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Summer Reading

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Note Prevails over Mortgage in the Event of a Conflict

By **Jessica Wong**
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A recent decision from The Supreme Court of Florida (the "Florida Supreme Court") in *WVMF Funding v. Luisa Palmero*, *et al.* (Fl. S. Ct.; SC19-1920, June 24, 2021) held that, while a note and mortgage must be read together, in the event of a conflict between the two, the terms of the note would prevail.

Roberto and Luisa Palmero, a married couple, had initially applied as co-borrowers for a mortgage loan to be secured by a reverse mortgage on their primary residence, but ultimately did not close on such loan. However, a few months later, the husband, Roberto Palmero, applied as the sole borrower for the same type of reverse mortgage loan (the "Mortgage Loan"). In connection with the Mortgage Loan, Mr. Palmero executed five principal documents: (1) the loan application, (2) the home equity conversion loan agreement, (3) the note, (4) a non-borrower spouse ownership interest certification and (5) a reverse mortgage. The note, loan application and loan agreement were each only executed by Mr. Palmero and identified him as the sole borrower thereunder. Both he and his wife signed the non-borrower spouse ownership interest certification, which identified Mr. Palmero as the "Borrower" and Mrs. Palmero as the "Non-Borrower-Spouse." Both spouses also signed the reverse mortgage, which defined Roberto Palmero as the "Borrower," but also included a signature block at the end that was preprinted with the names of each of them and the word "Borrower."

Similar to other reverse mortgage loans, the death of the borrower would trigger acceleration of the Mortgage Loan prior to the maturity date identified in the note and the mortgage. After Mr. Palmero's death and the failure of his estate to repay the Mortgage Loan, OneWest Bank, FSB, the petitioner's predecessor, commenced mortgage foreclosure proceedings.

In response, Mrs. Palmero and her children argued that, since she still continued to reside at the property that secured such mortgage as her principal residence, the mortgage could not be foreclosed because "both the note and mortgage conditioned enforcement of the debt on the following: 'A Borrower dies and the [mortgaged] Property is not the principal residence of at least one surviving Borrower.'" (*OneWest Bank*, *FSB v. Palmero*, 283 So. 3d 346, 364 (Fla. 3d DCA2019))

Although the trial court found that the wife "was not a co-borrower," it still denied the lender's foreclosure based on a federal statute that governed the insurability of reverse mortgages by the Secretary of the Department of Housing and Urban Development. On appeal, Florida's Third District Court of Appeal (the "Third District") rejected the trial court's reliance on the federal statute in denying foreclosure but affirmed the denial of foreclosure, finding that Mrs. Palmero was a borrower under the Mortgage Loan as a "matter of law" (*Id.* at 350) and holding that the lender "failed to establish the occurrence of a condition precedent to its right to foreclose, *i.e.*, that the subject property is not the principal residence of

Mrs. Palmero, a surviving co-borrower under the instant reverse mortgage." (*Id.* at 347)

The Florida Supreme Court reviewed the Third District's ruling *de novo*, finding that the Third District failed to follow well-established precedent dating back to decisions from 1907 and 1934, finding that "[t]he general rule for foreclosure actions [is that] if there is a conflict between the terms of a note and mortgage, the note should prevail." The Florida Supreme Court also disagreed with the Third District's holding that the location of the wife's signature on the mortgage "unambiguously and as a matter of law, … ma[de] her a co-borrower under the mortgage." The Florida Supreme Court instead found that both the note and mortgage defined the husband as the "Borrower" and the wife only joined in the mortgage because it "would have been required for the lender to have a valid security interest because the mortgaged property was her homestead." The Florida Supreme Court also found that the Third Circuit did not need to look beyond "the note and mortgage to the other documents that were part of the same transaction to determine, as a matter of law, how the parties intended to define the term 'Borrower,'" since "the Court's foreclosure precedent requires courts to read the mortgage together with the note it secures … and to look to the note to resolve any conflict."

