

Strafford

Presenting a live 90-minute webinar with interactive Q&A

Guaranty Insurance in Real Estate Finance Transactions

Policy Requirements, Provisions and Exclusions; Loan Document Provisions;
Determining Need for Backup Guaranty

WEDNESDAY, AUGUST 7, 2019

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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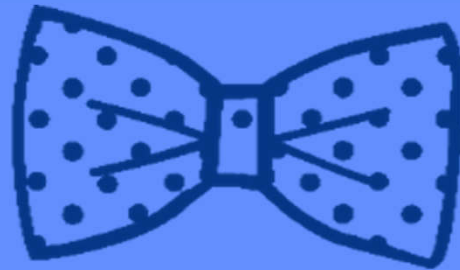
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Commercial Real Estate, Bond and Other Secured Loan Documentation Consulting Services



Ren RH Legal Consultants

Always Working Smarter

Strategic Challenges When Enforcing Commercial Loan Guaranties And A New Alternative For The Collection Of Secured Debt – Commercial Loan Guaranty Insurance



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Overview of Commercial Loan Recourse Issues

- **No Real Estate Loan is Truly “Non-Recourse”**
 - However, Enforcing Recourse Is Often A Lengthy And Expensive Proposition
 - Moreover, Payment Guaranties Often Become “Deficiency” Guaranties
- **Recourse Arises From, And Can Be Limited By, Statutory Provisions, Contractual Agreements, and Practical Concerns**
- **Recourse Also Differs with the Type of Loan Involved**
 - Constructions Loans With Completion Requirements For the Borrower Supported By A Completion Guaranty
 - Term Loans With Limited Recourse Provisions Combined With “Bad-Boy” Liability For Both The Borrower And The Guarantor(s)
- **Limited “Safe” Alternatives to Full Recourse Against All Parties**
 - Use of Guaranty Insurance as A Potential Substitute To Solely Relying on a Recourse Guarantor
 - Comparisons To Other Guaranty “Alternatives”



Strategic Guaranty Enforcement Issues – Outline of Discussion Topics

- ❑ Recourse Enforcement – Review of Statutory, Contractual and Practical Concerns
 - Statutory Limitations on Recourse Under State Law
 - De Facto Limitations on Recourse Resulting From the Structure of the Deal and/or The Parties
 - Contractual Limitations on Recourse
- ❑ Recourse Against Third Parties – i.e., Guarantors, Investors, Title Companies and Others
 - Most Always Involves Litigation With Questions Of Fact And Equitable Considerations
- ❑ Alternatives to Recourse Only Against The Collateral and a Guarantor



Non-Recourse Loan is an Oxymoron: All Loans Are Recourse and Typically Secured

- **Every Loan Involves Recourse; Without Some Level of Recourse, All You Have is a Gift**
- **The Issue is What, Why and How Recourse Is Enforced**
 - Difference Between Loan Secured By The Real Property + A “Bad-Boy” Guaranty (I.e., Term Loans) and A “Full Recourse” Loan (Bank Loans For Construction Loans, Bridge Loans, and/or Mini-Perm Loans)
 - Who Will be the “Recourse Parties” – Property Owner, Developer, Other Potential Guarantor Parties, and/or the Project Investor?
 - What Will be the “Recourse Assets” – Security Real Property, Other Pledged Collateral, Payment in Full, Completion of Project, and/or Other Payment Guaranties with a triggering Event (e.g., LTV Maintenance,
 - How is Recourse Enforced – Different Remedies for Real and Personal Property Collateral and Against Other Non-Pledged Assets Of a Borrower and/or Guarantor



Purposes For Different Forms Of Recourse

- Term Loans – Securitized or Non-Bank Portfolio Loans Primarily Reliant On The Real Property Security *Plus* Limited “Bad-Boy” Guaranties
 - Typically CMBS Loans, as Well as Insurance Company Loans are 10+ Year Term Loans With No Payment Guarantors, just “Bad-Boy” Liability
 - Purpose and Extent of “Bad-Boy” Guaranties
- Full Recourse Loans – Secured By The Real Property *Plus* A Payment Guaranty
 - Use Caution in Pursuing Other Remedies or Collateral (i.e., Seize Personal Property, Freeze Accounts, Use Impounds To Pay Loan, Etc.)
 - Please Note A Limited Exception – Environmentally Impaired Property and Letters of Credit Allow Limited Enforcement Of Debt



Basic Enforcement Considerations (Part II)

- Hurdles/Considerations When Enforcing Guaranties
 - Completion Guaranty – Cannot Compel Construction, so May Have to Settle For Money Judgment
 - Liquidated Recovery Approach (*See Attachment “A”*)
 - Difficulties In Proving Up Damages (*See Attachment “A”*)
 - Inclusion of Bad Boy Carve-Outs In Completion or Payment Guaranties
 - Range Of Potential Damages – Losses, Full Or Partial Liability, Extension Of Terms Such As “Waste”, Etc.
 - Can Be A Lengthy And Evidence Intensive Legal Battle To “Prove-Up” Damages For Bad-Boy Breaches



Perception Of Enforcement Advantages Supported By Guaranty (Part I)

- Action Against a Guarantor Can be Pursued Even if the Borrower files for Bankruptcy Protections.
 - This Is Viewed As One Of The Most Powerful Tools In Working Out A Bankruptcy Restructure, Or A Dismissal Of The Bankruptcy And/Or Other Relief – e.g., Collect On Letter Of Credit
 - Any Guarantor Who Has Received Proper Consideration Is Subject To Enforcement Of Its Guaranty, Regardless Of The Borrower Bankruptcy
 - Perceived As Best Way To Keep Principals And Investors Working For The Success Of The Property To Facilitate Repayment Of The Loan.



Perception Of Enforcement Advantages Supported By Guaranty (Part II)

- An Enforcement Action Against a Guarantor Can be Pursued For The Full Sum Allowed under the Guaranty *Regardless* of What Collection Actions Are Being Pursued Against the Borrower.
 - If a Borrower is an SPE/SAE and insolvent, a Lender can in many states disregard the Borrower and Enforcement a Guaranty of Payment Directly Against the Guarantor.
 - This Involves Sophisticated “Choice Of Law” Considerations.
 - While Choice of Law for Guaranties is Important, if you have a properly drafted Guaranty, a Lender Has an Expectation of Being Able to Enforce Its Guaranty as Written and as Intended.



Statutory Recourse Limitations

- ❑ Anti-Deficiency Rules (e.g., CCP Section 580 And Other State “Anti-Deficiency” State Laws)
 - Restricts Recourse Beyond Foreclosure On the Collateral
 - Please Note – Without Waivers, Protections for Borrowers Usually Extended to Guarantors
- ❑ One-Action Rules (e.g., CCP Section 726 And Other State “One-Action” Laws)
 - Establishes Method of Pursuing Recourse When a Debt is Secured by Real Property
 - May Obtain Waivers of Such Protections to Pursue Other Remedies or Other Collateral
 - However, Waiver Language Can Be Subject To Judicial Interpretation And Limitations In Enforcement
- ❑ Statutory and Common Law Issues, e.g., Community Property Issues



Contractual Recourse Limitations

□ **Bad-Boy Carve-Outs**

- Limited to Actual Losses of the Lender
- All Items Within a Borrower's Control
- Related to Fraud or the Income and Proceeds of Property
- Full Recourse Exception For Actions By The Borrower To "Defeat" Underlying Loan Structure (e.g., Bankruptcy, Violate SPE/SAE Provisions, Etc.)

□ **Springing Recourse**

- Related to Disruptions In "Cash Flow" From Property
- Full/Partial Recourse is The Penalty

□ **Recourse Burn-Offs/Recourse Allocation**

- Percentage vs. Cap Dollar Limitation



Specific Considerations For Enforcement In Light Of Anti-Deficiency Statutory Limitations

Key Principal – Borrower’s Statutory Protections Extend to Guarantors; However, Whereas Borrowers Cannot Waive Such Protections, Guarantors Can Expressly Waive These Matters.

