

2025 Financial Management Conference

Workout Primer

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STRENGTHMATTERS[®]



Continuing Professional Education (CPEs) Requirements for CPAs

- Please find the **SESSION HOST** to **SIGN IN** at the beginning and **SIGN OUT** at the end of every session. We use that attendance log to verify your participation for CPE credits.
- Please **submit all conference evaluations**. Evaluation links are emailed to registrants daily. The session host monitoring the sign-in process has paper evaluations if you prefer.
- For more information on CPE credits, contact Lindsay Wells at consult.lwells@gmail.com.

Objective of today's session

- Provide a Primer for approaching a troubled debt or investment situation with your lender or investor – a paradigm for a "workout".

Questions

- We will pause during presentation and again at the end for Q&A.

Polling Question 1

- *Are any of your organizations actively engaged in or thinking about approaching your partners to address a “workout” on a property? By show of hands after each possible answer.*
 - A. *Not engaged or thinking about approaching our partners*
 - B. *Actively thinking about but have not yet approached our partners*
 - C. *Ready to make our first call to engage with our lenders and investors*
 - D. *Already engaged in or have previously conducted a workout*

The Environment - Today

Macro

- Interest Rates
- Inflation
- Employment
- Bank disruption
- Administrative Priorities

Portfolios

- Collection issues
- Rising costs
 - Security
 - Insurance
 - Labor constraints
- Increased Permanent Supportive Housing

