

## MEMORANDUM

**TO:** The Board of Commissioners and the Executive Director of The Housing and Redevelopment Authority in and for the City of Ramsey, Minnesota

**CC:** Kurt Ulrich, City Administrator  
Stacie Kvilvang, Ehlers, Inc.  
Mary Ippel, Briggs and Morgan, P.A.

**FROM:** Thomas L. Bray

**DATE:** February 22, 2012

**RE:** **The Housing and Redevelopment Authority in and for the City of Ramsey, Minnesota--Purchase Agreement and Development Agreement with F&C Ramsey, LLC**  
**Our File No.: 12952.47**

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### I. BACKGROUND

On September 27, 2011 the Board of Commissioners ("Board") of The Housing and Redevelopment Authority in and for the City of Ramsey, Minnesota (the "HRA") approved a Purchase Agreement for the sale of Lot 3, Block 1, COR ONE, Anoka County, Minnesota (the "Property") to F&C Ramsey, LLC ("F&C Ramsey") (the "Purchase Agreement") and approved a Development Agreement among and between the HRA, the City of Ramsey and F&C Ramsey (the "Development Agreement"). The Development Agreement obligates the HRA to make a \$1.42 MM loan and an approximately \$6.825 MM loan (collectively, the "HRA Loans") to F&C Ramsey Member, LLC ("F&C Member"). F&C Ramsey intends to assign all of its rights, except the right to receive the TIF Note, and all of its obligations under the Purchase Agreement and the Development Agreement to F&C Ramsey Apartments, LLC ("F&C Apartments") before the Property closing or the PNC Loan closing. F&C Ramsey and F&C Member own 100% of the membership interests in F&C Apartments.

F&C Ramsey's obligations under the Purchase Agreement and Development Agreement are contingent upon the closing of an approximately \$20.475MM loan from PNC Bank, National Association ("PNC") to F&C Ramsey Apartments (the "PNC Loan"). As a condition of the loan, PNC requires that F&C Apartments, PNC, the HRA and the City sign a Debt Subordination Agreement (the "Debt Subordination Agreement"). Neither the requirement for nor the terms of

the Debt Subordination Agreement were known, when the HRA approved the Purchase Agreement and the Development Agreement, so the HRA's Board could not approve and authorize the execution of the Debt Subordination Agreement at that time. HRA staff is submitting the Debt Subordination Agreement to the Board for consideration at the Board's February 28, 2012 meeting.

This Memorandum describes the HRA's remedies if F&C Apartments defaults under the Development Agreement or if F&C Member defaults under either the Loan Agreement to be executed by the HRA and F&C Member (the "HRA Loan Agreement") or either of the two Promissory Notes that F&C Member will execute in favor of the HRA to evidence the HRA Loans (the "HRA Notes") and, where applicable, describes the impact of the Debt Subordination Agreement on those remedies.

## **II. RIGHT OF REVERTER**

The Purchase Agreement and Development Agreement provide for the HRA's conveyance of the Property to the "Developer" (initially F&C Ramsey but, following the assignment to F&C Apartments, F&C Apartments) subject to a right of reverter. If the Developer does not complete construction of the project on or before the date 27 months from the date of the conveyance, the HRA may commence an action in Anoka County District Court seeking a court order transferring title to the Property and any improvements thereon back to the HRA. In the Development Agreement the HRA agreed to subordinate its right of reverter to the lien of the mortgage securing the PNC Loan (the "PNC Mortgage"), so if PNC forecloses its mortgage and the Developer does not redeem the Property from foreclosure, the HRA must either redeem the Property from foreclosure by paying off the PNC mortgage or the HRA's right of reverter will be extinguished.

In the Debt Subordination Agreement, the HRA agrees that the HRA's enforcement of the right of reverter is a non-curable default under the terms of the PNC Mortgage. The HRA also agrees that if F&C Apartments defaults in the performance of its obligations to PNC under the PNC loan documents, the HRA will not oppose PNC's efforts to have a receiver appointed for the Property and will not seek to have the receiver discharged unless PNC fails to commence foreclosure proceedings within 6 months following the appointment of the receiver, PNC commences a foreclosure but fails to schedule a sheriff's sale within a reasonable period of time or the HRA redeems the Property from a foreclosure of the PNC mortgage.

## **III. ENFORCEMENT OF THE DEVELOPMENT AGREEMENT**

The Developer's failure to complete the project with 27 months of closing is a default under the Development Agreement. In addition, a default by F&C Ramsey under the Loan Agreement or the HRA Notes is a default under the Development Agreement. Although the HRA has the right to sue the Developer to recover damages resulting from a default, it would be difficult for the HRA to articulate the monetary damages the HRA would suffer from the Developer's failure to complete the project on time. The more significant remedy available to

the HRA is the right to suspend performance of the HRA's obligation to issue the TIF Note to F&C Ramsey or, if the HRA has already issued the TIF Note, the right to terminate and rescind the TIF Note.

