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Loan Modification Agreements

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I. Introduction

The purpose of this article is to explore the use of the commercial mortgage loan modification agreement and other documents, such as forbearance or standstill agreements, in a loan workout scenario. The author's objective is to present in this review issues and considerations of interest to both lenders and borrowers.

There may be instances when a loan matures before the borrower can perform its obligation of payment or when an event of default has occurred and remains uncured. In such cases, the lender must determine its available remedies and seek a course of action that is designed to maximize its recovery and limit its exposure to loss and liability. Likewise, the borrower also must determine its options, which may include requesting forbearance by the lender and/or modification or a deed in lieu of foreclosure. This situation can lead to one of several possible outcomes, including foreclosure or a workout agreement. One of the remedies that may benefit both lender and borrower is a workout. A loan modification agreement generally memorializes the agreement of parties to a loan that the facility has been amended to provide, for example, an extension of the maturity date, change in interest rate, payment of expenses, and payment of an extension or forbearance fee. Although a modification agreement may be the end goal as a selected remedy, a pre-negotiation letter may be required by the lender to ensure that the borrower performs timely and in good faith to modify the loan agreement; and the borrower may request a forbearance agreement to ensure that the lender does not exercise the remedy of foreclosure and to allow sufficient time to complete due diligence, modification negotiations and execution of applicable documents. Finally, the parties will seek to negotiate a loan modification agreement to redefine the rights and obligations of the parties going forward, that will allow the loan facility to remain in place in its modified form. This article assumes that both lender and borrower have analyzed their respective remedies and alternatives and have concluded that a loan modification is the preferred solution to a default or anticipated default.

Each lender and borrower will have issues unique to its position in the loan transaction; however, there are also issues common to both parties in the interest of maintaining a profitable business relationship. The borrower is interested in preserving its equity investment and cash flow as well as limiting the liability of guarantors. The lender is interested in loan performance and regulatory compliance, which may include preserving the integrity and value of the collateral, receiving loan payments to avoid write-downs or charge-offs, and limiting lender liability. Issues common to both parties include clarification of issues and conflicts, remedies, extending the time for performance, correcting or amending terms and conditions that may no longer suit the deal, and maintaining the financial relationship so that performance by both parties may satisfy the original intent of the business relationship, which was the accomplishment of a profitable transaction.

Modifications of REMICs or other securitized loans are beyond the scope of this article and are not discussed. Although a conventional commercial loan agreement modification may include federal income tax considerations and consequences.

Note that each loan transaction is unique and must be analyzed on its own in relation to the specific loan documents that originally gave rise to the transaction and any subsequent modifications or amendments. The forms attached as to this paper are samples of a beginning documentation framework, and each form must be revised, and appropriate research must be conducted, by qualified attorneys to suit particular situations. In addition, the State Bar of Texas Foreclosure Manual, 3rd Ed. (2015) contains forms that are useful templates with which to begin a lawyer's work.

This article was adapted in large part from Barton and Wilson, *Conventional Loan Workouts*, State Bar of Texas, Suing, Defending and Negotiating with Financial Institutions (2010). The author also wishes to acknowledge the contributions of the authors listed in the bibliography of this article, as well as the assistance of Christopher Bynum in assembling these materials.

II. The Need for a Loan Modification Agreement

The need for a loan modification agreement arises when a borrower is in default under a real estate loan agreement or ancillary instrument and the lender elects to continue working with the borrower and have the borrower continue to own and manage the loan collateral and resume payment of the note and perform other obligations under the loan agreement rather than foreclosing, accepting a deed in lieu of foreclosure or exercising some other available remedy. Defaults typically fall under three broad categories: monetary, covenants, or misrepresentations. A default commonly occurs when a loan matures and the borrower cannot perform its payment obligation or when another monetary or non-monetary event of default under the loan agreement, deed of trust, or other instrument occurs and remains uncured beyond any applicable notice and cure period. Some lender remedies are triggered automatically or after notice and some remedies are elective at the option of the lender. Triggered remedies may include default interest, acceleration of the indebtedness, charging late fees, or foreclosure. Elective remedies may include deed in lieu of foreclosure, forbearance, or modification of the loan.

Along with communications with the borrower, the lender must analyze the collateral and the financial strength of the borrower and any guarantors. Basically, the lender must conduct due diligence to the same or similar degree as underwriting a new loan. Likewise, the borrower has alternatives to consider such as availability of cash, access to capital markets, market conditions, value of the collateral, and borrower management expertise.

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