

FORBEARANCE AGREEMENTS

**By
Gordon L. Gerson, Esq.
May 2009**

Forbearance agreements in commercial real estate lending are utilized by lenders and borrowers who mutually agree to forestall a foreclosure or for other mutually beneficial purposes.

Forbearance agreements most often document any one or more of the following:

- Delaying the date that the lender will foreclose upon real property which secures a loan.
- Delaying the date that the lender will start foreclosure proceedings of the property.
- Lender agreeing to forbear from exercising other rights or remedies under the loan documents through a specific date.

In addition to the primary purpose of forbearance agreements as set forth above, lenders may also desire to modify covenants in loan documents during the forbearance period. During the forbearance period the lender may modify requirements such as payments becoming due under the promissory note evidencing the loan, financial reporting requirements, or other modifications to the loan documents.

GLF BEST PRACTICE RECOMMENDATIONS^{®1} with respect to forbearance agreements include the following:

1. If the loan is in default, the lender should send out a letter to borrower confirming that there has been an event of default under the loan documents, and clearly set forth the nature of the event of default. The lender should further state in its default letter that it is electing to accelerate the unpaid balance of principal and interest of the loan, and it intends to exercise all rights and remedies with respect to the loan.

2. Separate and apart from the default letter, prior to negotiating the forbearance agreement, the lender should first require the borrower to sign a pre-negotiation letter ("PNL"). The PNL should provide acknowledgments by the borrower of the following:

¹ **GLF BEST PRACTICE RECOMMENDATIONS[®]** are recommendations of GERSON LAW FIRM APC (GLF). GLF Best Practice Recommendations are not intended as legal advice on a specific matter. This article provides general information, and may not reflect

- During the course of "negotiations", the lender shall have no obligation of any kind to borrower to continue the negotiations and may terminate the negotiations at any time.
- There is no binding agreement or commitment of any kind between the lender and borrower with respect to the matters which are the subject of the negotiations or with respect to any other matter relating to the loan unless and until a definitive written agreement is reached and signed by an authorized representative of lender and borrower.
- Any communications during negotiations should be deemed as statements for purposes of settlement and protected by the Evidence Code of the state which governs the mortgage transaction as well as the state in which the property and lender are located, so that such communications cannot be used in any court proceeding.
- No modification of the loan documents shall be deemed effective unless fully executed by both the borrower and lender.

3. Recitals to the forbearance agreement should include factual background statements relating to the loan. Include detailed references to loan documents previously executed in connection with the loan, as well as any prior loan modifications or loan assumptions. The recitals should specifically reference the existing event of default (sometimes referred to as the "Identified Default").

4. The borrower and guarantor(s), if any, should ratify, reaffirm and confirm all of the terms and conditions of all loan documents relating to the loan and acknowledge that all loan documents are valid and enforceable obligations against the borrower and guarantor. All prior representations and warranties of the borrower and guarantor in the loan documents from when the loan was made, should be re-affirmed.

5. The borrower should represent and warrant to the lender certain matters, including that it has no claims, offsets, counter-claim, or defenses with respect to (i) the payment of the loan, (ii) the performance of the borrower's obligations under the loan documents, or (iii) any liability of the borrower under any of the loan documents. The borrower should also represent and warrant that the lender has not breached any duty to the borrower in connection with the loan, and that the lender has fully performed all obligations it may have had to the borrower.

6. The borrower and guarantor should release lender of any claim, whether known or unknown, which the borrower or guarantor may then have or claim to hold under any law in any manner relating to the loan or any of the loan documents. The release agreement should be a complete release and include any statutory requirements by the state in which the property, borrower, or lender is located, or the state laws which govern the loan documents. For California loan modifications, specific reference should

be made to Section 1542 of the Civil Code of the State of California, and include the statutory language as required by that statute.

7. The borrower and guarantor should each covenant that interest on the loan is accruing at the Default Rate (assuming the promissory note provides for a Default Rate of interest), and the date that the Default Rate of interest began to accrue.

8. The date in which the forbearance begins should be when all conditions precedent to the forbearance agreement have been satisfied (as discussed below), which for purposes of this article shall be the "Forbearance Effective Date" and which shall be specific as to the date and time on which the forbearance shall end (the "Forbearance Termination Date"). The Effective Date of the Forbearance Termination Date should be referred to in the forbearance agreement as the "Forbearance Period". The forbearance agreement should be very clear that the agreements of lender (whether it is agreeing not to commence foreclosure, not to complete foreclosure, or not to exercise other rights and remedies) is confined only to the Forbearance Period and any and all agreements of lender to forbear are only through the Forbearance Termination Date or (i) the date that there is an event of default of the loan other than the Identified Default; or (ii) the date on which the borrower or guarantor breaches any provision of the forbearance agreement; or (iii) the date on which the loan is fully paid.

