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ATTORNEY GENERAL
STATE OF ILLINOIS

November 25, 1991

FILE NO. 91-044

STATE MATTERS:
Restructure of Loans in
Insured Mortgage Pilot Program

COPY

Honorable Patrick D. Quinn
Treasurer
State of Illinois Center
100 West Randolph, Suite 15-1600
Chicago, Illinois 60601

Dear Treasurer Quinn:

I have your letter wherein you inquire regarding the validity of the second restructuring of three commercial loans made as part of the Illinois Insured Mortgage Pilot Program, which was instituted by the Treasurer's office in 1982. From my examination of the information and documents you have furnished, I have found no basis for concluding that the second restructuring agreement is legally invalid.

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The Illinois Insured Mortgage Pilot Program (hereinafter "IIMPP") was implemented through the execution of a Purchase Agreement, Trust Indenture and Servicing Agreement (hereinafter "Agreement") by the State of Illinois, The American National Bank and Trust Company of Chicago (hereinafter "ANB") and the American National Bank and Trust Company of Chicago as Trustee (hereinafter "Trustee") on July 14, 1982. Although the Agreement has subsequently been amended, the essential provisions of the program have not changed. The IIMPP provided the framework for the State to invest in securities backed by a pool of commercial mortgages, thereby making available to several industrial and commercial enterprises construction and start-up financing which would otherwise have been unavailable due to the prevailing market conditions at that time.

Pursuant to the Agreement, the State deposited $120 million with ANB and received in return investment certificates issued by ANB. ANB deposited the funds in the trust, which made interim investments as approved by the State. ANB arranged construction loans for selected projects, and funds from the trust in the amount of the loans were deposited with ANB. ANB assumed the credit risk during construction. Upon completion of each project, the loan was converted to a seven year mortgage loan which ANB assigned to the Trustee. Private mortgage insurance, and subsequently letters of credit or

bonds, were obtained to cover 15% of the outstanding principal of each loan. The remaining risk was incurred by the State, which now holds investment certificates in a trust with assets consisting of pooled commercial mortgages. At present, all but three of the mortgage loans have been repaid; it is the remaining three loans which are the subject of your inquiry.

The original mortgage loans were of a conventional nature, requiring monthly interest payments at the annual rate of 12 1/4%, with full payment of principal due at the end of seven years. All three properties, however, suffered substantial operating losses in their first years. One was reorganized in bankruptcy, and the other two were in default on their loans by mid-1987. In January, 1988, the trustee, with the concurrence of the State as certificate holder, restructured all three loans.

The first restructuring agreement added unpaid interest to the principal, extended maturity to 1995, reduced the average annual interest rate to 8%, a portion of which was to be paid from cash flow, required security for 15% of the principal and prohibited partnership distributions until the 8% annual interest was paid. Following the first restructuring, the three ventures continued to experience losses or limited profitability, and again defaulted on their loan payments. One of the loans was restructured a second time in May, 1990, and the other two were restructured in January, 1991. The terms of the second restructuring of each loan are similar.

The second restructuring agreement, entered into with the consent of the State as certificate holder, in each case added accrued unpaid interest to principal, extended the maturity date to the year 2010, and provided for an annual interest rate of 6% payable quarterly. Quarterly payments are to include the lesser of "Borrowers Obligations", defined as any interest, principal or other sum due and owing to the trustee under the restructured loan documents, or 100% of cash flow available plus 95% of secondary cash flow available. "Cash flow available" is defined to include gross receipts less specified expenses up to a stated sum each year. "Secondary Cash Flow Available" is the cash flow above the stated sum. The loan documents limit amounts which the ventures may pay on other obligations and prohibit partnership distributions until all sums due to the Trustee are paid in full. The requirement of insurance or letters of credit for 15% of the outstanding principal is continued. As additional collateral, however, the second restructuring agreement requires the borrowers to provide surety bonds to secure a portion of the principal and accrued interest which exceeds the appraised value of the mortgaged property (30% for the first loan year, increasing to 100% for the tenth and subsequent years). Because of the provision for payments based upon cash flow, a default is unlikely to occur prior to loan maturity, as long as the

documentation requirements are met. Further, as you have noted, no interest is to accrue on unpaid interest.

Section 22 1/2 of the Deposit of State Moneys Act (Ill. Rev. Stat. 1989, ch. 130, par. 41a) authorizes the Treasurer to invest funds which are not needed for current expenditures. The third and fifth paragraphs of section 22 1/2, which were in effect on July 14, 1982, provide:

> " * * *
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> "The State Treasurer may, with the approval of the Governor, invest or reinvest any State money in the Treasury which is not needed for current expenditure due or about to become due, or any money in the State Treasury which has been set aside and held for the payment of the principal of and the interest on any State bonds, in investment certificates and other forms of investment securities of banks incorporated under the laws of this State or any other state or under the laws of the United States; provided, however, that investments may be made only in those banks which are insured by the Federal Deposit Insurance Corporation.
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> * * *
>
> The investment certificates or other forms of investment securities described in the preceding two paragraphs shall not be required to be insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation or to be secured by any pledge of securities.
>
> * * * "

I note that the section has been amended, by Public Act 87-331, effective January 1, 1992, to delete these two paragraphs.