- Anti-Deficiency Protections When a Non-Judicial Foreclosure is Chosen as the Sole Remedy. Western States tend to have such protections, such as CA, AL, AZ, CT, HI, IA, MN, MT, NV, NM, NC, ND, OR, WA, and WI
 - Be Careful to Review the Specifics Applicable in each State because the They Differ From State to State, Both in How They Are Applied and What Waivers are Required.
 - For Example, AZ Law Regarding Anti-Deficiency Only For Single Family Homes on at Least 2.5 Acres; However, in CA this Protection Extends to Both SFRs and Commercial Properties.
 - Please See Attachment “A” For Basic Waiver Language.



Specific Considerations For Enforcement In Light Of One-Action Statutory Limitations

Key Principal – Again, Borrower Statutory Protections Extend to Guarantors; However, Whereas Borrowers Cannot Waive Such Protections, Guarantors Can Waive These Matters.

- ❑ One-Action Protections Applies When a Non-Judicial Foreclosure is Chosen as the Sole Remedy, the Borrower Cannot Be Pursued for any Deficiency Between the Debt Amount and the Appraised Value of the Property.
 - Be Careful to Review the Specifics Applicable in each State because the They Differ for each State, Both in How They Are Applied and What Waivers are Required.
 - For Example, AZ Law Regarding Anti-Deficiency Only For Single Family Homes on at Least 2.5 Acres; However, in CA this Protection Extends to Both SFRs and Commercial Properties.
 - Both CA and UT Have the Most Harsh Statutory Provisions, Whereas OR, WA, NV and ID have “Softer Versions” of this Rule. See example of a Standard Waiver in the Attachment.



Caution When Drafting Guaranty Waiver Protections For Lenders

Key Principal – Be as Specific as Possible, Both in Describing the Consequence of the Waivers and in Specifically Referring to Statutes Which are the Subject of the Waivers.

- Many States Have Adopted Specific Statutory “Safe Harbor” Waiver Language.
 - Suggested Tip - If the State Has Specific Waiver Language, Include Both the Statutory Language, as well as the Descriptive Provisions for the Consequences of all Waivers.
 - The Form Language provided in Attachment “A” Shows how these two Waivers are Balanced to Cover All Bases.
 - If the Required Waivers are **not** Included in the Original Guaranty, you can add them in a Forbearance Agreement, a Guarantor’s Approval of any Modification Agreement, etc.



Caution When Drafting Guaranty In Community Property States (Part I)

- Common Law States Tend to be Western States Which Have Spanish Roots.
 - The Following States are Common Law States – LA, AZ, CA, TX, WA, ID NV, NV, and WI.
 - Lender Must Consider How to Deal with Enforcing a Guaranty Where a Non-Active Business Spouse is not part of the deal, but the Lender wants to recover any deficiency or pay-off of the defaulted loan against the personal and community assets (including revocable trust assets).



Caution When Drafting Guaranty In Community Property States (Part II)

- The following is a Triage for enforcement:
 - **First**, check statutes for enforcement. For example, in AZ, both spouses must sign the guaranty. In OR, a Lender must bring an action against the guarantor(s) within 20 days after initiating foreclosure proceedings against the Borrower.
 - **Second**, if a trust's assets are part of the underwriting for the guaranty, you must name the trust as a guarantor party. So always ask at the inception of a deal if the guarantor includes in its financial statements.
 - **Third**, if the non-active business does not want to be a direct party to the guaranty, have such spouse execute The Guaranty Or, At Least, a spousal consent. A template form is attached hereto in the other materials.



Contractual Considerations To Enforce Guaranties

- Contractual Limitations May Include Limiting Multiple Guarantors to a Pro Rata Liability Based on Their Ownership Interests (As Opposed to the Typical Joint and Several Provisions); an Interest and Carry Costs and/or LTV Maintenance Guaranty; Bad-Boy Carve-Outs; a Cap on Liability; a Requirement that the Guarantor(s) are Liable only after all Collection Efforts Have Been Pursued Against the Borrower; Sliding or Springing Guaranties, etc.
 - Obviously, the key to enforcing a non-traditional guaranty is to have direct and clear language in the guaranty, but also language that you can easily explain to a court.
 - Generally, courts are not eager to enforce guaranties; however, all of the cases and bankruptcy matters that occurred during the “Great Recession,” courts have looked more favorably as to the enforcement of guaranties as long as they understand the language and reasoning for the guaranty. (see 172 Madison (NY) LLC v. NMP-Group, LLC, N.Y. Co. Index No. 650087/2010; and, Steven Weinreb v. Fannie Mae, 993 N.E.2d 223 (And. App. 2013).



Select Legal Considerations To Enforce Common “Bad-Boy” Guaranty Provisions

- ❑ The definition of “Waste” can include both actual damage to the collateral, as well as damages arising in another context, such as failing to pay rent on leased property which would be a liability of the Lender following a foreclosure.
 - ❑ For this reason, more guarantors want to limit waste to only “physical waste.” This clearly is a business issue, but one that you need to keep in mind when preparing an action against a guarantor to recover waste damages.
- ❑ Failing to pay key property costs, such as taxes and insurance premiums.
 - ❑ Using common bad-boy language, a guarantor could be liable for any and all taxes and insurance payments, regardless of the performance of the underlying business.
 - ❑ Accordingly, Guarantors have been seeking a limitation on liabilities to include only a failure to make such payments if the property is generating cash flow which is not applied to these matters. This commonly is referred to as a “Non-Recourse Guaranty.”



Select Legal Considerations To Guarantor Parties With Relationships To The Borrower's Owners/Investors (Part I)

- Upstream Guarantors, Downstream Guarantors, Cross-Stream Guarantors, Related Family Member Guarantors, Pay-for-Play Guarantors, etc.
 - Upstream Guaranty – A Subsidiary Company Guarantees Payment/Performance of its Parent Company's Debt. Enforcement Turns Almost Wholly on Whether Lender Can Show Consideration and Solvency for a Subsidiary Company to Execute Such a Guaranty.
 - The issues of consideration and solvency should not be assumed for any Upstream Guarantor.
 - Consideration should be spelled out specifically, more so than in an ordinary guaranty. Such consideration may include indirect benefits such as goodwill, strength of parent company's support of the Subsidiary Guarantor, etc.
 - Moreover, the Subsidiary Guarantor must have been solvent when the Guaranty is signed, and solvency should be tested under bankruptcy law requirements.



Select Legal Considerations To Guarantor Parties With Relationships To The Borrower's Owners/Investors (Part II)

- ❑ **Downstream Guaranty** - A Parent Company or Owner Guarantees Payment/Performance of its Subsidiary Borrower's Debt. Most Common Form of Guaranty and Generally Enforceable, But Never Ignore the Consideration and Insolvency issues to avoid Fraudulent Conveyance Issues.
- ❑ **Cross-Stream Guaranty** - A Subsidiary Company Guarantees Payment/Performance of a Related Subsidiary Company's Debt. Just as with Upstream Guaranties, Enforcement Turns Almost Wholly on Whether Lender Can Show Consideration and Solvency for a Subsidiary Company to Execute Such a Guaranty.
 - Consideration should be spelled out specifically, more so than in an ordinary guaranty. Such consideration may include indirect benefits such as goodwill, strength of parent company's support of the Subsidiary Guarantor, etc.
 - Moreover, the Subsidiary Guarantor must have been solvent when the Guaranty is signed, and solvency should be tested under bankruptcy law requirements.
- ❑ Use a "Contact Chart" to Determine Upfront the Direct and/or Indirect Connection Between Guarantor and Borrower.