9. Borrower should fully acknowledge those rights which the lender desires to reserve during the Forbearance Period. If the lender has already commenced foreclosure proceedings, the borrower should acknowledge that the lender properly caused a Notice of Default to be recorded and served (or complied with whatever state requirements are in effect with respect to commencing foreclosures). The lender may also want the borrower to acknowledge the right of the lender to publish a Notice of Foreclosure Sale during the Forbearance Period. Most important, the lender should require that the borrower and guarantor agree that following the Forbearance Termination Date, the borrower and guarantor shall not take any action to challenge, delay or interfere with a foreclosure of the property in accordance with state law, and shall fully cooperate with the lender in connection with the foreclosure.

10. The forbearance agreement should not be deemed effective until all conditions precedent to its effectiveness had been satisfied. Conditions precedent to the Forbearance Effective Date may vary from loan to loan but should include the following.

- Enumerated business points important to a lender (*e.g.*, an unpaid contractor be paid and its mechanic lien released).
- The lender shall receive assurance that it may require that its deed of trust or mortgage remains a valid first priority lien against the property and has not been nor will be impaired by the forbearance agreement.
- Borrower and guarantor have executed the forbearance agreement.

- No Event of Default other than the Identified Default shall occur and be continuing under any of the loan documents (include the forbearance agreement).
- The lender shall receive authorizing resolutions with respect to borrower to guarantor entering the forbearance agreement.
- The borrower and guarantor will pay all of out-of-pocket costs incurred by the lender prior to, during and any time after the Forbearance Period, in connection with the forbearance agreement.

The borrower should represent and warrant to the lender certain matters including but not limited to the following:

- All representations and warranties made by borrower and guarantor in the loan documents are true and correct.
- Other than the Identified Default, there is no other Event of Default under the loan documents.
- The borrower and guarantor each have the authority to enter the forbearance agreement
- On California loans, that the borrower and guarantor waive any right to claim that any action taken by the lender pursuant to the forbearance agreement constitutes an "action" by the lender under Section 726 of the California Code of Civil Procedure.

11. A forbearance agreement should be recorded if it (i) increases the outstanding principal balance of the loan, (ii) modifies terms of the deed of trust or mortgage, or (iii) includes any term that may affect a junior lienholder (*i.e.*, further subordinate position in a manner that did not exist at the time the juniorlienholder extended credit to the borrower and its lien attached to the property). In connection with the recording, an appropriate title endorsement should be obtained. In some instances the forbearance agreement may include information that neither the lender nor borrower may want of public record. In such event, a memorandum of the forbearance agreement should be prepared and recorded in the office of the county recorder where the mortgage property is located. A memorandum of the forbearance agreement may also be recorded instead of the forbearance agreement, if it would make available to the public matters not in the interest of the lender or the borrower to be of public record. Examples of such instances, would be if the loan is in default (as that would place potential buyers of the property on notice and provide them with superior bargaining positions) or if specific reference is made to financial covenants such as the net worth or liquidity requirements of a borrower or guarantor.

12. If there is a guarantor of the loan, the guarantor should be a party to the forbearance agreement. The guarantor should also reaffirm all waivers of defenses and other matters that were set forth in the initial guaranty given at the time of the making of the loan.

We strongly recommend that prior to negotiating and/or entering a forbearance agreement, the lender either internally, or with assistance of outside counsel, review its loan file and its loan documents to determine all matters required of it in connection with an event of default of the loan. As an example, if a requirement of five (5) days or ten (10) days of written notice is a requirement before a default triggers the right of the lender to impose a default rate of interest or commence foreclosure proceedings, the lender will want to make sure it complies. The lender will also want to make certain that all matters relating to its lender's title policy coverage are adequate and correct, as that may affect matters that the lender may want memorialized in the forbearance agreement.

Forbearance agreements may be complex or simple documents based upon particular issues relating to a particular loan and numerous other factors. Internally generated forms or vendor forms may or may not be appropriate for a particular loan forbearance agreement. Consultation with a counsel on this issue is recommended.

Lenders who do not have forbearance agreements that address all of the issues set forth above, risks having given the borrower the benefit of delaying a foreclosure or any other exercise of the lender's rights and remedies, while at the same time the lender may find that it did not obtain concessions of the borrower during the Forbearance Period that it should have obtained.

GLF BEST PRACTICE RECOMMENDATIONS[®] are made on matters of general interest on loan origination and loan servicing issues. For more information or other GLF Best Practice Recommendations contact inquiry@GersonLaw.com.