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Modification and Workout Documentation: This Time It's Contagious !

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Niles Holmes has participated in various facets of the real estate business since 1984. After receiving his master's degree in real estate, Niles was employed as a commercial real estate appraiser and completed all of the educational requirements for the MAI designation. Subsequently, Niles was employed by a large life insurance company for five years as an investment officer. His duties included real estate lending, foreclosures, workouts, management and sales of acquired properties covering a five state territory. Niles' legal experience also includes serving as the general counsel of a publicly traded small business lending concern and mortgage REIT. Niles was formerly a shareholder in the Dallas office of Winstead P.C. where he served as a member of the firm's opinion committee and as Chairman of the Real Estate Lending Practice Group. Niles is Board Certified in Commercial Real Estate Law by the Texas Board of Legal Specialization. Niles is Board Certified in Commercial Real Estate Law by the Texas Board of Legal Specialization and is "av-preeminent" rated by Martindale Hubbell for more than 15 consecutive years. Niles has been named as a *Super Lawyer* for the State of Texas for the years of 2007, 2008, 2009, 2010, 2011, 2012, 2013, 2014, 2015, 2016, 2017, 2018, 2019 and 2020. In 2015, 2016, 2017, 2018, 2019 and 2020. Niles and Niles Holmes PC was named as a *Best Lawyer* and *Best Law Firm in Texas* by the U.S. News and World Report. Niles is a frequent speaker and program coordinator specializing in commercial real estate lending topics including workouts, financial covenants and tenant in common lending. These educational and professional experiences give Niles a unique business and legal perspective to any transaction.

Education
Southern Methodist University, Dedman School of Law
J.D., cum laude, 1992
Order of the Coif; Southwestern Law Journal; Staff SMU Law Review Editor;
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Texas A&M University; M.Agr., in Land Economics and Real Estate, 1984
Texas A&M University; B.S., Animal Science, 1982

Professional Memberships & Affiliations
State Bar of Texas; Dallas Bar Association; Southwest Association of Bank Counsel; The College of the State Bar of Texas, American College of Mortgage Attorneys, Fellow

Community & Civic Involvement
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Presentation Topics

- Author/Speaker, Program Coordinator, Modification and Workout Documentation: This Time It's Contagious, Mortgage Lending Institute, University of Texas School of Law (September 2020)
- Author/Speaker, What's Really Negotiable in Lender Transactions?(What a lender wants!:What a borrower needs!), Advanced Real Estate Drafting Course (August 2020)
- Author/Speaker, Program Coordinator, How to Lose a Client With 10 or More Outdated Loan Provisions!, Mortgage Lending Institute, University of Texas School of Law (September 2020)
- Author/Speaker, HVCRE Changes and Other Federal Codes, Restrictions and Guidelines to Commercial Real Estate Lending, Mortgage Lending Institute, University of Texas School of Law (September 2018)
- Author/Speaker, Financial Covenants for Commercial Real Estate Lending Transactions, Mortgage Lending Institute, University of Texas School of Law (October 2012)
- Author/Speaker, Evolving Loan Structures, Mortgage Lending Institute, University of Texas School of Law (September 2011)
- Author/Speaker, Drafting Creative Financing Documents, Advanced Real Estate Drafting Course (March 2011)
- Author/Speaker, Real Estate Workouts, Advanced Real Estate Drafting Course (March 2010)
- Author/Speaker, Commercial Lending Coordinator, Financial Covenants for Lawyers, Advanced Real Estate Law Course (July 2004)
- Author/Speaker, Preforeclosure Documentation II (This time it is getting personal!), Advanced Real Estate Drafting Course (March 2004)

- Author/Speaker, Commercial Lending Coordinator, Workouts in the 21st Century, Advanced Real Estate Law Course (July 2003)
- Author/Speaker, Program Coordinator, Preforeclosure Documentation, Advanced Real Estate Drafting Course (March 2003)
- Author/Speaker, Form of Lender's Texas Title and Survey Objection Letter, Advanced Real Estate Drafting Course (March 2002)
- Author/Speaker, Texas Annotated Deed of Trust, Mortgage Lending Institute, University of Texas School of Law (October 1999)
- Author, Purchase and Sale Agreements, CLE International (October 1994)

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Modification and Workout Documentation: This Time It's Contagious

I. INTRODUCTION

A. Scope

This article addresses the documentation for the interaction between a lender and borrower related to the current economic turmoil created by the Covid epidemic. In regards to drafting assistance, this paper includes examples of document review checklists, preworkout agreements, modification agreements and alternative clauses for letters and agreements.

As in most secondary research CLE articles, this paper is drafted with the assistance and review of prior publications. The Appendix contains those articles reviewed in the preparation of this paper.

B. History of Workouts

It is helpful to understand the history of workouts so as to properly identify the issues and risks for the current workout experience.

