Bankruptcy Remote Entities in Commercial Real Estate Transactions

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This Practice Note discusses the use of bankruptcy remote entities in commercial real estate transactions, including different types of bankruptcy remote entities, the separateness provisions often required by lenders and the consequences of substantive consolidation. This Note discusses the fundamentals of using a bankruptcy remote entity to purchase real estate, including the reasons an investor may be required to establish a separate entity to purchase real property.

Bankruptcy remote entities (BREs) are often used in commercial real estate financing transactions for loans exceeding a certain threshold amount, typically $10 to $20 million depending on the lender. To limit certain risks associated with a borrower's bankruptcy filing, lenders often require borrowers to be BREs, which are separate legal entities that take title to the real property (and related personal property) securing the loan extended to the BRE. Lenders typically prefer BRE borrowers to be Delaware limited liability companies, and to some degree Delaware limited partnerships and corporations. While beyond the scope of this Note, Delaware entities may provide protections unavailable under the organizational laws of other states, (see *Real Estate Ownership: State Q&A Tool: Question 18 (http://us.practicallaw.com/3-517-4022#a937561)*).

A properly structured BRE isolates a lender's collateral from the insolvency and bankruptcy risks associated with other types of financing. Recourse to equity owners is generally limited and the costs of financing to the BRE may also be lower.

Practitioners, however, should be aware of BRE limitations, including:

- BREs are only bankruptcy-remote, not bankruptcy-proof.
- Particular provisions must be incorporated into the BRE's organizational documents and loan documents.
- BREs must be economically viable with respect to the debt it incurs.
- Equity owners must be able to comply with BRE organizational requirements throughout the term of the loan imposed on the BRE or suffer the consequences, which may include, in part, recourse to the equity owners.

DIFFERENCES BETWEEN SINGLE PURPOSE ENTITIES AND BANKRUPTCY REMOTE ENTITIES

In commercial real estate transactions, the terms "single purpose," "special purpose" and "bankruptcy remote" are often used interchangeably in the context of a structured or securitized commercial real estate loan transaction. However, there are important differences between a single purpose entity (SPE) (also sometimes called a special purpose entity) and a BRE.

SINGLE PURPOSE ENTITIES

An SPE generally refers to a corporation, limited partnership or limited liability company formed under the laws of a particular state (often Delaware in real estate transactions) and organized for the express purpose of holding a single real estate asset (or single portfolio of assets). All the major, nationally recognized rating agencies further define an SPE as an entity that is unlikely to become insolvent as a result of its own activities and is adequately insulated from the consequences of any related party's insolvency.

BANKRUPTCY REMOTE ENTITIES

Not all SPEs are BREs. A BRE is always an SPE, but it has additional characteristics that an SPE does not necessarily have. For example, for an SPE to be a BRE, it must include as part of its organizational structure at least one director, general partner, managing member or controlling person who is not otherwise affiliated or associated with the borrower. These people are called "independent directors" or "independent managers."

The independent directors' primary purpose is to approve or disapprove a borrower's bankruptcy filing. The borrower must have the approval of one or more independent directors to have sufficient authority to file for bankruptcy (see *Independent Directors and Protections Against Insolvency*).

WHAT IS A BANKRUPTCY REMOTE ENTITY?

BANKRUPTCY PROOF VERSUS BANKRUPTCY REMOTE

A BRE is not a bankruptcy-proof entity, as it would offend public policy to prohibit a person or entity from availing itself of the protections available to debtors under the Bankruptcy Code (the Code). A BRE cannot be prohibited from seeking Code protection, and any provisions creating that prohibition are likely unenforceable. When structuring a BRE, therefore, the goal is to reduce the likelihood that the BRE will:

- File a voluntary bankruptcy action.

- Become insolvent.
- Have an involuntary bankruptcy action filed against it.

To achieve this goal, a BRE's organizational documents should allow it to file a voluntary bankruptcy petition with the required approvals, including that of the independent person. These provisions are intended to create a hurdle to filing a voluntary petition but also be respected by a bankruptcy court. Lenders achieve bankruptcy remoteness by requiring several operational provisions in the BRE's organizational documents and the related loan documents (see *Characteristics of a Bankruptcy Remote Entity*).

