

# Buchalter

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## Negotiating and Documenting Commercial Mortgage Modification Agreements: Seven Major Factors

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and Mr. Rick Rodriguez

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Noon to 1PM PST

Webinar

Buchalter

1000 Wilshire Boulevard, Suite 1500

Los Angeles, California 90017

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# I.

## INTRODUCTION

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Modifying loan terms allows the lender and the borrower to advance additional funds to keep the project moving forward. It may also allow for restructuring loan terms when needed, to avoid costly defaults, foreclosure and related issues.

At the same time, lenders (or those servicing the loans) must be careful to preserve the lender's rights, including lien priority, title insurance coverage and to avoid "plastering over" unresolved problems and issues. Consider these factors:

- Use of a "protocol" agreement
- Obtaining appropriate waivers and releases as part of the consideration for the modifications
- Advances: Are the additional funds part of the existing loan or a new loan transaction?
- Lien priority: Avoiding the loss of current lien priority
- Title Insurance: Avoiding loss of, or inadequate coverage
- Documentation: Eliminating ambiguities which could lead to later disputes
- Anticipating potential challenges to lien priority by subordinate lenders or the borrower's bankruptcy trustee

**Real Estate markets and the economy always change.**

## II.

**CIRCUMSTANCES WHICH MAY WARRANT A  
MODIFICATION OF A COMMERCIAL MORTGAGE**

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- A. Borrower requires additional money.
- B. Borrower requires additional time.
- C. The project needs to be changed.
- D. Avoid a default.
- E. Clarify documentation.
- F. Change collateral.
- G. Change borrower or guarantors.
- H. Obtain waivers from the borrower and the guarantors.
- I. Change interest rate.
- J. Change payment provisions.
- K. Change disbursement provisions.

## III.

USE OF A “PROTOCOL” AGREEMENT

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- A. Introduction.
- B. No waiver of rights by entering into negotiations for a potential modification of the loan terms.
- C. Complete confidentiality.
- D. No change in loan terms until a new written agreement is signed by all parties and title insurance coverage is obtained.
- E. Inadmissible evidence.
- F. Including everyone, e.g., loan servicers and guarantors.
- G. Be circumspect if you cannot get all signatures to a protocol agreement.

## OBTAIN THE WRITTEN CONSENTS OF ALL BORROWERS AND GUARANTORS

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- A. Introduction.
- B. Obtain the participation of all borrowers and all guarantors in any discussions with respect to a potential modification.
- C. Obtain the signatures of all borrowers, servicers and all guarantors to a protocol agreement before negotiations are commenced.
- D. Obtain the written agreement of all borrowers and all guarantors to any proposed modification agreement before it is effective.
- E. The failure to obtain the written consent of all borrowers and all guarantors can materially or adversely affect the loan modification.

## AVOIDING THE LOSS OF PRIORITY OF THE CURRENT MORTGAGE

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- A. Introduction.
- B. The modification of the current mortgage loan may result in a loss of priority.
  - 1. The loss of priority could be a complete loss of priority to any junior lien.
  - 2. The loss of priority could be a loss only to the extent that a junior lien was prejudiced by the modification.
- C. How do you know who has a junior lien interest in the secured property?

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## *Save The Date!*

### **Loan Fraud: How To Recover Treble Damages and Attorney Fees Without Being The Source of Recovery**

**John L. Hosack, Esq., Jason E. Goldstein, Esq., Michael Flynn, Esq., Joffrey Long and Mr. Rick Rodriguez**

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## OBTAIN ESCROW PROTECTION FOR THE MODIFIED MORTGAGE

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- A. Introduction.
- B. The proposed modification agreement together with all written consents by all borrowers and all guarantors should be deposited with a financially responsible escrow agent.
- C. The lender should provide express written escrow instructions to the escrow agent to provide that the escrow for the modification agreement may only be closed if the lender's security remains the same and is not adversely affected by the modification agreement.



## OBTAIN TITLE INSURANCE COVERAGE FOR THE MODIFIED MORTGAGE

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- A. Introduction.
- B. There is a substantial risk that the title insurer will take the position that the title insurance coverage terminated if there is a modification of the insured mortgage.
- C. There is a material risk that the title insurer will take the position that the loan policy of title insurance does not extend to the modified mortgage.
- D. Obtain title insurance coverage for the modified mortgage, whether by an endorsement to the original policy or by the re-issuance of the policy.

OBTAIN ADEQUATE CONSIDERATION  
FOR THE MODIFIED MORTGAGE

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- A. Introduction.
- B. In general a modification of a mortgage loan is not binding unless supported by sufficient consideration. *See, Motown Record Corp. v. Brockert* (1984) 160 Cal. App. 3d 123, 133.
- C. A distinction is drawn between a modifying supplemental agreement and an explanatory supplemental agreement. The explanatory supplemental agreement does not provide additional consideration. *See, Cutter Laboratories Inc. v. Twining* (1963) 221 Cal. App. 2d 302, 311.

