard is rarely used at either of these extremes, although our research would suggest that the courts come closest to upholding all that which is not "crazy."

In one of its rare landlord-tenant decisions to overturn an agency decision, *Gilman v. DHCR*,[12] the Court of Appeals goes to the heart of its reasoning for overturning the agency without setting forth its latest understanding of when it is allowed to do so. There are two passages in the decision that afford some guidance, one where the court criticizes the DHCR for violating its own rules, and the other where the court accuses the DHCR of "extinguish(ing) . . . sound policy basis." Of course, "extinguishing sound policy" is a difficult standard to apply, but it does seem to be more severe than "unwarranted" and less extreme than "insane." So perhaps, this, insofar as it represents a standard, could be regarded as "violating public policy." If that is the rule, it is certainly more restrictive than Justice Marlow's "conscientious review power."

Where a court *will* overturn an agency will at times turn on interpretation of other CPLR 7803 grounds: failure to perform a duty, acting in excess of jurisdiction, abusing discretion, or acting without substantial evidence. The basis of the controversy may be that one side finds that one of these other grounds exists, but the other sees it really as the "arbitrary and capricious" standard. Thus in *I.G. Second Generation Partners LP v. DHCR*,[13] the majority saw a lack of jurisdiction for a result and the dissent saw that exercise of jurisdiction as having been rational. Amazingly, a court could think that an agency can "rationally" arrogate to itself a power denied to it by statute. Yet, such has become the power of the Article 78 rubber stamp.

That the administrative agencies mete out a substantial amount of injustice is clear even from the very cases that affirm their actions. For example, in *Partnership 92 LP v. DHCR*,[14] the agency took 21 years to process an application and, in doing so, applied a law passed more than a decade after the proceeding had been filed. In *333 East 49th Assocs., LP v. DHCR, supra*, the Appellate Division sustained a rent reduction order based on the agency making a finding that there was "filth" even though the agency's own record had no evidence to back that up. In *Hersh v. HPD*,[15] the agency delayed two years before beginning the processing of an application for a certificate of no harassment and, upon doing so, substantially relied upon hearsay.[16]

In examining the judicial literature in this field, one is perhaps most shocked by passages such as that found in *Verbalis v. DHCR*,[17] in which the First Department found that the Supreme Court had "exceeded its authority in determining that DHCR's decision on remand was inequitable." It justifies this shocking statement with the well familiar adage, "If the agency's decision is rational, it must be upheld, even though the court, if viewing the case in the first instance, might have reached a different conclusion." We must underline what is happening here: The second highest court in the State of New York is saying that fundamental fairness and equity are *irrelevant* in Article 78 proceedings. So long as there is some non-insane way of seeing the agency's decision as obeying the law, it does not matter how badly a litigant is unfairly hurt by that application of the law. Lewis Carroll's Queen of Hearts[18] would certainly approve.

Endnotes

1. Justice Marlow's dissent at *333 East 49th Assocs., LP v. DHCR,* 40 A.D.3d 516 (lst Dep't 2007).
2. Article 78 proceedings in the Third and Fourth Judicial Departments regarding landlord-tenant matters are almost entirely unheard of.
3. In the statistical analysis presented in this article, no attempt is made to differentiate among the various kinds of modifications.
4. In *Peckham v. DHCR,* N.Y.L.J., July 2, 2008, 26:1, the First Department insisted on affirming the DHCR over the latter's objection and refused a requested remand!
5. Both the raw data and a more complex analysis of them are available at www.alblawfirm.com/rubberstamp.pdf.
6. Cases in which the agency was sustained on Article 78 review are referred to as "*Aff'd*," those in which the agency was reversed on such review, "*Rev'd*," those in which the agency's action modified, "*Mod*," and those for which the Article 78 court decided to remand the matter to the agency for further consideration, "*Rem*."
7. The Court of Appeals handled 4%, the Second Department, 27%.
8. On the other hand, the Court of Appeals has not once reversed an agency ruling on a landlord-tenant matter in some five years. It did reverse agencies some 16% of the time from the period 10 years ago to five years ago.
9. In our judgment, for statistical purposes, it was not meaningful to compile numbers for reversals and affirmances of the Appellate Divisions by the Court of Appeals. The point of this article is how much deference the courts show the agencies, not each other.
10. *Supra* note 1.
11. S*ee Nehorayoff v. Mills*, 95 N.Y.2d 671 [2001]; *County of Monroe v. Kaladjian*, 83 N.Y.2d 185 [1994]; *Pell v. Board of Educ.*, 34 N.Y.2d 222, [1974]).
12. 99 N.Y.2d 144 (2002).
13. 34 A.D.3d 379 (1st Dep't 2006).
14. 46 A.D.3d 425 (1st Dep't 2007).
15. 44 A.D.3d 525 (1st Dep't 2007).
16. Actually it was, as the team from Adam Leitman Bailey, P.C. argued, double and triple hearsay in places, but the Appellate Division's decision was silent on the hearsay issue.
17. 1 A.D.3d 101, (1st Dep't 2003).
18. In Lewis Carroll's Alice's Adventures in Wonderland, the character of the Queen of Hearts is most famous for her repeated line, "Off with their heads!" Yet, the underlying premise of her justice system is all the more appropriate to this study of CPLR Article 78 in landlord tenant proceedings: "Sentence before verdict."

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Section 8: New York's Legal Landscape

By Gerald Lebovits, Sateesh Nori, and Jia Wang

I. Introduction

The Section 8 housing program enables almost a million low-income families to obtain safe, decent, and affordable housing nationwide. Yet the program remains a quagmire for landlords, tenants, and advocates. Governed by federal, state, and local laws as well as by reams of regulations particular to the administering public-housing authorities, the program is bureaucratic and legally complicated. Some landlords are unwilling to accept Section 8 because of its myriad requirements and obligations, while tenants feel discriminated against by potential landlords because of the tenants' status as Section 8 voucher holders.[1] On the other hand, Section 8 expands the affordable housing options for poor households while guaranteeing a stream of rent income to landlords. Section 8, while expensive for taxpayers and burdensome for participants, encourages free private enterprise and reduces the demand for public housing.

In New York State, the intersection of federal Section 8 laws with rent-regulatory schemes, local tax laws, and other provisions has left a web of rules and exceptions. Recent developments in Section 8 law have added to this jumble. This article attempts to capture the landscape of Section 8 in New York City.

II. Section 8: The Evolution

Public housing in the United States began as a response to the Depression. The United States Housing Act of 1937 created local Public Housing Authorities, or PHAs, which are established by individual states.[2] PHAs became the administrative building blocks for most federal housing programs, including Section 8 and public housing.[3] Initially, and for a period of approximately 30 years, PHAs, operating by the Depression Era philosophies of job creation and slum elimination, built and operated public-housing projects as the primary source of housing assistance for low-income families.

In the years that followed, the U.S. Housing Act was widely criticized as costly, its housing ugly, and its policies segregationist.[4] In response, the federal government tried to encourage the private sector to create and operate low-income housing. In 1965, Congress introduced the Section 23 Leased Housing Program, which amended the U.S. Housing Act to allow and encourage PHAs to contract with private landlords to lease vacant properties.[5] Under Section 23, PHAs paid market-value rent directly to private landlords, and the low-income tenants paid a reduced rent directly to the PHA.[6] PHAs selected eligible families from their waiting lists, placed them in housing from a master list of available units, and determined the rent that tenants would pay. PHAs also agreed to perform regular building maintenance for Section 23 tenants. Eventually, most Section 23-assisted units became Section 8 participants.[7] In 1965, the Department of Housing and Urban Development (HUD) was created as a cabinet-level agency to develop and execute policy on housing and cities.[8]

Before Section 23 was phased out, but before the inception of Section 8, Congress experimented with what later became the Housing Choice Voucher Program, a key element of Section 8. In 1971, Congress authorized the Experimental Housing Allowance Program, or EHAP.[9] EHAP tested the feasibility of providing housing allowances to eligible families and was conducted in 12 locations between 1971 and 1980.[10] During the EHAP experiment, nearly 50,000 households received cash assistance for housing. Participants leased units directly from private owners. Homeowners as well as renters were able to participate at two of the demonstration sites. The EHAP experiment demonstrated the following: (1) a housing-allowance program could preserve existing housing stock by encouraging owner repairs and maintenance; (2) allowing families mobility allowed them to select better neighborhoods; (3) families did not select expensive units; and (4) most tenants were able to pay their share of the rent for the selected units.[11]

The federal Section 8 program was born out of the Housing and Community Development Act of 1974, which amended the U.S. Housing Act of 1937 to create housing-voucher and housing-certificate programs.[12] This initiative cemented a shift in the federal housing strategy: More emphasis was placed on involving privately owned rental housing.[13] The term "Section 8" referred to the new section of the U.S. Housing Act that the 1974 amendments added.[14] At the outset, Section 8 was a rental certificate program modeled after the still-running EHAP, but it differed in two key respects. First, after a tenant selected an apartment, the PHA would make the subsidy payments directly to the landlord rather than to the family. The government's rent contribution would be such that the families paid 25% of their adjusted income toward the rent.[15] (This was changed to 30% in 1983.) Second, the gross rent of a unit leased could not exceed a fair-market value that HUD determined.[16]

A decade after the Housing and Community Development Act of 1974, the Housing and Community Development Act of 1987 further expanded the federal public-housing regime by adding a rental-voucher program to Section 8. This program was similar to Section 8's existing rental-certificate program, but it expanded the options available to recipients. With rental vouchers, the government's contribution to an eligible family's rent was pre-determined based on the family's need. Unlike

the certificate program, families could pay more than 30% of their adjusted income toward rent, depending on the cost of housing they chose. The government voucher payment would be fixed; thus, a fair-market-rent limitation was unnecessary. By the 1990s, the federal housing regime still included publicly provided housing projects, but Section 8's certificate and voucher programs involved private-property owners in providing much housing for low-income families.

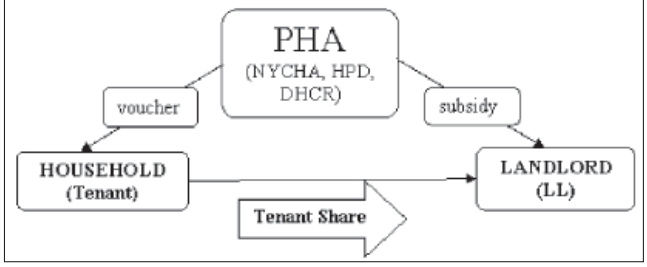
Over the next decade, HUD issued three "conforming rules" to combine and conform the rental-certificate and rental-voucher programs. In July 1994, the first part of the conforming scheme established unified admissions rules. The next year, in 1995, several administrative and leasing activities between certificate and voucher became standardized. The next conforming rule, in June 1998, dealt with rent reasonableness and determining housing-assistance payments.

Shortly after the third HUD amendment, Congress took a more direct approach by enacting, in October 1998, the Quality Housing and Work Responsibility Act. This act once again amended Section 8 of the U.S. Housing Act of 1937 and merged the certificate and voucher programs into a single program called the Housing Choice Voucher Program. The Housing Choice Voucher Program is colloquially called "Section 8," even though it is only a portion of Section 8 of the Housing Code. In May 1999, HUD issued an interim rule to implement the merger by phasing out the certificate program. From October 1, 1991, when the new regime took effect, all existing rental-voucher-program participants became subject to the requirements of the new Housing Choice Voucher Program. Those still under the rental certificate program would switch to the Voucher Program when they moved into a new home with assistance, renewed a lease, or received their second annual reexamination after October 1, 1991.[17]

III. Section 8: The Nuts and Bolts

The current Housing Choice Voucher Program is similar to its predecessor, the rental-voucher program. PHAs pay subsidies directly to landlords. Tenants pay landlords the difference between the subsidy and the actual rent charged. This assistance is considered "tenant based" because the voucher is tied to the tenant, not the dwelling unit.[18] Tenants are free to choose their homes. The voucher stays with them if they remain eligible.[19]

Figure 1: The Workings of the Housing Choice Voucher Program



The program is funded by the federal government through HUD and administered locally by about 2,500 PHAs across the country.[20] PHAs are usually run by state or local governments, although some are independent.[21] Each PHA is allocated a limited number of vouchers to administer. Congress annually allocates funding for each PHA's voucher and may in its discretion provide for additional vouchers.[22] Because vouchers are limited, about one in every four qualifying families who seek assistance actually receives it.[23]

In New York City, three different PHAs administer the Section 8 Housing Choice Voucher Program: (1) the New York City Housing Authority (NYCHA); (2) the New York City Department of Housing Preservation and Development (HPD); and (3) the Subsidy Services Unit of the New York State Division of Housing and Community Renewal (DHCR).

NYCHA administers vouchers to approximately 83,000 families in the five boroughs, making NYCHA's Section 8 program the largest in the United States.[24] HPD's program serves special categories of New Yorkers and provides assistance to an additional 26,000 households.[25] DHCR administers the Housing Choice Voucher Program across New York State.[26]

Although NYCHA is New York City's primary voucher-administering PHA, DHCR's Subsidy Services Unit administers another 7,200 vouchers in the five boroughs and Westchester County.[27] HUD has appointed DHCR and the New York State Housing Trust Fund Corporation (HTFC) the administrators of Section 8's project-based contracts in New York State.[28] According to DHCR, DHCR/HTFC's contracted private sector partner CGI-AMS, Inc., currently administers 999 contracts covering 91,967 units.[29]

A. Eligibility

To be eligible to receive assistance from the Section 8's Housing Choice Voucher Program, all applicants must satisfy HUD eligibility requirements. First, the family applying must fall within HUD's income guidelines.[30] To qualify, a family must be a "very low-income" household.[31] A very low-income household is a household whose annual income is at or below 50% of the median annual income of a household of that size living in a chosen county or area.[32] HUD estimates and annually publishes the very low-income limitation for each area.[33] The entire New York metropolitan area is considered a single area for the purposes of these published income limits.[34]

Although only very low-income households are eligible for Section 8 voucher assistance, HUD requires all PHAs to provide 75% of its vouchers to "extremely low-income" applicants—households whose incomes are no more than 30% of the area's annual median income.[35]

In limited circumstances, HUD allows households to receive Section 8 assistance even if their income is no greater than 80% of the area's annual median.[36] These households are

known as "low income" households. PHAs are also granted discretion to award assistance to low-income applicants if doing so is an essential local housing policy. For example, a financially strapped PHA might try to lower subsidy costs by allowing two very low-income sisters to live together if their combined annual income exceeds the very-low-income level but not the low-income level.[37] Assistance to a single two-bedroom apartment would be less than that paid to two one-bedroom apartments.[38]

As a second eligibility requirement, HUD calls for all applicants to meet a local PHA's definition of a family.[39] PHAs are given a fair amount of flexibility in setting this definition.[40]

As a third eligibility requirement, every Section 8 applicant must be a United States citizen, national, or permanent resident by immigration.[41] Those granted asylum or who have refugee status are also eligible, as are those lawfully present in the United States with the Attorney General's approval.