TYPES OF BANKRUPTCY REMOTE ENTITIES

While most BREs are typically Delaware limited liability companies (DELLC), there may be reasons to use another type of entity, such as the requirements of the jurisdiction in which the mortgaged property is located (see *Real Estate Ownership: State Q&A Tool: Question 18 (http://us.practicallaw.com/3-517-4022#a937561)*). Limited partnerships, corporations and though infrequently, statutory trusts, may be set up as BREs. When a limited partnership is the borrower, it is not uncommon for the borrower to create a Delaware limited partnership with a DELLC as its general partner. In this situation, both the Delaware limited partnership borrower and the DELLC general partner are typically structured as BREs.

The required BRE provisions generally apply no matter which entity form is used. While there may be some variations from one entity to the next, this Note primarily discusses a single member DELLC BRE. If properly structured, a DELLC may have a single member, which may:

- Simplify the borrower's organizational structure.
- Be required if the borrower is obtaining mezzanine financing.

While a corporation may be set up as a BRE, in current practice, a corporation is rarely used as an ownership vehicle (and therefore a borrower) in commercial real estate loan financings. Corporations present issues not generally seen with the use of a limited partnership, limited liability company or trust. Corporate laws generally require the officers and directors of a corporation to act as fiduciaries for the shareholders and to consider the best interests of the shareholders of the corporation above all else, particularly the corporation's creditors.

Laws governing limited liability companies and other forms of alternative entities are typically far more flexible. For example, when a DELLC is the BRE or the general partner of a limited partnership BRE, the factors considered can be altered or varied in a manner that is advantageous to a lender and increases bankruptcy remoteness. This includes requiring the directors, managers or officers of the DELLC to additionally consider the interests of a creditor of a BRE, in other words, the lender.

CHARACTERISTICS OF A BANKRUPTCY REMOTE ENTITY

An SPE is less likely to become insolvent as a result of its own activities if it:

- Is formed for the limited purpose of owning and operating specific real property.
- Holds itself out to the public as a separate legal entity distinct from any other person or entity.
- Maintains its assets in a way that segregates and identifies them separately and apart from the assets of any other person or entity.
- Conducts business solely in its own name.
- Has no indebtedness other than a loan that is secured by a particular parcel of property and indebtedness for trade payables incurred in the ordinary course of business.

These requirements seek to ensure that the borrower remains an SPE and does not file for bankruptcy or in the event of its parent's or affiliate's bankruptcy, will not be substantively consolidated into such bankruptcy (for a list of additional BRE requirements, see *Separateness Provisions* and *Box, Sample Separateness Provision*).

LIMITED PURPOSES

The purpose of a BRE set out in its organizational documents must be limited and typically states that the BRE's purpose is:

> "to [acquire,] own, maintain, operate, lease, etc. the real property and engage in any lawful act or activity and exercise any powers permitted to the BRE organized under the laws of the state of formation that are related or incidental to and necessary, convenient or advisable for the accomplishment of owning the property, including entering into the loan documents and the extension of the loan."

The BRE cannot own assets other than the real and personal property specified in its organizational documents. By requiring a limited purpose, lenders limit the potential pool of creditors and other operational risks that could arise if the borrower had a broader purpose or owned other assets.

ISOLATED ASSETS AND LIABILITIES

The separate legal entity principle is the key to the successful implementation of a BRE structure. The real and personal property and cash flow generated from the property are owned by the BRE, which is a separate legal entity from its equity owners. As a separate legal entity, a BRE should enjoy all the attributes and benefits associated with legal separateness. If properly structured, the BRE lender should incur less risk associated with creditors of the equity owners or of an insolvency or bankruptcy of an equity owner.

LIMITATION ON DEBT AND LIENS

Other than the loan extended by the BRE's lender, the BRE is generally prohibited from:

- Incurring any other debt, except a limited amount of trade debt associated with the operation of the property.
- Granting any liens on its assets.

These prohibitions are intended to limit the number of potential creditors that could possibly force the BRE into an involuntary bankruptcy or obtain a lien on the BRE's assets. They restrict the BRE from incurring any major debt other than the loan.

CONTROL BY LENDERS

Given the organizational flexibility of limited liability companies and limited partnerships, particularly in Delaware, the lender will have certain rights under the BRE's organizational documents, such as:

- The right to consent to:
  - amendments to the BRE's organizational documents as they relate to its bankruptcy remoteness; and
  - equity transfers in the BRE.

