

Borrower Side

Work-Out Planning and Principles
Including Entity Level Concerns

Table of Contents

Borrower Preparation for Presenting Best Case	3
Theory of Non-Judicial Workouts	6
Absolute Priority Rule	8
Plan Development	9
Completing Restructuring Plan Package	11
Executing Restructuring Plan	12

Note: The following material developed and oriented towards a mixture of corporate entity level restructuring and specific project level restructuring needs, not solely on a one-off project level basis.

Borrower Preparation for Presenting Best Case

- **Conduct a 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 Entity level and/or Property)
 - Get control of the facts / information
 - Look at cash flow, liquidity, valuation and or capitalization pressure points (both sides)

- **Incorporate 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)

- **Determine 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 / entity be made attractive for new money?

Borrower Preparation for Presenting Best Case

- **Formulate team 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)

Borrower Preparation for Presenting Best Case

- **Review 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?)

- **Analyze lender(s) position and impact on their strategy/objectives**
 - Single versus club / group (syndicated) versus securitized
 - Degree of concentration and fragmentation across secured / unsecured spectrum
 - 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)?

Theory of Non-Judicial Real Estate Workouts

- **Judicial (i.e. BK) proceedings destroys Company / value**
 - Company decision process handed over to courts where it is frequently contested
 - Legal fees eat up estate
 - Management often demoralized and Company markets may be destroyed
- **Best interests of creditors served if management (frequently representing substantial portion of company ownership) remains intact**
 - In order to entice management / ownership to stay, creditors must give up some of what is “rightfully” theirs as an incentive. Concept is management can create a bigger pie and should be given a slice
 - Lenders seldom prefer to take title to real estate projects
- **Final Plan must provide for viable entity with equity unfettered by outside controls (critical to the “white Knight” scenario)**

Theory of Non-Judicial Real Estate Workouts

- **Advantages of insolvency / BK proceedings have to be considered:**
 - Insolvency proceedings “stay” creditor actions
 - Filing of bankruptcy stops interest on unsecured debt
 - Amounts of liabilities are established according to Plan. Other liabilities are discharged or forgiven by law.
- **Company strategy is to convince creditors that insolvency proceedings are “distasteful alternative” and then use the threat of filing such proceedings as a club to enforce a voluntary stay**
- **Most real estate companies don’t have unsecured debt. To the extent they do, agreement can generally be reached without judicial action to stop the interest**
- **If creditors can be convinced to work together, non-judicial reorganization is always better than bankruptcy filings and a judicial reorganization**
 - Typically contrast recoveries under both scenarios
 - Highlight legal costs and transaction costs that eat up estate value
 - Raise timing uncertainty into the mix from court actions / processes

Theory of Non-Judicial Real Estate Workouts

Absolute Priority Rule

- Although a non-judicial workout may be pursued, parameters of the Plan must consider results under a judicial proceeding
- Absolute priority theory provides more favorable treatment to lenders with a higher priority, e.g. secured versus semi-secured debt, unsecured debt versus subordinated debt, etc.
- One major significant difference in non-judicial environment is that while absolute priority is recognized, in order to achieve a negotiated settlement, frequently lenders with a higher priority will give up benefits they may legally be entitled to for the benefit of lesser secured lenders and the shareholders
 - If there is nothing on the table, then those creditors may as well “tank it”
 - Power to destroy of the public

Plan Development

- **Objective of the Plan**
 - Cash flow relief from debt service
 - Maximum realization from assets in the ordinary course of business
 - Avoid selling off good assets to pay interest
 - Viable entity at the end of the Plan
 - Develop plan under the concept of debtor in possession (no preferences, freeze intercompany transactions, no receiver, etc.)

- **Classification of Lenders into groupings depending on security. Objective is to provide equitable treatment of lenders within each class (absolute priority rule)**
 - Can be a problem in those instances, for example, where you have one lender that is in a well secured credit and that is his only loan
 - On the other hand, the most cooperative lenders are those who are spread throughout the spectrum of secured, semi-secured and unsecured spectrum and covering asset level through entity type leverage

- **Unsecured Debt**
 - Generally have to be dealt with in negotiated settlement (vocal);
 - Extremely troublesome in situations where there are preference transactions or questionable debt versus equity classifications
 - Use illiquid assets but demonstrate realization better than a judicial alternative

Plan Development

- **Workouts can be compromised when the following are present**
 - Debtors are unable to make payments when due, hastening other legal actions
 - Creditors and debtors don't know whether the debtor's assets are sufficient to settle all claims and when they might be settled
 - Creditors are paralyzed – afraid to act on their security and fearful of taking any action to help the debtor which might compromise their security position
 - Creditors don't trust each other and are attempting to enhance their position at the expense of each other
 - Management of the debtor has lost credibility with the creditors (could be an issue with “most favored nation” type lender negotiations, or lack of full disclosure, transparency, or even reasonable parity within the various classes of lenders)

- **Full disclosure in a well thought out organized manner is the key to advancing the interests of the company and each creditor class**
 - Every party at interest will have to give up something for a viable plan which is generally acceptable; therefore they must understand each other's positions.
 - Negotiations can't proceed fruitfully when questions of fact are at issue
 - We are helpful in getting an agreement of facts by all parties, explaining those facts and using the facts to shape the plan to one that can be understood / internalized and ultimately accepted by the parties.
 - Need to get agreement on the major “Plan concepts” with the major participants, then fight over the money last

Completing Restructuring Plan Package

- **Concise, well thought out executive summary; many lenders may never get beyond this**
 - Pre-plan cash flow
 - Creditor realization based on judicial BK or going concern (non-judicial)
 - Plan summary
 - Post Plan cash flow
 - Post plan financial positions

- **Critical supporting schedules to be included in presentation package, in addition to balance sheet, cash flows, and entity / property level information as appropriate**
 - Creditor realization summaries
 - Qualifications of plan effects by lender
 - Summary of pre plan and post plan balances by lender
 - Number of shares of stock, if any, issued to various classes of lenders
 - Overall yields to lenders through the term of the Plan

- **Integrated and consistency within Plan and footnotes / supporting detail to provide transparency and smooth lender meetings**

Executing Restructuring Plan

- **Preparing Company to go through the process**
 - Top management must appear impressive to lenders and understand basic plan concepts
 - Strategic decisions regarding cash needs during the restructuring period
 - Building a “war-chest” to keep the company in business during negotiations
 - Time for ceasing debt service payments to lenders
 - War-chest needs
 - Timing in accordance with general creditors meeting
 - Building of cash horde can spur lenders to act on a plan

- **Dealing with recalcitrant lenders**
 - Generally must preserve integrity of Plan or a stampede will start
 - Leave an “out” in the Plan to address individual smaller lenders with limited involvement with the Company
 - Use peer pressure of other lenders or participant holders
 - Stress concept of “Mutual Sacrifice” for the collective benefit of all
 - Use the “war-chest” to fight in fields and trenches all the way to courthouse steps, as needed

Contacts

Firm Contact / Websites:

Reznick Restructuring Solutions

www.reznickrs.com

Reznick Group, P.C.

www.reznickgroup.com

Key Leaders

Jim Vincent

Senior Managing Director – Dallas, TX

(214) 369-2085 office

(214) 557-4246 cell

jim.vincent@reznickrs.com

Mark J. Einstein, CPA

Principal – Bethesda, MD

(301) 652-9100

mark.einstein@reznickgroup.com

David Kessler, CPA

Principal - Bethesda, MD

(301) 652-9100

david.kessler@reznickgroup.com