Under the plain terms of section 22 1/2, the Treasurer had authority to purchase the ANB investment certificates, since ANB is an institution which is insured by the Federal Deposit Insurance Corporation, even though the certificates themselves were not insured. The agreement and all subsequent documentation bearing the signature of the Treasurer on behalf of the State appropriately show the approval of the Governor, as required by the statute. It is well settled that the Treasurer has discretion to select among the various investments which he is authorized by law to make, and that other persons or entities cannot control that discretion. (Fairbank v. Stratton (1958), 14 Ill. 2d 307.) While the State, as the sole certificate holder, has the power to direct the Trustee in accordance with the Agreement, the State clearly remains the holder of investment certificates authorized by section 22 1/2, and is not the holder of the mortgages.

You have inquired whether the second restructuring of the mortgage loans may be invalid because the consideration supporting the transaction was inadequate. It is a fundamental principle that a promise to do something which one is already obligated to do does not constitute consideration, and creates no new obligation. (Moehling v. O'Neil Construction Co. (1960), 20 Ill. 2d 255, 266.) There is a distinction, however, between the question of the existence of consideration and the

question of the adequacy of consideration. While the existence of consideration is a question of law, the adequacy of consideration is a question of fact. (Abrams v. Awotin (1944), 388 Ill. 42, 47.) Courts will not review the amount of consideration which passed between the parties to determine whether either party made a bad bargain, unless the amount is so grossly inadequate as to shock the conscience of the court. (Bonner v. Westbound Records, Inc. (1979), 76 Ill. App. 3d 736, 743.) In essence, a contract will not be invalidated for failure of consideration if any significant consideration exists.

The second restructuring agreement does recite consideration. The Trustee, in the agreement, agreed to accept a lower interest rate and a longer term in return for the borrowers' agreement to pay virtually all available cash toward the debt, to forgo partnership distributions and to secure those parts of the loans which exceed the value of the mortgaged property. This last item may be particularly noteworthy, even though not immediately realized, in view of the fact that appraisals of the mortgaged properties performed shortly before the restructuring indicate that the value of those properties is less than the amount of the outstanding principal indebtedness, and the previous loan agreement required insurance or other security to the extent of only 15% of the principal. The

second restructure, whatever its shortcomings may be, appears to provide a greater likelihood for a full return of value at the end of the specified term than did the original agreement or the first restructure. In my opinion, it cannot be concluded that there was no consideration for the State's agreement to a lower rate of interest and a longer term, and I do not believe that a court reviewing the matter would find the consideration to be so inadequate as to shock the conscience.

Alternatively, you have suggested that the second restructuring of the loans may have involved the compromise of a debt of the State which required the concurrence of the Attorney General to be effective. It is well settled, of course, that the Attorney General is the law officer of the people, as represented in the State government, and is its only representative in the courts. Fergus v. Russel (1915), 270 Ill. 304, 337.

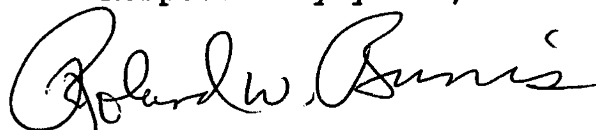
It is also well settled, however, that the Treasurer, with the approval of the Governor, has exclusive control over State investments. (Fairbank v. Stratton (1958), 14 Ill. 2d 307.) From the perspective of the State, as a holder of certificates of investment, the restructuring of the loans in question does not constitute the compromise of a debt, but is rather an agreement to a change in the terms of an investment. His position as chief legal officer of the State notwithstanding, the Attorney General is not required to direct or approve

any investment or reinvestment by the State, or the sale of any investment security. In my opinion, therefore, the approval of the Attorney General was not a prerequisite to the restructuring of the mortgages securing the ANB investment certificates. Consequently, the failure of the Treasurer to secure the approval of the Attorney General for the second restructuring agreement did not render the agreement invalid.

For the reasons stated, and based upon the information at my disposal, it is my opinion that the second restructuring of the loans in question was not invalid.

Nothing herein stated, however, should be construed as commenting upon the wisdom of the investment program under which these loans were made, or of the loans in question. It is noteworthy, in this regard, that those paragraphs of section 22 1/2 of the Deposit of State Moneys Act under which the original investment of public funds was made are apparently the only provisions of law which permit the investment of public funds in instruments which are not fully insured or otherwise secured. The General Assembly has evidently reconsidered its grant of authority for such investments, as it has, as noted above, adopted legislation which repeals that grant of authority effective January 1, 1992.

Respectfully yours,



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