



# Protecting and Perfecting Rights to Entitlements and Related Materials from the Impact of Foreclosure

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Over the past couple and for the next few years, numerous commercial real estate foreclosures have occurred and will occur while the owners or developers (or potential buyers, receivers and/or bankruptcy trustees) are processing entitlements when the trustee's sale or judgment for foreclosure happens. So, how does a lender protect and perfect rights to entitlements and related materials from the impact of a foreclosure?

Does the foreclosing lender acquire title to the real estate only? Do the entitlements, even if only in process, "run with the land" (i.e., an interest in real property), or are such entitlements merely personal property that are lost as a result of the real property foreclosure? Can the lender acquire the ownership interest in the needed materials used to process the entitlements and any interest in the actual entitlements, even if not approved, recorded or issued? From the perspective of the City or County, will the lender be able to "step into the shoes" of the person processing the entitlements (e.g., owners, developers, potential buyers, receivers or bankruptcy trustees)?

These are some of the questions that a foreclosing lender (e.g., banks, thrifts, mortgage bankers, pension funds, insurance companies, capital funds and private parties) ("Lender or Lenders") should consider. The purpose of this article is to explain the issues and processes relating to protecting and perfecting entitlements and related materials from the impact of foreclosure on applications, maps and permits, all of which can be thought of as part of, and the ultimate objective of, the entitlement or development process.

## APPLICATIONS, PLANS, ENTITLEMENTS, AND PERMITS

In order to ultimately perfect the ownership title in the Materials (defined below) and/or the Entitlements (defined below), the Lender should understand the status of the Entitlements and the status underlying title to the real and personal property. From this knowledge, the Lender can determine the cost, time and the related risk to complete the entitlement and development process.

For purpose of this article, entitlements are parcel maps, tentative maps, final maps, coastal permits, grading permits, building permits and the like, and related instruments (e.g., processing of a general plan or specific plan amendment) ("Entitlements"), and the materials used to process an entitlement usually, but not always (depending on the entitlement) include consultant contracts, renderings, draft maps, consultant reports, designs, building plans and specifications, and the like ("Materials").

Until the Entitlement "runs with the land" as defined by the government code or the mapping document, as a conservative approach, the Materials and the Entitlements should be viewed as personal property. Notwithstanding, permits should be viewed as personal property (i.e., a revocable license issued by a governmental entity). In all cases, unless the Entitlement "runs with the land," the governmental entity must be considered, consulted and consent before an acquiring Lender (or third party) can continue to process the map and/or the permit.

The exact steps in the process will vary based on the approvals being requested and on the requirements of the city or county where the project is being developed. Usually, the formal legal steps in the development process begin with the submission of a project application. When the initial application is rejected as incomplete by city staff, the planning department sends the developer a letter identifying where deficiencies exist and how they can be remedied. If the application is complete, the planning department sends the developer a letter explaining the process and the time lines that apply to the processing of the application.

It is common for developers at this stage to initiate outreach by meeting with community groups, stakeholders and decision-makers. Developers seeking development agreements, general plan amendments and other legislative approvals on major projects will usually consider requesting informal involvement of the planning department, the planning commission and even the city council to refine their project proposal through private and public workshops and design meetings.

Following a determination that a project application is complete, the planning department staff will begin to prepare recommendations. At this stage, sometimes earlier, the planning department staff usually begins processing the documentation and analysis of environmental impacts required under the California Environmental Quality Act (CEQA) by deciding whether the project is exempt from CEQA or if a negative declaration or environmental impact report must be prepared.

The developer then prepares the CEQA documentation for the project generally in parallel with the analysis by the planning department and other city departments of the merits of the project and any modifications or conditions of approval that the planning department staff recommends. Depending on the approval, the decision-maker may be the planning director, the planning commission, a board of zoning adjustments or the city council or board of supervisors.

