



FARELLA BRAUN + MARTEL LLP

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Strategies and Opportunities

In Acquiring (and Repositioning)

Distressed Assets

DEAN GLOSTER

GREG SHEAN

big firm know how + small firm know you

Agenda

- Deal Environment: Crisis and Opportunity
- Barriers to Distressed Deal Flow
- Overcoming Barriers to Distressed Deals
- Specific Deal Structures (Short sales, foreclosures, REO, bankruptcy sales, loan to own, deed in lieu)
- Maximizing Opportunity, Minimizing Risk

The Economy: Trump Trifecta

- Recession Squeezes Cash Flow
- Credit Crunch Reduces Loan to Value Ratios in Lending, Tighter Underwriting
- Credit Crunch and Recession Combine to Reduce Values

What is a Distressed Asset?

- An Asset Effectively Forced to Market on Non-Optimal Value
- External or Internal Forces
- Why? Impatient Investors; Management Problems; Economy; Negative Cash Flow; Loan Default or Maturity; Bankruptcy of Major Tenant
- Source of Trouble is Important

Next Phase: Liquidity Squeeze

- Commercial Vacancy Rates Rise
- NOI Declines
- Cap Rate Rise and Stabilize
- Commercial Default Rates Rise
- \$1.4 Trillion of Commercial Real Estate Debt Matures, 2010-2012 With No Ready Refinancing

CRE: Bad News Rising

- Typically (Non-Multifamily) CRE Vacancy Rates Trail the Economy by 12-18 Months (Peaking, Perhaps, in 2010)
- JP Morgan Predicts NOI Declines, CRE Properties, of 19% Peak-to-Trough
- Goldman Sachs Predicts Rise, then Stabilization, CRE Cap Rates
- Moody's: CMBS Default Rates are 10 Times 2008 Levels, and Still Rising

Extend, Pretend, End?

- Extensive, Rising Default Rate (>60 Days)
- \$1.4 Trillion in Commercial Real Estate Loans Mature 2010-2012: Goldman Sachs
- Congressional Oversight Panel: Nearly Half of Loans Maturing Through 2014 Are Currently Underwater
- Mid-Size and Smaller Banks Have Disproportionate Exposure to CRE Risks

Potential Further Risks

- “Jobless Recovery” Would Prolong Commercial Real Estate Recession
- “Double Dip” Recession Would Be Worse
- Rising Interest Rates Create Even More Pressure on Borrowers
- The “New Normal” of Lower Leverage, Lower Debt-Driven Consumption May Cool the Economy

Crisis = Danger + Opportunity

- Liquidity Squeeze Means Buyers With Cash Are King
- While Some Assets Retain High Valuations (Trophy, Multifamily, REIT Stocks) Others Will Go at Historic Discounts
- Lower Leverage Means Higher Targeted IRRs on Equity, and Lower Asset Prices

Barriers to Distressed Deals

- Equity and Mezzanine Debt Are Out of the Money, and Don't Want to Sell at Bottom
- Traditional Lenders “Extend and Pretend” Rather than Take a Loss
- Very Few “Voluntary” Deals
- Low Leverage Financing on the Buy Side
- Denial, Delay, and Valuation Disconnect

Lender Motivations

- Publicly Traded: Manage Earnings
- Banks: Performing Loans, Cash by Quarter End, Minimal Time
- Insurance Companies: Not Afraid of Taking Ownership
- CMBS Special Servicer: Maximize Fees, Don't Get Sued
- Mezzanine Lender: Cash or Carry

Key to Motivated “Seller”

- Who Is the Lender?
- What Is the Lender’s Collateral Value, Today and Next Year?
- What Is the Lender’s Priority?
- What Is the Lender's Motivation?

Unmotivated “Sellers”

- Modifications to REMIC Rules Make It Easier to Modify Conduit Loans, Retain Collateral Without Prompt Sale
- FDIC October 2009 Policy Statement Supports Workout of Commercial Real Estate Loans Despite Decline in Collateral Value
- Let’s Pretendistan

Techniques to Get to Yes

- Time Management: Some Deals Can't Be Done
- Give Decision Makers What They Need, Not Just Cash (Certainty, Performing Loans, Guaranty Relief, Tax Deferral, etc.)
- Structures: Hope Certificate, New Money vs. Old Debt
- Worst Case Scenario Avoidance

Deal Structure Overview

- Short Sale/Receiver's Short Sale
- Purchase at Foreclosure Sale
- Purchase Out of REO Portfolio
- Purchase Out of Bankruptcy
- "Loan to Own" Buying Existing Debt
- Post Acquisition Deed in Lieu
- Out of Money Option

Distressed Sale Features

- Limited Representations and Warranties
- Additional Insolvency Risks
- Unmotivated Parties Out of the Money
- Choices on How to Do the Deal, and With Whom
- Trade Off: Risk and Speed vs. Cost and Certainty

Short Sale/Receiver's Sale

- Borrower's Principals: Guaranty Relief?
- Cash for Cooperation?
- Lender Gets More than Note Sale, With Less Risk

Purchase at Foreclosure Sale

- Cash Bid, No Reps and Warranties
- Bidding Against “Credit Bid”
- A Regularly Conducted Foreclosure Sale Is Not a Fraudulent Transfer
- Lenders Are Often Careful (Where There Is a Guaranty) to Avoid “Bid Chilling”.
- Right to Possession

Purchase Out of REO Portfolio

- Few Representations and Warranties
- Befriend Your REO Contact—More Deals to Come
- Clean, but Limited

Purchase Out of Bankruptcy

- Certainty, at Considerable Expense
- Bankruptcy Code Section 363—Sale Clear of Liens, Claims and Interests. Good Faith Purchaser and Finality. Process.
- Sale Under a Chapter 11 Bankruptcy Plan—No Transfer Taxes, No Overbids

“Loan to Own” Buying Debt

- Type and Priority of Loan
- Due Diligence: Loan Documents, Collateral, Guarantors, Seller, etc.
- Excess Leverage and Bankruptcy
- Documenting the Purchase
- Underwriting
- Tax Treatment of Loan Modifications (Can Be Critical!)

Deeds in Lieu of Foreclosure

- Bankruptcy/Creditors Rights Issues
- Friendly vs. Unfriendly Deals
- Step Post-Purchase of Debt

Prior Webinars

- **Buying Hotels (and Other Commercial Real Estate) Out of Bankruptcy**
(Date: 03.17.10)
- **Guaranties of Debt in Default: What to Do Now (for Guarantors and Their Creditors)**
(Date: 03.31.10)
- **Working Out Problem Hotel Loans**
(Date: 04.14.10)
- **Tax Aspects of Debt Restructuring and Foreclosure: Using Tax Savings and Motivations to Make Better Deals**
(Date: 05.19.10)
- **Insurance in Bankruptcy: Preserving and Maximizing Insurance Assets of a Bankrupt Entity**
(Date: 06.02.10)

To listen to the following webinars, please go to www.fbm.com, click on Media, click on Speaking Engagements and search by the webinar date.

Future Webinars

- July 14--Restart Techniques for Technology and Intellectually Property-Driven Companies
- July 28--Employment Issues for Financially Troubled Companies
- August 4--Recapitalizing, Repositioning, Restructuring or Reorganizing Opportunities in the Wine Industry

Speakers

- Greg Shean is a partner and head of the real estate practice group at Farella, Braun + Martel in San Francisco
- Dean Gloster is a partner and head of the insolvency, reorganization, and creditors rights practice group at Farella, Braun + Martel in San Francisco