- Third-party beneficiary rights to enforce the bankruptcy-remote provisions.

The lender should have no rights to vote for or otherwise trump a voluntary bankruptcy proceeding. This type of provision would likely be unenforceable as against public policy. It is not, however, unusual for the lender to have substantial input regarding the removal and appointment of the BRE's independent managers or directors and the criteria that those persons must meet. Additionally, changes to the criteria and the provisions on which the independent managers or directors vote are often subject to lender consent or approval.

WHY DO LENDERS REQUIRE BANKRUPTCY REMOTE ENTITIES?

There are several different types of bankruptcy risks that motivate lenders to require their borrowers to be BREs, such as:

- The borrower's own acts, which may include risks related to:
  - the ownership and operation of the property that ensure the lender's collateral generates sufficient cash flow to cover debt service, reserves and expenses (such as property management fees);
  - actions affecting the borrower entity, such as consolidation, liquidation or merger; and
  - the borrower seeking voluntary bankruptcy protection.
- A related party's bankruptcy or insolvency. While an equity owner's solvency may not seem as crucial as the solvency of the underlying borrower, commercial lenders often evaluate lending risk based on the equity owners' creditworthiness, experience operating similar commercial property and general financial well-being (see *Bankruptcy, Insolvency and Substantive Consolidation Cases*).

Regardless of the risks and implications, lenders often require their borrowers to be BREs simply because of rating agency requirements. Market participants and investors in the commercial mortgage-backed securities market have expectations for the operational requirements of a BRE (see *Characteristics of a Bankruptcy Remote Entity*).

BORROWERS' CONCERNS WITH BANKRUPTCY REMOTE COMPLIANCE

Commercial real estate investors understand that complying with a lender's BRE requirements is part of the cost of doing business. However, compliance with a lender's requirements often causes concerns for commercial real estate borrowers.

BRE compliance guidelines often require a borrower to form more than one new entity in connection with a financing. This can result in additional costs, including:

- Up-front transactional fees.
- Annual franchise taxes.
- Entity filings.

Borrowers are also concerned with the minutiae of compliance, particularly because a breach of the separateness covenants in the borrower's organizational documents or the loan documents is often included as a nonrecourse carveout in the loan documents, making an otherwise nonrecourse loan fully recourse to the borrower and guarantors. To avoid this type of trap, borrowers' counsel should review and negotiate the language in the separateness requirements.

For additional information on nonrecourse carveouts, see *Practice Notes, Negotiating Nonrecourse Carveout Guaranties in Commercial Real Estate Loans (http://us.practicallaw.com/2-521-0515)* and *Trends in Nonrecourse Carveout Guaranties in Commercial Real Estate Loans (http://us.practicallaw.com/9-520-7581).*

Finally, the most persuasive argument a borrower has against requiring strict compliance with the separateness covenants is that the requirements limit a borrower's ability to structure a transaction in a way that minimizes the economic impact of state and local real property transfer taxes. Many states and municipalities impose transfer taxes on the purchase and sale of real property (see *State Transfer Tax Comparison Chart (http://us.practicallaw.com/4-579-9887)* and *Real Estate Ownership: State Q&A Tool, Question 10 (http://us.practicallaw.com/3-517-4022#a354566)*).

In some states, it may be possible to avoid the transfer tax by purchasing the stock, partnership interests or membership interests in the entity that holds title to the property, rather than purchasing the property itself. Unfortunately, the separateness requirements in a loan transaction often preclude a borrower from structuring its transaction with these considerations in mind.

WHEN ARE BANKRUPTCY REMOTE ENTITIES REQUIRED?

While not all lenders have the same standards, commercial real estate loans over a certain monetary threshold amount are generally subject to BRE lending strictures. The specific requirements for when a borrower must be a BRE vary from lender to lender and may be dependent on other factors, such as whether the loan will be securitized, participated or sold.

CMBS FINANCING

If the loan is destined for pooling with other commercial real estate loans for a commercial mortgage-backed securities (CMBS) issuance, certain rating agency criteria may apply, and the organizational documents of the BRE and the underlying loan documents need to contain many (if not all) of the standard separateness provisions (see *Separateness Provisions* and *Practice Note, Commercial Mortgage-backed Securities (CMBS) Finance: Overview (http://us.practicallaw.com/9-583-9145)*).

