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# Managing and Identifying Rising Risks of a CRE Loan Portfolio

# ➤ Introduction

- A. Current Trends and Economic Factors Affecting CRE
- B. Purpose of Risk Management
  - 1. Protecting Financial Stability and Minimizing Losses
  - 2. Ensuring Regulatory Compliance
  - 3. Enhancing Portfolio Performance and Value

# ➤ Identifying Risking Risk

- A. Market and Economic Factors
  - 1. Economic Cycles
  - 2. Real Estate Market Trends
  - 3. Occupancy and Lease Rates
- B. Borrower-Specific Risks
  - 1. Financial Health of Borrower
  - 2. Loan Performance Monitoring
- C. Property-Specific Risks
  - 1. Property Condition and Management
  - 2. Location and Development Risks

# ➤ Risk Management Strategies

- A. Portfolio Diversification
- B. Enhanced Due Diligence
  - 1. Thorough Underwriting Processes
  - 2. Ongoing Risk Assessment
  - 3. Performance Tracking
  - 4. Early Warning Systems to Detect Potential Issues
    - (a) Identifying “Red Flags” of a problem loan
- C. Developing Risk Management Policies
  - 1. Policy Formulation
    - (a) Timely involvement of SAD lender personnel
    - (b) Periodic review of Borrower structure and operations
  - 2. Staff Training
    - (a) Develop personnel for troubled loans
    - (b) Focus attention on non-monetary defaults, not just monetary defaults
- D. Technology and Tools
  - 1. Risk Management Software
  - 2. Data Analytics



# Managing and Safeguarding CRE Portfolios

# ➤ Introduction

## A. Why Explore Borrower Alternatives

1. Prevent Foreclosure and Maintaining Borrower Relationships
2. Identifying Proactive Solutions to Address Distressed Assets

# ➤ Early Intervention Strategies

## A. Loan Workout Programs

1. Restructuring and Modifications
2. Forbearance Agreements
3. Financial Counseling/Restructuring Specialists
4. Refinancing Options/Note Sale

# ➤ **Litigation Alternative**

- A. Cooperative Sale of Property
  - 1. Borrower Given Period of Time to Sell
  - 2. Engage Independent Broker

# ➤ **Litigation**

- A. Receiverships



# Alternatives for REO CRE Property



# ➤ **Property Management and Optimization**

- A. Property Assessment and Valuation
  - 1. Comprehensive Property Evaluation
  - 2. Market Analysis
- B. Operational Improvements
  - 1. Property Maintenance and Upgrades
  - 2. Enhanced Property Management
  - 3. Safeguarding Property
- C. Potential Revenue Generation Strategies
  - 1. Leasing and Occupancy
  - 2. Alternative Uses and Repurposing

# ➤ Lender Alternatives

## A. Lender Property Disposition Options

1. Direct Sale
2. Auction
3. Buyer of Distressed Properties
4. Boarding-Up/Holding

## B. Continued Use of Receiver

1. Environmental Issues
2. Title Issues
3. Finish Construction
4. Broad Sale/Disposition Options

# ➤ The Troubled CRE Loan <sup>1</sup>

- In March 2019, Honest Lead Bank provided a \$45.0M term Loan (with a 25% Participant) to CRE Debtor to finance the purchase of a non-Class A+ multi-story office Building near San Jose. The FMV appraisal of the Project at that time was \$65.0M. The CRE Debtor is composed of the Sponsor (2%) and other investors (98%), primarily a state pension fund (90%). The Sponsor signed a Completion and Payment Guaranty, and is the management company for the Project.
- The Building was completed in late 2022. Primarily as a result of COVID, and the stay at home mentality of Silicon Valley companies, and despite the efforts of CRE Debtor's broker, leasing the Building became problematic. By mid-2023, the Loan was in both monetary and non-monetary default. Honest Lead Bank declared the Loan in default in August 2023.
- In the next 9-months, CRE Debtor obtained numerous expressions of interest to purchase the Building in the \$25M to \$35M range. The last appraised value of the Building in early 2024 was \$38.0M. Honest Bank is currently owed \$45.5M.
- In July 2024, Honest Lead Bank filed a receivership action and a Receiver was appointed in October 2024.

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<sup>1</sup> This is a work of fiction. Any similarity to actual financial institutions or persons, living or dead, or actual events or numbers, is purely coincidental.

# ➤ Selected Receiver Issues

- Site visit of Project
- Take possession and safeguard the Building
- Determine cooperation of CRE Debtor
- Meet with CRE Debtor and Sponsor personnel
- Obtain access to books and records
- Meet with Honest Lead Bank and Participant
- Prepare operating budget
- Determine need for receivership certificates
- Determine current FMV of Building
- Engage new brokers?
- Remarket the Building for sale?
- Determine time line for marketing and ultimate sale of Building
- Explore type of receivership sale of Building
- Use a stalking horse bidder?
- Auction the Building or sealed bids?
- Determine interest of Honest Lead Bank and Participant in note sale
- Replace Sponsor as the management company?
- Establish reporting to Honest Lead Bank and Participant?

## Attorney Bio



### Scott O. Smith

Litigation – Shareholder – Orange County

Scott O. Smith is a Shareholder in the Financial Institutions, Litigation and Insolvency & Financial Law groups, working in both the Orange County office of Buchalter. Mr. Smith focuses his practice on representing financial institutions, with an emphasis in creditor's rights, commercial litigation, prejudgment remedies, receiverships, real estate, collections, loan workouts, restructuring and insolvency issues. Mr. Smith also has extensive experience in defense litigation, including lender liability and Uniform Commercial Code disputes.

Mr. Smith is a frequent speaker on bankruptcy, creditors' rights (secured and unsecured), provisional and post-judgment remedies, workouts and restructuring, lender liability, commercial law, and collection alternatives and strategy. Mr. Smith speaks at conferences and seminars including those presented by the Western Banking Association, California Community Bankers Network, Special Asset Managers Association, Financial Lawyers Conference, National Association of Chinese American Bankers, The Rutter Group, Robert Morris & Associates and the Los Angeles County Bar Association, as well as, in-house seminars for numerous financial institutions.

Mr. Smith, who is AV Preeminent rated by *Martindale Hubbell*, was selected a *2013 Top Rated Lawyer* in the area of Commercial Litigation by *American Lawyer Media*. In addition, Mr. Smith has been recognized in the *Best Lawyers in America*, Bankruptcy and Creditor Debtor Rights / Insolvency and Reorganization Law, for 2024.

Mr. Smith was a contributing author to The Rutter Group California Practice Guide, *Enforcing Judgments and Debts*, and has testified as an expert witness on those subjects.

#### Areas of Practice:

Insolvency & Financial Law Group  
Litigation

#### Industry Specialties:

Fiduciaries, Receivers & Trustees  
Financial Institutions Law  
Title Insurance & Escrow  
Agribusiness