## PROTECTING AND PERFECTING LENDER RIGHTS

There are four distinct aspects to perfecting rights in the Entitlements and/or Materials ("aspects"). In summary, these "aspects" are: (1) an express security interest must exist in the Entitlements and/or Materials; (2) the non-judicial foreclosure should, in most cases (not necessarily all) include a "unified sale"; (3) post non-judicial sale, the Trustee's Deed Upon Sale should include an express list of all of the Entitlements and/or Materials that were sold and subsequently transferred; and (4) the city or county (along with any associate agencies) and consultants providing services, must expressly acknowledge and consent to the transfer of interest.

Before a Lender pursues the Entitlements and/or the Materials, the Lender should determine whether an interest in these personal property items have been either assigned to the lender or if a security interest has been granted in these items. To make such a determination, these documents will need to be examined. The Lender will be looking for express language in the security agreement that expressly grants a lien in and on personal property collateral arising from and/or related to the development of the property.

In the security agreement, one is looking for such things as: (1) any and all applications, permits, licenses, authorizations, whether approved or in process; (2) tentative maps or any and all other land use entitlements; (3) development rights; (4) sewer capacity; (5) trip generation rights; (6) density allocations; (7) all studies, tests, contracts, plans, or specifications relating to the Property; (8) any contract rights, including any

and all guaranties and warranties relating to the construction or design of the improvements on the land; (9) development use rights, governmental permits and licenses; (10) applications for architectural and engineering plans, specifications and drawings, as built drawings, instruments and other documents which arise or relate to the development of the Property; (11) any breach of warranty in connection with construction of any improvement on the property, including causes of action arising in tort, contract, fraud or concealment of a material fact; and (12) any and all other rights or approvals relating to or authorizing development of the property.

If the Lender does have a lien right (or assignment) in these items, during any discussion regarding a workout or forbearance, the lender should obtain such lien rights (or assignment).

## DEFAULT, FORECLOSURE, AND THE UNIFIED SALE

A Lender holding real and personal property collateral may elect, for each item of personal property, between the two choices: (1) proceed separately against the personal property under the Commercial Code, or (2) include the personal property in a real property foreclosure conducted under real property law (i.e., unified sale).

Under a unified sale, the lender holding both real and personal property collateral will include some or all of the personal property in the real estate foreclosure. In that event, the real property foreclosure rules apply to both the real property and the included personal property. This option permits a unified foreclosure sale (judicial or non-judicial), which often makes more financial sense when the personal property relates to real property, adds value to the real property and will produce the highest price on foreclosure if it can be sold together (building and furnishings) as a single entity.

The Lender's election between separate foreclosure and unified foreclosure is available for each item of personal property collateral. Thus, the creditor may include some of the personal property in a unified foreclosure sale under real property law but proceed against other personal property separately under

the Commercial Code. The creditor is not deemed to have elected irrevocably to include any particular property in a real property foreclosure sale until that particular personal property has actually been disposed of in a unified sale. After the unified sale, the better practice is to include a list of the personal property items related to the Entitlements and the Materials expressly in the Trustee's Deed Upon Sale.

## CONSENT OF PROCESSING MUNICIPALITY

Prior to the completion of the foreclosure, the Lender should know whether the public entity will provide such consent, and timing of receiving of the consent. Once the Lender determines that the Entitlements add value to the real property, the Lender should open-up a dialog with the City or County processing the development application(s).

The discussions must be limited in scope; hopefully, allowed under a workout or forbearance agreement with the borrower and the guarantors. The Lender will want to avoid any potential interference or lender liability claims alleged by the borrower or the guarantors. Further, the potential added value to the real property and need for guarantor assistance may affect the bidding strategies and bid process.

Due to nature, complexity, cost and timing of a development, the lender or a third party will want to "step into the shoes" of the developer on the date of the foreclosure. Each application, report, map and permit will need to be placed into the name of the acquiring owner.

Obtaining the right to proceed may be as simple as sending a letter to the City or County, or as complex as receiving the authority to proceed from each department, the planning commission and the city council (or board of supervisors).