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**FEELING THE PINCH: LEGAL TIPS FOR
PROTECTING REAL ESTATE OWNERS AND
LANDLORDS IN DEALING WITH PRESSURES FROM
TENANTS, BANKS AND OTHER CREDITORS**

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AFTER HAPPY TIMES, THE CRISIS

- Real estate borrowers enjoyed the boom times of Romanian real estate between 2006 and 2008: The banks liberally gave financing for their real estate projects
- Prices kept climbing and investors kept coming and gobbling up projects at high prices
- Tenants were paying fabulous rents

Generally, those were happy times

- With the US sub-prime crisis as the catalyst, this dream has turned into the proverbial nightmare
- In 2009, banks in Romania have essentially stopped lending, thus causing "knock-on" effects: falling prices, lack of demand, and a general shake-up of the market

There seems to be little light at the end of the tunnel



WHAT NOW?

- Real estate borrowers have been thrown into distressed situations and are trying to think of measures to safeguard their real estate asset and their reputation
- Pressures come from different sources:
 - tenants/advance purchasers
 - constructor
 - other creditors
 - of course, the bank
- Banks to date have adopted a "wait-and-see" approach in order to avoid damaging write-offs of their assets in the books
- ***But ALL agree that "something has to happen"***
- Legal action by the entities above



WHAT WE WANT TO ACHIEVE TODAY

- Discuss various situations that real estate owners find themselves in, and that we encounter on a regular basis, and what practical tips we can offer:
 - A. Tenant/advance purchaser problems**
 - B. General Contractor issues**
 - C. Bank Workouts**
 - D. Bank Foreclosures**
 - E. Owner insolvency**
 - F. General Conclusions**
- Order above often reflects the general timeline of events (some clients already are at E & F)



WHAT WE WANT TO ACHIEVE TODAY (CONT'D)

- PLEASE ASK QUESTIONS!
- We won't address all situations, so questions are welcome
- Few opportunities to get legal advice for free (almost)!



A. TENANT PROBLEMS

1. RENT REDUCTION

- New national sport: tenants asking for rent reductions (whether crisis is affecting them or not)
- Same for pre-contracts
- Basis for asking reductions is tenant invoking alleged breaches of lease agreement
 - e.g. access is blocked by snow, structural or maintenance issues, etc.



A. TENANT PROBLEMS

1. RENT REDUCTION (CONT'D)

- Ultimately it is a commercial issue for the landlord to consider

Landlord TO-DO's

- **DO** re-read lease obligations and see if they're being respected
- **DO** send notices on timely basis (e.g., if deadline cannot be met for objective reasons)
- **DO** object (if appropriate) to any alleged breach
- **DO** watch out for late payments and be prepared with notices [termination if needed] and “somații de plată”
- **DO** respect all required notice formalities
- **DO** remind tenant of its breaches
- **DO** amend the lease in a manner favorable to the Landlord if you agree to rent reduction, e.g.,
- **DO** be very careful with expiring dates of bank letters of guarantee



A. TENANT PROBLEMS

2. TENANT INSOLVENCY/BANKRUPTCY: EFFECTS

- Some tenants threaten outright bankruptcy: what happens if they file?
 - Short answer: Not good news
- (i) **Unsecured Position of Landlords**
- Without a successful reorganization, chances to recover pre-filing rents and accrued interest are low, since landlords are unsecured creditors. The landlord cannot retain the goods since the trustee will ultimately seek possession and determine how best to use or dispose of them to further the interests of the creditors
- (ii) **No Self-Help Remedies Available**
- Under Romanian law, the landlord does not enjoy “self-help” remedies. As such, he cannot change the locks or take possession of tenant’s goods or in most cases cut off electricity



A. TENANT PROBLEMS

2. TENANT INSOLVENCY/BANKRUPTCY: EFFECTS (CONT'D)

(iii) **Past Rent and Accrued Interest Frozen**

- All pre-filing rent arrears, accrued interest, penalties and damages are frozen and cease to be enforceable against the tenant from the insolvency date going forward. Landlord can become like any other creditor and has to stand in line

