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Commercial Real Estate Loan Workouts: New Restructuring Opportunities

Leveraging the Latest Federal Guidelines in Negotiating an Effective Workout Agreement

A Live 90-Minute Teleconference/Webinar with Interactive Q&A

Today's panel features:

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12 pm Central

11 am Mountain

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Developing and Implementing a Workout Strategy

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A Broader PerspectiveSM

Overview of Workouts/Restructures

- DEVELOP A STRATEGY
 - Restructures vs. Workouts
 - Immediate Action Steps
 - Limits on the Lender's Objectives/Borrower's Options
 - Know Your Enforcement Options
- TYPES OF WORKOUTS
 - Foreclosure And Alternatives to Contested Proceedings
 - Forbearance Agreements
 - Bankruptcy and Mitigation Techniques

Restructures vs. Workouts

- Key Distinctions - Goals Follow Desired Exit Strategy
 - Restructure Involves Changing The Terms Of A Currently Performing Loan, Or To A Loan That Can Become Performing After The Restructure
 - Workout Involves Taking A Non-Performing Loan And Working To An Agreed-upon Exit Strategy
- Initial Agreements Set Terms For Future Relationship
 - Purposes Include Giving Notice Of Defaults, Reserving Rights/Remedies, Requiring Performance Under The Loan, “Cleaning-up” Deal, Warning Of “Consequences”
 - Borrower’s Ability to Negotiate

Immediate Actions

- Default/Acceleration Notices
 - Use Of Pre-Workout Letters
 - Establish Basis Of Disputes – Describe Disputes And Defaults
 - Sets Boundaries For Discussions – No Obligations On Lender, No Waiver Or Estoppel, Confidentiality, Right To Terminate And Pursue Remedies, Ease Path To Remedies - i.e., Receivership
- Enforceability of Pre-Workout Letters
 - Extent of Confidentiality/Evidentiary Protections
 - Specific Remedies/Attorneys' Fees Provisions

Immediate Actions (Part II)

- Obligations of the Property Manager
 - Terminate Or Continue
 - Insider vs. 3rd Party Managers
- Lockboxes
 - Change Application Of Funds; Hold Excess Proceeds
 - Springing Lockboxes; ARD Situations
- Staged Response
 - First, Default/Notice Letter
 - Next, Pre-Workout Letter
 - Finally, Forbearance Agreement

Limits on the Lender's Objectives

- Value Of Collateral
 - Oversecured vs. Undersecured
- Priority of Security Interest
 - Intercreditor Issues
 - Perfection Issues
- Recourse v. Non-Recourse Liability
 - One-Action and Anti-Deficiency Issues
- Securitized Loans And PSA Requirements

Forbearance Agreements

- Basic Elements

- Acknowledge Defaults
- Allow Notice and Cure Periods to Expire
- Initiate and Then Postpone Remedies
- Obtain Key Waivers Not Available In Other Contexts (i.e., One-Action, Anti-deficiency and Bankruptcy)
- Maintain Maximum Leverage Over Borrower
- Restructure the Business Terms

- Reasons for Using This Agreement

- Maintain Relationship as Part of Exit Strategy

Enforcement Options

- Receivership
 - Ex Parte vs. Motion for Appointment
 - Practical Considerations
- Writs of Attachment
 - Tool To Use On Guarantors
- Remedies Against Personal Property Collateral
- Judicial vs. Non-Judicial Foreclosure
 - One Action and Anti-Deficiency Considerations
 - Optional Use of Either Remedy; “Dual Tracking”
 - Timing Considerations

Enforcement Options (Part II)

- Bad Boy Carve-Out Guaranties
 - Enforced by Courts for Damages or Full Recourse
 - Not Prohibited as Liquidated Damages or Penalty Provisions
 - Specificity of Provisions Affects Enforceability
- Springing Recourse Guaranties
 - BK Filing, SPE Violations, Additional Debt and Unpermitted Transfers Can Be Recourse Triggers
 - Misapplication of Funds Can Apply to Transfers of Rents, Proceeds, Accounts and Receivables