## IX.

**ANTICIPATE CHALLENGES TO THE MODIFIED MORTGAGE**

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- A. Introduction.
- B. Challenges by the Borrower.
- C. Challenges by the Guarantors.
- D. Challenges by holders of junior liens on the borrower's property.
- E. Challenges by creditors of the borrower.
- F. Challenges by the Borrower's bankruptcy trustee.
- G. Verify that the modification was done correctly in accordance with the agreement of all parties.

## CAN THE MODIFICATION BE ATTACKED AS A FRAUD ON CREDITORS?

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- A. Introduction.
- B. Any change to the mortgage loan “opens a door” to an attack on the transaction as being a fraud on creditors.
- C. The standard loan policy of title insurance does not provide coverage against the claim that the transaction which created the lien of the modified mortgage is:
  - 1) A fraudulent conveyance or fraudulent transfer; or
  - 2) A preferential transfer.

## STANDARD PROVISIONS TO BE CONSIDERED IN DRAFTING A MODIFICATION AGREEMENT

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- A. Introduction.
- B. Alternative dispute resolution.
- C. Choice of venue.
- D. Statute of limitations.
- E. Limits on recoverable damages.
- F. Releases.
- G. Borrower's admissions of defaults.

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## RISKS WHICH ARE INHERENT IN LOAN MODIFICATION AGREEMENTS

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- A. Introduction.
- B. Litigation:
  - 1. Borrower; and/or,
  - 2. Guarantors.
- C. Bankruptcy.
- D. Third Party Claims.
- E. Consumer loan issues.
- F. Each communication should be viewed as a potential “Exhibit 1.”

## FEES, CHARGES AND A DEPOSIT FOR A MODIFICATION

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- A. Introduction.
- B. Original loan documents should provide that a reasonable deposit might be required as part of consideration for a modification.
- C. Time and expense to negotiate and document the modification.
- D. Risks to the lender for having agreed to a loan modification.
- E. The lender should impose fees and charges which are adequate to compensate it for: (1) the time and expense to negotiate and document the modification; and (2) the increased risk to the lender for having agreed to a loan modification.



THE RISK TO THE LENDER THAT A FORBEARANCE  
AGREEMENT MAY BE FOUND TO BE A *DE FACTO* MODIFICATION AGREEMENT

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- A. Introduction.
- B. It is not uncommon for lenders and borrowers to enter into a forbearance agreement, whether a written forbearance agreement or merely agreed upon inaction to undertake certain activity.
- C. A lender should be cautious about a forbearance agreement, whether formal or informal, because it may be alleged to be a *de facto* modification agreement which has changed the terms of the mortgage loan and subjects the lender to attack.
- D. Carefully track communications with the borrower.

THE RISK TO THE LENDER THAT THE FAILURE TO ENFORCE PROVISIONS TO THE  
LOAN AGREEMENT MAY BE FOUND TO BE A *DE FACTO* MODIFICATION AGREEMENT

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- A. Introduction.
- B. It is not uncommon for a lender to fail to enforce provisions to a loan agreement, especially if they appear at the time to be relatively minor.
- C. The loan agreement should provide that the lender's failure to strictly enforce the provisions of the loan agreement is not a waiver of any rights to enforce the loan agreement and it may be enforced according to its terms in the future, despite not having been enforced in the past.

SHOULD THE LENDER DECLINE TO ENTER INTO A LOAN MODIFICATION AGREEMENT  
AND INSTEAD REQUIRE THE BORROWER TO REFINANCE THE LOAN?

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- A. Introduction.
- B. Lender's evaluation of the risks and the benefits of a potential loan modification.
- C. The potential benefits and detriments to the lender of a refinance of the existing loan.
- D. Re-underwriting all or part of the loan.
- E. Updating estoppel notices.

## IS A DEED IN LIEU OF FORECLOSURE PREFERABLE TO A FORBEARANCE AGREEMENT?

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- A. Introduction.
- B. The “true” deed in lieu of foreclosure.
- C. The “modified” deed in lieu of foreclosure where the loan survives.

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## IS A FORECLOSURE SALE PREFERABLE TO A MODIFICATION AGREEMENT?

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- A. Introduction.
- B. A lender which is considering a modification agreement should consider all other options, including whether a foreclosure sale is preferable to a modification agreement.
- C. While a foreclosure sale will take time and money and is fraught with risk, it should be considered as an alternative because it will allow the lender a “fresh start” to deal with the loan.
- D. Does your underwriting analysis result in it being better to just say no?
- E. Consider junior liens and leases.

