GOODWIN

Zombie Assets: The Real Estate Asset Playbook

Not all troubled assets stay undead

Goodwin Dialogues: Webinar

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Today's Presenters



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Today's Agenda

I. Topic 1 – Triaging Troubled Assets

II. Topic 2 – Restructuring Operational Documents: Reanimating a Dead Deal

III. Topic 3 – Recapitalization and Preferred Equity: Helping Assets Rise from the Dead

IV. Topic 4 – Debt Solutions, Amendments and Lender Negotiations

TOPIC 1

TRIAGING TROUBLED ASSETS



Diagnostics, timing and stakeholder alignment

Before the asset joins the undead

The Diagnostic Framework

Checking whether the asset has a pulse

Know what you have before you act. Before you can fix it, you have to understand it fully. Not every troubled asset is a Zombie.

Financial diagnostics

- **Cash runway:** Months of liquidity remaining at current burn
- **Capex/TI&LC gap:** Business-plan requirements versus committed capital
- **Debt stack:** Principal, maturities, extension options and DSCR/LTV covenant headroom
- **NAV versus debt:** Is equity value worth fighting for?
- **Capital accounts:** Exit-scenario waterfalls: who gets paid, and when?

Legal and structural diagnostics

- **Title and liens:** Confirm clean title. Flag mechanic's liens, judgment liens and subordinate debt
- **Loan documents:** Monetary and non-monetary defaults, cure periods, cross-default and cross-collateralization
- **JV agreements:** Consent rights, deadlock mechanisms, buy-sell triggers, dilution and default loan provision
- **Fund documents:** GP authority for remedial action without LP consent, investment period status and commitment availability

Operational diagnostics

- **Leasing and collections:** Leasing velocity and rent collection trends
- **Capex execution:** Expenditure pipeline and contractor exposure (including considerations for TI & LC)
- **Management agreements:** Key agreements and termination rights
- **Insurance and condition:** Coverage adequacy and property condition

KEY TAKEAWAY: Diagnostics underpin every subsequent negotiation. Sponsors who negotiate without completing diagnostics may find that the deal may come back to bite them.

Timing: When to Act, When to Wait, and When to Accept the Apocalypse

Perspectives of a Borrower/Equity Owner

In distressed situations, timing is often more important than strategy.

Early Watch

INDICATORS

Covenant drift, leasing slowdowns, sponsor cash calls.

SPONSOR OPTIONS

Proactive lender dialogue, business plan revision.

Leverage: High

Technical Default

INDICATORS

Missed covenant, maturity approaching, LTV breach.

SPONSOR OPTIONS

Forbearance, waiver request, equity cure.

Leverage: Medium–High

Monetary Default

INDICATORS

Missed interest or principal payment.

SPONSOR OPTIONS

Loan amendment, A/B split, rescue capital.

Leverage: Medium

Acceleration / Enforcement

INDICATORS

Notice of default, UCC filing, receiver motion.

SPONSOR OPTIONS

Emergency recap, deed-in-lieu negotiation, bankruptcy.

Leverage: Low

Receivership / Foreclosure

INDICATORS

Court-appointed receiver, lis pendens.

SPONSOR OPTIONS

Negotiated settlement or litigation.

Leverage: Very Low

The “zone of insolvency” warning

GP/manager duties may expand to creditors near insolvency, depending on jurisdiction and entity structure. Engage legal counsel early to address fiduciary-duty exposure. Review documents and side letters carefully to ensure that the GP/manager is appropriately documenting applicable decisions with contemporaneous board/manager resolutions.

Timing biases to avoid

- **Pretend and Extend:** Extending maturities (unless time is the driving concern as was the case with Covid) without fixing the plan is a reliable way to create a Zombie.
- **Paralysis by analysis:** Over-diagnostics while the asset deteriorates.
- **Premature capitulation:** Handing over keys before exhausting leverage.

Stakeholder Alignment: Building the Coalition to Execute

Perspectives of a Borrower/Equity Owner

Every restructuring requires a human solution, not just a financial one.

The GP's dual role problem

- Conflicting duties: fiduciary duties to fund LPs versus contractual duties to the asset-level lender.
- GP or affiliate rescue capital: LPAC consent and independent fairness opinions are essential.
- Disclosure is a legal and reputational imperative.