Even for loans not subject to ratings criteria, borrowers' counsel may find that lenders still require the borrower to meet rating agency criteria. For smaller loans, however, some lenders may not require a BRE or may require a BRE that meets only some BRE requirements. For example, on smaller loans, lenders often:

- Waive the requirement that a borrower appoint an independent manager or director (or allow the borrower to have only one rather than two independent managers or directors).
- Limit (but almost never waive) separateness covenants, which are generally required in the borrower's organizational documents and the loan documents.

For additional information on credit ratings and rating agencies, see *Practice Note, Credit Ratings and Credit Rating Agencies (http://us.practicallaw.com/7-382-1002).*

MEZZANINE FINANCING

BRE structures are often used in commercial real estate financings when the borrower is obtaining mezzanine financing. The mortgage borrower is a single member BRE that owns the mortgaged property and grants the mortgage lender a lien on the property as collateral for the mortgage loan.

The mezzanine borrower is a separate BRE that owns 100% of the issued and outstanding ownership interests of the mortgage borrower BRE. The mezzanine borrower obtains a mezzanine loan from the mezzanine lender and in return pledges its interest in the mortgage borrower as collateral for the mezzanine loan. Having the mezzanine loan secured by the equity interest in the mortgage borrower, rather than the property itself, avoids junior mortgages on the real property. This allows the mortgage borrower to comply with the BRE provisions.

Mezzanine financing provides the borrower with an additional source of financing without requiring a junior mortgage on the property. This structure prevents a junior lender from placing a second mortgage or junior lien on the real property, which protects the senior lender against the risk of a junior mortgagee forcing a foreclosure under its loan documents.

For additional information related to mezzanine loans in commercial real estate finance, see *Practice Note Overview, Mezzanine Loans in Commercial Real Estate Finance (http://us.practicallaw.com/2-600-7787)* and *Real Estate Mezzanine Lending Chart (http://us.practicallaw.com/2-539-3505).*

INDEPENDENT DIRECTORS AND PROTECTIONS AGAINST INSOLVENCY

Lenders typically require their borrowers to use independent directors (also sometimes called independent managers or independent persons) as another safeguard to ensure an SPE borrower is bankruptcy remote. Appointing an independent director limits a borrower's ability to take certain actions associated with bankruptcy, insolvency and dissolution (and certain other material actions) without the independent director's vote (see *Major or Material Actions*). The independent director helps insulate against the risk that the shareholders, members, partners, directors or managers (as applicable) of the parent of the borrower will be able to control the borrower and vote to file a bankruptcy petition to help other related entities when the borrower may be otherwise solvent.

This mechanism requires that any decision affecting the solvency of the borrower has the approval of both:

- The borrower's member or manager (if the borrower is a limited liability company) or general partner (if the borrower is a limited partnership).
- One or more of the appointed independent directors or managers.

There may also be additional consent requirements in the member or general partner's respective organizational documents before that entity's consent is obtained.

These provisions generally require the independent director or manager to affirmatively vote or provide its written consent before a voluntary bankruptcy petition is authorized. Consent may also be required in certain other circumstances, such as for amendments to the company's organizational documents. Properly structured, these types of provisions are enforceable under the laws of the State of Delaware for a DELLC and respected in a proceeding under the Code. Many lenders require BREs to have two independent directors, both of whom must consent to the action being considered. Requiring the consent of two separate, independent individuals exercising their fiduciary or contractual duties under the organizational documents offers the lender additional protection.

As part of what is in the BRE's best interests, independent directors or managers may consider the economic interests of the lender before consenting to a voluntary bankruptcy proceeding. If a DELLC is used, the lender may require the limited liability company agreement to include language stating that:

> "to the fullest extent permitted by law, and notwithstanding any duty otherwise existing at law or in equity, the independent directors only need to consider the interests of the BRE when voting on major or material actions."

While the fiduciary duties of the independent directors can be eliminated for a DELLC, the organizational documents of the DELLC cannot eliminate the implied contractual covenant of good faith and fair dealing implicit in contracts.

