Reinhart

Working with Lenders—A Developer's Perspective

POSTED:

Dec 18, 2011

RELATED PEOPLE:

[Harvey L. Temkin](https://www.reinhartlaw.com/people/harvey-temkin)
https://www.reinhartlaw.com/people/harvey-temkin

As we valiantly work our way out of this Great Recession (something I consider to be more like a depression in the real estate world), we continue to see many developers being hounded by their lenders.

On the local level, most troubled loans are conventional loans funded by local lenders. We are yet to deal with the massive amount of CMBS (Conduit) loans that we anticipate will start coming due in 2012 with increasing amounts continuing to mature over the next five years. Accordingly, and while our experience to date has not been promising, the jury is still out on how it will be to deal with the special servicers controlling the Conduit market. What we do know is that special servicers are often unresponsive and refuse to devote sufficient attention to troubled loans. By way of example, even trying to get an assumption of a Conduit loan approved is a long, tedious process involving frequent resending of information previously submitted.

In dealing with conventional lenders on a more local level, the following are three of the many lessons we have learned:

First, we are dealing with a confluence of horrible factors. These include lender retained appraisers coming in with very low values which are often based on guess work as appraisers have not been able to find good comparables. A lack of good comparables also makes it difficult to mount an effective challenge to these low appraisals. We are also confronted with lenders reducing their loan to value ratios. Whereas an 80% loan-to-value was common a few short years ago, in restructuring a loan that is maturing or in default, the lender will frequently want to reduce the loan-to-value from 80% to 70%, or if the developer is lucky, 75%. Another ugly factor is low LIBOR rates, which has resulted in many of the swaps that developers had entered into being under water in a magnitude that frequently is in the seven- or eight-figure range. This, perhaps more than anything, can quickly bring down a developer who has guaranteed the loan. Finally, this Great Recession has frequently found courts siding with lenders, as opposed to borrowers, in litigation situations. In Wisconsin, perhaps the most glaring example is the Wisconsin Supreme Court decision concluding that lenders could pursue expedited redemption periods and still go after the individual guarantors for deficiency judgments (see *Bank Mutual v. S. J. Boyer Construction*, 2010 WI 74, 326 Wis. 2d 521, 785 N.W.2d 462).

All materials copyright © 2023 Reinhart Boerner Van Deuren S.C. All rights reserved.

Second, hope (and perhaps even pray) that your lender will act reasonably. In Madison, we have seen some lenders who have been particularly hard hit and are thus under tight regulatory scrutiny. Those lenders often pull the trigger quickly and commence foreclosure actions without giving the developer much opportunity to solve the problem.

Third, if you are fortunate enough to be dealing with a more reasonable lender who may pursue an "Extend and Pretend" approach, act reasonably. Under this approach, the lender will allow the developer a certain period of time, frequently in the three year range, to get its portfolio back in what the lenders view as the new balance. Under the "Extend and Pretend" approach, the lender will put very tight constraints on the borrower's activity during the extension. The lender, for example, may require certain assets to be sold, may prohibit future development, and will often limit distributions to the borrower. In addition, the lender will often require significant principal pay-downs so that at the end of the extension period, the borrower will either have a property that the lender would feel comfortable lending against or the borrower would have a property that other lenders might find attractive. We have found that many developers initially resist this approach and the constraints it brings with it. Although we understand and sympathize, we often advise the developer that, rather than going to battle with the lender (who is often holding an unlimited guaranty from the developer), he should use the extension term as an opportunity to get his portfolio in balance so that, in three years, when hopefully the economy has righted itself, the developer will be able to pursue new projects.

Our advice does not mean that the developer should adopt the lender's proposal "As Is." Rather, the developer needs to assure himself that the lender's proposal achieves his objectives as well. For example, the developer needs to be certain that the lender's proposal does not make the situation worse, such as by charging fees or interest rates that are too high rather than using those excessive amounts for principal paydown. We have also, on occasion, been able to negotiate additional breathing room for the borrower by using certain excess collateral that may have previously been pledged to create a line of credit that the borrower can use in a needed situation.

We acknowledge that many developers still have a difficult time accepting this approach. While we understand that, we also have to face the reality that the lender can bring the developer's house of cards down. If the lender believes that the developer will not cooperate, its last resort may be to foreclose and sue on the borrower's personal guaranty, if one exists. Particularly if foreclosure involves

All materials copyright © 2023 Reinhart Boerner Van Deuren S.C. All rights reserved.

a loan that has been swapped, and that the developer has personally guaranteed, the result can be the death knell for the developer. We, at Reinhart, have been very active and successful in structuring work-outs for developers over the past three years. Feel free to give us a call to discuss your situation or to get a second opinion. We hope that you will let us work with you to find the right path to ensure that you are in good financial health to make it to the next real estate boom, which we know will be coming.

These materials provide general information which does not constitute legal or tax advice and should not be relied upon as such. Particular facts or future developments in the law may affect the topic(s) addressed within these materials. Always consult with a lawyer about your particular circumstances before acting on any information presented in these materials because it may not be applicable to you or your situation. Providing these materials to you does not create an attorney/client relationship. You should not provide confidential information to us until Reinhart agrees to represent you.

All materials copyright © 2023 Reinhart Boerner Van Deuren S.C. All rights reserved.