The fourth requirement is that voucher applicants must not have been evicted from public housing or any Section 8 program for drug-related criminal activity.[42]

If a family has both eligible and ineligible members, the family is considered a mixed family, and its subsidy is prorated.[43] The ineligible persons are not counted for the subsidy level.[44] PHAs conduct a criminal background check on each member of the household 16 years and older. Family composition is restricted to family members listed as household members. Before adding a family member (other than a newborn baby), the family must request permission from the PHA.

Applicants might also be subject to additional eligibility requirements depending on where they live. This is because HUD has granted PHAs substantial flexibility under the federal guidelines to address the area's needs.[45] PHAs may, for example, favor certain types of families or housing needs. In New York City, the high demand for housing assistance has strained the three PHAs' ability to accept new applications. The PHAs have been forced to exercise this flexibility to restrict the applications they accept.

i. NYCHA

As of May 15, 2007, the New York City Housing Authority stopped accepting general applications. It accepts Section 8 housing assistance applications only from those in the following three emergency categories:[46] (1) applicants referred by the District Attorney's Office to the Intimidated Witness Program; (2) applicants referred by the Administration for Children's Services (ACS) Family Unification and Independent Living programs; or (3) victims of domestic violence. Further, applicants must meet NYCHA's definition of a family. To qualify as an eligible family, applicants must fall into one of three categories:[47] (1) two or more persons related by blood, marriage, registered domestic partnership, adoption, guardianship, or court-awarded custody; (2) two or more unrelated persons living together as a cohesive household group in a sharing relationship; or (3) a single person, with preference given to the elderly or disabled.

The applying family must also be a very low-income household. NYCHA does not accept low-income applicants.[48]

ii. HPD

As of July 2008, HPD serves only three categories of applicants.[49] First, the homeless are eligible for HPD vouchers. The second category covers persons affected by an HPD-funded renovation. Some buildings owned by or transferred to New York City (or an entity the City designates to achieve its housing goals) need renovation. HPD offers funds in the form of loans or grants to renovate these buildings and may provide voucher assistance to tenants to locate permanent, alternate housing.[50] Third, HPD can issue vouchers to residents currently living in buildings constructed or renovated with HPD financial assistance. Applicants in this last category must be referred by HPD program staff.[51]

HPD also administers "enhanced," or "sticky," vouchers to protect residents of rent-regulated apartments when the private-property owner opts out of a project-based contract to convert the property to market-rate housing.[52] Enhanced vouchers have higher income limits (up to 95% of the area's median income) and provide more help to pay the now-higher market rent.[53]

iii. DHCR

As of July 2008, DHCR is not accepting any new applications. It has closed its waiting list due to the large number of families already in line for DHCR vouchers.[54]

B. Rent-Setting

The amount of PHA assistance a voucher is worth to a household depends on three factors: (1) the household's adjusted income; (2) the selected dwelling's monthly rent; and (3) a PHA-determined "payment standard."[55] In determining the amount of rent a voucher covers, a household's income is adjusted, with deductions granted for children, students, elderly family members, and family members with disabilities.[56] The payment standard is a benchmark value that measures the amount needed to rent a moderately priced dwelling in a local housing market.[57] PHAs must set payment standards between 90% and 110% of the HUD-estimated "fair market rent."[58]

If the rent of the dwelling unit selected by voucher recipients is at or below the payment standard, recipients pay 30% of their adjusted income toward the rent. The voucher covers the rest.[59] Families are free to choose dwellings with rent above the payment standard, but the voucher will not cover any extra rent. Any rent the voucher does not pay must be met by an increase in the family's contribution.[60] When the family first enters the

voucher program, either by moving into a new unit or by signing its first voucher-assisted lease, it may not select a dwelling with a rent that would make the family's contribution greater than 40% of its adjusted monthly income.[61] Therefore, vouchers (with a few exceptions explained below) pay an amount equal to the payment standard less 30% of a family's adjusted monthly income, and the family pays between 30% and 40% of its adjusted monthly income toward rent.

Some exceptions apply to the rule above. HUD requires PHAs to set a minimum rent value between $0 and $50.[62] Families must pay at least this minimum contribution, even if it exceeds 40% of their adjusted monthly income.[63] NYCHA has no minimum dollar value. It instead requires a minimum contribution of 10% percent of gross income if the family's rent contribution according to the 30%-to-40% standard falls below 10% of gross income.[64] HPD requires tenants to pay the higher of 30%-to-40% of adjusted monthly income, 10% of gross income, or $50.[65] In addition, for dwellings in which the tenants pay utility costs directly to the landlord, a tenant's rent contribution will be reduced by a PHA-determined utility allowance.[66]

PHAs reexamine the family's income and composition at least annually to ensure continuing eligibility.[67] Payment amounts may be adjusted as a result of these recertifications based on changed income or increased rent.[68]

Once accepted into the Housing Choice Voucher Program, tenants are free to move with their vouchers to anywhere in the United States.[69] Families looking to move within a PHA's jurisdiction or to another jurisdiction might be subject to restrictions and must apply to their local PHA.[70]

C. The Landlord's Obligations

Before approved voucher recipients may move into a dwelling they have selected, the local PHA must inspect it to ensure that it complies with HUD's minimum Housing Quality Standards (HQS).[71] If the PHA approves the dwelling, the landlord enters into a lease with the tenant for at least one year, after which the landlord may initiate a new lease or allow the family to remain in the unit on a month-to-month basis.[72] The landlord simultaneously enters into a housing assistance payments (HAP) contract with the PHA.[73] Under this contract the landlord agrees to maintain both the minimum HQS as well as services agreed to as part of the tenant's lease. The PHA inspects the unit annually to ensure compliance. A landlord's failure to correct HQS violations after a failed inspection can result in the PHA's terminating or suspending the housing assistance paid to the landlord.[74]

D. Project-Based Assistance

Assistance provided under the Housing Choice Voucher Program may also be "project based." Project-based assistance is tied to a particular building rather than a particular family. Under a project-based HAP contract, the owner agrees to build or rehabilitate certain dwellings, and the PHA agrees to subsidize those dwellings upon the owner's satisfactory completion of rehabilitation or construction.[75] With project-based vouchers, PHAs can support the development of affordable housing. In return, the project owner is assured a steady stream of tenants and revenue.

HUD does not provide a separate funding allocation for project-based vouchers. Rather, PHAs are authorized to spend up to 20% of their Housing Assistance Voucher Program funds on project-based vouchers.[76] Further, there is no separate application for project-based vouchers. Instead, PHAs offer project-based assistance to families that apply for tenant-based assistance when eligible dwellings become vacant.[77] The family may then accept if it is interested or wait for a tenant-based voucher to become available. After a year under a project-based voucher, a family may transfer to a tenant-based voucher if one is available. Before the PHA approves that transfer, the voucher remains project-based, and the family loses the assistance if it moves.[78]

Project-based vouchers are part of the Housing Choice Voucher Program and are different from the project-based Section 8 program.[79] The latter, which is not funded through PHAs, refers to the remnants of the Section 23-style subsidy contracts with private building owners initially established during the 1970s and 1980s when the Section 8 program took over these operations.[80]

IV. Section 8 Litigation: The Long and Winding Road

Litigation has shaped many of the key elements of Section 8 in New York City. While tenants have sued to maintain procedural due process, landlords have fought to ease the program's restrictions and requirements.

A. *Williams* Consent Judgments and their Progeny

NYCHA settled several landmark class-action lawsuits with agreements that established and strengthened procedural safeguards for tenants. The most important of these is *Williams v. New York City Housing Authority*.[81] The case began on March 26, 1981, in the United States District Court for the Southern District of New York at a time when the older rental-certificate and rental-voucher programs were still in effect. The class-action plaintiffs represented "all families who are or will be assisted under the Section 8 Existing Housing or Voucher program."[82] They sued NYCHA and Section 8 landlords, challenging the existing termination and eviction procedures as violating their due process.

The parties entered into their first partial consent judgment—sometimes called "decree"—on October 4, 1984.[83] This initial settlement established procedures under which Section 8 tenants could challenge a NYCHA decision to terminate their Section 8 subsidy payments.[84] Under this settlement, tenants must first receive a warning notice from NYCHA and have an opportunity to correct

conditions that form the basis for the proposed termination.[85] If the tenant does not remedy the situation or otherwise disagrees with the allegations, a second notice is then sent. Tenants can then request a hearing before a NYCHA impartial hearing officer, who renders a determination. Subsidy payments continue while a determination is pending.

The hearing officer can order outright termination, termination unless certain conditions are corrected, or the continuation of the subsidy.[86] The NYCHA board reserves the right to review the hearing officer's ruling. If the NYCHA board chooses to issue a ruling less favorable to the tenant, the board must give an explanation. If the hearing officer or the NYCHA board orders a termination, the tenant is entitled to seek judicial review in a CPLR Article 78 proceeding in Supreme Court. Tenants are unable to continue receiving assistance if they are found to have defrauded the Section 8 program.[87] A tenant who does not respond to a second notice is sent a default notice. The tenant's subsidies are automatically terminated after 45 days if the default is not challenged. NYCHA must send all notices in English and Spanish by regular and certified mail.

On April 27, 1994, the district court approved a second partial consent judgment that resolved the remainder of the plaintiffs' claims.[88] This agreement set out new procedures for landlords who sought to evict Section 8 tenants in nonpayment cases. Before *Williams*, federal law allowed landlords to evict Section 8 tenants "for serious or repeated violation of the terms and conditions of the lease, for violation of applicable Federal, State, or local law, or for other good cause."[89] Before the *Williams* settlement, a landlord's eviction proceeding had to be preceded only by "written notice to the tenant specifying the grounds for such action."[90]

The second *Williams* partial consent judgment added procedural safeguards for tenants. Landlords seeking to evict a NYCHA Section 8 tenant must now give both the tenant and NYCHA 25 days' notice before commencing eviction proceedings.[91] The notice must contain specific factual allegations. The tenant is given 10 days to respond, after which NYCHA has 20 days to accept or object to the basis advanced for eviction.[92] NYCHA may object, for example, if it finds that the facts in the landlord's 25-day notice fail to set forth a good cause to evict even if the facts are proven. NYCHA may also object if a landlord alleging nonpayment of rent seeks to recover more than the tenant's actual share of the rent.[93] If NYCHA objects to the eviction proceeding, the landlord must name NYCHA as a respondent in the proceeding.[94]

The defendant-landlords argued that the additional procedures in the second *Williams* partial consent judgment, when added to the time required to serve a demand and a petition, would cost them several extra months of lost rent even in legitimate eviction proceedings.[95] The court found, however, that "[t]he proposed settlement, while less than perfect, is fair, reasonable, and adequate."[96] The court reasoned that although NYCHA was providing a service to the tenants, "the fact that Section 8 tenants receive a portion of their rent from the government should not deprive them of the right to feel secure in their dwellings, without concern of being unjustly evicted."[97] The court also praised the opportunity for NYCHA to object and be involved in the case, stating that "[f]or the Section 8 program to function effectively and equitably, [NYCHA] must maintain a monitoring role in the process."[98] The court further approved of giving tenants time to find out their rights, seek assistance, and determine how they want to proceed.

The procedures set out in the second *Williams* partial consent judgment initially applied only to nonpayment cases.[99] On September 29, 1994, the district court approved an extension of the agreement to include holdovers that "arise out of or are related to the termination or suspension of the Section 8 subsidy."[100] For all other holdover proceedings, the landlord may proceed as if the tenant were not subsidized, although a copy of the petition must be sent to NYCHA.[101]

Importantly, the second *Williams* partial consent judgment made it clear that nonpayment proceedings may not be brought against tenants solely to recover unpaid Section 8 subsidies. A nonpayment proceeding can be brought against a tenant only if the tenant's share of rent is outstanding.[102]

The *Williams* consent judgments apply only to NYCHA. They do not bind federal agencies or other PHAs.[103] Although *Williams* was settled before the Housing Choice Voucher Program replaced the older certificate and voucher programs, the procedures outlined in the consent judgment are still in effect.[104]

In *McNeil v. New York City Housing Authority*, tenants again filed a class-action lawsuit against NYCHA and Section 8 landlords over what they believed were NYCHA's inadequate procedures and policies when subsidies were suspended or terminated over Housing Quality Standards violations.[105] Tenants demanded notice, advice, and assistance when HQS violations were found in their apartment.[106] Tenants were often sued for nonpayment when subsidies were withheld, and tenants were often unclear about their rights. As long as their apartment contained HQS violations, it was ineligible for Section 8 assistance. Thus, tenants also demanded help to find alternative housing when violations are found and not remedied.[107]

In a settlement agreement dated April 29, 2002, NYCHA agreed to provide new and existing Section 8 landlords with notices explaining that landlords cannot seek judgments from Section 8 tenants for the subsidy portion of the rent.[108] In addition, NYCHA agreed to inform tenants if it found HQS violations in the tenant's apartment. NYCHA also agreed not to terminate subsidy contracts with the landlord for HQS violations. Instead,

NYCHA would "suspend" the subsidy, allowing the tenant to be eligible for the protections guaranteed to voucher recipients.[109] If the landlord did not correct the HQS violations, tenants would be granted transfer vouchers to find alternative housing.

In *Frunzescu v. Martinez*, tenants sued NYCHA over the timely provision of transfer vouchers.[110] Tenants complained that NYCHA's slow response to transfer requests caused Section 8 tenants to be evicted because their leases would expire in the interim. Under the stipulated settlement, if a Section 8 tenant request a transfer, NYCHA would respond within two weeks with a decision. This agreement was in effect for only three years—through 2004.