The Debt Subordination Agreement does not impact the HRA's ability to terminate the TIF Note based on a default under the Development Agreement.

Under the terms of the Development Agreement, the HRA has agreed that if PNC forecloses the PNC Mortgage, PNC may elect to either (i) treat the PNC Mortgage as being prior to the Development Agreement in which case the foreclosure would extinguish the Development Agreement and the TIF Note (but not the Assessment Agreement); or (ii) treat the Development Agreement as being prior in which case the Development Agreement would survive a foreclosure, PNC would be subject to all the terms of the Development Agreement and if PNC complies with the terms of the Development Agreement, PNC would be eligible to receive the TIF Note payments.

#### **IV. ENFORCEMENT OF THE LOAN AGREEMENT AND THE HRA NOTES**

Under the terms of the HRA Loan Agreement and the HRA Notes, the HRA may sue F&C Member for money damages if F&C Member fails to make payments due to the HRA under the HRA Notes or otherwise defaults under the HRA Loan Agreement. As we advised the Board during the Board's consideration of the Development Agreement, this right is of questionable value because it is unlikely that F&C Member will have any assets other than membership interests in F&C Apartments (and those membership interests will be subject to a security interest in favor of the HRA as described in Section V below).

The Debt Subordination Agreement imposes the following restrictions on F&C Member's right to make payments to the HRA, the HRA's right to receive payments from F&C Member and the HRA's right to sue F&C Member if those payments are not made:

1. So long as F&C Apartments is not in default under the terms of the PNC Loan documents,

(a) F&C Apartments may make annual distributions of "Net Cash Flow," as defined in the Development Agreement, to F&C Member, and F&C Member may make payments due to the HRA under the HRA Notes. If F&C Apartments defaults under the PNC Loan documents or if a distribution to F&C Member would cause F&C Apartments to violate covenants in the PNC Loan documents, F&C Apartments may not make distributions to F&C Member and F&C Member would have funds to pay the HRA;

(b) the members of F&C Member may make additional capital contributions to F&C Member and F&C Member may use those capital contributions to prepay amounts due under the HRA Notes; and

(c) F&C Member may obtain “take out” mezzanine financing and use the proceeds of such financing to pay amounts due under the HRA Notes provided PNC determines, in its reasonable discretion, that the terms of the “take out” mezzanine financing are not less favorable to PNC than the terms of the HRA financing;

2. Before PNC has made its first advance to F&C Apartments and after the PNC Loan has been paid in full (principal, interest and any fees or reimbursements), the HRA may sue F&C Member for defaults under the HRA Loan Agreement or the HRA Notes;

3. The Debt Subordination Agreement prohibits the HRA from suing F&C Member after PNC’s first advance and before PNC has been paid in full, but it does not prevent the HRA from foreclosing the Membership Interest Pledge described below.

If the HRA attempts to enforce the HRA Loan Agreement or the HRA Notes in violation of the Debt Subordination Agreement, PNC may seek an injunction to stop the HRA. If F&C Member makes or if the HRA receives payments other than as described in Section 1 above or in Section VI below, the Debt Subordination Agreement requires the HRA to pay those amounts over to PNC for application to the PNC Loan.

## V. MEMBERSHIP PLEDGE AGREEMENT

The HRA Loan Agreement obligates F&C Ramsey and F&C Member to grant the HRA a first lien security interest in their membership interests in F&C Apartments, and the Debt Subordination Agreement expressly recognizes the HRA’s right to foreclose that security interest and become the owner of F&C Apartments if F&C Member defaults under the HRA Loan Agreement or the HRA Notes. We assume that if the HRA forecloses its security interest, PNC will, if it has not already done so, commence foreclosure of the PNC Mortgage and seek to have a receiver appointed to complete construction and/or operate the Project until the foreclosure is complete. Unless the HRA can persuade PNC to enter into some type of workout agreement to allow the HRA to complete construction and/or operate the project, the affect of the HRA’s foreclosure of its security interest would likely be to trigger a foreclosure of the PNC Mortgage and give HRA the right to redeem the property from that foreclosure. Note, however that because the HRA does not have a mortgage on the Property, the HRA cannot effectively prevent F&C Apartments from conveying the Property to PNC pursuant to a deed in lieu of foreclosure a (although such a conveyance would be a default under the Development Agreement and allow the HRA to terminate the TIF Note).