Traditional “Hard” Guaranty “Alternatives”

- Funding or Equity Agreements
 - Used with Equity Investors and Similar Parties Who, For Various Business Reasons, Cannot Execute a Guaranty
 - Direct Obligation vs. Surety Obligations
 - Used With or Without a Separate Note
- Third Party Accommodator Pledge of Assets
 - Usually Subject to Recourse Limitations
 - Guarantor Waivers May Apply
 - Consideration is always an Issue
- Cash Management; Reserves
 - Springing Lockbox or Soft Lockbox
 - Changes In Waterfall Provisions
 - Application of Reserve or Other Excess Funds



Traditional “Soft” Guaranty “Alternatives”

□ **Require Lender Holding Reserves**

- Used in Securitized Deals
- Used When Borrower and Guarantor Do Not Have Strong, Independent Balance Sheets
- Application of Reserves Can Pose Risks To An Over-Eager Lender Because Of Recourse Limitations (e.g., One-Action and Anti-Deficiency Rules)

□ **Financial Covenants**

- Trigger Defaults, Not Springing Recourse
- Protects Downside Losses
- As a Practical Matter, This May Be Nothing More than Only A “Smoke Signal” Protection

□ **Borrower Indemnities**

- When and why



Summary; Final Thoughts

- Guaranties Can Be Difficult And Expensive To Enforce, Time-Consuming To Draft, And May Provide A Lender With An Incomplete Recovery
- Lenders Of Most Types Try To Avoid “Taking-Back” Collateral Property As Their Recovery On Secured Loans –
 - Liability Issues; State And Federal Chartered Banks Have An Expectation of Quick Disposition of Seized Assets; Loss Of Certain Protections For “Acting As An Owner” As Opposed To AN “REO-Owner”; etc.
- Guaranties, As Problematic As They May Be, They Are A Lender’s Most Advanced Tool For Protection Of Its Investment In A Commercial Loan
- Guaranty Insurance Poses A Very Compelling Alternative Or Substitute To Historic Guaranties





Guarantee Insurance in Real Estate Finance Transaction

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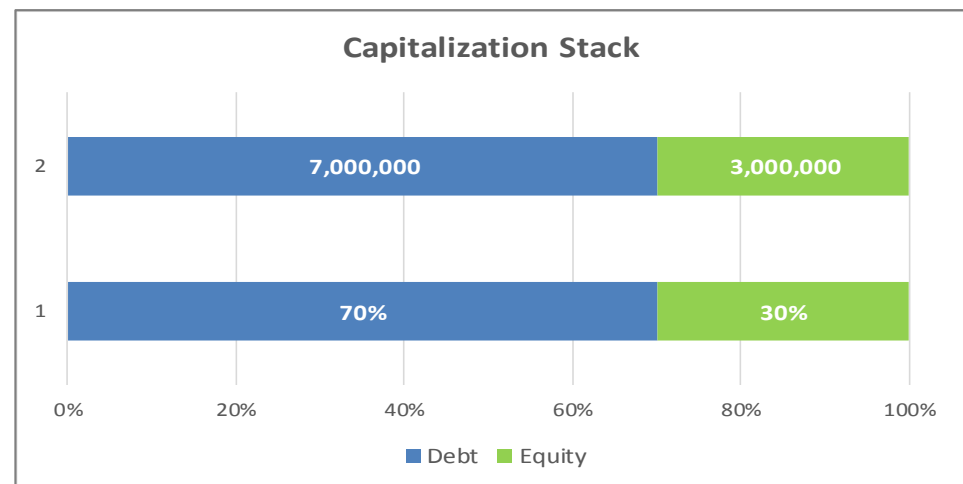
05 **Contact**

Appendix



Structure of a typical CRE Project

- Single Asset Entity
- Equity
 - Sponsor – Developer putting in 5%-10% of the equity
 - **Guarantor of the debt**
 - Promoted Interest, in addition to pari-passu equity
 - Investor – Passive investor putting in 90%+ of the equity
 - Does not guarantee the debt
- Debt (for S-T Financing)
 - Bank – typically requires recourse
 - Under 36 mo, 2 – 1-year ext. options



Debt - a Note, Mortgage and Covenants

Note

Promissory note secured by a mortgage. Describes the dollar amounts borrowed to repay, interest rate, and amortization.

Mortgage

(or Deed to Secure Debt)

Describes title transfer along with the obligations of each party – including borrower guarantee obligations.

Guarantees

- “Bad Boy” carve outs – fraud, misrepresentations, etc. Also, now includes environmental guarantees.
- Completion Guarantee – often defined to Certificate of Occupancy (C.O.)
- Repayment Guarantee / Deficiency Guarantee – in reality one and the same. Reason: Sponsor / guarantor must sell the property to repay – and thus any deficiency is what is guaranteed by the sponsor / guarantor.

Problems with Guarantees

- Difficult to Define Each Guarantee – and often what is litigated:
 - Completion Guarantee – what is definition of completion?
 - Repayment Guarantee – The small sponsor with little equity often does not have enough cash to repay a default, so property must be sold, and lender loses collateral.
- Initial Credit Underwriting / Ongoing Reporting – of financials backing the guarantee.
- Banks HATE to take a property back.
- **Banks rarely collect on guarantees of any significance.** Often leveraged into DPO.
- Net Worth and Liquidity Covenants – often deal killers for sponsors of good deals, rarely enforced.
- Sponsors often do not have the Net Worth requirements:
 - Must be quarterly reporting – hassle for borrower and more work for lender
- Sponsors often do not have the Liquidity Covenant requirement:
 - Must be quarterly reporting – hassle for borrower and more work for lender
 - This is often a covenant, not additional collateral, the lender can grab and use (so must still sue).
- Initial and ongoing reporting is often inaccurate and illiquid assets are hard to value – such as minority % in other properties, which is often the primary net worth of sponsors.
- Inaccuracies of Contingent Liabilities – initially and certainly on-going with minimum monitoring.

Excessive Time, Costs and Uncertainty in Collection

Procedure when a default occurs:

- Notice of Default (NOD)
- Cure Period (often limit to number and time)
- Foreclosure – Lender acquires title after bidding
- Lender Takes title and has foreclosure sale
- Marketing of Asset
- Pursue a Deficiency
- Negotiate a Discount
- Collection is highly uncertain
- Most lenders do not collect on PG's!

Steps	Existing - Foreclosure State	\$	Months	Cum. Months
1	Default	Internal		
2	60 Days to Cure	Internal		
3	Engage Attorney	\$	1	1
4	Foreclosure	\$\$	3	4
5	Acquire title and REO	\$\$	3	7
6	Market for Sale	3%-5%	3	10
7	Pursue Deficiency	\$\$\$	12	22
8	Discounted Payoff (DPO)	\$\$\$\$	2	24
9	Collect Deficiency (Guarantor)	?	3	27
Steps	Existing - Judicial Process State	\$	Months	Cum. Months
1	Default	Internal		
2	60 Days to Cure	Internal		
3	Engage Attorney	\$	1	1
4	Judicial Process	\$\$	15	16
5	Acquire title and REO	\$\$	3	19
6	Market for Sale	3%-5%	3	22
7	Pursue Deficiency	\$\$\$	12	34
8	Discounted Payoff (DPO)	\$\$\$\$	2	36
9	Collect Deficiency (Guarantor)	?	3	39

Typical Game Playing

- Lenders threaten, Guarantors frustrate and hide.
- Lenders rarely collect – certainly not in full.
- Borrowers use this leverage to negotiate a Discounted Pay Off (DPO):
 - Lenders hate REO assets, and borrowers know it. FDIC also has large penalties for REO on banks' books for over 12 months.
- Lenders always alert the IRS of a DPO – debt relief is taxed as ordinary income.
- Some deficiencies are based off appraisal (again often a court action), which further exposes lender to more loss and takes time.
- Multiple guarantors adds to confusion – and complicates lives.

- Conclusion**
- Lose / Lose – time, cost and great uncertainty.
 - Relationship is ruined.
 - Deposits are gone.
 - Resources (time and money) should be spent on problem solving, not game playing.

Nothing has Changed Since the Medicis - even after the Great Recession

- Banks still do not collect on PG
 - Competition is causing banks to lessen PG with “burn downs”. After C.O., reduces to 25% - 50%, and to 10% upon stabilization.
- Liquidity Covenants (LC) – Well meaning, but wrong application
 - LC are designed to have cash available to “fix” a problem.
 - However, LC are just a covenants, and banks cannot access unless through a law suit. They are also rarely enforced.
 - Liquidity Collateral – is accessible to banks, but less often the case.
 - LC are often not available from a Sponsor, and can kill good deals. LC are desired to be 10% of the loan amount and must be held in cash, or cash equivalent such as T-Bills – now earning only 1.74%. So, large amount of funds held up for 3 years earning almost nothing.
- Entity Guarantee – are back and one root cause of Great Recession problem
 - A new entity is formed to hold cash, or cash equivalent, and will serve a number of loans and lender’s LC requirement. Cumulative cash is often less – such as 5.0%-7.5% of total. Issue is one loan, or lender, can drain the pot and leave others without.