Williams's impact on holdover proceedings commenced against Section 8 tenants is less significant than its impact on nonpayment proceedings. Holdover proceedings may be commenced against Section 8 tenants at the expiration of the lease term[111] or if the tenant triggers a conditional limitation in a lease. A conditional limitation is a clause in a lease that provides for its automatic expiration a certain number of days after a contingency occurs.[112]

Tenants in breach-of-lease clauses and terms that are not conditional limitations must be given ten days to correct the violation. The lease is not automatically terminated. A landlord may not bring a holdover proceeding against a tenant while a lease is still in effect.[113] This opportunity to cure is statutorily guaranteed to Section 8 tenants.[114]

HUD provides a cause of action in a holdover against tenants if there is a finding of fraud in the tenant's income recertification. The HUD Housing Handbook requires that the landlord first notify the tenant in writing of the allegedly fraudulent act.[115] The tenant then has 10 days to meet with the landlord to discuss the allegations before the landlord makes a final decision.[116] Although the *HUD Handbook* is not formally published in the *Federal Register*, the courts have found that the *HUD Handbook* is binding and properly sets forth procedures to be followed under the Section 8 program.[117]

A landlord's failure to comply with the above procedures may provide the tenant with a complete defense in a nonpayment or holdover proceeding. In *433 West Associates v. Murdock*, the Appellate Division held that compliance with the *Williams* consent judgments as well as the clear mention of the tenant's Section 8 status as required by RPAPL 741 were "essential elements" to the landlord's case.[118] The *Williams* requirements of course still apply only to NYCHA Section 8, but the requirement to plead the tenant's Section 8 status applies to actions against all Section 8 tenants. Defenses based on a failure to meet these requirements are not jurisdictional; they are waived if a tenant fails to raise them.[119] Recently, though, some courts have held that failure to plead regulatory status is a flaw that can be remedied, as long as the tenant is not prejudiced by the initial failure.[120]

B. Housing Quality Standards and the Warranty of Habitability in Section 8 Units

As *McNeill* and its settlement provisions suggest, a possible termination of subsidy payments for HQS violations is controversial. In *Nichols v. Drake*, a New York City court held that a landlord's failure to pass an HQS inspection and the cessation of Section 8 subsidy payments do not automatically bar a landlord's eviction proceeding if the tenants do not pay their share of the rent.[121] As in *Nichols*, landlords may proceed with a nonpayment case if they can show that a tenant caused the violations by neglecting to maintain the dwelling or by interfering with the landlord's good-faith attempts to repair.[122] The court acknowledged that a landlord's failure to repair creates problems for Section 8 tenants, who often must move to another eligible apartment if they want to continue receiving assistance.[123] The court added, however, that enhanced due-process rights for tenants cannot come at the complete expense of the landlord's due-process rights.[124]

In *Cashmere Realty Corp. v. Hersi*, a landlord argued that because it failed to make repairs that NYCHA and HPD ordered its HAP contract with NYCHA was terminated and it was no longer bound by the *Williams* consent judgments.[125] The court disagreed. It found that if a subsidy is suspended or terminated after a failed inspection, the landlord still must comply with the *Williams* consent judgments.[126] NYCHA's Policy Memorandum LHD # 04-43 provides that *Williams* must be followed even if the tenant is no longer a voucher holder, provided that the subsidy was suspended because of the landlord's HQS violations.[127] According to the *Hersi* court, Section 8 landlords cannot escape their contractual obligations by failing to repair. The landlord's failure in *Hersi* to notify NYCHA of the eviction proceeding resulted in the dismissal of the petition.

Further repair-related legal problems arise because Section 8 voucher arrangements involve three parties, not two. When assessing a tenant's abatement claim for the landlord's violation of the warranty of habitability, compensation is determined using the fair market value of the premises.[128] The tenant is entitled to recover the difference between the fair market rent and the reduced value of the premises as a result of inadequate conditions.[129] In *Committed Community Associates v. Croswell*, a King's County nonpayment case, the tenant asserted a counterclaim alleging breach of the warranty of habitability and sought an abatement. The landlord argued that the abatement should be calculated according to the tenant's share of the rent and not the full contract rent. The trial court held that the proper measure of the fair market rent is the contract rent—the subsidy and the tenant's share combined.[130] The court reasoned that the total amount the landlord collected reflected the value of services pro-

vided to the tenant and that the HUD Housing Handbook, 4350.3, section 3-23, supported this.[131]

The Appellate Term affirmed.[132] The Appellate Term found that if the monthly rent of an apartment is $1,000, and the tenant's share is $300, a warranty of habitability violation that reduced the value of the apartment by one-fifth should entitle the tenant to an abatement of $200. It would be unjust to use the tenant's share to calculate damages; doing so would give the tenant in the above example only a $60 abatement even though the landlord provided only $800 worth of housing.[133] However, the Appellate Term added that because recovery from a breach of the warranty of habitability depends on paying rent, Section 8 tenants receiving vouchers cannot recover damages that exceed their share of the rent.[134] With the Appellate Term's cap, if the landlord's violations in the above example reduced the value of the apartment by one-half, the tenant's recovery would be capped at $300 even though the violations reduced the value of the apartment by $500.[135] The Appellate Division affirmed this decision.[136]

C. Challenging the Termination of a Section 8 Subsidy

Issues surrounding termination of subsidies provide grist for the Section 8 litigation mill. To maintain eligibility for NYCHA's Section 8 program, participants must be reviewed each year to ensure that their income and household composition continue to meet eligibility requirements.[137] Should NYCHA determine that a tenant is no longer eligible for the program or should a tenant somehow fail to comply with the eligibility requirements, subsidy payments might be terminated.[138] A subsidy might also be terminated if a tenant does not grant access to PHA inspectors to verify the landlord's continuing compliance with Housing Quality Standards.[139]

A key procedural due-process safeguard for tenants is the right to challenge an administrative determination in an Article 78 proceeding. Article 78 proceedings, derived from the corresponding CPLR article, are rooted in the common-law writs of *mandamus, certiorari*, and prohibition. Courts have upheld tenants' right to assert in an Article 78 proceeding all the procedural safeguards set out in the first *Williams* consent judgment.[140] Section 8 tenants can prevail in a Supreme Court Article 78 proceeding if the court finds that NYCHA's termination of their Section 8 benefits was arbitrary or capricious.[141] A failure to comply with the procedures in the *Williams* consent judgments might be arbitrary or capricious.[142]

New York courts have been strict about the notice requirements set out in the first *Williams* consent judgment. In *Baldera v. Hernandez*, the court found that a Brooklyn tenant's subsidy was improperly terminated when NYCHA's records showed that the default notice sent by certified mail had never been claimed and when NYCHA had no evidence that the notice was sent by regular mail.[143] Courts have also ruled that boilerplate notices in English and Spanish are insufficient to satisfy *Williams*'s notice requirements.[144] In *Almieda v. Hernandez*, the court restored a tenant's subsidy when NYCHA sent notices in English and Spanish but the specific claims against the tenant were filled out only in English.[145] The court found that this violated *Williams*'s requirement that the tenant be made aware of the grounds for termination.[146] The courts have also strictly scrutinized other mailing and language requirements as set out in *Williams*.[147]

A tenant must commence an Article 78 action within four months of the administrative agency's final determination.[148] If a tenant does not respond to the PHA's termination warnings, the termination is considered final and binding once the tenant receives the default notice.[149] New York courts have recognized a rebuttable presumption that a default notice is received five days after mailing.[150] Failure to receive a default notice tolls the statute of limitations.[151] In the event of a default, the four-month statute of limitations begins to run from the date that a tenant's application to vacate a default is denied.[152]

D. Opting Out of Tenant-Based Section 8

Several issues arose as Section 8 matured as a wide-reaching public-housing program. First, owners were concerned about the statute's "take-one, take-all" provisions.[153] The take-one, take-all rule came from section 8(t) of the U.S. Housing Act of 1937. That section forbade an owner who already entered into a HAP contract on any tenant's behalf in a multifamily housing project to refuse to lease a unit in the owner's multifamily housing projects, if the proximate cause of the refusal was that the family was a Section 8 certificate or voucher holder. Second, owners protested against what they called the Housing Act's "endless lease" provisions. Section 8(d)(1)(B)(ii) provided that an owner may not terminate a Section 8 tenancy except for serious or repeated lease violations, for violating applicable federal, state, or local law, or for other good cause. Third, owners disliked the opt-out requirement that they send a written notice to HUD before a HAP contract was terminated.[154] Section 8(c)(9) required an owner to provide written notice to a HUD field office and the family not less than 90 calendar days before a tenant-based HAP contract ended.

In 1996, Congress attempted to address what in the legislative history is referred to as "disincentives" to Section 8 owner participation. This act temporarily amended the U.S. Housing Act of 1937 to suspend the "take-one, take-all" provision. It also amended §§ 8(d)(1)(B)(ii) and (iii) so that landlords need good cause to terminate a Section 8 tenancy only during the term of the lease. In other words, landlords—with important exceptions explained below—are now free to stop accepting Section 8 subsidies without cause if they do so at the end of a lease term.

This act also amended Housing Act § 8(c)(9) to eliminate the requirement that owners participating in the certificate or voucher programs provide a 90-day termination notice to families that are voucher holders and one-year termination notices to HUD for project-based HAP contracts. In 1998, Congress made these amendments permanent.

Although the 1996 amendment is straight-forward as applied to non-regulated tenancies, controversy arose when applying it to rent-stabilized tenancies in New York State. New York's Rent Stabilization Code requires that landlords offer to renew all stabilized leases and that these renewal leases be "on the same terms and conditions of the expired lease."[155] In *Bran-Trav Development v. Matus*, a Kings County court found that accepting a Section 8 subsidy is "a material term and condition of a rent stabilized lease."[156] The court held that stabilized leases must be renewed and that a landlord's acceptance of Section 8 subsidies is a part of a stabilized lease also subject to renewal.[157] Citing *Mott v. Department of Housing and Community Renewal*, the *Matus* court held that the Section 8 regulatory scheme did not pre-empt state law regarding rent regulation.[158] In *M 1849 LLC v. Inniss*, a Bronx County court cited *Matus* with approval, adding that from a public-policy perspective, allowing landlords to opt out of Section 8 when renewing rent-stabilized leases would put tenants on the street and violate the Rent Stabilization Code.[159]

Other New York courts disagreed. In *Seminara Pelham, LLC v. Formisano*, a New Rochelle court found that Congress intended to allow landlords to opt out.[160] The court added that because Section 8 is a federal program, Congress was free to control who would receive benefits.[161] The court further found no conflict between state and federal law, because the Rent Stabilization Code and *Mott* dealt with rent regulation while the 1996 amendment controlled who would participate in the Section 8 program.[162] Similarly, in *Licht v. Moses*, a Kings County court noted that the 1996 amendment was introduced to improve landlord cooperation with the Section 8 program. Federal law should prevail over the New York Rent Stabilization Code because, according to the *Licht* court, the latter would obstruct the 1996 amendment's goals.[163]

Some New York courts took a middle ground, holding that although rent-stabilized leases must be renewed on the same terms and conditions, accepting Section 8 subsidies was not such a term and condition unless the original lease expressly provided for it.[164] These courts found that although HAP contracts between a local PHA and the landlord ran concurrently with a rent-stabilized lease, they were independent contracts.[165] Landlords choosing to opt out would terminate their HAP contract with the PHAs, and the rent-stabilized lease would continue without Section 8 subsidies unless the lease expressly allowed it.[166]

Even the PHAs disagreed on how to address the issue. DHCR took the position that the HAP contract and the actual lease were not "inextricably merged."[167] NYCHA, on the other hand, issued an opinion letter stating that "[i]f a landlord of an occupied rent stabilized apartment offers the tenant a renewal lease . . . the landlord cannot offer the tenant a renewal term without also renewing Section 8 subsidy for the tenant."[168]

In July 2007, the New York Court of Appeals resolved the controversy in *Diagonal Realty v. Rosario*.[169] The court found that a landlord's decision to accept Section 8 rental subsidy payments was a term of every Section 8 lease executed with a rent-stabilized tenant.[170] The court pointed to HUD's regulations that require landlords to include tenancy addendums in every lease they sign with Section 8 beneficiaries.[171] This addendum must state that the tenant is receiving Section 8 assistance and is not responsible for paying the subsidy portion of the rent. The court found that this was sufficient to make "acceptance of Section 8 subsidies a term of every lease that a landlord signs with a Section 8 tenant."[172] Thus, the court ruled, landlords may not opt out of Section 8 arrangements with rent-stabilized tenants. Because the Rent Stabilization Code refers only to the "existing" lease, it does not matter whether the tenants were Section 8 recipients when they first moved into the home.[173] The addendum would have been written into the lease when the tenants began to receive Section 8 benefits, and all subsequent renewals would contain that provision.[174]

Turning to the preemption question, the court found that one of the defenses Congress advanced in support of repealing the endless-lease provision was that "protections will be continued under State . . . and local tenant laws."[175] The court found no conflict between state and federal law to suggest implied preemption. Landlords remain free to opt out when the tenancy is unregulated. The New York Rent Stabilization Code applies only when rent-regulated tenancies are involved.[176]

A landlord's ability to opt out might be restricted in some additional circumstances. For example, landlords that received tax benefits under New York City Administrative Code § 11-243 may not decline to accept Section 8 subsidies. Subdivision (k) of § 11-243 is an anti-discrimination provision that prohibits landlords receiving tax benefits from discriminating against Section 8 participants. The Appellate Term, First Department, has held that allowing opt out when the landlord receives tax benefits "would have the effect of rendering the anti-discrimination provision meaningless."[177]

E. Opting Out of Project-Based Section 8

Project-based Section 8 assistance first became available in the 1970s. Participating landlords typically committed their housing project to a 20-year term.[178] Landlords have always been free to opt out of Section 8 after their project-based contract expired.[179]

When a landlord opts out, many low-income tenants become unable to pay their rent. As a result, Congress amended the Housing Act in 1999 to provide these tenants with "enhanced vouchers," also called "sticky vouchers."[180] These vouchers allow tenants to keep paying the rent they owed when their building was still under project-based assistance, as long as the tenant lived in the same building.[181] Enhanced vouchers are typically of higher value than the typical tenant-based, fixed-value voucher. In New York City, HPD administers enhanced vouchers.

