

Michigan Uniform Assignment of Rents Act Hypothetical

For purposes of this hypothetical the date is today but we are assuming that the Michigan Uniform Assignment of Rents is now in effect.

Fairview Apartments is a 3 building, 120 unit apartment complex located in Michigan. It is owned by Fairview Apartments LLC whose members are Owen Owner and Mary Moneybags. Owen Owner has a majority interest in the LLC and under the terms of the operating agreement has the right to control all major decisions including financing, sale of Fairview Apartments and file a bankruptcy petition.

Big City Bank, headquartered in New York City, made a \$12 million loan to Fairview Apartments LLC 8 years ago. The loan is secured by a mortgage, an assignment of rents and a non-recourse guaranty signed by Mr. Owner and Ms. Moneybags. The non-recourse guaranty includes typical carve-outs including springing recourse liability for any bankruptcy filing by Fairview Apartments. Moneybags is Owner's mother-in-law and she was never involved in the operations of the apartment complex. Ms. Moneybags owned a very successful business valued at over \$20 million at loan origination. She sold her business some years ago and is now a widow residing in Arizona.

Fairview Apartments is managed by Owner's solely owned company, Owen Management Corporation. The management agreement, approved by Big City Bank at loan origination, provides for a 6% management fee.

For the first 6 years of the loan, Fairview Apartments leased its units at market rents, maintained an occupancy over 92% and faithfully made its \$65,000 monthly loan payment. Large annual distributions were made to its 2 members.

Unfortunately in January 2021 there was a fire in the upper floor of one of the buildings, Building C. The fire department contained the fire to the upper floor but there was significant water damage to the lower floor. Trusting Owen Owner, Big City Bank released any claim to insurance proceeds with the understanding that Building C would be fully repaired. It is not entirely clear what happened to the insurance proceeds but the construction was never fully completed and there is now some evidence of mold. The local building inspector has denied issuing a certificate of occupancy for 15 units.

Occupancy at Fairview Apartments has hovered around 80% since the fire. Fairview struggled to make its loan payments in 2021 but was able to do so with some contributions from its members and a deferral of management fees by Owner Corporation.

Fairview stopped providing the required monthly financial statements in 2021, but back in February of this year it did provide an annual financial statement. This compilation financial statement disclosed an account payable for management fees of just over \$150,000.

Also in February Owen Owner submitted a proposal to the Bank by which the Bank would defer monthly loan payments for 18 months. Owen's explanation was that he had no funds to

contribute for further construction and that the LLC needed 14 months of loan payment deferrals which would generate about \$700,000 to complete all necessary repairs and improvements to the 15 down units. The 4 additional months of payment deferrals would provide the necessary lease-up period to restore occupancy to over 90%. The Bank's loan officer rejected this proposal telling Mr. Owner that any construction funds must come from the LLC members and not the Bank.

Frustrated at Big City Bank's response Fairview Apartments LLC stopped making loan payments in April. The Bank hired legal counsel earlier this month to deal with the defaulted loan.

The Bank's lawyer prepared three documents on behalf of Big City Bank all of which were served on August 10. First was a demand letter served on the LLC and the guarantors. The demand letter declared a default, accelerated the maturity of the loan and invoked the default rate of interest which increased the interest rate by 3%. The demand letter also included a demand for rents and stated that Fairview Apartments LLC and the guarantors would be held personally liable for any rents not turned over to the Bank.

The second was a Notice of Default under the Michigan Uniform Assignment of Rents Act. The Notice of Default demanded that Fairview Apartments turn over all gross rents collected and expressly denied that the Bank had or would approve the payment of any operating expenses for the property. This Notice was properly recorded and served on Fairview Apartments LLC by email which was a method of service authorized by the Mortgage Loan Agreement.

Finally, the Bank's lawyer sent a letter to Owen Management Corporation advising the corporation of the Bank's perfected security in Fairview's rents and its proceeds. This letter demanded that Owen Management Corporation turn over any rent proceeds that it might receive to the Bank.

We are now going to witness the first telephone conversation between the lawyers for Fairview Apartments and Big City Bank. Bob Bassel represents the borrower and Jim Allen represents the Bank.