MAJOR OR MATERIAL ACTIONS

A major or material action typically means:

- Filing any voluntary bankruptcy petition, instituting proceedings to have the BRE be adjudicated bankrupt or insolvent, or consenting to the institution of bankruptcy or insolvency proceedings against the BRE or filing a petition seeking, or consenting to, reorganization or relief with respect to the BRE under any applicable federal or state law relating to bankruptcy.
- Consenting to the appointment of a receiver, liquidator, assignee, trustee, sequestrator (or other similar official) of the BRE or a substantial part of its property.
- Making any assignment for the benefit of creditors of the BRE.
- Admitting in writing the BRE's inability to pay its debts generally as they become due, or take action in furtherance of any such action.

Material actions may also include sale of assets, merger or consolidation, liquidations and dissolutions. Any other actions included in the list of material actions should be carefully considered and counsel should determine the appropriateness of having to obtain the independent director's consent for these actions.

Independent directors also help to protect the lender from a borrower amending its organizational documents to circumvent the separateness requirements. Lenders generally prohibit the BRE from amending any of the provisions in its organizational documents that are associated with being a BRE until the loan is repaid in full:

- Without obtaining lender consent.
- After securitization, without a rating agency confirmation that the amendment will not result in a reduction, withdrawal, downgrade or qualification of the then current rating by a rating agency of the loan or any pool of loans of which the loan forms a part, or of any of the securities issued by a securitization trust of which the loan forms a part.

SEPARATENESS PROVISIONS

The borrower's organizational documents contain certain provisions, called separateness provisions or separateness covenants, that are intended to ensure that its managers, members, directors and other controlling persons operate the BRE as a separate legal entity. The loan documents also have:

- Representations from the BRE that it is in compliance with the separateness provisions.
- Covenants of compliance with the separateness provisions throughout the term of the loan.

The separateness provisions are intended to protect against a substantive consolidation in the event an equity owner or affiliate of the BRE becomes a debtor in bankruptcy (see *Bankruptcy, Insolvency and Substantive Consolidation Cases*). Under the Code, the equitable principle of substantive consolidation provides that if the activities of two entities are so entwined that it would be unjust to their creditors to treat them as separate entities, the court may combine the assets and liabilities of two or more entities and eliminate any inter-company debt among the consolidated entities. Creditors of the consolidated entities would share in the pooled assets as if there was only one debtor.

Despite taking precautions to minimize the possibility of the BRE becoming subject to a bankruptcy, a lender could still have a properly structured BRE that ends up consolidated into a bankruptcy case if the BRE does not comply with the separateness provisions and otherwise respect its separate legal existence from other persons.

The separateness provisions vary from lender to lender but are not significantly different and are often grouped together with other BRE-type provisions. For a comprehensive example of a separateness provision, see *Box, Sample Separateness Provision*.

RECYCLED ENTITIES

A lender generally requires its BRE borrower to be a new entity formed immediately before the transaction. This requirement limits the risk that any prior activity undertaken by the borrower before the loan is closed could be a basis for consolidating the borrower with any other entity or allow for a bankruptcy filing.

If a pre-existing entity is used, and it was not a BRE, it is referred to as a "recycled entity." If the lender allows the borrower to be a recycled entity, the lender typically:

- Reviews all past iterations of the borrower's organizational documents.
- Requires backward-looking representations and warranties in both the amended organizational documents and the loan documents and a legal opinion or accountant's certificate. These items attest to the past activities of the borrower so that the lender can confirm the borrower has always acted in compliance with separateness covenants, even though it may have had no obligation to do so.
- Requires search reports to confirm the borrower's representations and warranties.

If a pre-existing SPE or BRE is used (as is often the case in a stock purchase or merger), it is not technically a recycled entity. In practice, however, lenders' counsel typically undertakes the same type of entity-level due diligence review and requires the same deliverables in these scenarios as it would if the entity were a true recycled entity. In these instances, a lender may require the borrower to provide additional negative covenants and representations and warranties in the loan documents relating to actions that the borrower has not done in the past, nor will do in the future.

BANKRUPTCY, INSOLVENCY AND SUBSTANTIVE CONSOLIDATION CASES

A lender may also require a borrower to be a BRE to avoid a substantive consolidation of the borrower with its parent or other affiliate entity. If an entity is truly an SPE, it should not be affected by the insolvency of an affiliate. Under the general equitable powers provided in section 105 of the Code, however, a bankruptcy court may disregard the separate legal existence of an entity and substantively consolidate the assets and liabilities of that entity with those of any one or more of the entity's equity owners or affiliates. Substantive consolidation treats the assets and liabilities of the entities as if they belonged to one, enabling the creditors of each formerly separate entity to reach the assets of the consolidated estate.

