LEGAL UPDATES

Nine Steps a Lender Should Take When its Collateral is in Distress

With many signs in the market pointing to a possible real estate slowdown, lenders should consider early steps in dealing with distressed collateral. The following are nine practical steps every lender should take preemptively to mitigate such a situation.

1. **Enter into a pre-negotiation agreement**. Consider entering into a pre-negotiation agreement or “pre-workout” agreement before commencing any material negotiations with the borrower. The pre-negotiation agreement is important for you to consider revising the loan terms without prejudicing the rights you have already gained or will gain by virtue of the borrower’s default.
2. **Make sure your loan files are in order**. Review your loan files to confirm that you have copies of all loan documents and are not missing key documents such as the note or guaranty.
3. **Obtain as much information as possible from your borrower now**. As soon as you pull the trigger on exercising remedies, you can assume all cooperation will cease. Play nice; request info from the borrower. A current accounts receivable aging and inventory listing is critical if you have collateral that is not real estate. If the collateral is real estate, obtaining a current rent roll and copies of all leases is critical.
4. **Understand the collateral and get a current appraisal**. Obtain a current appraisal to ascertain the current value of the asset. Also, ask for current financials on the property.
5. **Trigger cash traps**. If the loan documents allow for a cash management or lockbox, consider requiring that all revenue from the property go through a lockbox that ensures that all cash is going to pay project costs or debt service, and not being distributed to the borrower.
6. **Review guaranties.** Determine whether there are any guaranties related to the loan. Are they recourse guaranties or non-recourse guaranties? If non-recourse, are there any exceptions or holes? A thorough analysis will help you determine whether anyone else can be held responsible for payment.
7. **Determine whether the distress is due to bad circumstances or bad management.** If the

borrower has fallen on hard times due to COVID, a natural disaster, or some other situation outside their control, consider forbearance or a standstill agreement (see step 8). If, however, the management company operating the asset has proven ineffective, then you may wish to replace the manager or consider filing a foreclosure action and appointing a receiver to manage the property.

8. **Extend and pretend.** Consider entering a forbearance agreement and giving the borrower as much time as you can, within reason, to work out the default because the moment foreclosure commences, the value of your collateral will plummet.
9. **Consider an asset disposition strategy**. To improve your balance sheet, consider an asset disposition strategy that includes engaging a broker to market the property or online auctions. Consider the time of year. If it is early in your fiscal year, you may not need to have the asset off your books immediately. If it is close to the end of the fiscal year, you may need the asset off your books to improve your overall portfolio and free up time to focus on more desirable assets.

If you need further information, please reach out to William Schwartz or a member of our Financial Services & Restructuring or Real Estate Groups.

Related Information:

Six Steps a Borrower Should Take When Its Property is in Distress