(iv) **Enforcement Proceedings Halted**

- There is an ‘automatic stay’ until the bankruptcy procedure is closed. A “stay” means that all enforcement and court proceedings against the tenant are brought to a halt – the bankruptcy court working at the advice of the creditors committee and the judicial trustee are the only bodies permitted to take decisions. The decision of terminating the ongoing leases, evicting the tenant, or even pursuing collection efforts belongs only to the judicial trustee



A. TENANT PROBLEMS

2. TENANT INSOLVENCY/BANKRUPTCY: EFFECTS (CONT'D)

(v) **Discretionary Powers over Leases (Cherry Picking)**

- All ongoing contracts are automatically taken over ('assumed', as per bankruptcy parlance) as of the date of the insolvency court order. If there are executory leases at the moment of the insolvency court order, they become subject to this rule, and cannot be terminated by the landlord

(vi) **Opt-out Mechanism**

- If the landlord wants to forfeit the leases and regain possession of the locations for re-lease to another tenant, the only option is to file a request with the trustee, who is compelled to make a decision within thirty (30) days. Failure to respond by the trustee means the leases are 'rejected' and the landlord may proceed with eviction. Note that in practice a trustee will always consult with the tenant before rejecting leases, as these could prove to be essential in the 'reorganization' and the tenant has the right to challenge any rejection before the insolvency court. This takes time



A. TENANT PROBLEMS

2. TENANT INSOLVENCY/BANKRUPTCY: EFFECTS (CONT'D)

(vii) **Guarantees Available**

- Third party guarantees benefiting the landlords (such as bank or parent guarantees) remain enforceable and can be pursued. Rental deposits are less secure: a landlord who failed to forfeit until insolvency date does not have an automatic right to keep a deposit, and if he nevertheless does, the trustee may request the insolvency court to claw back the amounts



A. TENANT PROBLEMS

3. WHAT CAN YOU DO?

- A tenant filing for bankruptcy is NOT good news
- What can be done?
- **DO** closely monitor tenant payments and be on the lookout for signs that trouble may be brewing, e.g., late payments, reports in the press, etc.
- **DO** promptly respond to any claims
- **DO** make invoices issued and received with all proper procedures respected



A. TENANT PROBLEMS

3. WHAT CAN YOU DO? (CONT'D)

- **DO** have termination notices already prepared and ready to be sent immediately once there is suspicion of filing for insolvency. Time is of the essence, and delays encountered can only damage a landlord's position
- **DO** check validity of rental deposits and third party guarantees and be on the lookout for expiry dates
- **DO** follow closely notification procedures – failure to properly notify can lead to the notification being considered as not having been delivered
- **DO** check online trade and court registries on a regular basis; monitor press



A. TENANT PROBLEMS

3. WHAT CAN YOU DO? (CONT'D)

- **DO** register your pledge with the *Arhiva Electronică de Garanții Reale Mobiliare* without delay
 - Art. 1730 from the Romanian Civil Code with landlord lien
 - This is a simple administrative procedure
 - Helps the tenant become a privileged creditor in insolvency proceedings
 - Amend your lease agreements in this regard and place a “data certă”



B. GENERAL CONTRACTOR ISSUES

- Constructor has a privilege over construction for unpaid bills (Art. 1737 (4))
- If registered, can cause all sorts of problems, especially with banks
- The legal procedure is very difficult (almost impossible) to be followed. However, due to legal inconsistencies it is possible that, in a initial phase, to register a contractor's privilege
- **DO** try in a construction agreement to have constructor waive the privilege
- **DO** monitor payments to sub-contractors in order to avoid registration



