

Clients & Friends Memo

General Growth Properties Bankruptcy Court Defers Final Ruling on Cash Collateral, Cash Management and DIP Financing Issues¹

May 11, 2009

Following several weeks of speculation about how pending cash collateral, cash management, and debtor-in-possession financing motions might affect basic principles of structured finance, the bankruptcy court deferred a final ruling on the motions and extended the interim cash collateral order. In so doing, Judge Allan L. Gropper of the United States Bankruptcy Court for the Southern District of New York suggested that CMBS lenders organize themselves so that common issues can be identified and resolution expedited. In the meantime, the project-level debtors are continuing to operate in the ordinary course of business and are continuing to pay interest on the CMBS loans at the non-default, contract rate. The next hearing on the motions will be held on May 13, 2009.

The Bankruptcy Filings

On April 16, 2009, General Growth Properties, Inc. ("GGP") and its operating partnership subsidiary, GGP Limited Partnership ("GGP LP"), commenced voluntary cases under Chapter 11 of the Bankruptcy Code. GGP also took 166 of its regional shopping center subsidiaries (the "Project-Level Subsidiaries") into bankruptcy. Many of those subsidiaries were formed as bankruptcy-remote, special purpose entities in connection with CMBS financings. The great majority of the project-level loans were performing at the time of the bankruptcy filings. GGP did not file bankruptcy cases with respect to its property management subsidiaries or shopping centers owned in joint ventures with third parties.

A threshold issue is whether the bankruptcy cases of the Project-Level Subsidiaries should be dismissed as bad faith filings. To help prevent bad faith bankruptcy filings, CMBS loans typically require the borrower to have one or more independent directors whose vote is required for the borrower to commence a voluntary bankruptcy case. In the weeks before the bankruptcy filings, GGP reportedly replaced each of the professional independent directors in 166 of its special

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purpose subsidiaries with new independent directors who supported the bankruptcy filings.

One CMBS servicer has filed a motion to dismiss eight of the bankruptcy filings by Project-Level Subsidiaries as bad faith filings by solvent entities that have no need for reorganization. In response, GGP has stated that the bankruptcy filings were necessary so that the Project-Level Subsidiaries could bargain with their creditors to extend the terms of their CMBS debt. A hearing on the motion to dismiss is scheduled for May 27, 2009.

Special purpose borrowers are designed to be bankruptcy remote, but not bankruptcy proof. The legal entities themselves are code-eligible debtors. Further, their directors, whether independent or not, have a fiduciary duty to support a bankruptcy petition under appropriate circumstances. The Bankruptcy Code does not require that a voluntary debtor be insolvent or that it be unable to pay its current debts. While the bankruptcy courts will dismiss a petition for relief under the Bankruptcy Code when filed in bad faith, a petition generally will not be in bad faith as long as the debtor has a legitimate rehabilitation objective. The need to restructure a debt with a large principal payment due on maturity may constitute a legitimate rehabilitation objective. Whether that position prevails may depend on the length of the remaining term of the loans or whether the CMBS loans need to be in default before the special servicer has the authority under the terms of the servicing agreement to grant an extension of the loan term.

Cash Management and Cash Collateral

At the first day hearing, Judge Gropper of the United States Bankruptcy Court for the Southern District of New York entered an interim cash collateral order permitting the debtors to continue using their prepetition cash management system. That system involved upstreaming all the income of GGP's subsidiaries into a single, commingled operating account out of which GGP paid its subsidiaries' expenses and made intercompany loans to affiliates in need of cash. The Project-Level Subsidiaries generate the bulk of GGP's revenue. Subsidiaries providing property management and project development services generate additional revenue. GGP has stated that it keeps accurate records of all intercompany loans.

GGP filed a cash collateral motion that sought permission to continue its prepetition cash management practices. GGP proposes that a Project Level Subsidiary making a loan be given an administrative claim in the bankruptcy case of the affiliated borrower. GGP proposes to provide adequate protection of the related CMBS lenders' cash collateral by granting the CMBS lender a replacement lien on such intercompany loans. GGP also proposes to pay current interest on the CMBS debt at the non-default, contract rate and to pay all property taxes relating to the Project-Level Subsidiaries. If granted, the cash management system would in effect turn the Project-Level Subsidiaries into debtor-in-possession lenders secured by administrative claims. Whether an administrative claim would provide actual protection may depend on the financial condition of each

of the intercompany borrowers and the extent to which the CMBS lender is overcollateralized by the mortgaged property. Numerous objections were filed to the cash collateral motion.