Enforcement Options (Part III)

- Expansion Of Waste Remedies
 - Failure to Maintain or Repair Property with Rents or Other Revenues
 - Failure to Pay Taxes or Insurance Premiums
- Material Adverse Change (or MAC) Provisions
 - Limited Case Law in the Loan Context
 - Subjective vs. Objective Standards
 - Trigger Default vs. Trigger Additional Lender Rights

Types of Workouts

- Alternatives to Foreclosure
 - Deed in Lieu of Foreclosure
 - Title Subject to Competing Liens and Other Defects
- Consensual Foreclosure
 - Permits a Lender to “Clean Up” Title, And Can Speed Up the Process
- Consensual Bankruptcy
 - Risk Of Trustee Or Judicial Interference
- Note Sale
 - Limited Market; Uncertain Pricing

Conclusion

- Understand the Advantages of Approaches and Use Them As Required to Stay On Top Of the Borrower and the Project
- A Little Advance Warning to Third Parties Is Invaluable to Identify Problems Or Possible Claims
- Remind Borrower of The Extent of Your Remedies, and take Action To Factually and Legally Preserve All Rights and Remedies



COMMERCIAL REAL ESTATE LOAN WORKOUTS
New Restructuring Opportunities

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The Threat of Bankruptcy
Forbearance Agreements
&
Bankruptcy Mitigation Techniques

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The Threat of Bankruptcy

- Measure workouts against bankruptcy
- Is there equity in the property?
- Are there junior creditors?
- What to do with cash collateral?



Till v SCS Credit Corp, 541 U.S. 465 (2004)

- Cram down interest rate for Chapter 13
- Prime rate plus 1-3%
- Footnote 10 says *Till* may apply to Chapter 11
- Footnote 14 points to DIP financing rates for Chapter 11
 - GGP case: DIP financing at LIBOR plus 12%
- *In Re American Homepatient Inc.*, 420 F3d 559 (6th Cir 2005)
 - Applies *Till* to Chapter 11
 - Treasury rate plus 3.5%
 - What is the appropriate spread?



SPE Bankruptcy Remoteness & Independent Directors

- Most CMBS/securitized loans contain SPE provisions
 - Designed to limit creditors and insulate the property
 - Avoid entanglement with parent bankruptcy
- Didn't work in the GGP bankruptcy
 - Performing properties were placed in bankruptcy
 - Independent directors apparently voted yes
 - Cases settled and so issue was not litigated
- Generally RE bankruptcies are not as common as 90s
 - Death of the new value exception
 - Single asset real estate provisions
 - Springing recourse

Alternatives to Foreclosure

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Alternatives to Foreclosure

- Threshold Question - Should the owner be replaced?
 - Identify the cause of the default
 - Analyze relationship between borrower and lender
 - Trust and confidence in borrower?

Alternatives to Foreclosure

- Evaluate Conduct of Borrower
 - Did borrower disclose problems to the lender
 - Has borrower preformed under loan documents and other agreements affecting the project?
 - How has borrower responded to the problems?
 - What is the status of
 - other projects of borrower?
 - similar projects in the market?

Alternatives to Foreclosure

- Leaving Borrower in Control
 - Tighten operational and/or financial controls and reporting requirements
 - Modify loan terms
 - extend the term
 - reduce interest rate and/or principal
 - forbearance
 - advance additional funds
 - obtain additional collateral
 - Taking equity interest in project

Alternatives to Foreclosure

- Removing Borrower
 - Foreclosure
 - Disadvantages
 - length of process and potential delay
 - expense
 - continued decline in value
 - no assurance of positive result
 - may trigger bankruptcy