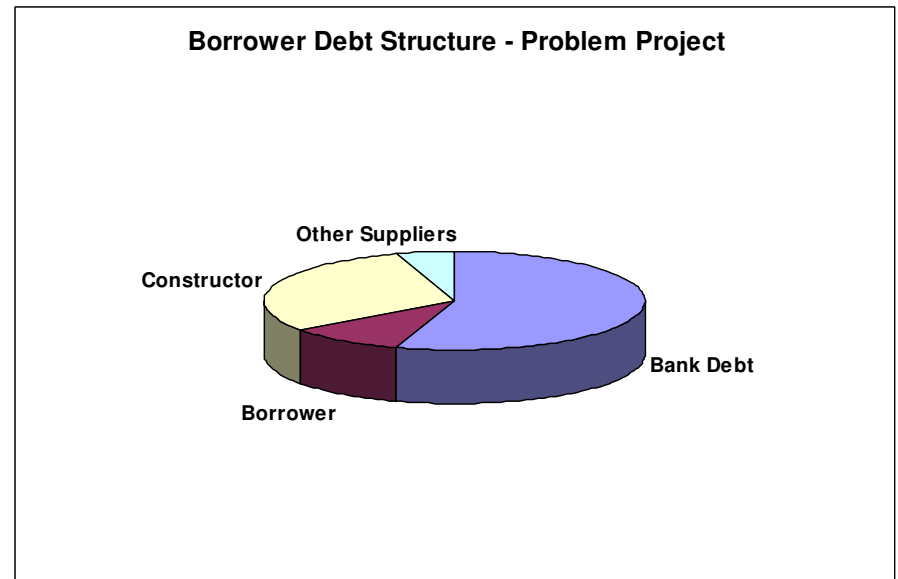
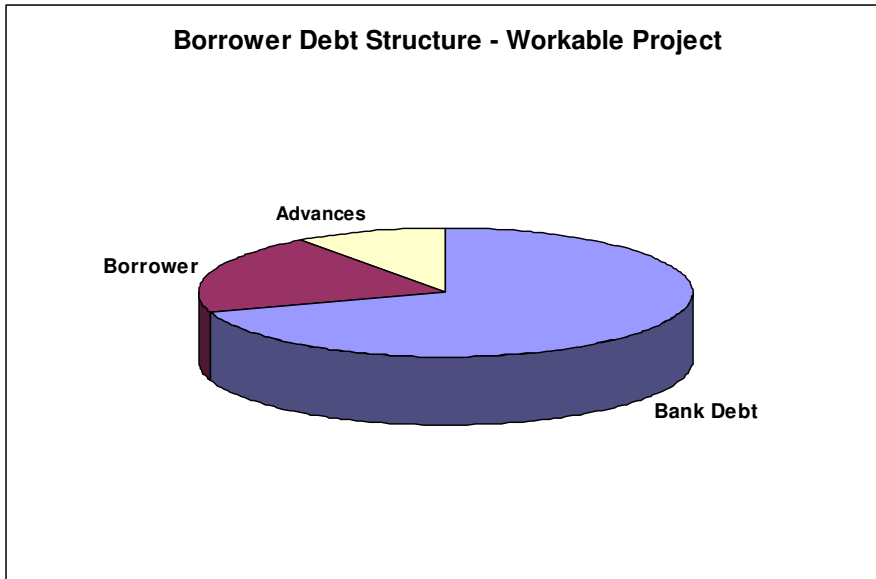
C. BANK WORKOUTS

1. REALIZING YOU HAVE A PROBLEM WITH THE BANK

- Warning signs include:
 - declining DSCR
 - breach of LTVR
 - unpaid contractor (quasi-partner in the project) or other suppliers
 - prolonged lease vacancies
 - dwindling advances on residential units
 - inability to bring required equity into the project
- **Borrower may consider starting dialogue with the bank now if the bank has not already called you**
- Many owners already past this point

C. BANK WORKOUTS

1. REALIZING YOU HAVE A PROBLEM WITH THE BANK (CONT'D)





C. BANK WORKOUTS

1. REALIZING YOU HAVE A PROBLEM WITH THE BANK (CONT'D)

- Items that should be reviewed when considering approaching the bank:
 - 1. LOAN**
 - 2. LEASES AND THE TENANTS/PRE-CONTRACTS AND ADVANCE PURCHASERS**
 - 3. PROPERTY**
 - 4. SUPPLIERS**
 - 5. LENDER**
 - 6. PROBLEM**



