

QUICK TIPS FOR REPRESENTING BORROWERS IN  
REAL ESTATE LOAN WORKOUTS

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## QUICK TIPS FOR REPRESENTING BORROWERS IN REAL ESTATE LOAN WORKOUTS

*So comes a reck'ning when the banquet's o'er,  
The dreadful reck'ning, and men smile no more.<sup>2</sup>*

### Introduction.

The “banquet” of cheap money, inflated appraisals, generous loan proceeds and suspect underwriting is over, and no one in the US real estate industry is smiling. Real estate lawyers today are more likely to receive calls from clients (to the extent clients are calling at all) regarding modifications<sup>3</sup> to existing loans, as opposed to documenting and closing new loans.

So, how can we as attorneys effectively help our client negotiate and document a mortgage loan restructuring? This article contains a short list of suggestions that may be useful to the borrower’s counsel in helping a client successfully and expeditiously negotiate a loan workout with its mortgage lender.

### Quick Tips.

#### Tip Number 1: Do Your Homework.

In preparation for loan workout negotiations, borrower’s counsel must understand not only the stated reasons for the pending loan workout, but also the following matters that may require attention in the loan modification documents: (i) any likely adverse

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<sup>2</sup> Gay, *The What D’ye Call It*, Act II, Sc. 9.

<sup>3</sup> Throughout this article the words “modification” and “workout” are used interchangeably.

short term changes in the physical condition of the property and/or the financial condition of the property or the borrower that the parties also should consider addressing in the loan modification process; (ii) the borrower's (and the borrower's partners and/or investors, if applicable) organizational structure(s), ability and/or willingness to contribute additional funds to operate the property or to service/guaranty the mortgage indebtedness; and (iii) to the extent information is publicly available, the lender's (and any co-lender's and participant's) current financial condition and recent history regarding negotiating loan modifications.

The borrower's counsel also must obtain (if he does not already have) and review a complete set of the existing loan documents for the transaction. As many borrowers and lenders are starting to discover, the pre-2008 "loan rush" to underwrite and document loan transactions (particularly CMBS loans) sometimes resulted in incomplete loan documentation (e.g., documents missing certain dates or amounts; loan files missing ancillary loan documents such as side letters or emails that modify loan document terms). Missing documents may contain material loan document provisions that might require modification as part of the loan workout negotiations.

Tip Number 2: Be Honest, Be Transparent.

The borrower and its counsel should be as honest and as transparent as practicable in their dealings with the lender during loan workout negotiations, particularly in (i) responding to the lender's requests for delivery of financial and/or property information, and (ii) explaining the rationale for requesting various loan document modifications. The parties may find it difficult, if not impossible, to successfully negotiate a loan workout

without a high level of mutual respect and cooperation. Developing a reputation as a “straight shooter” not only will serve you well in the current negotiations, but also will benefit you in future transactions with the lender(s) as well as with other parties.

Tip Number 3: Do a Reality Check.

The borrower and its counsel should carefully evaluate the borrower’s “leverage points” (i.e., those loan modification “must have” and “wish list” items where the borrower has the best negotiating positions to obtain borrower-favorable loan document changes) prior to commencing the loan modification negotiation and documentation process. Regardless of whether the borrower elects to take an aggressive or less aggressive negotiating posture, having a clear understanding of which party has the best leverage on the various issues can expedite the completion of the loan workout. In the current “extend and pretend” loan workout environment, a savvy borrower may have the advantage of more “leverage points” than in a more lender-friendly climate.

Tip Number 4: Establish a Strategy and Priorities.

For all complex loan modifications, Borrower and its counsel should develop a negotiation strategy and make two lists: (i) a list of “must have” loan document changes, and (ii) a “wish list” of desired changes to the existing loan documents (i.e., changes that clean up ambiguities in the documents and/or that make certain provisions in the documents more favorable to the borrower), ranked in order of the borrower’s priority in each category. When proposing loan document modifications to the lender, the borrower and its counsel should not announce to the lender whether a proposed change is a “must have” or a “wish list” item, nor should the borrower initially discuss the priority of its

changes. You and your client may find it advantageous to begin negotiations by presenting the “wish list” items first, as a method of gauging the lender’s approach to the loan document modification negotiations.