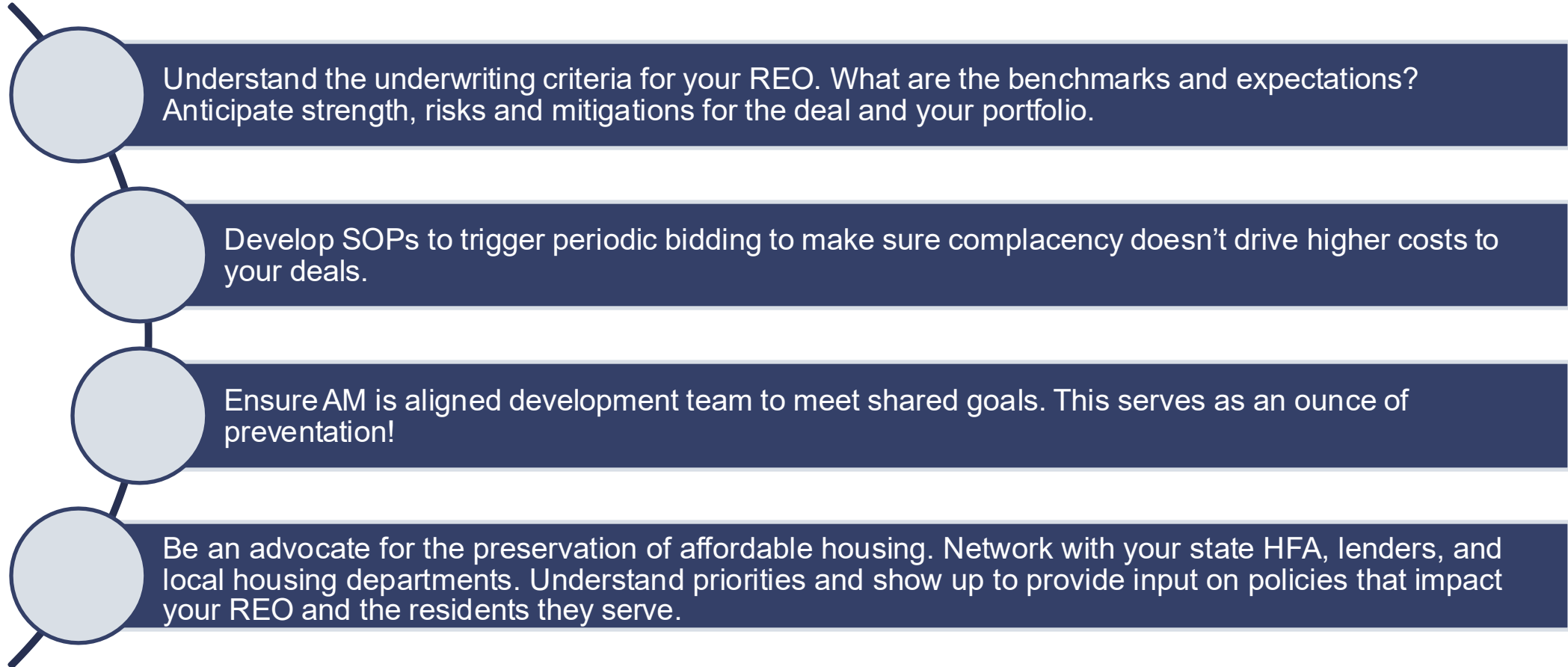
COMMUNICATE

- Effective and transparent discussions at all stages of the deal. Ask questions and involve internal colleagues and external partners sooner rather than later.
- Effective Property Management, Resident Services & AM coordination is vital.
- How is the information for each asset managed? Is there detailed tracking with key historic information and benchmarks to ensure continuity if staff changes?
- Compare layered financing agreements. If agreements are out of sync, it can take options off the table. Don't catastrophize but contemplate what you would need if things don't work out as planned.
- What tools do you have available in a worst-case scenario? How prepared is your team to uphold their guarantees and maintain their liquidity requirements?

INVESTIGATE

- Be proactive when AM sees red flags. Don't defer problems.
- Read you LPA, loan documents, and the associated Regulatory Agreements! This will help you understand what you can and cannot do and what consents you need.
- Anticipate long-term REO needs. Consider budgeting a 5-year hold period after Y-15 plus ongoing maintenance.
- Analyze PA/ROFR agreements. Know your options!
- Run internal stress tests based on market shifts, capital improvement concerns, or impacts to organizational financial strength

STRATEGIZE



Polling Question 2

- *Do you have a clear sense of the problem and a plan to discuss with your lender/investor? By show of hands after each possible answer.*
 - A. *Clear sense of problem, no plan (not sure what to ask for)*
 - B. *Clear sense of problem, clear plan*
 - C. *No clarity and no plan*
 - D. *I'm in a fox hole*

Being prepared - Defining the Problem

1. The first step is admitting there is a problem.
2. The second step is clearly and correctly identifying the problem(s)
3. Can you have an out of body experience and see where you are, how you got there, and tell someone else that story?

A Mandate from the Lender's Regulator

Defines key elements of work outs as follows:

1. Updated and comprehensive financial information on the borrower, real estate project and any guarantor;
2. Current valuations of the collateral supporting the loan and workout plan;
3. Analysis of appropriate loan structure;
4. Legal documentation; and
5. Demonstrate ability to monitor restructure.

Preparedness – The Problem

1. You need a **process** to identify the problem – re-underwrite the loan /prepare the Lender Memo.
2. Having a third party give an independent look is critical (consultant, someone internal not originally involved with the investment, Board member).
3. Be candid and honest in your self assessment with an eye toward the end game. Your tone should be balanced, there is no need to fall on your sword.
4. Tell the story, but be concise and to the point focusing on what is material.

Lender assessment

1. What division is handling the Loan?

- Are you in the regular bank? Is this your relationship loan officer or another loan officer?
- Are you with special servicing/workout unit?
- What is the approval structure? Is your Bank representative empowered to deal?

2. Does the Bank know it has a problem?

- What stage of awareness is it at?
- Are you keeping the loan current? Can you continue to keep the loan current?
- Is the loan on nonaccrual?
- Are there reserves on the loan?

Lender assessment

3. Accounting considerations

- reserves and capital considerations
- charge offs vs. recoveries

4. Relationship considerations

- is this the only loan on the Bank's books (this can work for or against you)?

5. Where is the Bank with its regulator and their ratios?

6. Bottom line – you must understand the business drivers for the Lender and build your case to play to the drivers.

Desired outcome – the Action Plan

1. Plan must convince Lender you have fully analyzed the financial situation and project viability and address the underlying problems that are creating the negative performance.
2. Plan should include cash flow projections.
3. Workable business plan & new loan terms that will be required to achieve success.
4. This is the synthesis of the assessment stage and the lender assessment stage.

Desired outcome –the Action Plan

5. Demonstrate you can repay the loan or lessen losses. Demonstrate the value you bring to the table.
6. Convince Lender plan is in Lender's best interests.
7. Be realistic with timeframes and achievement of results.
8. Understand Lender tools (reduced interest rate, moving hurdles and curtailments, extending maturities, etc.)
9. BE PROACTIVE – don't let the Lender come to you. Get to it quickly and with a well thought out action plan. Be candid and honest. The Lender's trust in you will be a key factor in its determinations.

Desired outcome – the Action Plan

10. What help do we need to resolve?
 - Attorney? Accountant? Consultants?

11. Be willing to provide all your information.

12. Provide context and third party support.

How do I get there?

