

# DELMARVA

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## Workouts: The Bailout for Everyone Else

Everyone seems to be getting bailed out these days — insurance companies, auto manufactures, investment houses, etc. But what about the real estate development firms that are struggling to keep up with debt payments during this current economic downturn? Many will be forced to shut their doors or let their assets be foreclosed upon. Others will declare bankruptcy. How can the distressed real estate project survive? Not all of them will, but for some, the answer may be a workout.

In its most basic form, a workout is a restructuring of debt. The concept is fairly simple — the lender agrees to new loan terms which the borrower can afford — but crafting a successful workout requires a careful and strategic dance with the lender and depends on many different factors. Who and what sort of entity is the lender? Is the borrower current or delinquent on payments? Is the debt nonrecourse? What are the borrower's potential sources of capital?

A workout generally starts

with the borrower's attorney contacting the lender's attorney or in-house counsel. Initially, the lender's attorney will want to rely on the loan documents and demand that the borrower make payment in full. The key to moving beyond this stalemate is educating the lender's counsel so that he or she understands that the lender will be better off with a workout than with trying to enforce the loan documents.

Under the existing terms of the loan, the lender would likely have to foreclose on property and/or become a creditor in bankruptcy. Depending on the circumstances, this could result in the lender collecting anywhere from the entire debt to pennies on the dollar. In this environment of declining real estate, stock and business values, it is less and less likely that a lender will collect the entire debt. Furthermore, the value of a business often drops dramatically when the current owner is no longer running it. These factors create room to negotiate. The lender often would be better off maintaining a

security interest in property which the borrower, who is experienced in working the property, continues to manage. Otherwise, the lender will have to either: i) try to manage the business, which lenders are generally loathed to do; or ii) fire-sell the property.

The borrower's attorney should present the lender's counsel with an offer which will leave both the borrower and the lender in significantly better positions than they would be in under the loan documents. To accomplish this, the borrower's counsel must understand what the lender can and cannot agree to and what the borrower is reasonably capable of paying. The most compelling offer a borrower can make is one in which the lender is eventually made whole. For example, a struggling real estate project might be saved by convincing the lender to forbear on its foreclosure and defer interest charges until sometime in the future when the economy will be stronger and the borrower can make the lender whole.

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Sometimes it is not possible to come up with an affordable plan which makes the lender whole. In such a case, the lender would have to agree to take less than full value. This type of workout can be accomplished, but it is obviously more challenging to get the consent from the lender.

Offers do not have to be limited to simple reworking of debt payments. Often, creativity is what gets the deal done. Can part of the debt be converted to equity?

Is there a partial sell-off of assets that could be made to pay down the principal? Are there other sources of capital such as a white knight that has the ability to bring funds or guarantee the debt?

Though this article and the examples contained herein are basic, workouts are not. Sensitive negotiations and the preparation of complex documents are usually needed to effectuate a successful workout.

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