Some landlords opted out of a project-based contract at the end of its term and then tried to opt out of taking the enhanced vouchers at the end of the next lease term. Federal law, however, prohibits landlords from refusing to accept enhanced vouchers. In *Esteves v. Cosmopolitan Associates, L.L.C.*, building owners argued that the Housing Act grants tenants a right to receive an enhanced voucher from PHAs but does not require landlords to accept them.[182] The District Court for the Southern District of New York disagreed, holding that because enhanced vouchers were created to allow tenants to keep their homes, a landlord must accept the voucher. Otherwise, the federal "right to remain would be illusory."[183] The owners argued that this interpretation would essentially be an "end run" around the 1996 repeal of the endless-lease provision. The court disagreed, finding that if anything, enhanced vouchers were created because of the 1996 repeal as a special exception "granting extra protection to [a] subgroup of tenants."[184] The court warned that if owners tried to circumvent this by refusing to enter into HAP contracts with HPD, they would be barred from suing an enhanced voucher-holder for the voucher portion of the rent.[185]

F. Nonpayment Issues After the Termination of Section 8 Subsidies

As long as a NYCHA Section 8 lease continues and the landlord is unable to opt out—for example, if the tenant is rent-stabilized—a landlord is prohibited by the second *Williams* partial consent judgment from suing the tenant to collect the subsidy portion of the rent. Even if a Section 8 subsidy is properly terminated, a landlord may not initiate a nonpayment proceeding to recover the subsidy portion of the rent from the tenant; under a Section 8 lease, the tenant agrees to pay only the tenant's portion of the rent.[186] If the PHA has properly terminated the HAP contract, the landlord is similarly unable to recover the value of the subsidy from the PHA.[187]

This does not mean that a landlord is without recourse. A landlord may seek what was formerly the subsidy portion of the rent from the tenant if, after the subsidy is terminated, the landlord and tenant enter into a new agreement "in which the tenant agrees to pay the non-tenant share of the rent."[188] This must be a new lease agreement, not merely a renewal lease.[189] If a tenant signs a new agreement, the landlord may initiate a nonpayment proceeding if the tenant fails to pay any portion of the specified rent.[190] In addition, landlords may refuse to offer a renewal lease or a new rental agreement. They may then initiate a holdover proceeding and possibly recover market-value use and occupancy for the holdover period.[191]

A stipulation to settle a nonpayment proceeding in which the tenant agrees to pay the subsidy portion of the rent does not constitute a new rental agreement and is invalid.[192] The implication is that because a nonpayment proceeding could not have been initiated in the first instance, there could be no settlement. The New York State rule for nonpayment proceedings prevents tenants from ever being "liable for the Section 8 share of the rent as *rent*"[193] absent a new agreement.

G. Section 8 and Succession

Under the Section 8 program, federal law recognizes the entire family as the tenant-household.[194] If a family member were to vacate or pass away, the remaining family members may succeed a tenant-based voucher if they were part of the household for one year (NYCHA vouchers) or six months (HPD vouchers), provided the household remains eligible.[195] It is possible for minor children to succeed the subject premises.[196] To succeed to a tenant-based voucher, remaining family members must be registered with the PHA. In *Evans v. Franco*, the New York Court of Appeals held that the remaining family members of a Section 8 tenant-based voucher holder could not succeed to the subsidy; they had not been certified as family members and did not appear on income affidavits.[197] The court reasoned that allowing succession based solely on evidence of extended cohabitability would open the door to possibly fraudulent claims against the Section 8 program.[198] To succeed to a tenant-based voucher, remaining family members must register with the PHA and have their income factored into the household's eligibility calculation.

New York law governing the succession of project-based Section 8 assistance is less clear than the law governing tenant-based Section 8 assistance. After *Evans* was decided in 1999, several courts, including the Appellate Term, First Department, applied the *Evans* holding to project-based subsidies as well as to tenant-based vouchers and rejected succession claims by persons the PHA did not approve as family members.[199] In *Manhattan Plaza Associates L.P. v. Department Housing Preservation and Development*, however, the Appellate Division declined to extend *Evans* to project-based subsidies.[200] The *Manhattan Plaza* court held that HPD's rules for project-based assistance did not preclude the possibility of a hearing to determine succession even if the claiming party was not certified on income affidavits.[201]

Later cases appeared to follow *Manhattan Plaza*. In *2013 Amsterdam Avenue Housing Associates v. Wells*, the Appellate Term, First Department, held that "the absence of [Wells's]

name on the family composition document was not fatal to her succession claim otherwise established by the trial evidence."[202] Wells could succeed because she could prove she lived in the apartment for two years before her mother's death, as required under New York tenancy succession law (i.e., not voucher succession).[203] *Wells* was followed by a New York City court in *Upaca Site 7 Associates v. Hunter-Crawford*.[204]

The *Manhattan Plaza* decision relied on New York City Mitchell-Lama regulations stating that the absence of income affidavits created only a presumption against co-occupancy.[205] However, these regulations have since been amended to require listing on affidavits in addition to proof that the applicant seeking to succeed lived in the dwelling for two years before the succession claim.[206] Few cases dealing with this question have arisen since *Wells*. It is unclear whether *Wells* represents a permanent departure from cases that applied *Evans* to project-based Section 8.[207]

Other laws governing succession of project-based Section 8 are more well-settled. Because some housing projects are contracted to provide housing for a specific class of tenants, tenants who fall outside that class cannot succeed a project-based subsidy even if they are certified and can otherwise prove extended co-residency. In *St. Phillips Church Housing Corporation v. George*, a 45-year-old son's application to succeed his father's unit was denied because the Housing Corporation had been granted a project-based contract to provide housing for low-income senior citizens.[208] A court found that because project-based subsidies are not portable, "the right to possession and the right to the subsidy cannot be separated."[209] Those ineligible to occupy an apartment may not succeed a project-based Section 8 subsidy tied to that apartment.

It is therefore possible in New York City for individuals to succeed to both tenant-based vouchers and project-based subsidies, especially if they are listed as members of the household in the recertification documents.

V. Section 8: Anti-Discrimination Issues

Tenant advocates and policy-makers have long struggled to prevent landlords from discriminating against Section 8 recipients.[210] Many landlords cite bureaucratic entanglements, delays, and the burden of inspections as reasons for their refusal to accept Section 8 from tenants. Other landlords reject Section 8 tenants to discriminate against the poor and minorities.

Various state and local jurisdictions throughout the United States have adopted anti-discrimination laws to protect Section 8 voucher holders. A statute in Los Angeles, California, provides that "[i]t shall be unlawful for any landlord to terminate or fail to renew a rental assistance contract with the Housing Authority of the City of Los Angeles (HACLA), and then demand that the tenant pay rent in excess of the tenant's portion of the rent under the rental assistance contract."[211]

The New York City Council attempted to enact its own anti-discrimination law but was initially thwarted. According to the *New York Times*, Mayor Michael Bloomberg said that the bill, while well-intentioned, prohibited landlords from making sound business decisions and required them to enter into contracts with government agencies they might otherwise avoid. In a press release, the Mayor stated that the bill "fails to recognize that the onus should be on government to make the program more attractive for private sector participation, not the other way around."[212]

On March 26, 2008, the City Council voted to override the Mayor's veto. According to a statement from Speaker Christine Quinn: "This legislation . . . will not only increase access for people eligible for Section 8 vouchers to affordable housing, it will fully protect an individual's right to housing, regardless of their financial circumstances."[213]

Specifically, this law amended Chapter 1 of Title 8 of the administrative code to proscribe lawful source of income as a category of discrimination and to define lawful source of income as "income derived from social security, or any form of federal, state or local public assistance or housing assistance including Section 8 vouchers."[214] This law does not apply to buildings containing fewer than six units,[215] although units in smaller buildings are also protected if the units are rent controlled or if the landlord of the unit owns another building with at least six units.[216]

Although it is difficult to predict the long-term effects of this law, at least one court has already cited it in favor of tenants who sued their landlord to force it to accept Section 8. In *Rizzuti v. Hazel Towers*, the court found that the new law is unambiguous: It requires landlords to accept Section 8 vouchers from otherwise eligible tenants.[217]

Recent Section 8 litigation may reflect a broadening anti-discrimination attitude in the New York courts when it comes to Section 8 tenants. The New York City Civil Court, Housing Part, recently held in *Metro North Owners v. Thorpe* that the Federal Violence Against Women Act applies to female Section 8 tenants to prevent them from being evicted on the basis of domestic violence against them.[218] In that case, the landlord had sought to evict the Section 8 tenant based on an alleged lease violation grounded in nuisance.[219] The incidents of nuisance were domestic-violence altercations between the tenant and a male aggressor. Because the tenant showed evidence of "battered woman syndrome" in her relations with the man, VAWA protection was appropriate.[220] It remains to be seen whether other courts will continue to expand anti-discriminatory protections for Section 8 tenants.

VI. Conclusion

The Section 8 program continues to be a boon for thousands of tenants and landlords in New York City. Its rules and regulations, while confounding to many, have provided steady rents for landlords and stable homes for tenants. As with any federal program, the story of Section 8 will continue to be written through litigation, legislation, and compromise. Its theme of a public-private partnership to provide safe, decent, and affordable housing will probably endure.

Endnotes

1. Congress has initiated reforms to the Section 8 program, called the "Section 8 Voucher Reform Act of 2007," or "SEVRA," to increase the number of vouchers, eliminate inefficiencies, and appease concerns of landlords and tenants. However, this bill remains controversial among low-income housing advocates and is currently stalled in a Senate committee. *See* http://thomas.loc.gov/cgi-bin/bdquery/z?d110:h.r.1851: (last visited Feb. 10, 2009).
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4. Lawrence M. Friedman & James E. Krier, *A New Lease on Life: Section 23 Housing and the Poor*, 116 U. PA. L. REV. 611, 611 (1968).
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6. *Id.* at 613.
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8. U.S. Dep't of Hous. & Urban Dev., HUD's History, *available at* http://www.hud.gov/library/bookshelf12/hudhistory.cfm (last visited Feb. 10, 2009).
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10. Katharine L. Bradbury, 20 J. ECON. LIT. 637, 637 (1982) (reviewing Housing Vouchers for the Poor: Lessons from a National Experiment (Raymond J. Struyk & Marc Bendick, Jr., eds. 1981)).
11. Guidebook, *supra* note 3, at 1–2.
12. *Id.* at 1–3.
13. *Id.*
14. *See* 42 U.S.C. § 1437 (2000).
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22. *Id.*
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28. N.Y. State Div. of Hous. & Cmty. Renewal, Section 8 Project-Based Contract Administration Program, *available at* http://www.dhcr.state.ny.us/programs/section8projectbased/index.htm (last visited Feb. 10, 2009).
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31. Introduction, *supra* note 18.
32. *Id.*
33. *Id.*
34. U.S. Dep't of Hous. & Urban Dev., 2008 Income Limitations—State: New York, 2 (2008), *available at* http://www.hud.gov/offices/cpd/affordablehousing/programs/home/limits/income/2008/ny.pdf (last visited Feb. 10, 2009) [hereinafter Income Limits].
35. Fact Sheet, *supra* note 30; Introduction, *supra* note 18.
36. Guidebook, *supra* note 3, at 5–3.
37. *Id.*
38. *Id.*
39. *Id.* at 5–1.
40. *Id.*
41. *Id.* at 5–3.
42. *Id.* at 5–1.
43. *Id.* at 5–5.
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45. Fact Sheet, *supra* note 30.
46. N.Y. City Hous. Auth., Guide to the Section 8 Housing Assistance Program, 1 (May 2008), *available at* http://www.nyc.gov/html/nycha/downloads/pdf/070213N.pdf (last visited Feb. 5, 2009) [hereinafter NYCHA Guide].
47. *Id.* at 2–3.
48. *Id.* at 3; Income Limits, *supra* note 34, at 2.
49. Residential Tenants, *supra* note 25.
50. *Id.*
51. *Id.*
52. *Esteves v. Cosmopolitan Assocs.* N.Y. L.J, Dec. 12, 2005, at 23, col. 3 (E.D.N.Y. 2005).
53. Residential Tenants, *supra* note 25.
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55. Introduction, *supra* note 18.
56. Introduction, *supra* note 18; NYCHA Guide, *supra* note 46, at 6.
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72. *Id.*
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76. *Id.*
77. *Id.*
78. Introduction, *supra* note 18.
79. *Id.*
80. *Id.*
81. *Williams v. N.Y. City Hous. Auth.*, 81 Civ. 1801, 1994 WL 323634 (S.D.N.Y. 1994)

[hereinafter *Williams Approval*] (decision approving class-action settlement).

82. *Williams v. N.Y. City Hous. Auth.*, Second Partial Consent Judgment, 81 Civ. 1801, at 2 (S.D.N.Y. 1995) [hereinafter *Williams II*].

83. *Williams v. N.Y. City Hous. Auth.*, First Partial Consent Judgment, 81 Civ. 1801 (S.D.N.Y. 1995) [hereinafter *Williams I*].

84. *Id.* at 1.

85. *Id.* at 2.

86. *Id.* at 8.

87. *Id.* at 10.

88. *Williams II*, 81 Civ. 1801.

89. 42 U.S.C. § 1437f(d)(1)(B)(ii) (2000).

90. 42 U.S.C. § 1437f(d)(1)(B)(iv) (2000).

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93. N.Y. City Hous. Auth., Consequences of *Williams* Consent Judgment for Housing Court Proceedings, 5 (1997) (prepared by NYCHA for Housing Court seminar of Oct. 27, 1997) [hereinafter Consequences].

94. *Id.* at 3.

95. *Williams Approval*, 1994 W.L. 323634, at *3.

96. *Id.*

97. *Id.* at *2.

98. *Id.* at *4.

99. Consequences at 5.

100. *Williams v. N.Y. City Hous. Auth.*, 81 Civ. 1801, 1994 WL 533572, at *1 (S.D.N.Y. 1994) (decision extending scope of second partial consent judgment).

101. Consequences at 5.

102. *Id.* at 3.

103. *Id.* at 1.

104. *See, e.g.*, N.Y. City Hous. Auth., Section 8 Frequently Asked Questions, *available at* http://www.nyc.gov/html/nycha/html/section8/lh_ll_faqs.shtml#q8 (last visited Jan. 4, 2009).

105. *McNeill v. N.Y. City Hous. Auth., Stipulation of Settlement*, 88 Civ. 5870 (S.D.N.Y. 2002).

106. *Id.*

107. *Id.*

108. *Id.*

109. *Id.*

110. *Frunzescu v. N.Y. City Hous. Auth., Stipulation of Settlement*, 2000 Civ. 6838 (E.D.N.Y. 2002).

111. *D'Alesso v. Haggins*, 9 Misc. 3d 138(A), 2005 N.Y. Slip Op. 51799(U), *4, 2005 WL 2937287, at *2, 2005 N.Y. Misc. LEXIS 2458, at *5 (Sup. Ct. App. T. 2d Dep't 2005) (Belen, J., concurring) (*citing Perrotta v. Western Regional Off-Track Betting Corp.*, 98 A.D.2d 1, 2, 469 N.Y.S.2d 504, 505 (4th Dep't 1983)).

112. *Perrotta v. Western Regional Off-Track Betting Corp.*, 98 A.D.2d 1, 2, 469 N.Y.S.2d 504, 505 (4th Dep't 1983).

113. *D'Alesso*, 9 Misc. 3d 138(A), 2005 N.Y. Slip Op. 51799(U) at*4, 2005 WL 2937287 at *2, 2005 N.Y. Misc. LEXIS 2458 at *6 (Belen, J., concurring).

114. *See* 42 U.S.C. § 1437f(9)(C)(ii) (2006); *see also Lemle Realty Corp. v. Desjardin*, N.Y. L.J., Mar. 24, 2004, at 19, col. 1 (Civ. Ct., Bronx Co. 2004).

