

DAILY BUSINESS REVIEW

CAPITAL SOURCES Mike Seemuth

A 'PEACEFUL' APPROACH TO COLLECTING UNPAID DEBT

Creditors still are taking plenty of commercial borrowers to court to recover unpaid balances on defaulted debts, but granting forbearance and modifying loan terms may become more common as the economy slowly recovers from recession, inspiring hope that delinquent commercial borrowers will recover, too.

Granting borrowers a "grace period" from default-based litigation for several weeks or months is always risky for a creditor. Loan forbearance for a cash-hungry business may merely delay a courtroom collision with the lender and the associated legal costs. But forbearance may be a safer bet during the early stages of an economic recovery than at the onset of a recession.

Compared to 2007, "the mentality today is more peaceful," said attorney **Jay A. Steinman**, a Miami-based shareholder of **Carlton Fields**, whose practice centers on commercial real estate, finance and business law. Steinman said lenders generally appear less inclined to fight with commercial borrowers in court over delinquent debt and burn money on legal fees in the process: "Each institution has their own criteria, but the crash-and-burn mentality is less today, I would say, than it was three years ago."

Much of delinquency in commercial lending stems from property developments that flopped. However, the parties in such cases may be less combative now than they would have been in 2007, when the historic collapse of the housing and mortgage markets was just beginning to reveal itself. "There are still people fighting and contesting litigation," Steinman said, but forbearance tied to loan modification can revive troubled real estate investors if they "get a little bit of time, and things improve, and they get some debt reduction, or maybe the interest rate lowered."

Forbearance agreements also can be one-sided deals that squeeze additional payments out of debtors and require little of lenders, said attorney **Scott J. Wortman**, name partner at the West Palm Beach firm **Korte & Wortman**. "I'm seeing a lot of them, and most of them have the same inherent flaw," Wortman said. "It's basically a timeout, but once the timeout expires, the borrower is right back in the same spot as before, and they've wasted several payments along the way without any promises from the bank to do anything to restructure the debt."

NO MAGIC CURE

Forbearance agreements alone provide no magic cure from commercial credit problems. For example, construction materi-



J. ALBERT DIAZ

Attorney Jay A. Steinman says commercial lenders today are generally less inclined to fight with commercial borrowers in court over delinquent debt than they were three years ago.

INNKEEPERS USA-MARRIOTT FORBEARANCE AGREEMENT AT A GLANCE

- **Innkeepers**, a Palm Beach-based hotel company in Chapter 11 bankruptcy, agreed to complete property improvements at 23 of its Marriott-branded hotels.
- **Marriott** to suspend its right to pull the Marriott brand from properties owned by Innkeepers, a move that would have wrecked their value.
- **The deal** helped Innkeepers obtain about \$68 million of debtor-in-possession loans to pay for the required property improvements at Marriott-branded hotels.



MELANIE BELL

Soneet R. Kapila, founding partner of Fort Lauderdale-based Kapila & Co., a provider of insolvency and financial restructuring advice, says banks are increasingly granting forbearance to delinquent business owners while negotiating modifications of their commercial loans.

als manufacturer **Imperial Industries**, based in Pompano Beach, defaulted on a credit line from **Wachovia Bank**, then obtained a forbearance agreement, but is still struggling. The bank agreed to hold off from taking legal action against Imperial while the manufacturer repaid borrowings under the credit line.

Imperial fully repaid the balance last year and has operated since without a credit line. The company cut its first-quarter net loss to \$319,000 this year from \$876,000 last year. But at the end of the first quarter, its independent accounting firm expressed doubt about the company's ability to continue as a going concern.

Forbearance agreements take many forms and involve many types of creditors, ranging from banks to insurers to franchisers. Consider, for example, the reorganization of **Innkeepers USA Trust**. The Palm Beach-based hotel company is set to exit a preplanned Chapter 11 bankruptcy by selling 69 hotels, most of them franchises of Marriott International.

Innkeepers last week won bankruptcy court approval of the planned sale. New York City-based **Cerberus Capital Management** agreed to buy 64 of the hotels, and Palm Beach-based **Chatham Lodging Trust** agreed to buy the other five. But the primary catalyst was **Marriott**.

A 1-year-old forbearance agreement from Marriott set the reorganization of Innkeepers in motion. In June 2010, Innkeepers agreed to complete property improvements at 23 of its Marriott-branded hotels to comply with franchise agreements.

In exchange, Marriott signed a forbearance agreement suspending the hotel chain's right to remove the Marriott brand from hotels in Innkeepers' portfolio, a move that would have wrecked their value.

The forbearance agreement with Marriott, in turn, paved the way for Innkeepers to obtain about \$68 million of debtor-in-possession loans to pay for required property improvements at Marriott-branded hotels.

"I think there is a greater trend toward forbearance rather than going into an insolvency proceeding," said **Soneet R. Kapila**, founding partner of Fort Lauderdale-based **Kapila & Co.**, a pro-

vider of insolvency and financial restructuring advice. Kapila, who frequently serves as a trustee in Chapter 7 and Chapter 11 bankruptcy cases, said banks increasingly grant forbearance to delinquent business owners while negotiating modifications of their commercial loans and personal loan guarantees.

"The forbearance generally involves some level of restructuring and trying to deal with the personal guarantee obligation at the same time," Kapila said.

Litigating with a business in bankruptcy is a much more expensive way for a lender to resolve commercial loans gone bad because "the cost can be six figures." Moreover, efforts to reorganize a troubled company in Chapter 11 may fail if no lender is willing to finance the company's exit from bankruptcy.

"A bankruptcy proceeding, with no money for a true exit, doesn't really resolve the issue," he said.

'DE FACTO PARTNERS'

Many lenders resist litigation as a means to resolve delinquent commercial debt because they understand that, "at some point, they have to be de facto partners with the principal of the business," Kapila said. In many situations, "they are not going to get any better result in bankruptcy than by just agreeing to forbear."

Foreclosing on a commercial mortgage loan clearly can be problematic if the collateral value is declining. The commercial real estate market is recovering slowly from an economic punch that left many office, retail and industrial landlords gasping for air, so seizing a commercial property in foreclosure may prove more expensive for a lender than modifying the loan terms instead.

Glenn Lazarus, a director of **Situs Cos.**, said he can see some of problems in commercial real estate from his office in Boca Raton. "At the Town Center Mall, right in front of my office, there's some vacancy. But it's not like some of the centers you see in West Broward that are completely vacant," said Lazarus, whose company provides commercial real estate services to banks and institutional investors.

Forbearance tied to commercial mortgage modification can be a low-cost alternative to foreclosure because "you're not paying all those legal fees, and the property is not losing value," Lazarus said. Besides, "if you're a bank, you're in the lending business. You're not in the real estate business."

LOSS OF VALUE

Among other reasons, foreclosed commercial buildings can lose value due to reduced property maintenance and increased rental delinquencies. Some properties already are in rough shape when delinquent borrowers surrender them.

"If you [the borrower] have no wherewithal and you just want to give the property back, nine times out of 10, you're giving it back because it's not performing, and there's some vacancy there," Lazarus said.

He also said even if banks exercise more forbearance, reduced market demand for offices, stores and warehouses probably could lead to more losses on commercial real estate loans.

"Whatever is out there that has been foreclosed, there is probably twice as much in default right now," Lazarus said. "I think we're in a very, very bad market. Most people think we've hit bottom. I don't think we've hit bottom yet. We haven't seen a lot of the commercial hit, like we have the residential."