False Myths vs. Reality

- **“holding borrower’s feet to the fire”** – assuming more skin in the game. This is completely wrong – as it is the small sponsor facing personal ruin, not the passive big money investor. It is also “adversarial” from the start of a problem, and not cooperative in solving a problem.
- **“we want a warm body”** – same as above, and that warm body is often leaving the scene as they are threatened and facing ruin.
- **“we collect on PG”** - not true. 8 out of 10 bankers will admit they **never collect on PG** (certainly not in full), and the other 2 are in denial or liars.
- **Repayment Guarantee is different than Deficiency Guarantee** – When really the same. Personal Guarantor will liquidate property in Repayment Guarantee; thus, banks lose that collateral and still must collect deficiency. However, Personal Guarantors rarely perform well as secondary forms of repayment. So, in practice, Deficiency Guarantees perform no difference than Repayment Guarantees.

Current – or only - Alternatives

- **Co-Guarantor** – with a stronger / wealthier individual, but same problems on time, cost and collection; if not worse, as wealthy individuals have expensive lawyers to negotiate non-full repayment.
- **Multiple Guarantors** – joint and several. Perhaps even more time, cost and for not more security.
- **Entity Guarantor** – as previously discussed, this is often a LOWER level of cumulative net assets and is liquidity that might only protect one loan / lender, while leaving the others without. It is often just a covenant and lender must sue for cash – which can likely be moved during borrower's frustration strategy for a DPO. Borrowers must keep in very low yielding cash or cash equivalent vs. deploying that capital in higher yielding investments, particularly other CRE deals – at 20%+ / year higher returns.

NEW SOLUTION – Just Now Available.

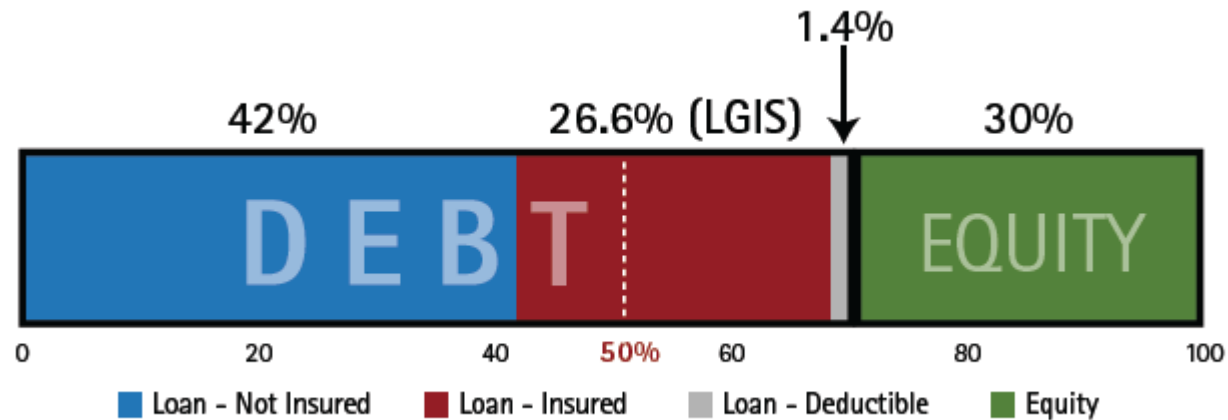
- An investment grade insurance product to transfer the riskiest part of the loan. A new product called Commercial Property Loan Insurance (CPLI) is being brought to market after 10 years in development (4.5 years in obtaining a patent).
- Serves as a substitute, or supplement, for the PG.
- A purpose-built solution by an investor / developer – with lender input.
- Takes advantage of what banks do best (accumulate and distribute capital) and what insurance companies do best (assess, manage and price risk).
- Other areas within banks have taken this risk transfer and competitive advantage approach – PMI for residential and SBA for C&I loans, so time is now for CRE.

How does it work

CPLI insures loans that meet the following criteria:

Equity Requirement	25%-40%, most 25%-30%
Property Types	Office, Ind., Retail, Multi-family, some Hotel
Markets	1st + 2nd Tier cities – Populations > 1M
Loan Sizes	\$5 - \$50M – target size
Loan Types	Constr., Value Add, Redevelopment, Acq., Loan Modifications
Coverage	25%-40% of Loan Amount w/ 2% min. Deduct.
Term	< 36 month, co-terminus w/ underlying loan
Borrower	Partnership, JV, Corp., LLC's, Individuals

Capitalization Stack Example



The example illustrates the capitalization stack for:

- 30% Equity / 70% Loan
- 40% Loan Insurance (% of total loan amount)
- 2% Deductible (% of total loan amount)

4 Step Process

1 Preliminary Review – 24 hours

2 Application with Application Fee

3 Underwriting and Approval – 10 Business Days

4 Issue Loan Policy – at closing along with collection of Premium

Cost (Premium) 2.50% - 3.75% of Loan Amount – 1x

Named Insured Lender

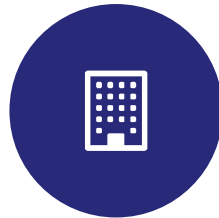
Policy Life Cycle - Phase 1: Preliminary Review

We conduct thorough reviews of individual loans and not portfolios.



Probability of Take Out

Refinance or Sale are the only two options



Project Feasibility Focus

Over bank focus on borrower's ability to repay.



Underwriting Perspective

If we don't want to own the asset we simply pass.



Threshold Underwriting

Accept only if it meets criteria and avoid higher premium for higher risk.

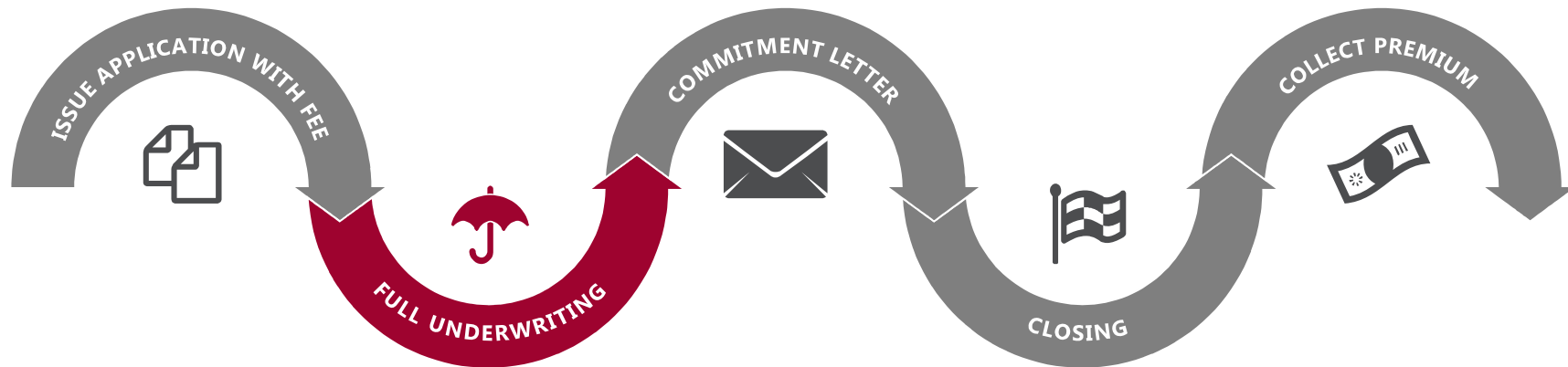
Selectivity Is the Key

LGIS carefully selects only the best individual risks that adhere to our underwriting parameters.

We do NOT underwrite portfolios!

We rely on our own underwriting (not the banks').