CONSEQUENCES OF SUBSTANTIVE CONSOLIDATION

The creditors of an insolvent upper-tier debtor would seek to look to the assets of that debtor's wholly owned subsidiary if the subsidiary has substantial equity value above its secured debt. Creditors look for sources of repayment anywhere they can find them.

However, a secured creditor's right to its collateral is still respected even if a borrower is substantively consolidated with another entity. Though the lender's lien will be respected, there are potential harms the lender wants to avoid, including:

- The automatic stay of section 362 of the Code that prevents the lender from exercising any rights over its collateral or against the BRE without first obtaining relief from the court. Seeking relief from the automatic stay would likely result in delay of payment to the lender. Also, the lender will incur the cost of retaining counsel to protect its interests in the bankruptcy case.
- The lender's secured debt could be subject to restructuring in the bankruptcy case it now finds itself a part of as a result of the substantive consolidation. A bankruptcy court may alter the terms of the loan in a way that helps the consolidated debtors if the bankruptcy court finds that there will be no harm to the lender. Examples include lengthening the term of the loan or lowering the borrower's monthly payments.

A bankruptcy court is a court of equity and there may be a compelling equitable argument for substantive consolidation under the right facts. For example, the court might favor small "mom and pop" creditors that did business with the debtor and may lose their family businesses because they were left with no recovery over another lender that has its secured claim respected and is paid in full with interest even if the court allows substantive consolidation. This is a sympathetic dynamic for the creditors seeking substantive consolidation and the court may be looking for a reason to justify relief that appears to help many and harm nobody in any tangible way.

A deemed consolidation should be distinguished in a Chapter 11 plan for distribution purposes. In a deemed consolidation, assets and liabilities of the debtor are treated as if there were a true substantive consolidation. Merger of the separate affiliated entities and inter-company liabilities and guarantees would be eliminated, but solely for purposes of the Chapter 11 plan confirmation and claims distribution process. Creditors of each separate entity would therefore be lumped together by class to vote on the plan and for distributions under the plan. There would be no actual consolidation or merger of the entities.

While there are many precedents and standards a bankruptcy court might use to determine if substantive consolidation is warranted, depending on the jurisdiction in which the court is located, as a general matter they are all fairness tests. It is often stated in judicial opinions that substantive consolidation should be used sparingly and as a last resort. Stated tests for substantive consolidations on their face appear difficult to meet.

For example, in *In re Owens Corning*, the test used by the court for consolidation established that:

> "[W]hat must be proven (absent consent) concerning the entities for whom a substantive consolidation is sought is that (i) prepetition they disregarded separateness so significantly their creditors relied on the breakdown of entity borders and treated them as one legal entity or (ii) postpetition their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors." (See *419 F.3d 195 (3d Cir. 2005)*.).

Clearly, such a test sets a high hurdle to clear.

SAMPLE SEPARATENESS PROVISION

The following sample clause is a comprehensive set of separateness requirements a lender may require in a borrower's organizational documents and loan documents.

Arguably, some of these requirements are unrelated to separateness and are instead related to being a BRE, but they are often grouped together under one heading typically entitled "Single-Purpose Entity" or "Separateness Covenants." In practice, the loan documents contain corresponding covenants of the BRE borrower's compliance. Counsel for the borrower should pay close attention to the list, as a breach of the separateness covenants often causes the nonrecourse nature of the loan to become recourse to the guarantors (see *Practice Notes, Trends in Nonrecourse Carveout Guaranties in Commercial Real Estate Loans (http://us.practicallaw.com/9-520-7581)* and *Negotiating Nonrecourse Carveout Guaranties in Commercial Real Estate Loans (http://us.practicallaw.com/2-521-0515)*).

