



## **The key to a successful loan workout for owners and developers: Preparation!**

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Many owners and developers of financially troubled assets are fighting to preserve their portfolios in light of the declining property values and reduced cash flow of today's commercial real estate market. For many, a loan workout is the only hope to protecting their interests, negotiating favorable new terms and maximizing their capital recovery. But the fact that so many are seeking a loan workout actually presents another problem. Confronted by a flood of non-performing loans, note holders are forced to determine which property owners warrant a loan workout. Thus, note holders are rigorously scrutinizing the financial health of all underlying assets or collateral and taking aggressive positions about the property's financial viability.

The key for an owner to achieve a successful loan work is preparation. Receiving favorable terms in a loan workout depends upon an owner being able to satisfy lender concerns by clearly conveying the property's current value and its projected future value. This means owners must be fully aware of and able to effectively represent all the ramifications of a proposed workout before negotiations with the lender begin.

### How to Prepare?

Prior to approaching the negotiation table, owners are increasingly undertaking comprehensive financial due diligence property audits to meet the demands for accurate, up-to-date evaluations. While in-house appraisals can help provide a reference point, real estate trading values are simply too difficult to determine in today's market. That is why property owners are turning to financial due diligence specialists with deep experience in auditing distressed assets.

The first step is to determine the asset's true value. Arriving at a property's true value demands a thorough review of its financial statements, budgets, leases, income and expenses, including the evaluation of reimbursable income and expense methodology. Owners are best served by hiring a due diligence specialists with the expertise to:

- \* Accurately assess all income and expense line items;
- \* Analyze, review and report on the financial health of the property;
- \* Prepare operating budgets;
- \* Update underwriting models;
- \* Report on projected asset performance.

Along with meticulously completing the complex tasks of financial assessment, an experienced due diligence specialist can also help distressed property owners to develop positive strategies for possible workout options and resolutions. Additional assistance can include coordinating matters with foreclosure and bankruptcy counsel and negotiating with special servicers and other lender representatives.

It was exactly this type of preparation which reaped results for one real estate holding company. The

owner had purchased a 15-tenant class A office building in a suburban area, near a major metropolitan city, four years ago for \$21.8 million. Purchased as a value-added property, the owner invested \$1.3 million to update the common areas, install new elevators and make other improvements, which helped to retain quality tenants and attract new ones. However, due to the downturn in the economy, the vacancy rate had grown over the last year and the property was no longer generating sufficient income to cover the debt service. Facing foreclosure, the owner needed a loan modification to preserve its capital investment and its opportunity cost in the property. The challenge for the owners was to convince the lender that a loan workout for this property was in the lender's best interest. The owners understood that they would be more likely to make the case for a loan modification if they could present a third-party, independent, comprehensive financial analysis of the property, breaking down every element of the distressed asset. Armed with data and a persuasive case, the property owner was able to attain a favorable loan workout which extended the life of the loan and reduced the interest rate, thereby decreasing the monthly debt service by 30%. As developers and owners struggle to stay afloat in these troubled times, many understand that this type of comprehensive financial due diligence expertise is what can prevent a property asset from turning into a liability.

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