Policy Life Cycle - Phase 2: Origination



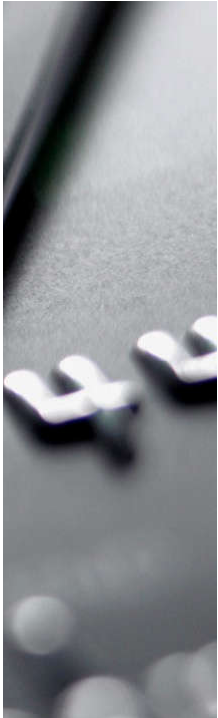
Policy Life Cycle - Phase 3: Guarantee Monitoring



Before Certificate of Occupancy

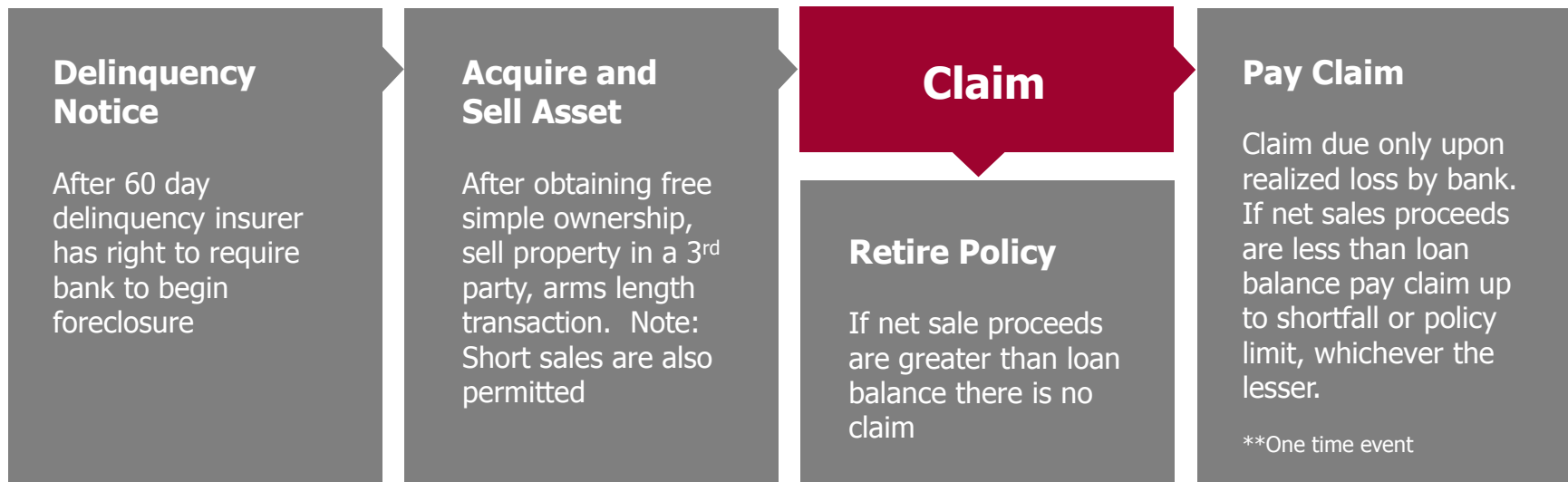
- ✓ Monthly Reviews
- ✓ Loan Draws
- ✓ Inspection Reports
- ✓ Before CO

After Certificate of Occupancy

- ✓ Quarterly Reviews
 - ✓ P&L to Budget
 - ✓ Marketing Reports
 - ✓ Loan Performance Reports
- 

Policy Life Cycle - Phase 4: Retirement or Claim/Work Out

The LGIS claim process allows lenders to recoup their money fast without costly lawsuits and waiting periods.



Dual Claim Trigger: (1) Borrower Default/Foreclosure Sale, and
(2) Uncured default with quantifiable loss

Claim

Must have a quantifiable Loss to calculate a claim.

- Need to have a sale – deed-in-lieu, foreclosure or a short sale.
 - NOTE: Short Sale allows lender option to not put on their books / REO.
- Claim must be made during Policy period after a default. However, process and settlement can extend beyond the end of the policy term. “Claims Made” form.
- Claim allows for an additional 2% of the outstanding loan balance for Property Preservation costs plus some accrued interest.
- Claim also has a minimum deductible of 2% of the Loan Amount.
- Borrower is fully insured - only exception is repayment of any claims paid if file for bankruptcy (which there is no need now).

Claim Example

Scenario: Default Loss Mitigation Analysis

This analysis illustrates the benefit to the bank should the loan default.

LGIS Insured Loan

Project - Total Capitalization *		10,214,505
Equity	30.0%	3,064,351
Debt	70.0%	7,150,153
Outstanding Loan Balance - at time of Default	100.0%	7,150,153
Term (Yrs.)		3
LGIS Coverage (% of Loan Amount)	40.0%	2,860,061
Bank / Borrower Exposure		4,290,092
LGIS Premium (% of Loan Amount)	3.0%	214,505
Liquidation Value (% of Total Capitalization)	50.0%	5,107,252
Property Taxes	1.25%	
Insurance	0.5%	
Agent Commission	4.0%	
Miscellaneous Costs	1.0%	
Sales Proceeds		5,107,252
LESS: Agent Commission	4.0%	204,290
Net Sales Proceeds		4,902,962
LESS: Transaction Costs + Carry Costs		
Property Taxes (half year)	0.63%	63,841
Insurance (half year)	0.25%	25,536
Miscellaneous Costs	1.00%	51,073
Other		-
SubTotal - Transaction Costs + Carry Costs		140,449
Net Sales Proceeds		4,762,513
Loss **		2,387,640

Not Insured Loan

Project - Total Capitalization		10,000,000
Equity	30.0%	3,000,000
Debt	70.0%	7,000,000
Outstanding Loan Balance - at time of Default	100.0%	7,000,000
Term (Yrs.)		3
Bank / Borrower Exposure		7,000,000
Liquidation Value (% of Total Capitalization)	50.0%	5,000,000
Property Taxes	1.25%	
Insurance	0.5%	
Agent Commission	4.0%	
Miscellaneous Costs	1.0%	
Sales Proceeds		5,000,000
LESS: Agent Commission	4.0%	200,000
Net Sales Proceeds		4,800,000
LESS: Transaction Costs + Carry Costs		
Property Taxes (half year)	0.63%	62,500
Insurance (half year)	0.25%	25,000
Miscellaneous Costs	1.00%	50,000
Other		-
SubTotal - Transaction Costs + Carry Costs		137,500
Net Sales Proceeds		4,662,500
Loss **		2,337,500

Max. Lender Loss 2.0% 143,003

Lender Loss 33.4% 2,337,500

* Includes LGIS Premium ** Less Commission and Transaction Costs *** Less Ins. Claims adjustments

Who is backing this?

Backed by State National, a wholly-owned subsidiary of an S&P A Rated NYSE Company

StateNational

- State National Insurance Company, Inc. is A.M. Best A rated and a wholly-owned subsidiary of Markel Corporation (NYSE: MKL) S&P A rated
- State National is a specialty provider of property and casualty insurance operating in two niche markets, **Program Services** and **Lender Services**. The company is licensed to do business in all 50 states and D.C.

**LGIS is also
properly licensed
in all states
planned for
business**



Value for Lender

- **Portfolio Optimization with Investment Grade Credit**
- **Operating Enhancements**
- **Improved Customer Experience**
- **Deposits**
- **Competitive Advantage**

Portfolio Optimization

With Investment Grade Credit



Less capital held in reserves means more available for making loans, leading to higher Return on Equity (ROE). See Appendix for Implied Specific Reserve slide and Capital Relief slide.

Improves collateral without guarantor reliance.

Collateral Deficiency Repayment with certainty.

Cuts collection time and cost significantly with a certain two-step process including filing a claim with payment within 60 days.

More profitable CRE loans but with lower collateral risk than ever before.

Strategy to raise equity freeing equity from reserves is cheaper than raising new equity.

Operating Enhancements



Improved Customer Experience

Initially when negotiating loan, there are **no contentious discussions** of personal guarantee.



In the case of default, relationship can still be maintained to **cooperatively work out situation** with less pressure knowing banks will be repaid and borrowers protected.