115. I*mpac Assocs. Redev. Co. v. Robinson*, 9 Misc. 3d 1065, 1066, 805 N.Y.S.2d 253, 254 (Civ. Ct., N.Y. Co. 2005).

116. *Id.*

117. *Robinson*, 9 Misc. 3d at 1067, 805 N.Y.S.2d at 254 (*citing Nelson v. Roberts*, 304 A.D.2d 20, 757 N.Y.S.2d 41 (1st Dep't 2003)).

118. 276 A.D.2d 360, 360, 715 N.Y.S.2d 6, 6 (1st Dep't 2000); *see also* Jennifer Levy, Federally Subsidized Housing 6–7 (2009) (unpublished monograph for 2009 Summer N.Y. St. Jud. Seminars).

119. *Id.*

120. *See, e.g.*, P*aikoff v. Harris*, 185 Misc. 2d 372, 713 N.Y.S.2d 109 (Sup. Ct. App. T. 2d Dep't 1999) (failing to state regulatory status is amendable, at least where tenant is apprised of issue in prior litigation); *see also* Levy, *supra* note 118, at 8.

121. *Nichols v. Drake*, 2 Misc. 3d 902, 905, 771 N.Y.S.2d 823, 825-26 (N.Y. Civ. Ct., N.Y. Co. 2004).

122. *Id.*, 771 N.Y.S.2d at 825–26.

123. *Id.*, 771 N.Y.S.2d at 825–26.

124. *Nichols*, 2 Misc. 3d at 904, 711 N.Y.S.2d 823 at 825.

125. *Cashmere Realty Corp. v. Hersi*, 2005 N.Y. Misc. LEXIS 3573, at *5-6 (Civ. Ct., N.Y. Co. 2005).

126. *Id.* at *10.

127. Memorandum LHD #04-43 from Gregory A. Kern, Director of the N.Y. City Hous. Auth. Leased Hous. Dep't to all Leased Hous. Dep't supervisors (Nov. 5, 2004), *available at* https://a996-housingauthority.nyc.gov/Landlord/view_doc.aspx?id=92 (last visited Feb. 10, 2009).

128. *Committed Cmty. Assocs. v. Croswell*, 164 Misc. 2d 756, 757, 625 N.Y.S.2d 441, 442 (Civ. Ct. N.Y. Co. 1995) [hereinafter *Croswell I*].

129. *Committed Cmty. Assocs. v. Croswell*, 171 Misc. 2d 340, 342, 659 N.Y.S.2d 691, 692 (Sup. Ct. App. T. 1st Dep't 1997) (*per curiam*) [hereinafter *Croswell II*].

130. *Croswell I*, 164 Misc. 2d at 758, 625 N.Y.S.2d at 443.

131. *Id.* at 757, 625 N.Y.S.2d at 442.

132. *Croswell II*, 171 Misc. 2d at 345, 659 N.Y.S.2d at 694.

133. *Id.* at 344–45, 659 N.Y.S.2d at 693 (for the reader's convenience, the numbers in this example have been modified from those given in the *Croswell* opinion).

134. *Id.* at 344, 659 N.Y.S.2d at 693.

135. *Id.* at 344–45, 659 N.Y.S.2d at 693.

136. *Committed Cmty. Assocs. v. Croswell*, 250 A.D.2d 845, 846, 673 N.Y.S.2d 708, 708 (2d Dep't 1998) (mem.).

137. *See* 24 C.F.R. 982.516 (2008); *see also* 24 C.F.R. 982.551(b) (2008).

138. *See Singletary v. Hernandez*, 9 Misc. 3d 1127(A), 2005 N.Y. Slip Op. 51807(U), 2005 WL 2997752, 2005 N.Y. Misc. LEXIS 2470 (Sup. Ct., Kings Co. 2005).

139. 24 C.F.R. § 982.405 (2008).

140. *See Matos v. Hernandez*, 10 Misc. 3d 1068(A), 814 N.Y.S.2d 562, 2005 N.Y. Slip Op. 52188(U), 2005 WL 3617745, 2005 N.Y. Misc. LEXIS 2980 (Sup. Ct. N.Y. Co. 2005).

141. *Id.* at 1068(A), 814 N.Y.S.2d at 562, 2005 N.Y. Slip Op. 52188(U) at *2, 2005 WL 3617745 at *2, 2005 N.Y. Misc. LEXIS 2980.

142. *Id.*

143. N.Y. L.J., Dec. 28, 2005, at 19, col. 1 (Sup. Ct., N.Y. Co. 2005).

144. *Almieda v. Hernandez*, 9 Misc. 3d 986, 991, 804 N.Y.S.2d 648, 651 (Sup. Ct., Kings Co. 2005).

145. *Id.*

146. *Id.*

147. *See Quesada v. Hernandez*, 5 Misc. 3d 1028(A), 2004 N.Y. Slip Op. 51597(U), 799 N.Y.S.2d 163, 2004 WL 2903633, 2004 N.Y. Misc. LEXIS 2620 (Sup. Ct., N.Y. Co. 2004).

148. *Id.*, 5 Misc. 3d 1028(A), 2004 N.Y. Slip Op. 51597(U) at *2, 799 N.Y.S.2d at 163, 2004 WL 2903633 at *2, 2004 N.Y. Misc. LEXIS 2620 at *2.

149. *Matos*, 10 Misc. 3d at 1068(A), 814 N.Y.S.2d at 562, 2005 N.Y. Slip Op. 52188(U) at *4, 2005 WL 3617745 at *3, 2005 N.Y. Misc. LEXIS 2980 at *3.

150. *Singletary*, 9 Misc. 3d 1127(A), 2005 N.Y. Slip Op. 51807(U) at *4, 2005 WL 2997752 at *3, 2005 N.Y. Misc. LEXIS 2470 at *9.

151. *Yarbough v. Franco*, 95 N.Y.2d 342, 346, 740 N.E.2d 224, 225, 717 N.Y.S.2d 79, 80 (2000).

152. *Id.*

153. *Licht v. Moses*, N.Y. L.J., Dec. 15, 2004, at 19, col. 3 (Civ. Ct., Kings Co.).

154. *See Kulick & Rheingold Realty v. Montero*, 8 Misc. 3d 1007(A), 801 N.Y.S.2d 778, 2005 N.Y. Slip Op. 50974(U) at *2, 2005 WL 1528750 at *2, 2005 N.Y. Misc. LEXIS 1275 (Civ. Ct., N.Y. Co. 2005) (holding that landlord was under no obligation to inform NYCHA because he had opted out before proceeding had commenced).

155. N.Y.C.R.R. tit. 9, ch. VIII 2522.5(g)(1) (2009).

156. N.Y. L.J., Aug. 11, 2004, at 19, col. 3 (Civ. Ct., Kings Co.).

157. *Id.*

158. *Id.* (citing 211 A.D.2d 147, 151-54, 628 N.Y.S.2d 712, 715-17 (2d Dep't 1995)).

159. N.Y. L.J., Nov. 10, 2004, at 20, col. 3 (Civ. Ct., Bronx Co.).

160. 5 Misc. 3d 695, 782 N.Y.S.2d 898 (New Rochelle City Ct. 2004).

161. *Id.* at 698, 782 N.Y.S.2d at 901.

162. *Id.*, 782 N.Y.S.2d at 901.

163. *Licht v. Moses*, N.Y. L.J, Dec.15, 2004, at 19, col. 3 (Civ. Ct., Kings Co. 2004).

164. *See Cosmopolitan Assocs. v. Ortiz*, N.Y. L.J., Nov. 12, 2004, at 20, col. 1 (Civ. Ct., Queens Co.).

165. *Id.*

166. *Id.*

167. *In re Admin. Appeal of Highland Mgmt. Corp.*, DHCR Dkt. No. QB910041RO, Nov. 6, 2002.

168. *Tibout Estates, L.L.C. v. Coleman*, N.Y. L.J., Oct. 19, 2004, at 20, col. 1 (Civ. Ct., Bronx Co.) (citing Memorandum LHD #03-22 from the N.Y. City Hous. Auth. Leased Hous. Dep't (Aug. 19, 2004)).

169. 8 N.Y.3d 755, 872 N.E.2d 860, N.Y.S.2d 748 (2007); *see also* Mitchell L. Posilkin, Section 8 (2009) (unpublished monograph for 2009 Legal Update Training) (portion entitled "Section 8 as a Term and Condition of Rent-Stabilized Leases").

170. *Id.* at 762, 872 N.E.2d at 863, N.Y.S.2d at 751.

171. *Id.* at 762, 872 N.E.2d at 863, N.Y.S.2d at 751(citing 24 C.F.R. § 982.305(a)(3) (2007); 24 C.F.R. § 982.308(b)(2) (2007)).

172. *Id.* at 762, 872 N.E.2d at 863, 860 N.Y.S.2d at 751.

173. *Diagonal Realty v. Rosario*, 8 N.Y.3d, 755, 762, 872 N.E.2d 860, 863, 860 N.Y.S.2d 748, 751 (2007).

174. *Id.*

175. *Id.* at 763, 872 N.E.2d at 864, 860 N.Y.S.2d at 752; S Rep No. 195, at 32 (1996).

176. *Rosario*, 8 N.Y.3d at 763, 872 N.E.2d at 864, 860 N.Y.S.2d at 752.

177. *See Cosmopolitan Assocs. v. Fuentes*, 11 Misc. 3d 37, 812 N.Y.S.2d 738 (Sup. Ct. App. T. 2d Dep't 2006) (mem).

178. *Esteves v. Cosmopolitan Assocs.*, N.Y. L.J., Dec. 12, 2005, at 23, col. 3 (S.D.N.Y.).

179. *Id.*

180. 42 U.S.C. § 1437f(t) (2000).

181. *Id.*

182. N.Y. L.J., Dec. 12, 2005, at 23, col. 3 (S.D.N.Y.).

183. *Id.* (*quoting Jeanty v. Shore Terrace Realty Ass'n*, N.Y. L.J., Aug. 18, 2004, at 24, col. 1 (S.D.N.Y.)).

184. *Esteves*, Dec. 12, 2005, at 23, col. 3.

185. *Id.*

186. *Rainbow Assocs. v. Culkin*, 2003 N.Y. Slip Op. 50771(U), *2, 2003 W.L. 2004427, at *1, 2003 N.Y. Misc. LEXIS 392, at *2 (Sup. Ct. App. T. 2d Dep't 2003) (mem.).

187. *See Cooper v. N.Y. City Hous. Auth.*, 13 Misc. 3d 132(A), 831 N.Y.S.2d 347, N.Y. Slip Op. 51874(U), 2006 WL 2829858, 2006 N.Y. Misc. LEXIS 2761 (Sup. Ct. App. T. 2d Dep't 2006) (mem.).

188. *See Moshulu Assocs. v. Cortes*, N.Y. L.J., Apr. 5, 2006, at 21, col. 3 (Civ. Ct., Bronx Co.).

189. *Id.*

190. *Id.*

191. *Id.*

192. *See Dawkins v. Ruff*, 10 Misc. 3d 88, 810 N.Y.S.2d 783 (Sup. Ct. App. T. 2d Dep't 2005) (mem.).

193. *Prospect Place HDFC v. Gaildon*, 6 Misc. 3d 135(A), 800 N.Y.S.2d 355, 2005 N.Y. Slip Op. 50232(U), *2, 2005 W.L. 487008, *1, 2005 N.Y. Misc. LEXIS 331 (Sup. Ct. App. T. 1st Dep't 2005) (*per curiam*) (emphasis added).

194. *Upaca Site 7 Assocs. v. Hunter-Crawford*, 12 Misc. 3d 1154(A), 819 N.Y.S2d 213, 2006 NY Slip Op. 50887(U), 2006 W.L. 1341018, 2006 N.Y. Misc. LEXIS 1164 (Civ. Ct. N.Y. Co. 2006).

195. Edward Josephson & Jennifer Levy, Federally Subsidized Housing 16 (2008) (unpublished monograph for 2008 Summer N.Y. St. Jud. Seminars); N.Y. City Dep't of Hous. Pres. & Dev., Housing Choice Voucher (Section 8) Administrative Plan, 5–4 (2007).

196. *See generally Borough Park Courts Assocs. v. Mori*, N.Y. L.J., Sept. 21, 2005, at 19, col. 3 (Civ. Ct., Kings Co.) (citing authority in concluding that minor child can be awarded succession rights).

197. 93 N.Y.2d 823, 825, 687 N.Y.S.2d 615, 616-17, 710 N.E.2d 261, 262–63 (1999).

198. *Id.*, 687 N.Y.S.2d at 617, 710 N.E.2d at 263.

199. *See Davidson 1992 Assocs. v. Corbet*t, 190 Misc. 2d 813, 738 N.Y.S.2d 813 (Sup. Ct. App. T. 1st Dep't 2002) (*per curiam*).

200. 8 A.D.3d 111, 112, 778 N.Y.S.2d 164, 164 (1st Dep't 2002) (mem.).

201. *Id.* at 112, 778 N.Y.S.2d at 164.

202. 10 Misc. 3d 142(A), 814 N.Y.S.2d 893, 2006 N.Y. Slip Op. 50084(U), 2006 W.L. 176950, 2006 N.Y. Misc. LEXIS 109 (Sup. Ct. App. T. 1st Dep't 2006) (*per curiam*).

203. *Id.*

204. 12 Misc. 3d at 1154(A), 819 N.Y.S2d at 213.

205. *See* Josephson & Levy, *supra* note 195, at 17.

206. *See id.*; *see also* New York, N.Y., R.C.N.Y. Tit. 28, § 3-02(p) (2008).

207. *See* Josephson & Levy, *supra* note 195, at 17.

208. N.Y. L.J., Jan. 26, 2005, at 19, col. 1 (N.Y.C. Civ. Ct., New York Co. 2005). *See also* Levy, *supra* note 118, at 2.

209. *Id.*

210. Manny Fernandez, *Bias Is Seen as Landlords Bar Vouchers*, N.Y. TIMES, Oct. 30, 2007, *available at* 2007 WLNR 21341685.

211. Los Angeles, Cal., Mun. Code § 151.04(b) (2002).

212. Manny Fernandez, *Mayor Vetoes Bill Protecting Section 8 Tenants from Landlord Bias*, N.Y. TIMES, Mar. 1, 2008, *available at* 2008 WLNR 4094552.

213. N.Y. City Council, Preserving Access to Affordable Housing, Council Votes on Override to Protect Low-Income Renters from Discrimination, *available at* http://council.nyc.gov/html/releases/024_032608_prestated_sec8override.shtml (last visited Feb. 10, 2009); *see also* Posilkin, *supra* note 169 (portion entitled "Discrimination Based Upon Source of Income, Including Section 8").

