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How to Prepare for a Real Estate Enforcement in Europe, Part 2 – The Importance of Valuation in Enforcements


By **Bevis Metcalfe**
Partner | Financial Restructuring


By **William Sugden**
Associate | Financial Restructuring


By **Rizwana Haque**
Trainee Solicitor | Financial Restructuring

Former British Prime Minister Tony Blair once famously declared that "our top priority was, is and always will be education, education, education." To adopt this mantra in an enforcement context, for lenders the top priority should always be *valuation*, *valuation*, *valuation*.

Kicking off Part 2 of our mini-series on "How to Prepare for a Real Estate Enforcement in Europe," the focus turns to valuation. In Part 1 we detailed what steps lenders should take when preparing for a real estate enforcement. A key preparatory step is obtaining robust valuation evidence.

Valuation determines who controls the enforcement

A real estate enforcement typically involves a sale by a secured lender (or security agent on behalf of a club/syndicate of lenders) of a secured asset (or more often shares in a propco) and the application of the sale proceeds to the secured debt owed to creditors. The value of that secured asset, and where that value "breaks" in the capital structure of the borrower, will determine which of the stakeholders are "in the money" and which stakeholders are "out of the money."

Why is this important? Where the value "breaks" determines which stakeholders have an economic interest in the assets and are therefore likely to be able to control the enforcement process. They can do this because of the ability to "credit bid" secured debt claims. This involves bidding a release of the debt up to the full face amount of the claim. Unless a bidder emerges who is prepared to pay the full face amount of the secured debt in cash, the credit bidder will be the winning bidder in an auction for the secured assets. Issues may arise where value breaks close to the face amount of the debt being bid that will expose the bidder to a

greater risk of the sale being challenged, and it will often be prudent in those circumstances to obtain independent valuation evidence (we have included a note on valuation challenges below). Although uncommon in practice, another scenario to contemplate is if the valuation shows that the value exceeds the secured debt. In this scenario the interests of the company (or junior creditors if there are any) will need to be considered.

Duties of secured lenders

Under English law, lenders have certain duties when selling secured assets. A key legal duty for lenders is to take reasonable care to obtain the best price reasonably obtainable in the circumstances.[1] However, lenders are not required to delay the sale in the hope or possibility of obtaining a higher price in the future, especially if this mean the lenders would incur additional expenses by holding the asset.[2] A similar duty is imposed on receivers and administrators (although it has been argued that the duty is more stringent on these office-holders). The courts have been reluctant to prescribe what specific steps lenders need to take to satisfy the duty and, indeed, this duty will be assessed on a case-by-case basis. Despite this, lenders should always take steps to act reasonably to establish value before transacting to minimise litigation risk.

How value is established

Value is typically established either by: (i) obtaining a "book" valuation or (ii) through running an M&A/sale process of the asset. In many larger transactions the intercreditor agreement should also be reviewed, as it will typically set out certain fair value "safe harbours" that will allow the security agent to be deemed to have satisfied its duty of care to the debtor.

If a "book" valuation (sometimes called a "desktop" valuation) is obtained, the lenders should ensure that the valuation expert engaged is experienced in valuing the specific type of asset and is familiar with the market where the property is located. Demonstrating that the valuer has adequate expertise is important where the lender intends to rely on the valuer's advice. In some cases lenders will require some degree of cooperation from the borrower in order to obtain information necessary to undertake the valuation. However, lenders often have a general right to request information and often will want to make the provision of information a condition to any amendments or waivers sought by the borrower (see our discussion on waiver conditions in Part 1.) The valuation produced should be independent, supported by sound commercial judgment and able to withstand scrutiny from the company, other creditors and the court. A valuation guide such as the RICS "red book" may also be a helpful guide but is not necessarily determinative.[3]

If a sale process is pursued, this should be managed by an independent advisor (such as a real estate agent or firm of accountants). The process should be run before the enforcement is undertaken, perhaps as a condition to any waivers that may be requested by the borrower, although in some cases it may be necessary to do it in parallel or as an intermediate step following appointment of receivers or other steps to remove incumbent directors. As part of the sale process a range of trade and financial buyers should be contacted. The lenders should also seek advice on the appropriate method of sale – for example, querying whether sale by way of an auction is appropriate. The length of the process will differ depending on

the financial position of the borrower. A typical sale process after enforcement might be as short as one to two weeks if there is a cash liquidity crunch. If there are no immediate liquidity issues, the process could be longer. In addition, a data room should be made available for prospective bidders.

Although there are conflicting authorities on whether book valuations or sale processes carry greater evidential value, the general consensus is that because a sale process produces a "real" valuation with real bidders invited to participate, it should generally be afforded greater weight than a book valuation, which is inevitably a theoretical exercise.

These considerations relate to the position under English law. Lenders will need to take specific advice when looking to enforce in European jurisdictions regarding their legal duties and any valuation requirements. However, the key takeaway for lenders is that to reduce litigation risk they should run an open and transparent sale process, with broad marketing of the asset and following the advice of the investment bank or accounting firm managing the process. Risks will arise when lenders try to limit the information published to bidders, or limit the universe of parties invited to bid.

Valuation challenges

When lenders take enforcement action there is always the risk of challenges from stakeholders, such as junior creditors and the borrower. Challenges in enforcement often turn on valuation. For example, a junior creditor at risk of being "out of the money" might put forward competing valuation evidence to try to establish that they are "in the money" to get a seat at the table. It will be important to analyse any such competing valuations on their merits during negotiations to assess whether the assumptions and methodology employed are appropriate for the property concerned and whether the lender's own valuation is sufficiently robust.

Another area ripe for challenge for junior creditors and borrowers relates to the lender's duty to take reasonable care to obtain the best price reasonably obtainable. While there is no legal obligation for lenders to make their valuation evidence available, there may be merit in disclosing assumptions and methodology in some cases to demonstrate the steps that the lenders have taken to discharge their duties and to quell any brewing challenges. This reinforces the importance of ensuring the lender retains suitably qualified and reputable professionals to undertake any valuation or M&A process.

Ultimately, the optimal route for lenders will be to appoint an insolvency practitioner, whether a receiver or an administrator (in the case of a propco), who will assume any risk of undervaluing the property in a sale transaction. We will look at this in more detail in our next edition.

[1] *Cuckmere Brick Co. Ltd v Mutual Finance Ltd* [1971] 1 Ch 949. Some of the cases refer to the obtaining of a "proper" price.

[2] *Silven Properties Ltd v Royal Bank of Scotland* [2003] EWCA CIV 1409.

[3] See *Swiss Cottage Properties Limited (in liquidation)* [2022] EWHC 1495 (Ch).