Deposits

Banks making CRE loans **require all deposits** go back into the bank into "sweep accounts". LGIS also has a "LGIS Deposit Program" for cooperating banks.



We will **leave money in their banks** – even at below market rates – for the entire term of the loan, known as "Sticky Deposits"

Initial Steps for Value Creation



Personal Guarantee Supplement vs. Substitute Option

Supplement a Personal Guarantee with LGIS insurance as the first position of the guarantee to payout any financial claim.



Liquidity Requirements

Replace minimum liquidity requirements – increase borrower's ROE and enhances the Bank's credit position.



Other Steps

As the Bank becomes more comfortable with the credit enhancement LGIS is offering, the more confident they become in providing a more competitive structure to valued borrowers and use LGIS as complete substitute.

Superior to Existing Models

	LGIS	Existing Foreclosure State	Existing Judicial Process State
Resolution Time (months)	5.5	27.0	39.0
Cost of Resolution	\$*	\$\$\$\$	\$\$\$\$\$
Probability of Collection	100%	50%	50%
Credit Strength	Investment Grade	Personal	Personal
Capital Relief	Yes	No	No

* LGIS allows 2% of outstanding balance for property preservation / collection in claim.

Value for Borrower

- **First loss position transferred to LGIS**
- **Lower borrowing costs and terms improves returns and offsets costs / premiums** (see Appendix Example)
- **Upgrades lender selection and ability to participate in more deals with no capacity issues**
- **Circumvent bankruptcy and taxation on debt forgiveness**
- **Unlocks tied up cash in low yielding cash equivalent and redeploy into higher yielding invest. / new deal.**
- **Expands capacity – to do more deals.**
- **Enhances relationships**

How Can Banks Use This New Tool

- Using CPLI solves the problems mentioned
 - Solves problem uncertainty, time and cost of collection. →
 - Keeps REO assets off balance sheet – if not for much less time.
 - Provides Capital Relief, or frees up capital for new loans vs. raising new equity – increasing ROE
- Provides a Competitive Advantage
 - Banks – offering in essence a non-recourse loan to regain market share (from non-banks and banks), enhance relationships, enhance deposits, lowers cost of capital
 - Borrowers – can do more loans / deals and better position to negotiate with JV partners.
- Provides Cooperation – in times of distress with no game playing

- No hoping for PG collection or being left out in an Entity Guarantee structure.
- Significantly reduces the time for resolution (5.5 mo. v. 27-39 mo.)
- Avoid significant carry costs, penalties and legal fees.

How Can Borrowers Use This New Tool

- New and better way to structure all deals going forward
- Scalable business model
- Can still allow Entity Guarantee – but better
- Allows a fuller budget, with higher contingencies, to access cash needed to “fix” a problem – better mechanism than a Liquidity Covenant
- Resolves problems quickly – time and cost (particularly legal)
- Improves lender selection
- No more capacity issues allowing sponsor to do more deals
- Improves borrowing terms, negotiations w/ JV partners.
- Provides Cooperation – in times of distress with no game playing

How Can Lawyers Use This New Tool

Greatly Assists In Legal:

- Solves definitional inconsistencies in what is covered under certain guarantees.
- Removes leverage from borrower for a DPO or BK action.
- No going to court for a deficiency judgement – including fighting over an appraisal approach – which is theoretical.
- No wasted time / money pursuing a deficiency judgement (still can't collect).
- Greatly reduces process for initial guarantee negotiations and should there be a default.
- Nothing prevents a loan modification, or other settlements, to resolve a problem.
- **Tool for value-add legal services to borrowers / sponsors and banks - more efficient and cost effective for deal making and problem solving. More business.**
- Provides Cooperation – in times of distress with no game playing

Contact Us



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www.lgisgroup.com



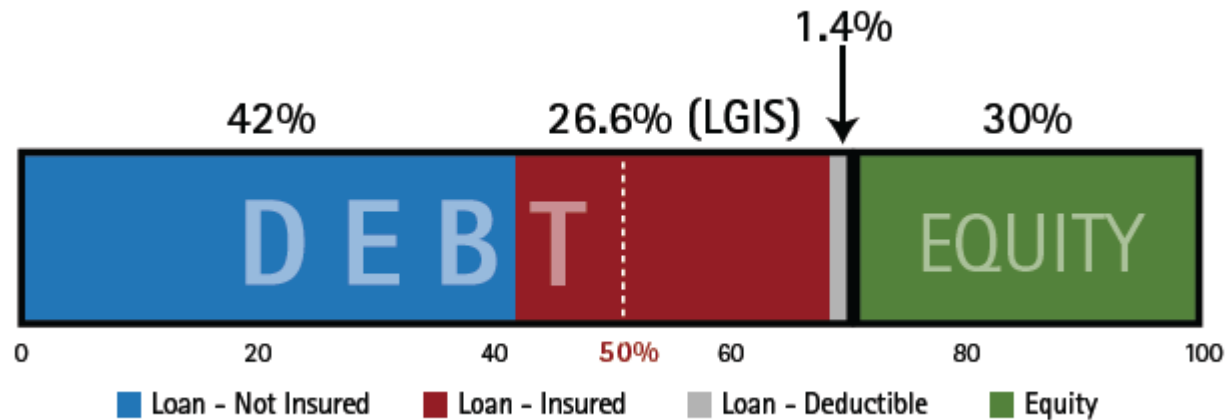
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949-563-0732 (O); 949-701-0731 (C)

renrh@renrhlegalconsultants.com
www.renrhlegalconsultants.com



Appendix

Capitalization Stack Example



The example illustrates the capitalization stack for:

- 30% Equity / 70% Loan
- 40% Loan Insurance (% of total loan amount)
- 2% Deductible (% of total loan amount)

Compare Existing to New Model – Workflow

Steps	Existing - Foreclosure State	\$	Months	Cum. Months
1	Default	Internal		
2	60 Days to Cure	Internal		
3	Engage Attorney	\$	1	1
4	Foreclosure	\$\$	3	4
5	Acquire title and REO	\$\$	3	7
6	Market for Sale	3%-5%	3	10
7	Pursue Deficiency	\$\$\$	12	22
8	Discounted Payoff (DPO)	\$\$\$\$	2	24
9	Collect Deficiency (Guarantor)	?	3	27

Steps	Existing - Judicial Process State	\$	Months	Cum. Months
1	Default	Internal		
2	60 Days to Cure	Internal		
3	Engage Attorney	\$	1	1
4	Judicial Process	\$\$	15	16
5	Acquire title and REO	\$\$	3	19
6	Market for Sale	3%-5%	3	22
7	Pursue Deficiency	\$\$\$	12	34
8	Discounted Payoff (DPO)	\$\$\$\$	2	36
9	Collect Deficiency (Guarantor)	?	3	39

Steps	With LGIS	\$	Months	Cum. Months
1	Default	Internal		
2	60 Days to Cure	Internal		
3	Deed in Lieu	Internal	0.5	0.5
4	Market for Sale	3%-5%	3	3.5
5	Claim Paid	Internal	2	5.5

Conclusion		LGIS	Existing System	
1	Much Quicker Resolution (mos)	5.5	27.0	39.0
2	Much Less Expensive Resolution *	\$	\$\$\$\$	\$\$\$\$\$
3	Probability of Collection	100%	50%	50%
4	Credit Strength	Investment Gd.	Personal	Personal
5	Capital Relief	Yes	No	No

* NOTE - LGIS allows 2% of outstanding balance for Property Preservation / Collection in Claim.

Default Loss Example

Scenario: Default Loss Mitigation Analysis

This analysis illustrates the benefit to the bank should the loan default.