Any strategy discussions should: (i) consider the various factors described in the first paragraph of Tip Number 1 above and the possible impact of those factors on the borrower’s objectives and priorities in obtaining loan document modifications, (ii) involve determining how aggressive the borrower plans to be in negotiations with the lender, and (iii) identify the borrower’s realistic options in the event the parties cannot reach agreement on the “must have” loan modifications. Those options may include (a) a bankruptcy filing<sup>4</sup>, (b) initiating litigation against the lender, (c) allowing the lender to exercise its rights under the loan documents, or (d) negotiating a deed-in-lieu of foreclosure.

Tip Number 5. Be Careful, But Quick.

Depending on the complexity and financial significance of the proposed loan modifications, negotiating and documenting the transaction can require significant borrower human capital resources that otherwise could be administering day-to-day and other borrower business operations. Also, delays in negotiating and documenting the deal may result in adverse financial consequences for the borrower (e.g., if the borrower is seeking to convert a floating rate loan into a fixed rate loan and interest rates rise during negotiations). Finally, an extensive process may result in higher than expected

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<sup>4</sup> See, e.g., Michael H. Goldstein and Adam M. Starr, *Navigating the Distressed Real Estate Workout*, Probate & Property, May/June 2010, at 13.

legal fees from the borrower's counsel, particularly if the negotiations occur in the "stop-and-start" pattern that currently seems to be a trend in many real estate deals.<sup>5</sup>

While some borrowers and lenders spend significant time negotiating the pre-workout letter with the intention of using that letter as a detailed blueprint for preparing and negotiating the actual loan modification documents, where speed of starting documentation is crucial it may be better to negotiate only the most basic pre-workout letter and immediately begin working on the actual loan modification documents.<sup>6</sup> Regardless of the borrower's desire, if any, to speedily negotiate and document the loan modifications, counsel must use care to make sure that the final documentation accurately reflects the borrower's agreed-upon modifications, including cleaning up any prior imperfections in the loan documents and addressing anticipated loan document problems (if applicable). The negotiated loan modifications may represent the borrower's best opportunity with respect to amending the loan documents in a favorable manner.

Tip Number 6. Do Not Make it Personal.

Successfully completing a loan workout can have a positive or adverse affect on the involved individuals' finances and/or careers. With so much sometimes riding on completing a loan modification transaction, the pressure can lead to acrimonious negotiations if people do not act professionally. For attorneys in particular, losing your

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<sup>5</sup> This trend is a result of some or all of the following factors: (i) the lender's inability to correctly value assets in a timely fashion; (ii) more careful, and time consuming, underwriting by lenders, and/or (iii) indecision on the part of prospective loan and/or asset sellers and/or buyers.

<sup>6</sup> Moving quickly to finalize the pre-workout letter is particularly important in situations where the borrower needs immediate loan document financial covenant relief or forbearance and the lender will not commence workout negotiations prior to having a fully executed pre-workout letter.

temper and making angry threats (especially if you have to end up backing off of the threats) is counterproductive, and being verbally abusive or temperamental can lead to careless and costly mistakes and can also damage your reputation. Always endeavor to act in a rational and professional manner.<sup>7</sup> Both your clients and the lender(s) ultimately will appreciate your efforts in this area.

#### Conclusion.

The quick tips described above in this article are only a few tools in the attorney's loan workout toolbox. The borrower and lender (together with their respective counsel), by taking a common sense approach to identifying, resolving and properly documenting loan document problems, and acting in an honest, cooperative and professional manner, can successfully and efficiently negotiate and document a loan modification transaction.

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<sup>7</sup> A good rule of thumb: "treat others as you want to be treated."