## VI. GUARANTIES

Under the terms of the Development Agreement, F&C Member is required to cause Flaherty & Collins Construction, Inc. to execute a corporate guaranty guaranteeing the full performance of F&C Member’s obligations and the payment of the amounts due under the terms of the Promissory Note evidencing the \$1.42 MM loan from the HRA to F&C Member and is obligated to deliver a personal guaranty of David Flaherty guaranteeing the full performance of

and the payment of the amounts due under the Promissory Note evidencing the \$6.825 MM loan from the HRA to F&C Member (the “HRA Guaranties”). Under the terms of the HRA Guaranties, the HRA may commence an action against the guarantors if F&C Member fails to repay the HRA loans when and as due or otherwise defaults under the HRA Loan Agreement or the HRA Notes. The Debt Subordination Agreement restricts the HRA’s right to enforce the guaranties as follows:

1. The HRA retains the unrestricted right to enforce the guaranties at all times prior to PNC’s first advance and after PNC has been paid in full.
2. After PNC’s first advance and prior to PNC’s receipt of payment in full, the HRA retains the unfettered right to enforce the personal guarantees if:
  - a. PNC voluntarily satisfies or releases the Mortgage;
  - b. PNC releases the guarantors from the terms of PNC’s guarantees or otherwise agrees not to enforce the PNC guarantees(which could happen in a deed in lieu situation); or
  - c. PNC forecloses the PNC mortgage and the amount bid at the foreclosure sale equals the amount owed to PNC; and
3. If After PNC’s first advance and prior to PNC’s receipt of payment in full, F&C defaults in the performance of its obligations under the PNC loan documents and PNC either accepts a deed in lieu of foreclosure without releasing or agreeing not to enforce the PNC guarantees, or PNC forecloses but the amount PNC receives from the foreclosure sale is less than the amount that PNC owes, either PNC or the HRA may commence enforcement of their rights under their respective guarantees but only after providing the other party with 30 days prior written notice and subject to the requirement that any resulting enforcement action will be taken jointly by PNC and the HRA and the proceeds from such joint action will be allocated between PNC and the HRA on a pro rata basis based on the then-outstanding balances of the PNC loan and the HRA loans. If notice of an enforcement action is given and the other party elects not to proceed with enforcement then the party providing the notice is free to pursue collection under its own guarantees; and
4. If PNC and F&C Apartments amend the terms of the PNC loan documents to extend the maturity date of the PNC loans beyond March 1, 2018, the HRA may commence an action to enforce its guarantees but enforcement is subject to the same joint enforcement provisions described in Subsection 3 above.

As described in Section IV with respect to the HRA’s right to obtain a judgment against F&C Member, if the HRA obtains payments from the guarantors that are prohibited by the terms of the Debt Subordination Agreement, the Debt Subordination Agreement requires that the HRA

remit the amounts collected in violation of the terms of the Debt Subordination Agreement to PNC for application to the PNC debt.

## VII. CONCLUSIONS

In general, the Debt Subordination Agreement is intended to ensure that if the project struggles or fails and there is not enough money to pay both PNC and the HRA that PNC is made whole before the HRA. In that respect, it does not significantly change the HRA's position. The HRA is and always has been a junior creditor in this transaction. The Debt Subordination Agreement does not impact the rights of the City and the HRA to enforce the Development Agreement as drafted and to terminate the TIF Note if the Developer does not perform under the Development Agreement. Likewise, the Debt Subordination Agreement does not impact the HRA's right to enforce the Membership Pledge Agreement, although, with or without the Debt Subordination Agreement, enforcement of the Membership Pledge Agreement is not a remedy is likely to result in direct cash recovery if the project is not performing. It could, however, give the HRA a redemption right which, if exercised, could allow the HRA to capture any value in excess of the PNC debt.

The most significant impact of the Debt Subordination Agreement is to prevent the HRA from suing the guarantors if there is a default under the HRA Notes between the time PNC first advances loan proceeds and when PNC is paid off or elects to foreclose its mortgage. This eliminates one tool the HRA could use to put pressure on F&C and the Guarantors to address the defaults under the HRA Notes. It is important to remember, however, that, in the first instance, the HRA, as a junior creditor, is far more likely to seek to maximize their recovery by negotiating with F&C and modifying the repayment terms than by moving to enforce the HRA's legal remedies, and, if those negotiations fail, two other tools, termination of the TIF Note and foreclosure of the Membership Pledge Agreement, remain available to the HRA. Another significant impact, which is more difficult to quantify, is the fact that, once PNC has advanced loan proceeds to F&C, any legal action by the HRA to enforce the Loan Agreement or the Guaranties in effect becomes a three party action and any disputes between the HRA and PNC regarding the meaning or effect of the Debt Subordination Agreement get added to the list of issues that may need to be resolved through litigation. That can certainly have an impact on the time and money the HRA may have to spend to enforce its rights.

BRIGGS AND MORGAN

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