LGIS Insured Loan

Project - Total Capitalization *		10,214,505
Equity	30.0%	3,064,351
Debt	70.0%	7,150,153
Outstanding Loan Balance - at time of Default	100.0%	7,150,153
Term (Yrs.)	3	
LGIS Coverage (% of Loan Amount)	40.0%	2,860,061
Bank / Borrower Exposure		4,290,092
LGIS Premium (% of Loan Amount)	3.0%	214,505
Liquidation Value (Same as Not Insured Loan)	49.0%	5,000,000
Loss **		2,489,530
Max. Lender Loss	2.0%	143,003

Not Insured Loan

Project - Total Capitalization		10,000,000
Equity	30.0%	3,000,000
Debt	70.0%	7,000,000
Outstanding Loan Balance - at time of Default	100.0%	7,000,000
Term (Yrs.)	3	
Bank / Borrower Exposure		7,000,000
Liquidation Value (% of Total Capitalization)	50.0%	5,000,000
Loss **		2,337,500
Lender Loss	33.4%	2,337,500

* Includes LGIS Premium ** Less Commission and Transaction Costs *** Less Ins. Claims adjustments

Implied Specific Reserve

Scenario: Reserve Requirement

This analysis illustrates the benefit the bank will receive with an LGIS insured loan.

LGIS Insured Loan

Loan Amount	\$10,000,000
Probability of Default	1.5%
Loss Given Default*	2.0%
Percent of Loan Held in Reserve	0.010%
Implied Specific Reserve	\$3,000

Not Insured Loan

Loan Amount	\$10,000,000
Probability of Default	1.5%
Loss Given Default*	33.4%
Percent of Loan Held in Reserve	0.167%
Implied Specific Reserve	\$50,100

The \$47,100 difference in Implied Reserve Requirement results in a \$5,652 additional ROE per year Lender would receive based on a 12% required return.

Source: Methodology from former Chief Risk Officer of UCBI, David Shearrow.

Capital Relief

Scenario A: Guarantee for Top 50% (most risky)		
	Without Substitution	With Substitution, Full Period
Exposure Type	HVCRE Exposure	HVCRE Exposure
Loan Amount	\$ 10,000,000	\$ 10,000,000
Risk Weighting	150%	150%
Exposure Period (Months)	24	24
Exposure Capital Reserve	\$ 15,000,000	\$ 15,000,000
Guaranty Exposure Type	None	Corporate
Guaranty Amount	50% \$ 5,000,000	\$ 5,000,000
Guaranty Risk Weighting	0%	100%
Guaranty Period (Months)	0	24
Recognized Guaranty	\$ (714,286)	\$ 5,000,000
Guaranty Reserve	\$ -	\$ 5,000,000
Exposure Amount	\$ 10,714,286	\$ 5,000,000
Exposure Reserve	\$ 16,071,429	\$ 7,500,000
Total Capital Reserve	\$ 16,071,429	\$ 12,500,000
Reduction		\$ 3,571,429
Required Core Capital	7.00%	7.00%
	-	250,000
Return on Equity - Annually	15.0%	15.0%
Additional Earnings - Annually	-	40,189
Additional Earnings - over Period	-	86,838
Add'l Annual Earnings / Loan Amount	0.00%	0.40%
Add'l Period Earnings / Loan Amount	0.00%	0.87%

Scenario B: Guarantee for 50% (most risky), and assume bottom 50% would be considered No Risk by Supervisors.		
	Without Substitution	With Substitution, Full Period
Exposure Type	HVCRE Exposure	HVCRE Exposure
Loan Amount	\$ 10,000,000	\$ 10,000,000
Risk Weighting	150%	150%
Exposure Period (Months)	24	24
Exposure Capital Reserve	\$ 15,000,000	\$ 15,000,000
Guaranty Exposure Type	None	Corporate
Guaranty Amount	100% \$ 10,000,000	\$ 10,000,000
Guaranty Risk Weighting	0%	100%
Guaranty Period (Months)	0	24
Recognized Guaranty	\$ (1,428,571)	\$ 10,000,000
Guaranty Reserve	\$ -	\$ 10,000,000
Exposure Amount	\$ 11,428,571	-
Exposure Reserve	\$ 17,142,857	-
Total Capital Reserve	\$ 17,142,857	\$ 10,000,000
Reduction		\$ 6,071,429
Required Core Capital	7.00%	7.00%
	-	425,000
Return on Equity - Annually	15.0%	15.0%
Additional Earnings - Annually	-	68,321
Additional Earnings - over Period	-	147,624
Add'l Annual Earnings / Loan Amount	0.00%	0.68%
Add'l Period Earnings / Loan Amount	0.00%	1.48%

Improved Terms Example

Scenario: Borrower Benefit with LGIS Insurance					
Assumptions					
Assumption: Investment grade guarantee will allow more favorable rate and debt dollars.					
Deal Size	10,000,000				
Cost of Equity	20.00%				
Cost of Debt	5.00%				
Without LGIS Insurance	K		Cap. %		Weighted K
Equity	20.00%	X	35.00%	=	7.00%
Debt	5.00%	X	65.00%	=	3.25%
			100.00%		10.25%
			Year 1	Year 2	Year 3
Cost of Capital			1,025,000	1,025,000	1,025,000
NPV @	10%	\$2,549,023			
With LGIS Insurance					
Less Rate		0.50%			
More Debt		5.00%			
	K		Cap. %		Weighted K
Equity	20.00%	X	30.00%	=	6.00%
Debt	4.50%	X	70.00%	=	3.15%
			100.00%		9.15%
			Year 1	Year 2	Year 3
Cost of Capital			915,000	915,000	915,000
NPV @	10%	\$2,275,470			
Savings (Cost)	10%	273,554	110,000	110,000	110,000
LESS:					
Debt		7,000,000			
LGIS Premium	3.25%	227,500			
NET Savings (Cost)		46,054			

Compare to Alternative/Non-Bank Example

Scenario: Compare Bank Deal w/ LGIS Ins. vs. Alternative Non-Recourse Lenders			
Cost		10,000,000	
Equity	30%	3,000,000	
Debt	70%	7,000,000	
Rate	Spread	2.50%	
	Alternative Lender	6.50%	
	Bank	4.00%	
		In	Out
Points	Alternative Lender	1.25%	0.50%
	Bank + LGIS	3.75%	0.00%
Alternate Lender		1	2
Points		87,500	35,000
Interest		455,000	455,000
Total Costs		542,500	490,000
NPV		1,237,359	
Bank		1	2
Points		262,500	-
Interest		280,000	280,000
Total Costs		542,500	280,000
NPV		934,955	
Savings (Cost)		302,404	
% Difference		32.3%	

Assumption: Insurance Guarantee will allow more favorable rate and debt dollars.

Entity Guarantee – Improvement using CPLI

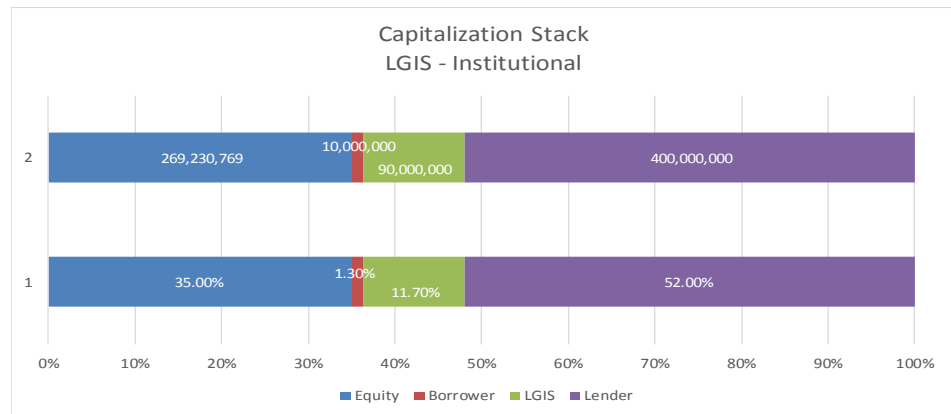
Below is an example that frees Cash, or equivalent, to redeploy at higher rates for borrower and doubles the security for lender.