214. Int. no. 61A.

215. NYC CODE § 8-107.5(o); Local Law No. 2008/010, *available at* http://nyccouncil.info/pdf_files/bills/law08010.pdf (last visited Feb. 10, 2009).

216. *Id.*

217. N.Y.L.J., Apr. 2, 2008, at 27, col. 1 (Sup. Ct., N.Y. Co.).

218. 870 N.Y.S.2d 768, 773-74 (Civ. Ct., N.Y. Co. 2008) (Gerald Lebovits, J.).

219. *Id.* at 769.

220. *Id.* at 773-74.

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Pitfalls in Modifying Building Loan Contracts

By Thomas A. Glatthaar

It has been said that no area of New York real property draws more blank stares than the Lien Law. It touches most real property transactions that you see, yet many practitioners do not understand its inner workings. This is particularly so in the area of construction loans. New York's Lien Law, with its use of statutory trusts to protect lien claimants, is unique,[1] and its application, particularly in the area of construction lending, is highly technical and its penalties very harsh. This is so because the governing Lien Law statutes in this area[2] are primarily disclosure statutes, intended to provide information for the benefit of contractors, materialmen and laborers, as to the net sum of the building loan available to the project.[3]

One of the areas of construction lending where confusion is greatest, in my experience, is in the context of the restructuring or modification of an existing construction loan during the course of the making of the improvement. The purpose of this article is to shed some light on the Lien Law requirements with respect to the restructuring or modification of an existing construction loan during the course of the making of the improvement. If history is any guide, as the economy weakens, recasting construction loans becomes something of a "growth" industry. Projects drag out, raising funds for equity contributions becomes more difficult, and funds have to be reallocated and budgets redrawn as projects get scaled down or reconfigured. As a result, the loan documents need to be modified, and it is important to be mindful of the various pitfalls in the Lien Law that arise in such a context. The triggering of these problems can result in dramatic consequences for the lender.

A discussion of the background involving building loans is appropriate in order to establish the context in which our subject matter arises. The term "building loan" is not a defined term in the New York Lien Law. There is, however, ample statutory and case law references to this and related phrases to allow one to conclude that a "building loan" is a loan made by a lender to an owner in consideration of the express promise of the owner to make an improvement upon real property,[4] which loan is advanced in stages as the improvement is erected.[5] It is the mutuality of promises (to lend on the one hand and to erect improvements on the real property on the other) that is determinative of the question of whether any particular loan is a building loan.[6]

"New York's Lien Law, with its use of statutory trusts to protect lien claimants, is unique, and its application, particularly in the area of construction lending, is highly technical and its penalties very harsh."

These promises must be contained in the governing loan documents,[7] which must be in writing and acknowledged in a manner that would entitle them to be recorded.[8]

These mutual promises are contained in a document called a building loan contract. This building loan contract, in addition to the mutual promises aforesaid, contains the various terms and conditions pursuant to which advances are to be made as well as the procedure for requesting such advances, and other information as determined by the parties thereto. This building loan contract must be filed in the Office of the County Clerk where the subject property is located prior to or simultaneously with the recording of the building loan mortgage.[9] A failure to timely file the building loan contract (that is, before the building loan mortgage is recorded, or simultaneously with the recording of the building loan mortgage) results in the subordination of the entire interest of the lender to any person who files a mechanic's lien for work done or materials furnished in connection with the making of the improvement.[10]

In addition to the information set forth above, the building loan contract must contain an affidavit of borrower that sets forth the consideration paid or to be paid for the loan and the expenses, if any, incurred or to be incurred in connection therewith, as well as the net sum available to the borrower for the improvement. When read in conjunction with Lien Law § 13(3),[11] all of this means that the proceeds of a building loan mortgage can be used only for (a) expenses (including consideration for the loan), if any, incurred or to be incurred in connection with the loan provided that such expenses also constitute a cost of improvement,[12] and (b) improvement of the premises.[13]

The purpose of this affidavit, often referred to as § 22 affidavit or a Lien Law affidavit, is to publicly disclose how the building loan proceeds are used or to be used, so that prospective lien claimants can determine compliance with the law and can further determine how much money is available for the making of the improvement itself. This affidavit must be materially correct. Any lender that knowingly files a building loan contract containing a § 22 affidavit that materially misrepresents the net sum available to the borrower for the making of the improvement suffers a subordination of its mortgage to subsequently arising mechanic's liens.[14] The statutory penalty (the threat of loss of priority) is imposed on the lender even though the borrower is the maker of the affidavit,[15] and is intended to act as an effective deterrent to a lender that allows the filing of a

§ 22 affidavit it knows to be false,[16] or a lender that is indifferent to the truthfulness of the § 22 affidavit.[17]

A § 22 affidavit does not materially misrepresent (overstate) the net sum available to the borrower for the making of the improvement if it includes sums to pay for improvements completed prior to the issuance of the construction loan.[18] It does not materially misrepresent the net sum available to the borrower for the making of the improvement if it includes sums previously advanced to borrower under notices of lending made prior to the execution of the building loan contract.[19] The § 22 affidavit also does not materially misrepresent the net sum available to the borrower for the making of the improvement if the lienor (claimant) has been paid more than the net sum as stated in the § 22 affidavit;[20] or if the net sum includes interest on the building loan that accrues during the making of the improvement and provided that the § 22 affidavit contained a statement to that effect.[21]

By contrast, a § 22 affidavit does materially misrepresent the net sum available to the borrower for the making of the improvement where roughly 3% of the loan amount was in fact used to pay off and satisfy a prior existing mortgage and where the § 22 affidavit does not disclose such use of funds;[22] where more than one-third of the loan amount was used to acquire existing mortgages by assignment and where the § 22 affidavit does not disclose such use of funds;[23] and where the net sum available was invaded to pay accrued and unpaid interest on the earlier mortgages made by the lender[24] provided that the amount thereof was material.

With the knowledge of how building loans work, how these loans are documented and how the proceeds are to be used, and understanding the unusual statutory penalties imposed by the Lien Law, we turn now to the unique problems that arise by the modification of a building loan.

As with the original building loan agreement, a modification must be in writing and must be acknowledged. It, too, must contain a § 22 affidavit that sets forth the consideration paid or to be paid for the loan and the expenses, if any, incurred or to be incurred in connection therewith, as well as the net sum available to the borrower for the improvement.[25] This affidavit must be materially correct, and the filing of a § 22 affidavit that materially misrepresents the use of the building loan proceeds or the net sum available for the making of the improvement will result in the imposition of a penalty subordinating the lien of the building loan mortgage to the lien of all claimants that file liens arising from the making of the improvement. The modification must be filed within 10 days after the execution thereof (as distinguished from the filing of the original building loan agreement and the recording of the building loan mortgage, the order of recording/filing of the modification of the building loan agreement and the modification of the building loan mortgage not being relevant);[26] if the modification of the building loan agreement is not filed within 10 days of its execution, the subordination penalty described above is imposed, subordinating the lien of the building loan mortgage to the lien of all claimants that file liens arising from the making of the improvement.

Further, any such modification of the building loan agreement does not affect the rights of any person who has performed work, furnished materials or provided services to the project that could result in the filing of a mechanic's lien, or any person who contracted[27] prior to the date of filing of the modification to perform work, furnish materials or provide services to the project that could result in the filing of a mechanic's lien. The rights of this protected class of persons are governed by the original (unmodified) contract. This means that, so long as the original building loan agreement and building loan mortgage comply with the law, members of this protected group can assert priority over the lien of the building loan mortgage to the extent (and only to the extent) that such persons are impaired by reason of the modification. For example, members of this group could assert priority over the lien of a building loan mortgage where the building loan agreement was modified, resulting in a reduction of the net sum available for the improvement, to the extent of this reduction. These members could also assert priority over the lien of a building loan mortgage where the building loan agreement was modified in a non-monetary manner (i.e., that did not reduce the net sum as aforesaid), but that otherwise affected the ability of the claimant to be paid in full.[28] This result would hold except, and to the extent that, such persons would agree in writing to consent to the modification and to have their rights governed by the building loan agreement as amended thereby.[29]

Notwithstanding the language in § 22 that ". . . any modification (of a building loan contract) . . . must be in writing and . . . any subsequent modification of any such building loan contract so filed must be filed within ten days of execution," it is not every modification of a building loan agreement that must be filed.[30] Only those modifications that are "material" must be filed in accordance with § 22.[31] A "material modification" is not limited only to those modifications that result in a change to the net sum available;[32] it is also one that alters the rights and liabilities otherwise existing between the parties to the agreement or enlarges, restricts, or impairs the rights of any third party beneficiary,[33] or one where an essential term of the building loan contract is changed, such as the amount or the manner of payment.[34]

Among the kinds of modifications that have been deemed material are: the waiver (by failure to enforce) of a building loan contract provision requiring borrower to obtain a payment bond as a condition to

the advance of loan proceeds;[35] the amendment of a provision of the building loan agreement authorizing the conversion of the property to condominium;[36] and the amendment of a provision of a building loan agreement which requires that other sums or sources be made available for payment of contractors or suppliers aside from the loan proceeds.[37]

By contrast, the waiver of a building loan contract provision calling for borrower to obtain a payment bond that could, *in the discretion of the lender,* be required;[38] a straight extension of time that left the parties with the same rights and liabilities;[39] and the waiver of the right to hold borrower in default even though the building loan agreement would allow the lender to do so,[40] are all examples of modifications that were determined to be non-material which, accordingly, did not require the filing of a modification.

* * *

Let us assume that a loan closing occurred on Blackacre on December 1, 2007. The loan is intended to fund construction of a 15-story building containing 150 luxury condominium units and ground floor commercial space, with a total construction budget of roughly $80 million. The total loan amount is $65 million. The loan is comprised of two parts: a building loan component of $57.5 million, and a project loan component of $7.5 million. At the time of the closing, the borrower executes several notes, a building loan mortgage in the amount of $57.5 million, a project loan mortgage in the amount of $7.5 million, a building loan agreement in the amount of $57.5 million, a project loan agreement in the amount of $7.5 million, and various ancillary loan documents. The building loan agreement contains all of the relevant terms and conditions required by law and agreed to by the parties. It has, as an exhibit a § 22 affidavit made by the borrower that recites the following salient information:

a) That the consideration paid for the loan is $287,500, which is to be paid out of the loan proceeds;

b) That the borrower has incurred or will incur the following expenses in connection with the loan or the project, and which are to be paid out of the loan proceeds: mortgage tax of $1,330,000; recording fees of $400; bank attorney fees of $250,000; title insurance premiums and search and examination of $168,048; expenses incurred to acquire prior mortgages by assignment of $10,000,000; architect fees of $60,000; real estate taxes, and water charges and sewer assessments that accrued prior to the commencement of the improvement of $12,000, and also real estate taxes, water charges and sewer assessments that accrued during the making of the improvement of $45,000; interest accruing on the building loan during the construction period of $2,910,000; and survey fees of $6,500.[41]

c) That the net sum available for the making of the improvement is $42,430,552.

Construction has been ongoing for more than nine months, and the project is running behind schedule and over budget. The main commercial tenant has filed Chapter 11 and rejected the lease, so that virtually all of the commercial space in the project is not leased. In addition, unit sales are going very slow and, in the down market that we are experiencing, there is little chance that sales will pick up soon, since the market is currently flooded with units in similar price ranges. Roughly $50 million has been advanced to date under the building loan mortgage and building loan agreement. The borrower is looking for a restructuring of the building loan in order to give it some breathing room. It needs additional time to finish the project, and to sign up some commercial tenants it is negotiating with and locate others. It also plans, in view of the housing market, to change the property over to a luxury rental, and is requesting flexibility in the project loan funds in order to use up to $2.5 million of that loan to help pay for improvements. The borrower is offering to increase its equity contribution in exchange for these concessions, as well as offering certain other financial assurances. As a result of these discussions, the borrower and the lender enter into a series of instruments affecting these amendments, including amendments to the building loan mortgage and building loan agreement, and the project loan mortgage and project loan agreement. The amounts of the building loan mortgage and the project loan mortgage were unchanged, and the modification documents merely reflected the extension and the change in the nature of the project and the business deal between the parties. The amendment to the building loan agreement did the same, and, again, has, as an exhibit, a § 22 affidavit made by the borrower that recites the following salient information:

a) That the consideration paid for the loan is $287,500, which is to be paid out of the loan proceeds;

b) That the borrower has incurred or will incur the following expenses in connection with the loan or the project, and which are to be paid out of the loan proceeds: mortgage tax of $1,330,000; recording fees of $650; bank attorney fees of $300,000; title insurance premiums and search and examination fees of $168,048; expenses incurred to acquire prior mortgages by assignment of $10,000,000; architect fees of $90,000; real estate taxes, and water charges and sewer assessments that accrued prior to the commencement of the improvement of $12,000, and also real estate taxes, and water charges and sewer assessments that accrued during the making

of the improvement of $45,000; interest accruing on the building loan during the construction period of $4,850,625; and survey fees of $6,500.

c) That the net sum available for the making of the improvement is $40,409,677.

The amendment that has been agreed to by the parties results in a reduction of the net sum available for the improvement by just over $2 million.

* * *

Let us now analyze the facts presented in light of the legal principles heretofore set forth:

Obviously, the modification is a "material" one on at least two bases: the net sum available is being reduced,[42] and the project is being converted from a condominium project to a rental.[43] Accordingly, the modification of the building loan contract must be filed in the Office of the County Clerk, and this filing must occur within 10 days of execution of the modification; if the modification is not filed within 10 days of its execution, any lien filed by a claimant who files a mechanic's lien for work done, materials furnished or services rendered in connection with the making of the improvement will take priority over the lien of the building loan mortgage.

Even assuming a timely filing of the modification of the building loan contract, however, all those persons who have, prior to the date of the filing of the modification of the building loan contract, (i) done work, furnished materials or provided services in connection with the making of the improvement, or (ii) who have entered into a contract to perform work, furnish materials or perform services in connection with the making of the improvement, will have priority over the building loan mortgage as modified, at least to the extent that the net sum available was reduced pursuant to the modification.[44] What this means is that, in the event of a foreclosure, liens filed by these claimants would be entitled to be paid before the last $2,020,875 (or such larger amount to the extent that the lien claimants can successfully assert impairment) of building loan proceeds were paid, regardless of whether the liens were filed before or after the building loan proceeds were fully advanced. Because of this issue, the lender will generally impose a requirement that borrower get consents to the modification from all persons who have performed work, furnished materials or provided services to the project that could result in the filing of a mechanic's lien, or any persons who contracted prior to the date of filing of the modification to perform work, furnish materials or provide services to the project that could result in the filing of a mechanic's lien.

