

Weathering the Storm:

A Guide to Banking in Uncertain Times

Session 4: Strategies for Effective Management and
Disposition of Problem Assets

A Jones Walker Webinar Series
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Introduction and Overview

- ❖ This is the fourth of six sessions addressing issues for bankers navigating a difficult banking environment.
- ❖ The first three sessions dealt with the current regulatory environment, the regulatory enforcement process and the raising of capital.
- ❖ This session will focus on:
 - Analyzing and enforcing secured obligations; and
 - Disposing of problem assets.

Analyzing and Enforcing Secured Obligations

- ❖ Analyze documentary rights and obligations
- ❖ Engage obligors in dialogue along parallel path toward collateral disposition
- ❖ Judicial enforcement of obligations
- ❖ Commence and oversee receiverships, collateral monitoring and other collateral stabilization

Analyzing Documentary Rights and Obligations

- ❖ Challenges gathering documents within institutions that were generated at the time of loan origination
- ❖ Confirming that the institution has original promissory note
- ❖ Costs and benefits of proceeding based upon incomplete documents and information
- ❖ Demand, notice and opportunity to cure provisions (payment default or covenant default)

Analyzing Documentary Rights and Obligations, cont.

- ❖ Choice of forum
- ❖ Substantive defects in loan documents and curing defects in restructuring
- ❖ Title issues
- ❖ Types of collateral and devising workout and litigation strategies based upon appraisals and site visit

Parallel Path Toward Collateral Disposition

- ❖ Preserving rights when communicating with obligors or accepting partial payments
- ❖ Meeting with obligors
- ❖ Litigation defenses or claims that may arise from informal workout discussions
- ❖ The litigation does not stop until our documents are executed
- ❖ Contents of forbearance agreement or stipulation
- ❖ The importance of pre-executing every document for every possible collateral disposition

Judicial Enforcement of Obligations

- ❖ Complaint
- ❖ Threshold motions:
 - ❖ Offensive - Rents or Receiver
 - ❖ Defensive - Enlargement or Dismiss
- ❖ Affirmative defenses
- ❖ Counterclaims (or pre-emptive obligor complaints)
- ❖ Discovery
- ❖ Mediation

Judicial Enforcement of Obligations, cont.

- ❖ Dispositive motions
- ❖ Hearings
- ❖ Final judgments and collateral sale provisions
- ❖ Appeals
- ❖ Judicial sales
- ❖ Deficiency judgments

Receiverships and Other Collateral Stabilization

❖ When to consider a receiver or monitor, and why they may be useful:

- Income-producing office or retail and apartment deals;
- Fractured condominium projects;
- Incomplete construction;
- Preserving developer rights and otherwise dealing with local government; and
- Receivership estate - forfeited deposits and closing contracts.

Receiverships and Other Collateral Stabilization

- ❖ When to consider a receiver or monitor, and why they may be useful, cont.:
 - Fraudulent transfers; and
 - Contempt remedies.
- ❖ Costs associated with receivers or monitors and strategies to mitigate
- ❖ Flow-through of stewardship into ownership

Disposition of Problem Assets

- ❖ First Step: Admit There's a Problem:
 - Preventative Portfolio Review
- ❖ Second Step: Realize Not All Problems can be Solved:
 - Analysis of Realistic Transactional Candidates
- ❖ Third Step: Be Flexible:
 - Minimize Response Time
 - Utilize Preferred Providers
 - Avoid Accounting and Regulatory Desperation.

Methods of Disposing of Problem Assets

- ❖ *Loan Renewal/Extension* - Lender agrees to a modification of loan terms with the borrower ostensibly while the credit remains in good standing.
- ❖ *Loan Forbearance* - Lender agrees to a modification of loan terms with the borrower notwithstanding a default, thereby restoring the credit temporarily to good standing.
- ❖ *Deed in Lieu of Foreclosure* - Lender takes a deed to property collateral in exchange for release of a part or all of the indebtedness.
- ❖ *Short Sale* - Lender approves a sale of the property collateral to a third party, taking part or all of the net sales proceeds to pay down the indebtedness.

Methods of Disposing of Problem Assets, cont.

- ❖ *Loan Sale* - Lender enters into a sale of the note, mortgage and other loan documentation, with all proceeds used to pay down the indebtedness.
- ❖ *REO Property Sale* - Lender enters into a sale of property that it has obtained via deed in lieu of foreclosure.
- ❖ *Refinancing* - Third party refinancing limited in this economic environment.

Loan Renewal/Extension

- ❖ For many credits, it is too late for renewal.
- ❖ Delinquency as an impediment to renewal.
- ❖ Transactional Costs can be high if only short renewal periods can be approved.

Keys:

- Cap or eliminate lender disbursement obligations and borrower extension options;
- Cross default or obtain additional collateral; and
- Restructure payment terms to minimize likelihood of further short term restructurings.

Loan Forbearance

- ❖ Borrower may not take this seriously enough in wake of default.
- ❖ May delay and disadvantage lender if other secured parties have claims.
- ❖ Varying terms may result in compliance and monitoring challenges.

Keys:

- Realism must be built into terms of the agreement;
- Restructure payment terms to minimize likelihood of further short term restructurings;
- Agreement's terms and benchmarks must be clearly drafted; and
- Increased financial reporting and operations information, and shore up documentation deficiencies.

Deed in Lieu of Foreclosure

- ❖ Title must be reasonably clear of subordinate encumbrances.
- ❖ Transaction costs are high, in terms of time and resources.
- ❖ May create liability issues for lender with limited opportunities for due diligence.

Keys:

- Lender must approach transaction like a property investor;
- Lender must be prepared to own/manage property;
- Establish Special Purpose Entities (SPEs); and
- Costs should be offset by specific bank disposition plan.

Short Sale

- ❖ Net proceeds of sale must be acceptable to the lender.
- ❖ Contract must be weeded of conditions, complicated requirements and extension options.
- ❖ Lender cannot be disadvantaged in its litigation or security position prior to closing.

Keys:

- Lender must receive and approve a draft HUD up front;
- Purchaser must be familiar with the property; and
- Lender must be responsive and strike when iron is hot.

Loan Sale / Assignment of Judgment

- ❖ Purchaser must be comfortable with purchasing paper.
- ❖ Risk of linking the loan sale to the underlying property.
- ❖ Knowledge of the loan file a must.

Keys:

- Keep due diligence periods brief;
- Hand off of the loan must be “clean”; and
- Lender should review foreclosure litigation and loan file.

REO Property Sale

- ❖ Lender and Purchaser must know what is being sold.
- ❖ Lender may need to consider seller financing.
- ❖ Neglect presents challenges to disposition.

Keys:

- Up front diligence by purchaser prior to offer;
- Non-refundable fees for contracting and extending; and
- Limit obligations of seller.

Transactional Best Practices Recommendations

- ❖ Know your problem assets.
- ❖ Don't compound the boom-time errors of desperate origination with desperate deal-making.
- ❖ Focus on which problem assets are cleanest and most easily conveyed.

Question & Answer Session

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