## SHOULD THE LENDER RECORD A NOTICE OF DEFAULT WHILE IN NEGOTIATIONS WITH THE BORROWER OVER A POSSIBLE FORBEARANCE AGREEMENT?

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- A. Introduction.
- B. Frequently, a modification agreement is considered as a result of a default by the borrower which would entitle the lender to record a notice of default.
- C. Frequently, the borrower will request that the lender not record a notice of default during the period of time that the borrower and the lender are discussing a possible forbearance agreement.
- D. In the event that the borrower files for bankruptcy, the lender will not be able to record a notice of default until it first obtains relief from the automatic stay.
- E. The recordation of a notice of default by the lender will avoid the risk to the lender that the borrower, during the negotiations over the forbearance agreement, will file for bankruptcy and prevent the lender from recording a notice of default until after relief from the automatic stay is obtained.
- F. Dual Tracking (consumer loans).

THE BORROWER SHOULD PROVIDE DETAILED AFFIRMATIONS  
TO THE LENDER ABOUT THE LOAN, INCLUDING THE ADMISSIONS OF ANY DEFAULTS

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- A. Introduction.
- B. Frequently, a modification agreement is considered because the borrower and the lender have some issues with respect to the terms of the loan.
- C. To eliminate any disputes between the borrower and the lender with respect to the terms of the loan, the borrower should provide detailed affirmations to the lender about the loan (*i.e.*, the principal amount owed, the current interest rate, *etc.*), that there are no defenses to the loan, no breaches by the lender, nothing which affects title (lien priority), had the opportunity to consult with counsel and had sufficient time to make a decision on the modification.



THE MODIFICATION AGREEMENT SHOULD EXPRESSLY PROVIDE THAT EXCEPT AS EXPRESSLY MODIFIED,  
ALL OTHER OBLIGATIONS REMAIN IN FULL FORCE AND EFFECT  
AND ARE REAFFIRMED BY THE BORROWER AND ALL GUARANTORS

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- A. Introduction.
- B. A modification agreement is an agreement by the parties to an existing contract to alter their obligations without deleting any of the elements essential to the validity of the original contract. *Carlson Collins, Gordon & Bold v. Banducci* (1967) 257 Cal. App. 2d 212.
- C. A modification of the details of a contract which leaves its general purpose undisturbed is a modification rather than a rescission. *Travelers Ins. Co. v. Workmens Comp. App. Bd.* (1967) 68 Cal. 2d 7, 17.

## XXII.

**BORROWER AND GUARANTORS' AUTHORITY TO ACT**

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- A. Introduction.
- B. Since the original loan was entered into, the status of the borrower or guarantor may have changed.
- C. Since the original loan was entered into, the status of the guarantors may have changed.
- D. Before entering into negotiations with respect to a potential modification agreement, determine the current status and authority of the borrower and the guarantors to act.

**HAVE THE TITLE COMPANY  
RECORD A NOTICE OF THE MODIFICATIONS**

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- A. Introduction.
- B. The lender should cause to be prepared a written memorandum relative to the modification of the loan agreement.
- C. The lender should request the title company to record the notice of the modification of the loan agreement.

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## DETERMINE THE STATUS OF TITLE TO THE PROPERTY BEFORE ENTERING INTO NEGOTIATIONS AND BEFORE EXECUTING THE MODIFICATION AGREEMENT

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- A. Introduction.
- B. It is difficult in many states (including California) to determine the status of title to the property.
- C. There are a variety of ways that the status of the property could have been altered since the initial loan was made.
- D. The lender should make it clear to the borrower and all guarantors that the status of the title to the property must be as good, if not better, as it was when the original loan was made.

## OBTAIN THE WRITTEN CONSENT OF ALL JUNIOR LIENS TO THE MODIFICATION AGREEMENT

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- A. Introduction.
- B. It is difficult in many states, including California, to determine the existence of junior liens.
- C. A junior lien holder is entitled to object if the modification agreement subjects the junior lienholder to a greater burden than it had before.
- D. Before spending a substantial amount of time and money on a potential modification agreement, the lender should determine whether the holders of all junior liens on the borrower's property would consent to the proposed modification agreement.
- E. Borrower's affidavit as to junior or senior liens (or application for loan modification)

HAVE ALL GUARANTORS REAFFIRM THEIR GUARANTEES AND EXPRESSLY CONSENT TO ALL OF THE CHANGES IN THE LOAN TERMS WHICH ARE PROVIDED FOR IN THE MODIFICATION AGREEMENT

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- A. Introduction.
- B. When the issue of a potential modification agreement is first raised, the lender should make it clear that as a condition to any modification agreement all guarantors must expressly consent to all of the changes in the loan terms which are provided for in the modification agreement, and reaffirm their obligations under the loan as modified.
- C. The guarantors should be required to participate in any negotiations with the borrower relative to a potential modification agreement.