In addition, we need to make a determination on whether the § 22 affidavit is materially correct. As with the failure to file the required modification in a timely fashion, the penalty for a § 22 affidavit that is not materially correct or that materially misrepresents the net sum available is that the entire mortgage (even the portion previously advanced, the priority of which, arguably, ought to have been determined at the time these funds are advanced) is subordinated to any lien filed by a claimant who files a mechanic's lien for work done, materials furnished or services rendered in connection with the making of the improvement.[45]

One other fact in our example merits discussion, and that is the statement that the borrower was "requesting flexibility in the project loan funds to use up to $2.5 million of that loan to help pay for improvements."

A project loan and project-loan mortgage are vehicles intended to allow a borrower to use loan proceeds to pay for expenses related to the construction project, but which expenses cannot be paid out of building loan proceeds because of the statutory constraints on the uses of building loan funds.[46] Subject to the constraints imposed by Lien Law § 13, project loan proceeds can be used for all sorts of purposes, and could even be used to pay for the making of the improvement.

The problem with this use stems from the requirement that a building loan contract be filed in accordance with Lien Law § 22 for every "building loan." Since, under our facts, the borrower is to use this $2.5 million to pay for improvements, is the project loan now a building loan in the statutory sense, therefore mandating that a building loan contract be filed? If so, since the mortgage is presumably already of record, the statutory requirement that the building loan contract be filed prior to, or simultaneously with, the recording of the building loan mortgage cannot be complied with, which will result in the imposition of the subordination penalty. But will this subordination apply only to the $2.5 million portion of the project loan now being used for improvement purposes, or will it apply to the entire project loan? The entire building loan?[47] Since this portion of the project loan is going to be used to pay for improvements, perhaps one could sever this piece off of the project loan note and mortgage, recast this piece as a supplemental building loan mortgage and file a building loan contract for this loan prior to the recording of substitute (supplemental building loan) mortgage?

There is no case law on these points. Some practitioners argue that, if the $2.5 million portion of the project loan is really going to be used to cover expenses related to the improvement, the safest vehicle would involve the severance of the project loan into $2.5 million and $5 million portions, with a substitute mortgage recorded for the smaller piece as a supplemental building loan mortgage. The parties would also execute an amended building loan contract that includes the additional $2.5 million of "new" building loan proceeds (which amended building loan contract would need to be filed within 10 days of its execution in accordance with Lien Law § 22). Such

a mechanism would not be used, however, where the parties' intent is to give the borrower flexibility to use the $2.5 million as needed, including the ability to use these funds to pay for the improvement.

Others argue that, especially where the funds are not earmarked to be used to pay for the improvement, a single, lump-sum advance from the project loan to be used to pay for improvements does not, of itself, transform a project loan into a building loan or impose any of its requirements. I suspect, however, that the advance of these funds in installments would make it more likely that the loan would be viewed as a building loan; the fact that one-third of the loan is being used to pay for improvements would also make such a finding more likely, though there is no "magic number" below which such a change in use of proceeds could safely be made.

Again, it is difficult to say how courts would react to an agreement between borrower and lender to take a substantial portion of project loan funds and use them for building loan purposes, and it would be better, absent guidance from the courts, to avoid such agreements.

If, however, the funds were flowing in the opposite direction (that is, building loan proceeds were being used for project loan purposes), the results would be clearer, though still somewhat problematic. Such a change would result in a reduction in the net sum available for the improvement; as described above, a modification of the building loan agreement would need to be filed and, in all likelihood, consents to the modification from all persons who have performed work, furnished materials or provided services to the project that could result in the filing of a mechanic's lien, or any persons who contracted prior to the date of filing of the modification to perform work, furnish materials or provide services to the project that could result in the filing of a mechanic's lien. Further, because use of building loan proceeds for unauthorized purposes would result in the imposition of the subordination penalty, the amount of the building loan mortgage would need to be reduced and the project loan side increased. This could be accomplished by an amendment which reduces the building loan amount (coupled with the making of a new project loan mortgage, on which mortgage tax would be due), or by a severance of the building loan mortgage and the recording of a substitute project loan mortgage.

* * *

In conclusion, the stringent requirements of the New York Lien Law in the area of the modification of building loan contracts, and the severe penalties for a failure to comply, even in a strictly technical sense, impose significant hurdles for the real estate lending practitioner. It is important to be conversant with the statute and its requirements, and to be able to work closely with the borrower to obtain accurate information so that both lender and borrower can take the steps necessary to protect themselves and the project while the loan gets modified to reflect the new "acts on the ground."

Endnotes

1. *See* New York Lien Law § 13 and New York Lien Law Article 3-A. No other state creates statutory trusts operating in the manner that New York law does for the purpose of protecting inchoate lien claimants.
2. New York Lien Law § 22 (McKinney, 2005).
3. *Howard Sav. Bank v. Lefcon P'ship*, 209 A.D. 2d 473 (2d Dep't 1994).
4. New York Lien Law § 2(13) (McKinney, 2005).
5. *Weaver Hardware Co. v. Solomovitz*, 235 N.Y. 321 (1923); *Finest Inves. v. Sec. Trust Co. of Rochester*, 96 A.D. 2d 227 (4th Dep't 1983), *aff'd.*, 61 N.Y. 2d 897 (1984); *Juszak v. Lily & Don Holding Corp.*, 224 A.D. 2d 588 (2d Dep't 1996).
6. *Weaver Hardware Co. v. Solomovitz*, 235 N.Y. 321 (1923).
7. *In re 455 CPW Assocs.*, 192 B.R. 85 (B.C., SDNY, 1996), *aff'd*, 225 F 3d 645 (2d Cir. 2000).
8. *Sullivan v. Young*, 95 Misc. 658 (Sup. Ct., N.Y. Co. 1916).
9. New York Lien Law § 22 (McKinney, 2005).
10. *Id. See Atlantic Bank of N.Y. v. Forest House Holding Co.*, 234 A.D. 2d 491 (2d Dep't 1996) (holding that the use of the phrase "entire interest" operated to subordinate that portion of lender's building loan mortgage that was originally purchase money and was taken by assignment as part of the building loan closing).
11. New York Lien Law § 13(3) requires that the proceeds of a building loan mortgage will be received . . . as a trust fund first for the purpose of paying the cost of improvement, and that borrower will apply the same first to the payment of the cost of improvement before using any part of the total of same for any other purpose.
12. New York Lien Law § 2(5) (McKinney, 2005).
13. New York Lien Law § 2(4) (McKinney, 2005), which is generally referred to as "brick and mortar," though the definition also covers costs of demolition, architect's plans and specifications and certain other items.
14. *Nanuet Nat'l Bank v. Eckerson Terrace, Inc.*, 47 N.Y. 2d 243 (1979).
15. *HNC Realty Co. v. Golan Heights Developers, Inc.*, 79 Misc. 2d 696 (Sup. Ct., Rockland Co. 1974).
16. *Id.*
17. *Nanuet Nat'l Bank v. Eckerson Terrace, Inc.*, 47 N.Y. 2d 243 (1979).
18. *Ritz-Craft Corp. of Pa, Inc. v. Nat'l Electric Benefit Fund*, 234 F.3d 114 (2d Cir. 2000); *United States of America v. Eljos Assocs.*, 1986 U.S. Dist. LEXIS 20351 (S.D.N.Y. 1986).
19. *Adirondack Trust Comp. v. Thomas J. Bien & Assocs., Inc.*, 168 Misc. 2d 919 (Sup. Ct., Saratoga Co. 1996).
20. *FDIC v. Kisosoh Realty Corp.*, 1994 U.S. Dist. LEXIS 17884 (S.D.N.Y. 1994).
21. *Realty Improvement Funding Co. v. Stillwell Gardens, Inc.*, 91 Misc. 2d 718 (Sup. Ct., Westchester Co. 1977). The more common practice today is to include a separate cost of improvement line item for interest on the building loan that accrues during the making of the improvement.
22. *Ulster Sav. Bank v. Total Communities, Inc.*, 55 A.D. 2d 278 (3d Dep't, 1976). Note that the New York Lien Law does allow building loan proceeds to be used to satisfy prior mortgages provided that such use is disclosed on the Section 22 affidavit and the funds so used are not included in the net sum available.
23. *HNC Realty Comp. v. Golan Heights Developers, Inc.*, 79 Misc. 2d 696 (Sup. Ct., Rockland Co. 1974). Note that the New York Lien Law does allow building loan proceeds to be used to acquire prior mortgages by assignment provided that such use is disclosed on the § 22 affidavit

and the funds so used are not included in the net sum available.

24. *FDIC v. Skyhaven Landing Corp.*, 207 A.D. 2d 519 (2d Dep't 1994).

25. The § 22 affidavit that is filed in connection with a modification will reflect the overall numbers for the use of the loan proceeds as modified by the modification being made. It is not intended to reflect only the undisbursed portion of the building loan at the time the modification is entered into.

26. New York Lien Law § 22 (McKinney, 2005).

27. There is no expressed requirement that such a contract be in writing.

28. For example, a modification that allowed for the release of a portion of the mortgaged property without a paydown of mortgage debt, or a modification waiving the requirement that the borrower maintain performance or completion bonds.

29. Such an agreement cannot constitute a waiver of the right to file or enforce a lien, which is void as against public policy in accordance with Lien Law § 34, or a subordination of a lien, but is merely an acknowledgement that such a person's contractual and statutory rights, including the priority of any lien filed, is to be governed by the building loan agreement, *as modified*.

30. *Pa. Steel Co. v. Title Guarantee & Trust Co.*, 193 N.Y. 37, rehearing denied, 193 N.Y. 682 (1908); *Sec. Nat'l Bank v. Vill. Mall at Hillcrest, Inc.*, 85 Misc. 2d 771 (Sup. Ct., Queens Co. 1976).

31. *N.Y. Sav. Bank v. Wendell Apartments, Inc.*, 41 Misc. 2d 527 (Sup. Ct., Nassau Co. 1963).

32. *In re Admiral's Walk*, 134 B.R. 105 (W.D.N.Y. 1991).

33. *Howard Sav. Bank v. Lefcon P'ship*, 209 A.D. 2d 473 (2d Dep't 1994).

34. *Sec. Nat'l Bank v. Vill. Mall at Hillcrest, Inc.*, 85 Misc. 2d 771 (Sup. Ct., Queens Co. 1976).

35. *HNC Realty Comp. v. Bay View Towers Apartments, Inc.*, 64 A.D. 2d 417 (2d Dep't 1978); *Yankee Bank for Fin. and Sav., FSB v. Task Assocs., Inc.*, 731 F. Supp. 64 (N.D.N.Y. 1990).

36. *Sec. Nat'l Bank v. Vill. Mall at Hillcrest, Inc.*, 85 Misc. 2d 771 (Sup. Ct., Queens Co. 1976). It is interesting to note that the subordination penalty was deemed available in this case even though to change the project to a condominium was disclosed on documents executed by the borrower and lender, recorded on the public record.

37. *In re Admiral's Walk, Inc.*, 134 B.R. 105 (W.D.N.Y. 1991).

38. *In re Grossinger's Assocs.*, 115 B.R. 449 (S.D.N.Y. 1990).

39. *N.Y. Sav. Bank v. Wendell Apartments, Inc.*, 41 Misc. 2d 527 (Sup. Ct., Nassau Co. 1963).

40. *Howard Sav. Bank v. Lefcon P'ship*, 209 A.D. 2d 473 (2d Dep't 1994).

41. It is important to remember that the purpose of the § 22 affidavit is to set forth how the proceeds of the building loan are being used; it is not (necessarily) reflective of the project budget. Accordingly, the budgeted expense for some or all of these items may be higher than the figure used in the § 22 affidavit, with the balance being paid from other sources, e.g., equity.

42. *Howard Sav. Bank v. Lefcon P'ship*, 209 A.D. 2d 473 (2d Dep't 1994).

43. *Sec. Nat'l Bank v. Vill. Mall at Hillcrest, Inc.*, 85 Misc. 2d 771 (Sup. Ct., Queens Co. 1976).

44. That is, at least $2,020,875, which is the extent of direct financial impairment. To the extent that these persons can establish further impairment, say, because of the change from a condominium to rental project, they could assert priority over a larger portion of the building loan mortgage.

45. *Nanuet Nat'l Bank v. Eckerson Terrace, Inc.*, 47 N.Y. 2d 243 (1979).

46. In fact, the use of building loan funds for purposes other than (i) expenses incurred or to be incurred in connection with the loan provided that such expenses also constitute a cost of improvement as defined in Section 2(5) of the Lien Law, or (ii) improvements, as defined in Section 2(4) of the Lien Law, would constitute an improper diversion of building loan funds, resulting in the same total subordination penalty described above, as well as other penalties.

47. *Atlantic Bank of N.Y. v. Forest House Holding Comp.*, 234 A.D. 2d 491 (2d Dep't 1996).

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Protecting a Commercial Sublandlord from Its Subtenant's Holdover

By Amy Carper Mena

A commercial landlord's damages are generally foreseeable when a tenant fails to surrender possession of the leased premises at the end of the lease term. Such damages typically relate directly to the amount of rent that the landlord would have received upon a reletting of the premises.

But holdover damages may surprise a commercial sublandlord and its subtenant alike when a subtenant holds over, absent careful drafting of the sublease. In such a situation, the sublandlord may be responsible to the prime landlord for use-and-occupancy or liquidated-holdover damages for the entire leased premises, rather than just for the lower rental rates of typically smaller premises that were subleased by the holdover subtenant. In turn, a holdover subtenant that has knowledge of the prime lease's terms may be startled to find that under New York law, it is ultimately liable for the holdover damages of the entire premises, often at an amount many times its own sublease rental rate. Despite the equitable nature of New York law, an unsuspecting sublandlord may lose its right to such damages through thoughtless drafting of subleases.

The purposes of this article are (1) to identify how a sublandlord can incur liability to its landlord as a result of the subtenant's failure to surrender possession of the subleased premises before the prime lease's termination, and (2) to provide practical guidance to a sublandlord so that there may be a greater likelihood of the sublandlord's recouping its losses if its subtenant holds over.