But the Florida Supreme Court was divided in its ruling, with two of the justices dissenting. The dissenting justices agreed that a note should prevail over a mortgage, but that there was no authority that required the same result in a reverse mortgage context since "conventional mortgages are distinguishable from reverse mortgages because no personal liability is attached to a borrower in a reverse mortgage." But the Florida Supreme Court explained that it didn't matter that the Florida Supreme Court's precedent dealt with traditional mortgages rather than a reverse mortgage because "first principles – *i.e.*, the reason for the documents at issue – tell us why we should read a mortgage together with the note it secures regardless of the type of mortgage being foreclosed: '[T]he promissory note, not the mortgage, is the operative instrument in a mortgage loan transaction, since 'a mortgage is but an incident to the debt, the payment of which it secures, and its ownership follows the assignment of the debt.'" Since the Florida Supreme Court found that such precedent applied to a reverse mortgage, the case was sent back to the trial court.

Limited Recourse Financing Series: The Need for Limited Recourse Structures

By **Livia Li**
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Limited recourse financing (also sometimes referred to as "non-recourse") is a very common structure adopted in real estate financing transactions in Europe. The principle around limited recourse financing is essentially ring-fencing the assets which are placed in security in favour of the Lender, segregated from assets that are outside of the transaction. The Lender will only have recourse to the assets subject to security, without any recourse (or limited recourse) to any asset outside of the secured assets, nor against any entity outside the Borrower/Obligor group. The Borrowing entity is usually set up as a special purpose vehicle ("SPV"), and all of the Borrower's assets (which include the underlying real property(ies), along with associated assets affecting the cash flow, such as leases, insurance contracts, etc.) are subject to security for the facility.

In this series of articles in *REF News and Views*, we will look at some of the key features in limited recourse financing structures, as well as some common issues that may arise, in the context of real estate financing in the European market.

What is limited recourse finance and why is it used in real estate financing transactions?

The key principle of limited recourse finance is to ensure that the security and claim with respect to the loan is limited to only a prescribed set of assets and against prescribed entities. It is often used in the context of real estate finance because the fundamental source of recovery for the lender is the underlying asset (*i.e.*, the real property) itself and the cash flow it generates. In contrast, corporate finance facilities look to the creditworthiness of the Borrower and the trading group and therefore would generally require full recourse to all of the group's assets.

Benefits of limited recourse structures

Limited recourse finance is preferred for Sponsors who often have multiple projects. Limited recourse structures would allow the Sponsor to ensure each project is completely segregated. Importantly, if the loan becomes a non-performing loan and the Sponsor is of the view that the value of the asset has deteriorated to a point where it is no longer worth the investment, it is possible that the Sponsor could walk away without any further liability as the Lender takes over the asset.

From a Lender's perspective, limited recourse financing also provides certain benefits – namely, the pricing and the terms would be more tailored to the quality of the underlying asset and security in question, and the focus is on the lending to the one particular asset (or portfolio of assets). Lenders can also take comfort in the fact that its security and the vehicle it is funding would not be tainted by any

other activities or portfolio holdings and liabilities outside the Obligor group. For this same reason, limited recourse financing is often used in leveraged facilities and project finance facilities.

Instances where limited recourse may not be appropriate

Given the premise of limited recourse financing relies on the fact that the Lender only has recourse to the ring-fenced assets, it goes without saying that in assessing the security pool, the value of the assets (and the cash flow associated with such assets) must be sufficient on its own to make whole the loan in the event of enforcement.

In addition, the quality of the asset and the cash flows are of particular significance, given this is the only route to enforcement. Assets that are not considered stable or do not have stable cash flows may not be suitable for this type of structure (as the Lender may require additional support). The most obvious example in this category would be construction facilities, where there are additional risks in the building process involved and the asset has yet to generate stable income streams. It is often required by the Lenders that, as part of the security package, a certain commitment from the Sponsor (whether this is a full recourse guarantee, or a commitment of a certain amount to cover costs and overruns) would be required until the asset is "stabilised" and generating a certain amount or predictable cash flow.