The BRE since the date of its formation and at all times on and after the closing date, has complied with and shall at all times comply with the following requirements:

A. is and shall be organized solely for the purpose of acquiring, developing, owning, holding, selling, leasing, transferring, exchanging, managing and operating the [REAL PROPERTY] (the Property), entering into and performing its obligations under the loan documents with lender, refinancing the Property in connection with a permitted repayment of the loan, and transacting lawful business that is incidental, necessary and appropriate to accomplish the foregoing;

B. has not engaged and shall not engage in any business unrelated to the activities set forth in clause (A) above;

C. has not owned and shall not own any real property other than the Property;

D. does not have, shall not have and at no time had any assets, other than the Property and personal property necessary or incidental to its ownership and operation of the Property;

E. has not engaged in, sought, consented or permitted to and shall not engage in, seek, consent to or permit (i) any dissolution, winding up, liquidation, consolidation or merger or (ii) any sale or other transfer of all or substantially all of its assets or any sale of assets outside the ordinary course of its business, except as permitted by the loan documents;

F. has not caused (other than with respect to the operating agreement of BRE entered into on the closing date) and shall not cause, consent to or permit any amendment of its limited partnership agreement, articles of incorporation, articles of organization, certificate of formation, operating agreement or other formation document or organizational document (as applicable) with respect to the matters set forth in these separateness provisions;

G. if such entity is a limited partnership, has and shall have at least one general partner and has and shall have, as its only general partners, BREs each of which (i) is a corporation or single-member Delaware limited liability company, (ii) has two (2) independent directors, and (iii) holds a direct interest as general partner in the limited partnership of not less than a certain percentage amount (often 1.0% or less);

H. if such entity is a corporation, has and shall have at least two independent directors;

I. if such entity is a limited liability company (other than a limited liability company meeting all of the requirements applicable to a single-member limited liability company), has and shall have at least one member that is a BRE, that is a corporation or a single-member limited liability company, that has at least two independent directors and that directly owns at least some minimum percentage of the equity of the limited liability company;

J. if such entity is a single-member limited liability company, (i) is and shall be a Delaware limited liability company, (ii) has and shall have at least two independent directors serving as managers of such company, (iii) shall not take any bankruptcy related action and shall not cause or permit the members or managers of such entity to take any bankruptcy related action, unless two independent directors then serving as managers of the company shall have consented in writing to such action, and (iv) has and shall have two natural persons or one entity that is not a member of the company, that has signed its limited liability company agreement and that, under the terms of such limited liability company agreement becomes a member of the company immediately prior to the withdrawal or dissolution of the last remaining member of the company;

K. has not and shall not (and, if such entity is (i) a limited liability company, has and shall have a limited liability agreement or an operating agreement, as applicable, (ii) a limited partnership, has a limited partnership agreement, or (iii) a corporation, has a certificate of incorporation or articles that, in each case, provide that such entity shall not) (1) dissolve, merge, liquidate, consolidate; (2) sell all or substantially all of its assets; (3) amend its organizational documents with respect to the matters set forth in this definition without the consent of lender; or (4) without the affirmative vote of two independent directors of itself or the consent of the person that is a member or general partner in it, take any bankruptcy related action;

L. has at all times remained solvent and paid its debts and liabilities from its assets as the same became due and has maintained adequate capital and, to the extent there exists sufficient cash flow from the operations of the Property to do so, will at all times remain solvent and will pay its debts and liabilities (including, a fairly allocated portion of any personnel and overhead expenses that it shares with any affiliate) from its assets as the same become due, and will maintain adequate capital for the normal obligations reasonably foreseeable in a business of its size and character and in light of its contemplated business operations (in each case, to the extent there exists sufficient cash flow from the operations of the Property to do so; provided, that the foregoing shall not require any member, partner or shareholder of BRE to make any additional capital contributions to the BRE);

M. has not failed and shall not fail to correct any known misunderstanding regarding the separate identity of such entity and has not identified and shall not identify itself as a division of any other person;

N. has maintained and shall maintain its bank accounts, books of account, books and records separate from those of any other person and, to the extent that it is required to file income tax returns under applicable law, has filed and shall file its own income tax returns, except to the extent that it is required by law to file consolidated tax returns and, if it is a corporation, has not filed and shall not file a consolidated income tax return with any other corporation, except to the extent that it is required by law to file consolidated tax returns;

O. has maintained and shall maintain its own records, books, resolutions and agreements;

P. has not commingled and shall not commingle its funds or assets with those of any other person and except as contemplated by any property management agreement (where the property manager is acting as an agent of the BRE), has not participated and shall not participate in any cash management system with any other person except each co-borrower under the loan;