C. BANK WORKOUTS

1. REALIZING YOU HAVE A PROBLEM WITH THE BANK (CONT'D)

1. LOAN

- Review all loan documents and related correspondence and create a list of what you hope to gain
- Become familiar with (or read for the first time the contract):
 - Timing and notice requirements
 - Cure periods and curable vs. non-curable defaults
 - Immediate consequences of default (e.g., default interest)



C. BANK WORKOUTS

1. REALIZING YOU HAVE A PROBLEM WITH THE BANK (CONT'D)

1. LOAN (CONT'D)

- Identify any clauses in loan docs in your favor (unlikely)
- Calculate outstanding amount, principal accrued interest, default interests, fees, penalties, etc.
- Carefully review any guarantees, cross-defaults, etc.
- Confirm location of original *bilete la ordin*, security deposits etc.
- Identify other assets which may be offered as additional collateral as part of workout



C. BANK WORKOUTS

1. REALIZING YOU HAVE A PROBLEM WITH THE BANK (CONT'D)

2. LEASES AND THE TENANTS/PRE-CONTRACTS AND ADVANCE PURCHASERS

- Primary source of income for owner and debt service for lender
- Revise cash flow projections by examining:
 - Further advances payable
 - Estimated completion dates + penalties for delays
 - Vacancy/Unsold units
 - Lease rollover
 - Tenant mix
 - Rents compared to market
 - Purchase prices compared to market
- Locate original copies of pre-contracts and leases



C. BANK WORKOUTS

1. REALIZING YOU HAVE A PROBLEM WITH THE BANK (CONT'D)

3. PROPERTY

- Determine status of real estate tax payments
- Consider new appraisal



C. BANK WORKOUTS

1. REALIZING YOU HAVE A PROBLEM WITH THE BANK (CONT'D)

4. SUPPLIERS

- See if a loan default has consequences third party agreements
- What third-party contracts will affect property operations and what can be terminated



C. BANK WORKOUTS

1. REALIZING YOU HAVE A PROBLEM WITH THE BANK (CONT'D)

5. LENDER

- Understand the bank's goals
- Single biggest problem because banks often do not seem to know what they want



C. BANK WORKOUTS

1. REALIZING YOU HAVE A PROBLEM WITH THE BANK (CONT'D)

6. PROBLEM

- What is the reason for the default?
 - Short-term vs. long-term problem
 - Can it be remedied or not?
 - Economic/market situation, construction delays and market position of the property
 - Tenant bankruptcies and lease expirations
 - Inability to sell required number of apartments
 - Crisis vs. over-extending vs. mismanagement



C. BANK WORKOUTS

2. TO-DO's for Borrowers

- **DO** promptly object (if appropriate) to any claims made by the bank
- **DO** show good faith and agree to meetings, etc.
- **DO** consider the possibility of making partial or interest payments
- **DO** perform a cost-to-benefit analysis of whether a workout is possible



C. BANK WORKOUTS

2. TO-DO's for Borrowers (CONT'D)

- **Arguments for workouts:**
 - Avoid expensive and protracted legal proceedings
 - Bank should not be in the business of owning and managing real estate (Romania seems to be different)
 - Avoid negative publicity
- **Arguments against workouts and proceed to foreclosure:**
 - Often, there is nothing to workout: more expensive to workout than just do nothing
 - No more equity to put in
 - Assumptions for revenue can no longer be sustained; it was a different market
 - No guarantee of success; banks in Romania have little experience with workouts



D. BANK FORECLOSURES

1. INTRODUCTION

- Assume the real estate borrower is in arrears on its repayment obligations; thus, it is in default under the loan documentation
- What could happen to the typical real estate borrower who gave the bank a first-rank mortgage on a property and a pledge on shares?