Alternatives to Foreclosure

- Deed in Lieu of Foreclosure
 - Relatively inexpensive and expeditious
 - Consideration
 - Title insurance
 - Junior liens and encumbrances
 - Discharge and merger of mortgage
 - Documentation
 - settlement agreement
 - representations and warranties
 - conveyance documents

Alternatives to Foreclosure

- Consensual Foreclosure
 - May be preferable if subordinate liens and encumbrances exist
 - Length of process
 - Judicial vs. non-judicial
 - Bidding considerations

Alternatives to Foreclosure

- Additional Considerations Where Borrower Surrenders the Project
 - Release of borrower and guarantors
 - Project management
 - Share in sales proceeds
 - Right of first refusal/brokerage commissions

Alternatives to Foreclosure

- Risks to Lenders Taking Ownership
 - Environmental considerations
 - Premises liability
 - Lender liability
 - Re-characterization of lender-borrower relationship
 - Bankruptcy considerations
 - Due diligence is critical

Alternatives to Foreclosure

- Consensual Bankruptcy
 - Advantages
 - preservation of assets
 - conveyance of title by court order
 - appointment of trustee vs. receiver under state law
 - Modify voting requirements for syndicated loans
 - Disadvantages
 - expense and length of time
 - potential loss of control

Alternatives to Foreclosure

- Bankruptcy Considerations
 - Automatic stay
 - SARE – single asset real estate
 - Adequate protection
 - Cash collateral and post-petition financing
 - Executory contracts and unexpired leases
 - Plan confirmation

Alternatives to Foreclosure

- Sale of the Project or Loan
 - Project
 - Simplest solution/short sale
 - Three party negotiation
 - Borrower/seller, buyer and lender
 - Terms – cash or lender financing
 - May involve modification of existing loan
 - Evaluate loan to value and effect of debt service
 - Documentation
 - Due diligence

Alternatives to Foreclosure

- Sale of the Project or Loan
 - Loan/Note
 - Due diligence considerations
 - Limited opportunity will probably result in lower price
 - Capital structure
 - Receivership
 - Allows REMICs to provide seller financing
 - May increase recovery



Forbearance Agreements

- *Hope springs eternal*
- Short term forbearance agreements designed to lead to near term payoff of the loan
- Reinstatement agreements designed to lead to near term restoration of the loan to non-delinquent status
- “One bite at the apple” forbearance structures designed to achieve finality.



Classic mortgage loan workouts

- What's in it for the Lender? Lender "wish list" includes:
 - -paydown of the loan or other cash infusion
 - -additional collateral
 - -increase the interest rate or amortization, shorten the period to maturity or retrade other business terms such as payoff provisions
 - -add guarantors or recourse to a non-recourse loan
 - -establish escrows (tax, insurance, capital reserves, tenant work)
 - -activate or establish a lockbox to control cash flow
 - -obtain/require supplemental property information or reports
 - -reduce/eliminate Borrower rights such as partial releases of collateral
 - -increase/enhance lender rights such as approval over budget or leasing
 - -correct any legal weaknesses/deficiencies in the existing documents
 - -waive existing offsets, defenses or lender liability claims
 - -change in property management/leasing agent



“One bite at the apple”

- Forbearance Agreements with finality
- Waivers, acknowledgements, and factual stipulations re: foreclosure
- Springing recourse liability for any opposition to Lender’s remedies
- Releases of guaranties conditioned upon the Borrower’s compliance
- Discounted payoff rights which expire after the forbearance period
- Deed in lieu of foreclosure held in escrow
- Consent judgment of foreclosure held in escrow
- Consent order incorporating the forbearance terms
- Prepackaged bankruptcy



Bankruptcy mitigation

- How to discourage bankruptcy filing?
- Springing recourse
- Stay relief waivers
 - Absence of equity
 - Single asset real estate
 - Two party dispute: no other creditors
- Absolute assignment of rents
- Collateral assignment of equity
- “Don’t come crying to me”