Liquidity Requirement Assumptions			
Number of Projects		5	/ Project
Project Cost		769,230,769	153,846,154
Loan Amount	65.0%	500,000,000	100,000,000
Guarantee	20.0%	100,000,000	20,000,000
Borrower - 1st Takes (% of Loan)	2.0%	10,000,000	2,000,000
LGIS - 2nd Takes		90,000,000	18,000,000
Liquidity Requirement (% of Loan)	10.00%	50,000,000	10,000,000
Borrower Benefit			
Liquidity Requirement		50,000,000	
Borrower - 1st Takes (% of Loan Amt.)	2.0%	10,000,000	2,000,000
Freed Liquid Collateral		40,000,000	
Term (Years)		3	
Liquidity Collateral Investment Rate (T-Bills)		1.74%	
CRE Investment Returns		20.00%	
LGIS Premium - % of Loan Amount		2.00%	
Freed Liquid Collateral - End of Term		69,120,000	
Liquid Collateral Investment - End of Term		42,124,542	
Difference		26,995,458	
LESS: Cost of LGIS		10,000,000	
Net Benefit		16,995,458	
Interest Rate Savings			
Loan Amount	500,000,000		
Interest Rate Savings	0.25%		
Savings / Year	1,250,000		
Years	3		
Total - Interest Rate Savings		3,750,000	
Total Net Benefit		20,745,458	

Bank Comparison - Liquid Collateral Covenant Scenarios

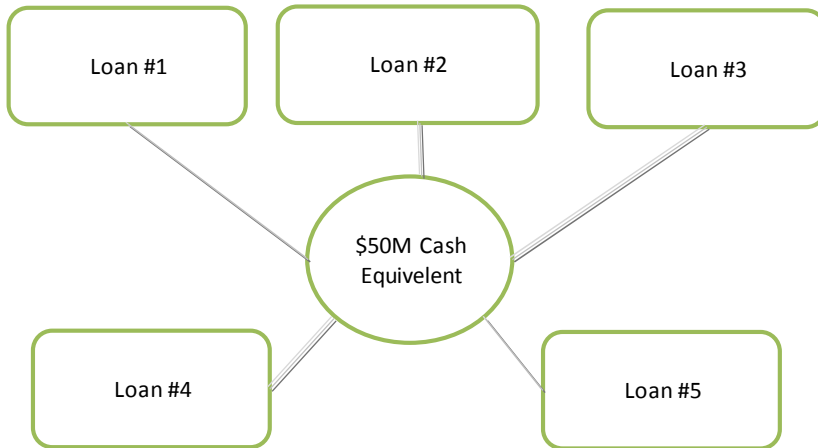
	Option 1	Option 2	Difference
Number of Loans	5	(Different Lenders)	
Loan Size / Loan	100,000,000		
Total Loan	500,000,000		
Borrower Cash Collateral (All Lenders)	50,000,000	10,000,000	40,000,000
LGIS *			
LGIS / Loan		18,000,000	
# of Loans		5	
Total LGIS Coverage	0	90,000,000	
Total Guarantee	50,000,000	100,000,000	50,000,000
% Increase			100.0%
% of Loan	10.0%	20.0%	100.0%

* Guarantee Claim paid after a sale - Short Sale, Deed-in-Lieu or Foreclosure Sale.

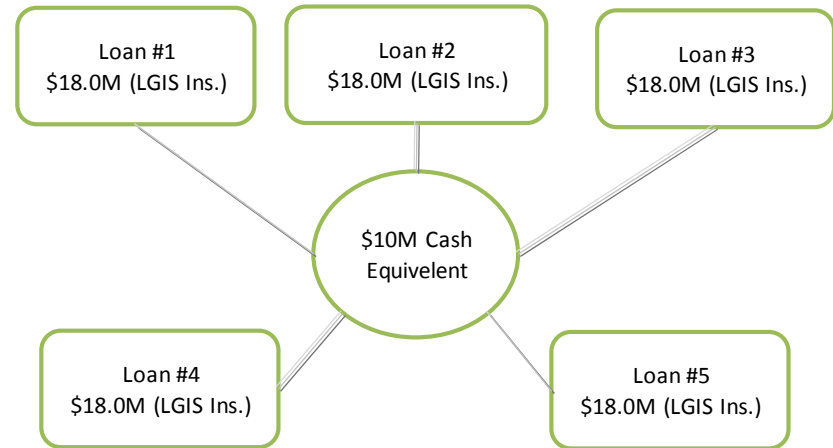


Graphic Illustration of Above Example

Scenario 1 - \$50M Cash Equivalent + \$0 Ins. On each Loan (Total = \$50M)



Scenario 2 - \$10M Cash Equivalent + \$18.0M Ins. On each Loan (Total = \$100M)

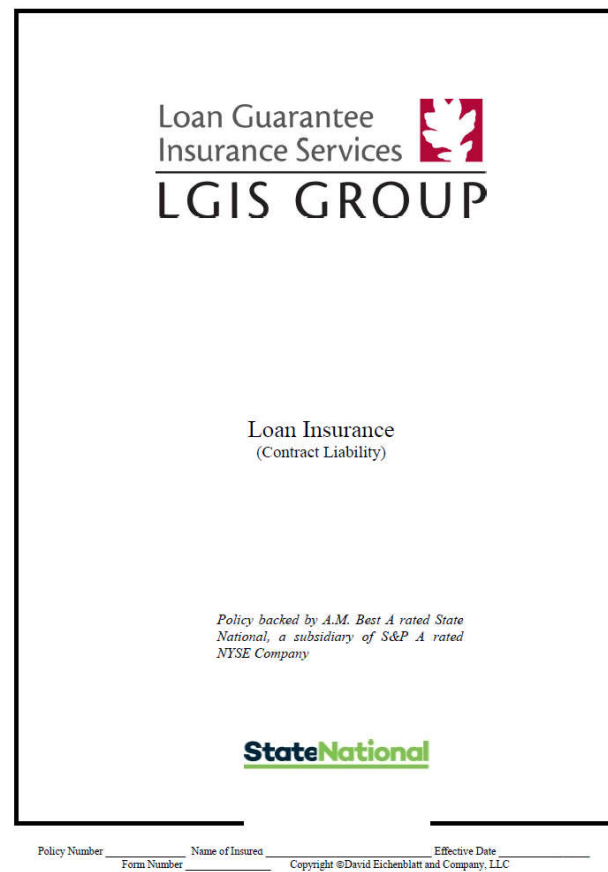


Policy

The policy on the web site

Go to: www.lgisgroup.com

LogIn Tab: Password: "lgisclient"



Related Reading

Date	Publication	Headline	Link
7/15/19	MortgageOrb	David Eichenblatt: CRE Lenders Must Adapt to New Market Realities	https://mortgageorb.com/david-eichenblatt-cre-lenders-must-adapt-to-new-market-realities
7/12/19	GlobeSt.com	The Appeal of Non-Recourse Repayment Option	https://www.globest.com/2019/07/12/the-appeal-of-non-recourse-repayment-options/
7/10/19	Mortgage Prof. America (MPA)	Non-recourse loans will tempt most developers poll reveals (Harris Poll)	https://www.mpamag.com/market-update/nonrecourse-loans-will-tempt-most-developers-poll-reveals-172257.aspx
7/9/10	Morningstar	New LGIS / Harris Poll Study Reveals Nearly 4 in 5 CRE Developers Would Prefer Working With Banks That Offer Non-Recourse Repayment Options	https://www.creditunions.com/press-center/article/44101/new-lgis/harris-poll-study-reveals-nearly-4-in-5-cre-developers-would-prefer-working-with-banks-that-offer-non-recourse-repayment-options/
7/1/19	Yahoo! Finance	LGIS Announces New Team Members in Response to Rapid CRE Industry Growth	https://finance.yahoo.com/news/lgis-group-announces-team-members-133000094.html
6/10/19	MortgageOrb	Leveraging a Commercial Property Loan Insurance Strategy To Increase Credit and Grow CRE Lending	https://mortgageorb.com/leveraging-a-commercial-property-loan-insurance-strategy-to-increase-credit-and-grow-cre-lending
6/5/19	MBA Newlink	LGIS Introduces Commercial Property Loan Insurance	https://www.mba.org/cmfi-newslinks/2019/june/mba-cmf-newslink-6-6-19/news-and-trends/commercial/multifamily-briefs
6/3/19	AP Newswire	LGIS Group Introduces Commercial Real Estate Industry's First Commercial Property Loan Insurance (CPLI)	https://apnews.com/Business%20Wire/772a7f36bb75430d8f0ace79102b2f21