Banks may proceed with foreclosure procedures:

- Mortgage foreclosure: The bank goes after the encumbered asset
- Foreclosure on pledge of shares: The bank goes after the business as a going concern

In any event, borrowers should know what to expect. An informed borrower should know its rights and can buy time



D. BANK FORECLOSURES

2. MORTGAGE FORECLOSURE: STEPS AND TIMING

- **Bank Notification:** The Bank notifies the borrower by recorded delivery or via a court bailiff (Romanian: *executor judecătoresc* – the “**Bailiff**”). This opens up the way for foreclosure of the loan guarantee
- **Bailiff Notification:** The Bank calls in a Bailiff to begin foreclosure. The Bailiff approves the foreclosure with the court
- **Auction:** The Bailiff values the asset and proceeds with sale by auction. The Bailiff will usually announce the auction to the press (publication of wide circulation)



D. BANK FORECLOSURES

2. MORTGAGE FORECLOSURE: STEPS AND TIMING (CONT'D)

- **Sale:** The Bailiff will draft a deed stating the outcome of the auction, a copy of which is given to the auction winner to serve as title over the asset. The asset is acquired free of mortgages or other encumbrances
- **How Long Does It Take?:** If the Bailiff follows the procedure to the letter, it could finish within approximately six (6) to eight (8) weeks of a bank's decision to foreclose

Due to workload and other factors, a realistic timeline is five (5) to seven (7) months



D. BANK FORECLOSURES

3. FORECLOSURE ON PLEDGE ON SHARES: PRACTICAL HURDLES

- Banks normally have a pledge on the shares of the company owning the asset. Does foreclosure on shares go any faster for the bank than mortgage foreclosure?
- **Bank Notification:** The bank sends the customary notification
- **Sale:** The bank, through its own Bank Bailiff (Romanian: *executor bancar*) puts the shares up for sale or even transfer them directly to the bank if the pledge contains clauses to this effect

The asset must be sold within a reasonable period of time and for the best price applicable on the market

- The process could be completed within a two-week period. In practice, unless the bank itself becomes the holder of the shares, it would be more difficult to find buyers



D. BANK FORECLOSURES

3. FORECLOSURE ON PLEDGE ON SHARES: PRACTICAL HURDLES (CONT'D)

Pledge foreclosures are rare in Romania:

- With limited liability companies (SRLs) having more than one shareholder, the bank may need the express agreement of shareholders of at least three quarters (3/4) of the share capital in order to foreclose on the shares
- Because of legal formalities, the registration of the bank as a new shareholder could result in litigation if the other shareholders (or the sole shareholder) refuse to consent. The long duration of litigation may deprive the bank's guarantee of practical value



D. BANK FORECLOSURES

3. FORECLOSURE ON PLEDGE ON SHARES: PRACTICAL HURDLES (CONT'D)

- From an accounting perspective, inversion of debt can occur
- Typical situation: bank signs pledge agreement with the shareholder of SRL, with SRL being the borrower
- If bank forecloses on the pledge, from an accounting perspective, the value of the bank's debt could become an unsecured debt owed by the SRL to the former shareholder of the SRL
- So bank owes you money (indirectly)
- Can be modified contractually so that there is a waiver of debt: read your contracts carefully



D. BANK FORECLOSURES

4. FORECLOSURE ON PLEDGE ON SHARES: STEPS AND TIMING

- Due to restrictions and practical roadblocks to register new ownership, coupled with banks' general reluctance to hold shares (difficulty in valuing, owning, managing, and disposing of them)
- **Bottom line: unlikely you have to worry about exercise of share pledge**



D. BANK FORECLOSURES

5. WHAT CAN THE BORROWER DO?

There are a number of options open to the borrower:

- **Pay the Due Amounts:** Once a Bailiff sends an official summons, the borrower has a last chance to pay within ten (10) calendar days. If the mortgaged asset is an income-producing property, then the borrower may also request the court for a six (6)-month delay, if it can prove that rental income from the property will cover all due amounts
- **Use Legal Roadblocks:** The borrower can buy time and (a) submit an emergency court motion for an injunction (Romanian: *ordonanță președințială*) arguing no default under the loan, or (b) allege a procedural flaw – that the Bailiff did not respect the procedure in some form or fashion (Note: unlikely). These do not halt, but only postpone, foreclosure
- **Participate in the Foreclosure Auction:** “Friendly” parties may bid at the auction, including other Romanian companies owned by the borrower’s shareholder (assuming that there are no restrictions in this regard under the loan documentation)