I. New York Law on Holdover Liability

Under New York law, a tenant must surrender possession of the entire leased premises at the end of the lease term, vacant of any sublease.[1] This mandate is true even where the landlord originally consented to the sublease, and where the subtenant holds over without the sublandlord's permission and against its wishes.[2] A subtenant's wrongful holdover, therefore, creates a sublandlord's wrongful holdover when it prevents the sublandlord from surrendering possession of the leased premises vacant at the end of the lease term.[3]

A tenant generally subleases its premises because it has no further use for the space that it leased, or because it leased more space than it currently needs, anticipating that it will later move into such space to accommodate its growing business when the sublease term ends. Usually, the rental charged under a sublease is less than the amount payable under the prime lease. This may occur for one of several reasons: the smaller size of the subleased space; the shorter term of the sublease; or the tenant's lower bargaining position as compared to the landlord's. As a result, the damages payable to the landlord when the subtenant holds over may be more than the rent that the subtenant pays to the sublandlord.[4] For example, assume that the landlord leases premises at the market rate of $60 per square foot per year, and the sublandlord subleases the entire premises for $35 per square foot per year. The damages suffered by the landlord due to the subtenant's holdover hypothetically might be almost twice the subtenant's rent, assuming that $60 per square foot per year is the landlord's use-and-occupancy charge for the holdover period.

Quite soundly, well-settled law provides that a holdover subtenant that is aware of the sublandlord's liability under the prime lease's terms is liable for the actual amount of damages owed by the sublandlord for a holdover, and not just for the amount of rent charged at the end of the sublease's term.[5] This is true even where the holdover subtenant paid a lower rent to the sublandlord than the sublandlord paid under the prime lease for the same premises, as illustrated by the previous example, thereby potentially making the subtenant liable for damages almost twice its own rent. For example, in *Phelan v. Kennedy*, a holdover subtenant whose rent was $81.82 per month was required to pay the full $175 per month rental paid under the prime lease to the landlord by the tenant for the four months of the holdover term in which the subtenant remained in possession, on a theory of recovery for breach of the covenant to surrender possession and not as rent.[6]

Moreover, the sublandlord's liability to the prime landlord due to its subtenant's wrongful holdover may be even more out of proportion with the rent charged to the subtenant under the sublease if the subtenant subleased only a portion of the entire premises leased to the sublandlord. This is because a holdover of even part of the premises constitutes a holdover of the entire premises.[7] Thus, using the same rental figures as stated above ($60 per square foot per year is tenant's rental; $35 per square foot per year is subtenant's rental), assume that the subtenant has subleased only half of the entire leased premises. Here, if the subtenant wrongfully holds over, thereby creating a holdover of the entire premises, the sublandlord's liability to the landlord may be almost four times the amount of rent charged under the sublease.

Fortunately for the sublandlord, New York law provides that a subten-

ant wrongfully holding over also is liable for the actual amount of damages owed by the sublandlord where the holdover subtenant subleases only a portion of the total premises leased by the sublandlord from the prime landlord. For example, in *1133 Building Corp. v. Ketchum Comm. Inc.*, the Appellate Division concluded that a holdover subtenant was liable for use-and-occupancy charges of the sublandlord's entire leasehold interest in floors 41 through 45, even though the subtenant subleased and held over only on the 44th floor.[8] Similarly, in *Syracuse Assocs. v. Touchette Corp.*, the Appellate Division found that the subtenant's liability extended to the entire building leased by the tenant, and not merely to the quarter that it occupied past the term's expiration.[9]

The key to holdover damages is that they must be foreseeable, typically at the time of lease (or sublease) execution. A holdover tenant, therefore, will not be liable for consequential damages of a landlord's lost opportunities where the landlord was unable to deliver to a new tenant the premises that included, in part, the premises held over by the tenant, and where the lease does not provide for such damages.[10] Rather, holdover damages will be limited only to the incidental and use-and-occupancy damages concerning the originally leased premises, unless otherwise provided in the lease.[11]

II. Drafting Subleases to Protect a Sublandlord's Right to Recover Damages from Its Holdover Subtenant

Despite New York law's equitable nature, sublandlords may inadvertently obstruct their ability to avail themselves of the law's protection due to poor drafting of the sublease.

For example, subleases commonly contain provisions that conflict when it comes to holdover damages. One common scenario is for a sublease to incorporate the prime lease with the exception that financial terms are deleted and replaced with the sublease's financial terms, and the prime lease's references to the term "premises" in the sublease mean the "subleased premises." As a result, a strict interpretation might result in holdover damages' being limited to damages related only to a holdover of the subleased premises, at the rents stated in the sublease. Another example of poor drafting would be to limit holdover damages or rent in the sublease exclusively to the amount of rent due under the sublease (or some multiplier of same).[12]

A sublandlord can protect its right to recover the full extent of its damages in the event of a subtenant's holdover by several simple techniques. First, the sublease should make clear that the subtenant has fully reviewed the prime lease, and, to the extent feasible, the prime lease should be attached as an exhibit to the sublease. By doing this, a sublandlord can avoid any claim by its subtenant that the subtenant was not aware of the amount of the sublandlord's liability to the sublandlord in the event of a holdover of the entire premises demised to the sublandlord. Frequently, sublandlords redact the rental numbers from the copy of the prime lease provided to the subtenant or attached to the sublease. But if such prime-lease rentals are greater than the sublease rent, sublandlords should not redact them. Second, in addition to containing the customary subordination provision that explicitly states that the sublease is subject and subordinate to the prime lease, the sublease should provide that the subtenant shall not do or permit anything to be done in connection with the sublease or the subtenant's occupancy that will violate the prime lease.

Under a belts-and-suspenders approach, a cautious sublandlord could even include in the sublease a specific disclosure to the subtenant of the actual damages that its holdover will cause, and an indemnification from the subtenant concerning any such holdover damages in the form of a specifically tailored provision perhaps along the lines of the following:

> Subtenant acknowledges that (1) under the prime lease Sublandlord must pay holdover damages to the prime landlord with respect to the subleased premises and the remainder of the [___nd] floor of the building in the aggregate amount of $_____ per month (the holdover damages payable by Sublandlord with respect to the entire [____nd] floor of the building are collectively referred to in this Sublease as the "Holdover Damages") if Subtenant does not surrender the entire subleased premises from and after the expiration of the Sublease's term, (2) Sublandlord's damages resulting from any failure by Subtenant to surrender timely possession of the entire subleased premises from and after the expiration of the Sublease's term will be substantial and will equal or exceed the Holdover Damages payable during Subtenant's holdover, and (3) the Holdover Damages will be the damages actually suffered by Sublandlord on account of any holdover by Subtenant after the expiration date and are not an estimate thereof. Subtenant shall pay to Sublandlord for each month and each portion of any month during which Subtenant holds over in the subleased premises after the expiration of the Sublease's term, for use and occupancy, the Holdover Damages, notwithstanding anything to

the contrary contained in this Sublease or the prime lease. Subtenant shall pay to Sublandlord the foregoing sums upon demand, in full without setoff, and no extension or renewal of this Sublease shall be deemed to have occurred by such holding over, nor shall Sublandlord be precluded by accepting such aggregate sum for use and occupancy from exercising all rights and remedies available to it to obtain possession of the subleased premises. The terms of section _____ of the prime lease will otherwise be applicable to any failure by Subtenant timely to surrender the subleased premises upon the expiration or sooner termination of this Sublease.

In conclusion, holdover subtenants who are aware of the sublandlord's liability to the landlord in the event of a wrongful holdover are responsible under New York law for landlord's incidental and use-and-occupancy damages when they cause a holdover past the expiration of the prime lease's term. Such liability can often be several times the rent that such subtenant pays under its sublease. A sublandlord, to protect its right to recover from such holdover subtenants, should carefully draft the sublease to avoid any confusion or doubt as to its subtenant's liability in the event of a holdover.

Endnotes

1. *See Stahl Assocs. Co. v. Mapes*, 111 A.D.2d 626, 629, 490 N.Y.S.2d 12, 14 (1st Dep't 1985).
2. *Id.* at 629, 490 N.Y.S.2d at 14–15 (*citing Sullivan v. George Ringler & Co.*, 59 A.D. 184, 69 N.Y.S. 38, *aff'd*, 171 N.Y. 693, 64 N.E. 1126 (1902); *Manheim v. Seitz*, 21 A.D. 16, 47 N.Y.S. 282 (2d Dep't 1897)); *see, e.g.*, 1133 *Building Corp. v. Ketchum Comm. Inc.*, 224 A.D.2d 336, 638 N.Y.S.2d 450 (1st Dep't 1996) (holding that the sublandlord was unable to surrender timely possession of its leased premises because its subtenant remained in possession of the subleased premises without the prime landlord's permission for one month beyond the sublease's and prime lease's expiration date).
3. *Stahl*, 111 A.D.2d at 629, 490 N.Y.S.2d at 14 ("It is well settled that a wrongful holding over by a subtenant is to be deemed the same as a wrongful holding over of the tenant sublessor" (*citing Syracuse Assocs. v. Touchette Corp.*, 73 A.D.2d 813, 424 N.Y.S.2d 72 (4th Dep't 1979); *Goodwin v. Humbert*, 216 A.D. 295, 215 N.Y.S. 20, *appeal dismissed*, 244 N.Y. 584, 155 N.E. 906 (1927))).
4. *See Ketchum Comm.*, 224 A.D.2d at 336, 638 N.Y.S.2d at 450–51.
5. *See id.*; *see also Touchette Corp.*, 73 A.D.2d at 814, 424 N.Y.S.2d 72.
6. 185 A.D. 749, 752, 173 N.Y.S. 687, 690 (1st Dep't 1919).
7. *See Ketchum Comm.*, 224 A.D.2d at 336, 638 N.Y.S.2d at 450–51.
8. *Id.*
9. 73 A.D.2d 813, 424 N.Y.S.2d 72, 74 (4th Dep't 1979).
10. *See 437 Madison Ave. Assocs. v. A.T. Kearney, Inc.*, 127 Misc.2d 37, 38, 488 N.Y.S.2d 950, 951 (Sup. Ct. App. Term 1st Dep't 1985). The landlord, in the instant case, entered into a new lease agreement with an incoming tenant that bundled an existing tenant's premises with additional space in the building. When the existing tenant held over, the landlord was unable to deliver timely the incoming-tenant's entire premises. The landlord claimed that the holdover tenant should be liable for the rent for the entire premises to be leased to the incoming tenant, not just for the premises leased holdover tenant. The court denied consequential relief to the landlord, finding no reason to depart from the rule limiting landlord's remedy to removal of the tenant, incidental damages, and use and occupation, absent an agreement in the holdover tenant's lease providing otherwise. *Id.* at 38–39, 488 N.Y.S. at 951.
11. *See id.* But note a recent line of Appellate Division, First Department, cases have found that a holdover tenant or subtenant may be liable to a new tenant for tortious interference with contract concerning the new tenant's lease. *See Havana Central NY2 LLC v. Lunney's Pub Inc.*, 49 A.D.3d 70, 72-73, 852 N.Y.S.2d 32, 34 (1st Dep't 2007) (holding tortious-interference-with-contract claim sufficiently plead by new tenant against a holdover tenant where landlord could not timely deliver premises to incoming tenant due to existing tenant's holdover, even though the new lease provided that landlord had no liability to new tenant for failure to deliver timely the premises due to tenant's holdover); *Kronish Lieb Weiner & Hellman LLP v. Tahari, Ltd.*, 35 A.D.3d 317, 829 N.Y.S.2d 7 (1st Dep't 2006) (finding new tenant to have sufficiently plead the causation element of tortious interference of contract and trespass against a holdover subtenant where such holding over delayed delivery of the premises to the new tenant). An analysis of damages owed to third parties as a result of holdovers, based on a tort rather than a contract theory, is beyond the scope of this article.
12. *See* Edward W. Jessen *et al.*, 7 *Real Property Service New York* § 69.49 (2008 Cumulative Supp.) A form of sublease provides that holdover rent will be the same rate of rental in effect at the time of the sublease's termination. *Id.*

The author thanks Andrew L. Herz of Patterson Belknap Webb & Tyler LLP for reviewing this article in draft.

Bergman on Mortgage Foreclosures: Can New York Tell You What Interest to Charge?

By Bruce J. Bergman

Not for residential first mortgages. [*Mayor of City of New York v. Council of City of New York*, 4 Misc. 3d 151, 780 N.Y.S.2d 266 (Sup. Ct. 2004)].

What the legal rate of interest is in New York and how it relates to the concept of usury is a particularly difficult arena—one we won't address here because it is really a different subject. [If there is a special need to drown in nuance—but find answers—see 1 *Bergman on New York Mortgage Foreclosures*, Chapter 6, Usury, Matthew Bender & Co., Inc. (rev. 2006).]

And don't confuse this with the predatory lending law in New York. Among many other things, that statute advises that if a lender does charge above a certain rate of interest, then a host of mandates and prohibitions become operative. But the statute does not dictate what the interest rate may be or what ceiling might be imposed.

Here is what is to be addressed now. Suppose some local governmental entity (such as the City of New York) passes a statute providing that lending institutions shall not charge more than a certain rate of interest upon home loans as a condition of doing business with that governmental subdivision. Can they do that?

No, and mortgage professionals may recall the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) whereby the federal government preempted all state restrictions on interest rates for federally related lenders making first mortgage loans on residential real estate (a 1-6 family home). An underlying basis for the statute was to allow interest rates from time to time to accommodate the circumstances of changing conditions. Unless a state opted out of that preemption, for the noted type of loan there simply was no interest cap which a state could impose.

In the case at issue, the court found that the DIDMCA preempted any state or local laws which purported to put a cap on interest rates. So, no one can tell a lender they can't do business with a governmental entity because they don't like your interest rates.

Mr. Bergman, author of the three-volume treatise *Bergman on New York Mortgage Foreclosures* (Matthew Bender & Co., Inc., rev. 2004), is a Partner with Berkman, Henoch, Peterson & Peddy, P.C., Garden City, New York; an Adjunct Associate Professor of Real Estate with New York University's Real Estate Institute, where he teaches the mortgage foreclosure course; and a special lecturer on law at Hofstra Law School. He is also a member of the USFN and the American College of Real Estate Lawyers.

Real Property Law Section











Thursday, January 29, 2009

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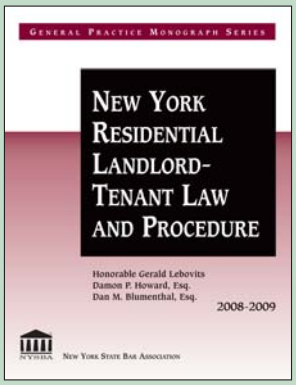
New York Residential Landlord-Tenant Law and Procedure*



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New York residential landlord-tenant law is daunting to newcomers and the experienced alike, given its patchwork statutory framework, discordant case law, and emotion-laden disputes involving homes, money, and the charged landlord-tenant relationship. This monograph introduces the fundamentals of residential landlord-tenant law and offers a guide to the procedural mechanics practitioners face in landlord-tenant disputes.

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