



Five Strategies for Special Servicer Negotiations: How to avoid the most common stumbling blocks

Whether you are a borrower, a B-piece holder or a foreclosing mezzanine lender, at some point you have found yourself in the unenviable position of dealing with a special servicer. By gaining insight into what motivates special servicers, you will solidify your negotiation strategy and better understand how to avoid a few common pitfalls.

In the CMBS world, the special servicer is the gatekeeper of all workouts. A loan enters special servicing when it is more than 60 days behind in payments or has matured or when some other default has occurred or is imminent. The special servicer has leeway to modify or extend the loan -- or agree to a forbearance or workout -- or it can choose to foreclose or commence other enforcement actions.

The special servicer is contractually bound to act so as to maximize recovery for the trust as a whole. But there may be other factors that motivate special servicers, such as their fees, affiliation with certain bondholders or a desire to purchase and hold the collateral for their own account.

Here we look at five strategies for avoiding common missteps in special servicer negotiations by understanding what drives them to act as they do.

1. ***Be prepared.*** In today's environment, the asset managers who work for special servicers often are stretched far too thin and may be overwhelmed with their caseload. If you succeed in connecting with the right person and are able to set up a meeting, make sure to use the time wisely. When you call or email to follow up after a meeting, you want the asset manager to respond, so leave him with a positive impression. Show your knowledge of the property by presenting current financial information and a compelling business plan. Arm yourself with a strategy to improve operating performance or otherwise enhance the value of the asset. Arrive prepared with a written proposal for the terms of a modification or workout that the servicer can respond to. Expect that the servicer may require an equity infusion in exchange for rate relief, term extension or a write-down or subordination of principal. Make an offer and be prepared to negotiate. Above all, don't make the mistake of showing up unprepared and alienating the asset manager from the start.

2. ***Understand the pooling and servicing agreement.*** Under the pooling and servicing agreement, the special servicer must adhere to the "servicing standard". As such, it is required to use the same degree of care and diligence as it would with its own assets in order to maximize recovery, on a net present value basis, to the trust as a whole. Unlike the master servicer, the special servicer is permitted to use its discretion in resolving troubled loans, including extending the term, modifying the interest rate, writing down principal, granting forbearance, accepting a discounted payoff or foreclosing or taking a deed in lieu of foreclosure. When making a proposal to a special servicer, it is impor-

tant to understand the obligations that govern the special servicer and the options available to it. Your proposed plan must fit within these guidelines and meet the servicer's goal of maximizing recovery to all bondholders. Failing to understand the special servicer's mandate under the PSA could easily result in a rejected proposal.

3. ***Be aware of other motivating interests.*** While special servicers are obligated to act in the best interest of all bondholders, they could be motivated by other factors. In some cases, this creates a conflict of interest that could constitute a breach of the pooling and servicing agreement. Outside factors that could influence a special servicer include answering to the controlling noteholder, who often can terminate and replace the special servicer. A special servicer may also be affiliated with a bondholder and thus beholden to its interests over others'. Also, with four of the five largest special servicers having been acquired by real estate investors in the past two years, there is likely a motivation on the part of special servicers to acquire real property collateral for their own account. Understanding these potential motivating factors and determining which of them exist in a given case will help you formulate a proposal that appeals to the special servicer and is more likely to be approved.

4. ***Gain some leverage.*** With the potential for conflicts of interest and with asset managers at special servicers stretched thin, there is the potential for breaches of the pooling and servicing agreement and other missteps on the part of special servicers. It is important to understand the duties and obligations of your special servicer and whether you might have claims against it. To be sure, it would be unwise to go into your first meeting with guns blazing, but just as the servicer will be prepared to exercise rights and remedies on behalf of the trust, you must understand what rights you have in order to level the playing field. While a borrower would not typically have standing to sue for breaches of the pooling and servicing agreement, servicers are sensitive to whether or not they are complying with the servicing standard and will govern their conduct accordingly, regardless of whether you would be able to assert such a claim. Moreover, there are a plethora of theories of lender liability under which you may have a claim, and you should explore with an attorney any factual scenarios that might support such claims. Understanding what claims you have can go a long way to building some leverage in your workout negotiations.

5. ***Know your documents.*** A good special servicer will know the loan documents, including whether there are payment guaranties or whether recourse has been triggered under a non-recourse carveout guaranty. They will know what reporting they are entitled to and what remedies they have at their disposal. It is important that you too understand the documents and what rights the lenders have and what rights they don't have. What might the special servicer need from you but have no right to request under the documents? Is filing for bankruptcy an option or does it trigger recourse and if so to whom? Does the lender have an obligation to be reasonable in considering certain requests? These are all questions to which you ought to know the answers before meeting with the special servicer. Failing to understand the documents can leave you at a severe disadvantage.

As you prepare to meet with your special servicer, consider these five strategies. Those who attempt to negotiate with a special servicer without understanding what motivates it, do so at their own peril. Armed with the insights we examined in this article, you should be able to avoid some of the common pitfalls of negotiating with special servicers.