Creditors of the borrower cannot bid for less than 75% of the auction starting price



E. OWNER INSOLVENCY

1. FILING FOR REORGANIZATION: A FINAL HOPE

- Romanian bankruptcy law allows for: (i) an insolvency reorganization during which the borrower is protected from creditors and is allowed to restructure its business, or (ii) if there is no hope of redress, outright bankruptcy and liquidation of assets
- Borrowers that are special purpose entities owning a single real estate asset do not consider the option of opening insolvency proceedings. However, they should

If they seek protection under bankruptcy law, borrowers must act quick enough to file and obtain the status of insolvency, before banks start foreclosing their assets



E. OWNER INSOLVENCY

1. FILING FOR REORGANIZATION: A FINAL HOPE (CONT'D)

- The borrower can file for this action relatively quickly (within generally 4 to 6 weeks)
- Bankruptcy judges normally will allow the procedure to open; A bankruptcy judge may refuse to place the company into insolvency if it feels that its management is 'playing for time' or has no reasonable hope of reorganization
- ***The most apparent and direct advantage of opening insolvency proceedings is to buy time:***
 - Whereas a Bailiff foreclosure procedure may take five (5) to seven (7) months, the commencement of a bankruptcy procedure would extend the procedure by at least a further four (4) to six (6) months



E. OWNER INSOLVENCY

2. FILING FOR REORGANIZATION: PRO's & CON's

PRO's

- If the borrower has arrangements in place with investors to sell its business, applying for insolvency makes twofold sense:
 - During the time that proceedings are opened, there is an 'automatic stay' on all claims, which remains in place until the insolvency procedure is closed
 - This will prevent the bank from foreclosing on the asset or suing the borrower
- ***The bank could be even forced to accept a restructuring plan and see its debt rescheduled***



E. OWNER INSOLVENCY

FILING FOR REORGANIZATION: PRO's & CON's (CONT'D)

CON'S

- The downside is that the borrower may lose control of the company. A judicial trustee (Romanian: administrator judiciar) may take over control of the company, or operate it together with the existing management. The trustee's role is to protect the company's financial situation and oversee day-to-day payments

If the borrower demonstrates that it has reasonable chances to secure funding, the trustee will recommend the court to endorse a restructuring solution. If not, the trustee will be forced to proceed directly to bankruptcy and liquidation of the borrower's assets

- Damage to reputation/credibility
- Administrator liability in certain circumstances
 - At times, used as leverage



F. GENERAL CONCLUSIONS

- Chances are the owner/landlord will end up in court for something or another
- A general observation is that we have seen owners/landlords place themselves in a far worse situation by simply not knowing their contracts or knowing their legal rights or being disorganized in terms of knowing key dates and location of key documents
- Often see their lawyers when the situation is already too late
- Time is of the essence: usually the longer you wait, the worse position you will be in



F. GENERAL CONCLUSIONS (CONT'D)


- **TO DO:**
 - **DO** re-read your agreements
 - **DO** send required notices on time, especially for late payment
 - **DO** respect terms such as notices in the contract
 - **DO** have templates ready
 - **DO** object to any breaches
 - **DO** conduct yourself in a manner that demonstrates good faith: show that you're a "good guy"
 - **DO** any required clean-up
 - **DO** watch out for expiring of bank letters or guarantee
 - **DO** know location of all originals
- Essential that an internal checklist/time line of key dates and events be established



F. GENERAL CONCLUSIONS (CONT'D)

- The borrower should be aware that there are perfectly legal roadblocks and other measures at its disposal that could at least buy it time and possibly improve its bargaining position with the tenants and bank
- A strategy should be established with the borrower's legal counsel as early as possible in the process
- **BE VIGILANT!**

Not all hope is lost

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