## XXVII.

### ADDRESS THE RISK OF FUTURE EVENTS OF DEFAULT BY THE BORROWER

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- A. Provision which states that the granting of a loan modification is not a guarantee of further modifications of the loan.
- B. Expressly reserve the right to deny any request for a further modification of the loan.



## IS THE LENDER REQUIRED TO PROVIDE ANY ADDITIONAL DISCLOSURE?

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- A. Introduction.
- B. Depending upon the nature of the loan (*i.e.*, is it a “commercial” loan or a “consumer” loan?), the lender, when the loan was originally made, may have been required to make certain disclosures to the borrower.
- C. When the loan is modified, depending upon the nature of the loan and the nature of the modification, it may be necessary for new disclosures to be made by the lender to the borrower relative to the modification.

## XXIX. CONCLUSION

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Modification agreements can be useful to both the borrower and the lender. However, the entry into a modification agreement raises most, if not all, of the issues which are associated with the origination of the loan. Accordingly, the borrower should commit sufficient time and resources to make sure that the modification is appropriately done so as to avoid jeopardizing the security of the existing loan.

## John L. Hosack—*Presenter*

John L. Hosack is a Shareholder in the firm's Litigation Practice Group in Los Angeles and a member of the firm's Mortgage Banking Group. Mr. Hosack represents mortgage brokers, secured lenders and property owners at trial and on appeal in real property disputes including, broker liability, lender liability, fraud, breaches of contract, mechanic's liens, stop notices, judicial foreclosures, receiverships, escrow claims and title insurance claims. His transactional practice includes commercial real property loan documentation, loan workouts, REO sales and foreclosures. He is an Affiliate Member of the California Mortgage Association and a member of the Los Angeles Mortgage Association, a Fellow of the American College of Real Estate Lawyers and a Fellow of the American College of Mortgage Attorneys. He is the author of "California Title Insurance Practice (First Ed., Calif. Cont. Ed. Bar), the first book on title insurance, and is a past Chair of the ABA's Title Insurance Litigation Committee.



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## Jason E. Goldstein—*Presenter*

Jason E. Goldstein is a Shareholder and Co-Chair of Buchalter's Mortgage Banking Group. Mr. Goldstein specializes in "private money," real property related litigation, title, escrow and trade secrets. Mr. Goldstein has an extensive legal background which includes defending lenders, brokers and servicers in court (negligence, fraud, TILA, RESPA, HBOR, wrongful foreclosure, lender/servicer liability defense, etc.), prosecuting escrow and title insurance litigation (on behalf of the insured), insurance coverage (Title, CGL, E&O, etc.), litigating misappropriation of trade secret claims, defending and prosecuting claims on behalf of general contractors and prosecuting receiverships. Mr. Goldstein is a fellow of the American College of Mortgage Attorneys ("ACMA") and a member of the ACMA Title Insurance Committee.



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## Michael Flynn—*Presenter*

Michael Flynn is a member of the Firm's Corporate Practice Group and Co-Chair of Buchalter's Mortgage Banking Group in the Los Angeles office. Mr. Flynn applies his unique background as the former Acting General Counsel of HUD, and the former General Counsel of PNC Mortgage and Flagstar Bank, to counsel clients on a variety of regulatory, mortgage, consumer financial services, FinTech and real estate matters.



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## Rick Rodriguez—*Presenter*

Mr. Rodriguez is the founder and principal of Rodriguez and Associates Advisory Group ("R&A"), a Los Angeles based consultancy firm that has provided a unique array of services to its clients since 1992. For the past 24 years, R&A has successfully formulated creative workout and loan restructure resolutions to complex multi-party debtor-creditor transactions in judicial and non-judicial settings.



**Rick Rodriguez**  
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## **Joffrey Long—*Presenter***

Active in making, arranging and loan servicing of both hard money ("private money") and institutional real estate loans, and in arranging and servicing trust deed investments since 1979. President of mortgage company, past president and education chair and current director and member of the education committee of the California Mortgage Association. Extensive teaching and training experience as an instructor for loan originator and loan servicer continuing education classes, including those required under the Nationwide Mortgage Licensing System, (NMLS) seminars on mortgage industry practices, and as a contract instructor for Park University Enterprises. Author of numerous courses and seminars regarding loan origination, loan servicing and the sale of loans to investors.

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**Joffrey Long**  
Southwest Mortgage

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