Workouts in the 80's and Early 90's

The workouts in the 80's and 90's were an unpredictable acrimonious environment. This was the result of many factors. The loans were generally full recourse for the borrower and the individual principal of the borrower. The financial institutions were failing and merging, resulting in a governmental instrumentality controlling much of the decision process. The business economy was staggering as a result of the collapse of the Texas oil and gas industry. The 1986 tax code changes retroactively applied to all prior real estate transactions, which were specifically designed under the prior real estate friendly tax laws. Their investors benefitted from large tax write-offs. These investments were purchased for artificial after-tax cash flow considerations and not economic driven parameters. Thus, the appraised values of the real estate deals were performed during an energy-driven business boom and those purchase prices which were also based on a tax law that negatively and retroactively changed overnight. Much of the loan documentation was prepared by non-lawyers and internal counsel utilizing outdated forms drafted prior to the specialization of real estate lending attorneys. During the consolidation, acquisition and failure of the financial institutions, much of the correspondence and faxes were misplaced or destroyed, large number of employees resigned or were terminated and large loan portfolios were purchased by various types of entities at sales prices with a very large discount in comparison to the stated principal amounts. The real estate values diminished in amounts ranging from 20% to 50% of the original values. All of these factors resulted in a very acrimonious workout environment. It was a series of negotiations and threats involving poorly documented loans and a minimal amount of first-hand knowledge on the lender's behalf. The property values were less than the loan amounts yet the investor's tax basis was often small. The occupancies and rents were low. The deficiency between loan amounts and values were very large and most real estate principals had fully guaranteed multiple transactions which were many times the investor's actual net worth and whose financial statements did not reflect these large contingent liabilities. Finally, for a period of time, the judiciary was more sympathetic to the borrower's lender liability arguments and the bankruptcy courts were overwhelmed with single asset real estate debtor filings. Those were the times that tried men's souls and allowed those with cash to acquire assets for a very small price, all of which experienced large increases in value over the subsequent ten years.

The Roaring 90's

For the greater part of 90's and the beginning of the 21st century, the capital and lending departments evolved dramatically. The interest rates dramatically lowered and the economy grew to an extent that the real estate industry enjoyed rising values due to actual economic parameters and not artificial tax structures. The CMBS market was created and produced the most efficient capital delivery system in the history of commercial real estate industry.

911 Realignment 2001-2004

As a result of the tragic 911 terrorist event, the economy slowed and certain areas were disproportionately impacted. The convenience stores, hospitality and C multi-family projects all experienced dramatic value declines resulting in large numbers of foreclosures and bankruptcies. Although other sectors were slowed, the events occurred in a falling interest rate environment which provided a source of relief in the workout context. While most of the earlier lender liability and usury theories were resolved in favor of the lender, the Texas legislature did enact a form of anti-deficiency statute to protect borrowers and guarantors. The market value reductions of the properties were in a comparatively small range of 10% to 25% and the original appraisals were completed under conformity with the strict appraisal guidelines of FIRREA and sound lending principles.

Post 911 Resurgence

Subsequent to the 911 realignment, the real estate economy exploded in a low interest competitive lending environment.. The CMBS lending market grew exponentially ! The other types of lending institutions evolved into construction and short term bridge lenders. Typical non-construction lending evolved to either non-recourse or limited recourse. Most term loan guaranties became limited to "carve-outs" or "bad boys." The guarantors were more frequently a capitalized entity rather than an individual.

2008-2010 Recession

Unfortunately, all great things must come to an end. Ouch ! In the first real commercial real estate crash that was not of our own making, the 2008 crash was the result of a collapse of the single family securitized mortgage industry. Values declined by 10% to 40% across the country. The liquidity of the fee developer construction borrower disappeared overnight. Predictably, this workout cycle was less acrimonious due to the CMBS structure limited recourse structure. Often times, there were more parties involved in the workout decision making. There were mezzanine lenders, loan participants, syndicate partners, equity investors, large credit tenants, servicers, and special servicers. The CMBS industry had no experience structure or staff to adequately address the suddenly servicing burden. The most shocking revelation was that the CMBS loans could not be foreclosed due to securitization complications. For the first time in workout history, the appointment of a receiver workout technique was widely utilized in a non-malfeasance context.

2010-2020 Recovery and Expansion

The subsequent 10 year recovery and expansion was dramatic. The CMBS continued its long term capital domination. However, the DUS, Freddie and Fannie agency loan volume ballooned as a major competitive alternative to CMBS loans. Institutional equity participated in many platforms for all of the transactions. Construction lending exploded in attempts to serve the increased demand for all segments. Most initial construction lending in the cycle included a mezzanine piece for the equity capital structure. Subsequently equity increased their percentage participation in the capital stack with most mezzanine lending being EB-5 sourced. Life insurance companies entered the market as equity and as construction lenders. Many transactions were interest rate hedged during different periods of interest rate volatility. There were various classical real estate development structures which became less profitable. The classical 2% equity developer construction borrower model failed miserably in the recession, thus there was virtually no sophisticated capital available for that structure. The grocery anchored retail structure was greatly diminished. The big box retail development virtually disappeared. Since 2010, there were comparatively few foreclosures or workouts. The majority of the existing lending officer professionals

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