Debtor-in-Possession Financing

As part of the cash collateral motion, GGP sought approval of a debtor-in-possession loan (“DIP Loan”) in the amount of \$375 million to be provided by several hedge funds that currently own stock and bond positions in GGP. Immediately prior to the hearing, GGP filed a new credit agreement that provided for a \$400 million DIP Loan from Pershing Square Capital Management, L.P., which was the agent on the original DIP Loan proposal. GGP and GGP LP are the proposed borrowers. GGP proposes that the Project-Level Subsidiaries guarantee the DIP Loan and secure those guarantees with second liens on substantially all their assets. It does not appear, however, that the Project-Level Subsidiaries would receive any direct benefit from the DIP loan as the proceeds would be disbursed to their parent entities, GGP and GGP LP. However, the parents provide necessary management services to the Project-Level Subsidiaries.

GGP proposes to use \$210 million of the loan to satisfy prepetition secured indebtedness to Goldman Sachs. As a rationale for paying Goldman’s prepetition secured debt ahead of other secured debt, the Debtors pointed to an Incentive Agreement entered into the day before the filing which provides for the payment of fees and 1.5% of the unpaid principal amount of the Goldman indebtedness if such indebtedness was paid in full prior to June 2, 2009. Numerous objections have been filed to the proposed DIP Loan.

Although the Debtor pressed for the entry of a final cash collateral order and the court heard direct testimony from Alix Partners, the Debtors’ financial advisor, on various evidentiary issues related to cash collateral and permitted some cross-examination of the witness, the court deferred ruling on the cash collateral and cash management motions. Pending a final order, the interim cash collateral order entered on April 16 will continue to govern the Debtors’ use of cash collateral.

The large number of parties that wanted to object to the various motions caused Judge Gropper to suggest that the lenders organize so that common issues could be identified and the resolution expedited. At the request of the parties, the court established a deadline of 1 p.m. on Monday, May 11th for the submission of all DIP financing proposals from all prospective DIP lenders with a meeting thereafter to try to reach agreement on the cash collateral, cash management, and DIP issues. The proposed final DIP credit agreement must be filed with the court by 12 p.m. on Tuesday, May 12th. The cash collateral, cash management and DIP hearing is now scheduled for Wednesday, May 13th, at 11 a.m. Judge Gropper stated that although the CMBS lenders may have had pre-petition expectations regarding separateness, they are not significantly harmed because virtually all of them are fully secured and because the Debtors are willing to continue to make interest payments on the loans.

Impact of the Bankruptcy Filings

The ultimate impact of the bankruptcy filings on the CMBS lenders will depend in large part on how the cash collateral and DIP Loan issues are resolved. The immediate impact of the filing is mitigated by GGP's proposal to continue paying interest at the non-default contract rate on the CMBS debt during the bankruptcy cases. That proposal amounts to a tacit acknowledgement that many of the special purpose subsidiaries could fall under the rules governing single asset real estate debtors, which generally require the filing of a plan of reorganization or the commencement of interest payments at the non-default, contract rate within 90 days following the filing of the bankruptcy case. Thus, under the proposed cash collateral order, the CMBS lenders would receive the benefits of the single asset real estate requirements without having to litigate the issue on a property by property basis. Even if contract rate interest is paid, however, the filing may harm holders of junior notes or junior participations by causing all such payments to go to the holder of the senior note or senior participation under the terms of the applicable intercreditor agreement.

The bankruptcy filings have not disrupted operations at the project level. GGP is continuing to operate the Project-Level Subsidiaries in the ordinary course of their business and continuing to pay interest on the CMBS loans at the non-default, contract rate. In addition, the bankruptcy filing by the Project-Level Subsidiaries and the transfer of the loans to CMBS special servicers may enable the special servicers to grant extensions of maturing loans where the servicer would be unable to do so.

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