

## **LOAN MODIFICATION AGREEMENTS**

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

Loan modification agreements in commercial real estate lending have become an important tool for lenders in loan workouts.

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

- Reduction in interest rate.
- Modifying the requirement of monthly payments of principal and interest to interest only.
- Extending the maturity date of the loan.
- Waiving requirement of monthly payments for a period of time.

In addition to the most common purposes of loan modification, lenders may also desire to modify covenants in loan documents such as financial reporting requirements (*i.e.*, usually requiring greater reporting requirements by borrowers), or covenants relating to loan-to-value, or debt service coverage ratio requirements.

**GLF BEST PRACTICE RECOMMENDATIONS<sup>®1</sup>** with respect to loan modification agreements include the following:

1. If the borrower is in default of a loan at the time the borrower and lender want to negotiate a loan modification 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:

- 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

---

**GLF BEST PRACTICE RECOMMENDATIONS<sup>®</sup>** 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 most current developments.

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.

2. The recitals to the loan modification 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.

3. 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.

4. 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.

5. The borrower and guarantor should release the 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.

6. The loan modification agreement should not be deemed effective until all conditions precedent to its effectiveness had been satisfied. Conditions precedent to its effectiveness may vary from loan to loan. Among conditions precedent should be that:

- The borrower shall pay a fee in connection with the loan modification.
- The lender has obtained a necessary title endorsement in connection with the loan modification.
- The borrower pays all of the lender's out-of-pocket cost in connection with the loan modification, including its attorney's fees, title endorsement, and escrow filing or recording fees.
- Except for an event of default of the loan which is expressly identified in the loan modification agreement, that there exists no other event of default of the loan.
- If the borrower is a corporation, partnership, or limited liability company, it should provide the lender with satisfactory evidence that whoever is executing the loan modification agreement is duly authorized.

7. A loan modification 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 junior lienholder 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 loan modification agreement may include information that neither the lender nor borrower may want of public record. In such event, a memorandum of the loan modification agreement should be prepared and recorded in the office of the county recorder where the mortgage property is located. A memorandum of the modification may also be recorded instead of the loan modification 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.

8. If there is a guarantor of the loan, the guarantor should be a party to the loan modification 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.

It is strongly recommended that prior to negotiating and/or entering any loan modification agreement, the lender either internally, or with assistance of outside counsel, review its loan file and its loan documents to determine if the loan was properly documented or if there are any issues that should have been covered in the loan documents or the lender's title insurance policy at the time the loan was made which were

not covered; and further, if there are any material changes in the condition of the borrower, guarantor, or the property that require provisions of the loan documents to be modified, other than those modifications requested by the borrower, which was the primary purpose of having a loan modification agreement. The loan modification agreement may be utilized as a tool to correct prior mistakes lender may have made in the loan documentation process.

Loan modifications 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 modification transaction. Consultation with counsel on this issue is recommended.

Lenders who do not have loan modification agreements that address all of the issues set forth above, risk providing unforeseen benefits to borrowers.

***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](mailto:inquiry@GersonLaw.com).***