Sponsor guarantees or commitments for a certain set amount may also be required in hotel financing, where the cash flow is quite cyclical, and due to the nature of the property being a hotel, its value is highly dependent on the health of the hotel business. It is often the case that, even in a financing structure where the property and the business are sitting under separate entities, and the financing is only provided to the SPV which owns the property and relies on the cash flow from a pre-agreed intragroup lease on a set rent amount, the Lenders would nevertheless look at the operating company which operates the hotel and, in some cases, the Sponsor for additional collateral. For more discussions on structures of hotel financing, please refer to our hotel financing series.

In instances where the Lender requires additional guarantee or Sponsor commitment, the financing is often structured so that the terms of such guarantee (or sometimes, if guarantees cannot be provided, is structured as investment commitments) are limited to a specified amount and the recourse to the Sponsor is therefore limited to this agreed amount. In addition, sometimes the ability to claim could be limited for certain triggers only (*e.g.*, cost overruns in a construction facility) and not as a general guarantee or indemnity.

In Part Two of this series next month, we will look at common features of limited recourse structures.

COVID-19 Update: Supreme Court Denies Request to Lift CDC's Eviction Moratorium

By **Steven M. Herman**
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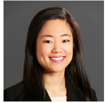
By **Eunji Jo**
Associate | Real Estate

On June 29, 2021, the Supreme Court denied an application by a group of real estate agents and associations to lift the eviction moratorium issued by the Centers for Disease Control and Prevention (the "CDC"). Originally issued on September 4, 2020, the CDC's order temporarily banned evictions of residential tenants in an effort to mitigate the spread of COVID-19. The order, which was originally set to expire on December 31, 2020, was extended to January 31, 2021, further extended to March 31, 2021, and extended again until June 30, 2021. Most recently, on June 24, 2021, the CDC Director renewed the order until July 31, 2021.

The applicants, a group of real estate agents and associations, with the Alabama Association of Realtors acting as lead plaintiff, filed an action on November 20, 2020, against the United States Department of Health and Human Services, alleging that the eviction moratorium issued by the CDC exceeds the CDC's statutory authority. On May 5, 2021, U.S. District Judge Dabney Friedrich ruled that the eviction moratorium exceeded the power that Congress had given the CDC. In response, the Department of Justice appealed to the U.S. Court of Appeals for the District of Columbia Circuit and requested an emergency stay of the order pending the appeal, which was granted. On June 2, 2021, the Court of Appeals upheld the emergency stay, which meant the eviction moratorium remained in place. The plaintiffs then filed an emergency application with the Supreme Court to vacate the stay.

The Supreme Court decided 5-4 to deny the application to vacate the stay. Justices Thomas, Alito, Gorsuch and Barrett would have granted the request to lift the CDC's eviction moratorium. Justice Kavanaugh wrote a short concurring opinion, stating that he agreed with the District Court and the applicants that the CDC exceeded its statutory authority by issuing the nationwide eviction moratorium. However, because the moratorium is set to expire in only a few weeks, and because those few weeks will allow for "additional and more orderly distribution" of the congressionally appropriated rental assistance funds, he voted to keep the stay in place. He noted that "clear and specific congressional authorization (via new legislation) would be necessary for the CDC to extend the moratorium past July 31."

Recent Transactions

Here is a rundown of some of Cadwalader's recent work on behalf of our clients.

Recent transactions include:

- Represented Wells Fargo and Goldman Sachs as co-lead lenders of a nine-lender syndicate in a $3 billion single-asset/single-borrower securitized refinancing of the newly developed One Vanderbilt skyscraper in midtown Manhattan, the second-tallest building in New York and a Class A, LEED Gold and Platinum office tower, for a partnership led by SL Green Realty.
- Represented the administrative agent and initial lenders on $860 million mortgage and mezzanine loans secured by an office tower in midtown Manhattan.
- Represented the mortgage and mezzanine lenders in connection with an aggregate financing package of $205 million for a portfolio of multifamily properties in New York City.