Q. has held and shall hold its assets in its own name;

R. has conducted and shall conduct its business in its name or in a name franchised or licensed to it, except for business conducted on behalf of itself by another person under a business management services agreement that is on commercially reasonable terms, so long as the manager, or equivalent thereof, under such business management services agreement holds itself out as an agent of the BRE;

S. (i) has maintained and shall maintain its financial statements, accounting records and other entity documents separate from those of any other person; (ii) has shown and shall show, in its financial statements, its asset and liabilities separate and apart from those of any other person; and (iii) has not permitted and shall not permit its assets to be listed as assets on the financial statement of any of its affiliates except as required by GAAP, however, that (1) any such consolidated financial statement contains a note indicating that the BRE's separate assets and credit are not available to pay the debts of such affiliate and that the BRE's liabilities do not constitute obligations of the consolidated entity and (2) such assets shall also be listed on BRE's balance sheet, as applicable;

T. has paid and shall pay its own liabilities and expenses, including the salaries of its own employees, out of its own funds and assets, and has maintained and shall maintain a sufficient number of employees, if any, in light of its contemplated business operations;

U. has observed and shall observe all partnership, corporate or limited liability company formalities, as applicable;

V. shall have no Indebtedness other than (i) the loan, (ii) permitted debt under the loan documents, and (iii) such other liabilities as the BRE is expressly permitted to incur pursuant to the loan agreement or as otherwise imposed by law;

W. has not assumed, guaranteed or become obligated and shall not assume or guarantee or become obligated for the debts of any other person, has not held out and shall not hold out its credit as being available to satisfy the obligations of any other person, in each case except as permitted pursuant to the loan agreement and the other loan documents;

X. has not acquired and shall not acquire obligations or securities of its partners, members or shareholders or any other owner or affiliate;

Y. has allocated and shall allocate fairly and reasonably any overhead expenses that are shared with any of its affiliates, constituents, or owners, or any guarantors of any of their respective obligations, or any affiliate of any of the foregoing, including, but not limited to, paying for shared office space and for services performed by any employee of an affiliate;

Z. has maintained and used and shall maintain and use separate stationery, invoices and checks bearing its name and not bearing the name of any other entity unless such entity is clearly designated as being the BRE's agent;

AA. has not pledged and shall not pledge its assets to secure the obligations of any other person;

BB. has held itself out and identified itself and shall hold itself out and identify itself as a separate and distinct entity under its own name or in a name franchised or licensed to it and not as a division or part of any other person;

CC. has maintained and shall maintain its assets in such a manner that it shall not be costly or difficult to segregate, ascertain or identify its individual assets from those of any other person;

DD. has not made and shall not make loans to any person and has not held and shall not hold evidence of indebtedness issued by any other person or entity (other than cash and investment-grade securities issued by an entity that is not an affiliate of or subject to common ownership with such entity or permitted debt under the loan documents);

EE. has not identified and shall not identify its partners, members or shareholders, or any affiliate of any of them, as a division or part of it, and has not identified itself and shall not identify itself as a division of any other person;

FF. other than capital contributions and distributions permitted under the terms of its organizational documents, has not entered into or been a party to, and shall not enter into or be a party to, any transaction with any of its partners, members, shareholders or affiliates except in the ordinary course of its business and on terms which are commercially reasonable terms comparable to those of an arm's-length transaction with an unrelated third party;

GG. has not had and shall not have any obligation to, and has not indemnified and shall not indemnify its partners, officers, directors or members, as the case may be, in each case unless such an obligation or indemnification is fully subordinated to the loan and shall not constitute a claim against it in the event that its cash flow is insufficient to pay the loan;

HH. has not had and shall not have any of its obligations guaranteed by any affiliate except as provided by the loan documents with respect to the guaranty and environmental indemnity;

II. has not formed, acquired or held and shall not form, acquire or hold any subsidiary; and

JJ. has not permitted and shall not permit any affiliate or constituent party (other than the property manager, solely in its capacity as an agent of the BRE) independent access to its bank accounts.

For additional information related to bankruptcy legal opinions typically required by lenders in commercial real estate loan transactions, see *Practice Note, Legal Opinions: Commercial Real Estate Finance: Bankruptcy Law Legal Opinions (http://us.practicallaw.com/3-590-8127)*.

08-15