- Have a proposal for a restructure, a list of needs, and wants.
- Structure that request in Lender speak – match the relief needed to the problem
 - If true write-off is needed - seek it.
 - If impairment is temporary, structure with principal recovery in mind.
- Know your legal rights
 - At what point are you approaching lender – default, technical (performance hurdles, covenant breaches, failure to provide information), or payment?
 - Was there any lender liability?

How do I get there?

- Understand the implications of your request and be prepared for reaction (don't bluff).
 - Do you really need to protect your cash to maintain solvency?
 - Are you prepared for a foreclosure?
 - Will you file bankruptcy to protect yourself?
 - What are the implications of this act on other Bank, permanent, or soft debt?
- Other considerations
 - Priority of liens/Other creditors
 - Unintended consequences – access to reserves, default interest rates, audit of files, reputational issues (vendors, tenants, etc.)
- Accounting considerations

Tools at your disposal

I/O (interest only) vs. P&I (principal and interest)

- Temporary cash flow relief needed

Interest rate reduction

- Temporary cash flow relief needed

Covenant modifications

- Temporary or permanent relief needed

Performance hurdles

- Temporary relief needed - project performance will be caught up in time

Cash flow sweeps

- A tool to get improve Lender's position, give control, and potentially hyperamortize loan, resulting in improved LTV

Tools continued

Forbearance - time

Standstills and negotiation letters

Troubled Debt Restructures – over leverage with some upside

Deeds in Lieu

Sale of collateral

Foreclosure

Bankruptcy

Conclusion

- Working out a problem will be stressful but can be managed professionally.
- Put your best foot forward as quickly as you can to provide clear indication of your willingness to do the right thing (but don't be afraid to stand up for yourself).
- Outside perspective is critical.
- Know your desired end result, be realistic, be tough.

Case Study #1

Situation

- Borrower with single asset nonrecourse agency loan
- Workout Goals: temporary relief
- Other Goals:
 - Limit cash outlays from sponsor
 - Maintain ownership of property

Resolution

- Steps taken
 - Prenegotiation Letter
 - Forbearance
- Plan elements – milestones and performance hurdles/time and contract relief
- Resolution/Tools used – Forbearance, interest added to note balance

Case Study #2

Situation

- Borrower with single asset nonrecourse agency loan
- Workout Goals: revised debt structure/TDR (A/B note structure with cash flow sweep)
- Other Goals:
 - Limit cash outlays from sponsor
 - Maintain ownership of property

Resolution

- Steps taken
 - Prenegotiation Letter
 - Restructure presented and denied
 - BK
- Plan elements – revised terms proposed which were rejected
- Resolution/Tools – Bankruptcy/court cramdown/improved deal terms

Case Study #3

Situation

- Borrower with large land positions, limited liquidity and limited cash flow impacted by declining market values. Significantly overleveraged.
- Workout Goals: deleverage organization, preserve cash, avoiding bankruptcy
- Other Goals:
 - preserve housing/affordability restrictions
 - preserve jobs

Resolution

- Steps taken
 - All debt service payments stopped
 - BK analysis presented with full financial disclosure
 - Multiple lenders – commercial banks, local banks, CDFIs, state and federal
- Plan elements – equal treatment like creditors (13)
- Resolution/Tools used - Deed in lieu, Charge-offs, Discounted note sales, restructures with changed business terms
- Avoided bankruptcy

Case Study #4

Situation

- Borrower with \$30MM debt overhang corporate
- Workout Goals: deleverage organization and avoid bankruptcy
- Other Goals:
 - Preserve housing
 - Preserve jobs

Resolution

- Steps taken
 - Identify “knight” to save organization
 - Cleanse organization through merger
- Plan elements – all creditors treated equally, bk analysis developed, \$0.10/\$1.00 recovery for unsecured creditors
- Resolution/Tools – Merger, debt write-offs, asset sales, modifications

Case Study #5

Situation

- Borrower with nonperforming portfolio of real estate assets (15 assets)
- Workout Goals: deleverage
- Other Goals:
 - Limit cash outlays from sponsor

Resolution

- Steps taken
 - Education
 - Restructure not an option
 - Permission to sell
- Plan elements – appraisal/bov/gtys
- Resolution/Tools – Sales/5Q “free ride” plan

Concluding Thoughts

- Success driven by achieving win-win where possible
- Have clear and realistic goals, with an understanding and acceptance of implications of workout

Evaluation Reminder

- Please submit all conference evaluations.
- Look for the electronic evaluation link in your email.
- Contact consult.lwells@gmail.com if you do not receive the link.