

# **Reznick and Ballard Spahr**

## **Forum on Work-Out and Recapitalization Strategies**

**Los Angeles, CA  
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# Workout Strategies & Options

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## Typical strategies and options:

- Maturity date extension
- Additional funding
- Interest rate reduction / amortization relief
- Principal balance reduction
- A/B Note split
- Relief from personal guaranty
- White Knight / Rescue financing
- Short sale
- Deed-in-lieu of foreclosure
- Foreclosure
- Bankruptcy

# Workout Planning & Assessment

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## Borrower Preparation for Presenting Best Case

- **Realistic Assessment of current economic situation/analysis of relative strengths and weaknesses of various parties (Includes a review of legal/tax positions, interests and underlying causes of current problems at Borrower and/or Property)**
  - Get control of the facts/information
  - Look at cash flow, liquidity, valuation and or capitalization pressure points from both sides
  
- **Understanding of complex (opaque) nature of today's credit markets and effect on any loan modification/recapitalization planning as well as execution. This may also extend to the terms/parameters for additional capital (via recapitalization, etc)**
  
- **Economic and Financial abilities of Borrower/Borrower's Principals**
  - Internal additional capital availability?
  - Financial status of Borrower/Principals (economic distress/imminent BK?)
  - Additional Third party capital investment?
    1. New equity/mezzanine debt or other takeout financing?
    2. What is feasibility of raising new third party capital?
    3. Can property be made attractive for new money?

# Workout Planning & Assessment

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## Borrower Preparation for Presenting Best Case Cont'd

- **Business/Legal terms of the loan transaction and analysis of lender**
  - Recourse provisions (e.g. Bad boy, anti BK recourse, prepayment obligations, environmental)
  - Construction loans (conditions for lender to fund versus withhold draws?)
  - Default provisions (any default notice outstanding or imminent?, acceleration of loan? Default interest being charged?)
  
- **Analysis of Lender(s) and impact on their strategy/objectives**
  - Single versus club / group (syndicated) versus securitized
  - Nature, agenda and philosophy of lender
    1. Aggressive or cooperative
    2. Reputation and relationship considerations with borrower/Principals
    3. Quick exit (sale or DPO) more important than maximum recovery?
    4. Ability of lender/servicer to take over and manage (how does that vary depending on type of asset/stage of development)?

# Workout Planning & Assessment

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## Borrower Preparation for Presenting Best Case Cont'd

- **Approach to resolving the issues**

- Team Approach

1. Typically in every case: accountants, financial advisors (including tax), lawyers, mortgage, sales and leasing brokers
2. As needed: Tax, bankruptcy and litigation counsel; construction experts, if needed

- Addressing problems earlier rather than later; comprehensive preparation and early intervention are key

- Creating pragmatic and achievable goals by Borrower under a pragmatic plan that addresses Borrower (as well as Lender) needs.

- Creating a open and professional dialogue between both parties and recognize it's a process (not a normal run of the mill transaction)

# Scenario 1: Valuation/Refinance Takeout Challenge

## Property / Market Dynamics

- **Valuation an issue for takeout financing**
  - Takeout financing suggests first mortgage proceeds of \$72-75MM
- **Suffered nominal NOI decline**
- **Significant deferred maintenance as equity partner went BK**

## Capital Structure Dynamics

- **\$90MM Whole Loan Amount against \$120MM value**
  - \$85MM CMBS first mortgage; Interest only (I/O) – 5 year balloon
  - \$5MM mezzanine; I/O – 5 year balloon
  - Client would struggle to make debt service with amortization constant
  - Client unable to refinance
  - Imminent default situation
- **Bankrupt Equity Partner**

## Modification/Recapitalization Options

- Modification options / solutions
  - Loan extension for X term, X% extension fee
  - Partial loan pay-down; \$X or X%
  - Debt reduction or DPO
- Replacement equity provided by new capital group

## Scenario 2: Extreme C/F Decline; Value below Debt

### Property / Market Dynamics

- Large Tenant Vacates 68% of space
- NOI drops 90% from previous year
- Depreciating property value based on current market appraisal
  - Current value of \$28MM
- Client does not have available funds to provide necessary TI concessions for new tenant

### Capital Structure Dynamics

- \$50MM Original Loan Amount
  - Whole loan held in CMBS Trust
  - 5<sup>th</sup> largest loan in the CMBS Trust
  - Secured by first lien deed of trust on two Class A office buildings
- Original LTV of 75%
- Borrower had significant equity in the project, but depleting liquidity

### Modification Options

- Loan balance reduction; potential DPO (discounted pay-off)
- Bifurcate loan into separate A and B Notes with adjusted terms
- Borrower fund \$X into TI reserves at closing; for TI (next 12-18 months)
- Borrower will fund all future net cash flow shortfalls as needed

## Scenario 3: Broken or Busted Development Deal

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### Property / Market Dynamics

- Vacant land entitled for 100,000 SF multi-family development
- Strong market in Washington DC
- Demand fundamentals have softened somewhat, but overall market conditions still positive

### Capital Structure Dynamics

- Original \$20MM land loan (portfolio lender) against \$40MM valuation
- Borrower failed to get construction financing as credit markets shut down
- Land loan in default; lender pursuing partial recourse and taking back property
- Developer spent most of equity on interest/legal fees

### Modification / Recapitalization Options

- DPO on old land loan to \$16MM (25% reduction); recourse settled
- Private Equity provides "White Knight" recapitalization
  - Fund new equity on 70% / 30% basis
  - Obtain Construction financing of \$20MM based on new equity

## Workout Strategies & Options – Scenario Comparison

	Valuation/Refi/ Takeout Issue	Cash Flow Decline; Value Below Debt	Busted Development
Maturity date extension	H	M	L
Partial principal pay down (by Borrower)	H	M	M
Interest rate reduction/amortization relief	M	M	L/M
Principal balance reduction (by Lender)	L	M	M
Discounted Pay Off (DPO)	M	H	H
A/B Note split	M	H	M/H
Relied from personal guaranty	L	L/M	L/M
“White Knight” or Rescue Financing/ Funding	M	H	H
Short sale	L	M	H
Deed-in-lieu of foreclosure	L	H	H
Foreclosure	L	H	H
Bankruptcy	L	H	H

Key: Relative Strength of Workout Strategy H = High; M= Medium; L= Low