Alignment best practices

- Consider whether necessary to establish a restructuring sub-committee with clear authority and delegated decision-making.
- Use one consistent information protocol to reduce litigation risk.
- Use NDAs and confidentiality walls for sensitive lender talks.
- Consider a financial advisor / CRO for independent credibility.

Stakeholder	Primary interest	Typical concern	Alignment tool
Senior Lender	Loan repayment, collateral protection	LTV erosion, default liability	Forbearance, business plan transparency
Mezz Lender / Preferred Equity	Return of capital + yield	Squeeze-out, subordination risk	Intercreditor negotiation, PIK arrangements
LP Investors	Capital preservation, return of equity	GP self-dealing (preservation of reputation over enhancing asset returns), information asymmetry	Enhanced reporting, LP advisory committee engagement
LP Advisory Committee	Oversight, conflict management	GP conflicts on rescue capital	LPAC consent process, independent valuations
JV Partner / Co-Investor	Asset-level return, governance rights	Dilution, forced decisions	Buy-sell negotiation, deadlock resolution
Tenants	Lease continuity	Landlord insolvency, disruption	Estoppel, SNDA agreements
Property Manager	Fee continuity	Non-payment, transition risk	Management fee subordination agreements

TOPIC 2

RESTRUCTURING OPERATIONAL DOCUMENTS: REANIMATING A DEAD DEAL



JV Restructurings: Deadlocks, Divorces and Default Provisions

How to prevent a Zombie from eating you alive: JV restructuring combines financial negotiation and relationship management, with legal enforcement as the backstop.

Common triggers

- **Business-plan disputes:** Hold versus sell, or repositioning strategy.
- **Capital shortfall:** One partner cannot or will not fund capital calls.
- **Agreement breach:** Failure to fund or unauthorized encumbrance.
- **Change of control:** Ownership changes at a partner.
- **Financing event:** Loan maturity or lender enforcement.
- **Market deterioration:** Exit cap rate expansion or NOI deterioration.

Key legal considerations

- **JV agreement:** Review notice requirements, cure periods and buy-sell valuation methodology.
- **Lender and intercreditor:** Check intercreditor terms and lender consent for any JV ownership change.
- **ROFO / ROFR:** Does the non-selling party have a right of first offer or first refusal?
- **Anti-dilution:** Can a default loan actually dilute the partner without triggering additional consents?

The JV restructuring toolkit

- **Negotiated buyout:** One partner buys the other's interest at an agreed price. Conflicting value views pricing and valuation central. An independent appraisal often informs value but is binding only if previously negotiated in the documents.
- **Buy-sell / shoot-out:** One party names a price. The other must buy or sell at that price, encouraging honest valuation. The mechanism can disadvantage a party without capital to buy.
- **Forced sale:** Both parties market the asset, with the highest bid winning. Often the fallback if talks fail, or a remedy triggered by the JV's deadlock mechanism.
- **Default loan / preferred return:** The non-defaulting partner funds the shortfall. The loan often accrues at 15–20%* and ranks ahead of the defaulting partner's equity. Unpaid loans convert to equity, creating dilution and possible economic squeeze-out without a buy-sell.
- **Governance restructuring:** Reset approval thresholds, authority and veto rights. Bring in an outside operator / asset manager or appoint an independent director with a casting vote.

*15–20% is the user-supplied indicative default-loan rate. Actual terms and remedies depend on the JV agreement.

Fund-to-Club Conversions and GP-Led Secondary Transactions

When a fund structure no longer serves the assets, restructure the fund, not just the assets.

Why the fund stops working

- **Fund life:** Expiration of fund term forces sales into a bad market.
- **Divergent LP needs:** Some LPs need liquidity. Others want to hold.
- **Capital constraints:** Commitments exhausted or investment period expired.
- **GP economics:** Management fees become untenable as AUM shrinks. Disconnect between time spent on EOFL and LP expectations.
- **Mixed asset performance:** Performing and distressed assets create conflicts in one fund.

Fund-to-club conversion

Restructure a commingled fund into direct co-investment or a "club," giving specific LPs more direct interests in specific assets.

How it works

- Convert pro rata fund interests into direct interests in one or more underlying assets.
- Nonparticipants sell to participating LPs or third parties at agreed or market value.
- Fewer LPs, direct asset ownership and a simpler governance model and waterfall.

Benefits

- Removes fund-term constraints.
- Aligns LPs with chosen assets.
- Simplifies governance.
- Separates performing and distressed assets.

Challenges

- LP-by-LP consent and valuation.
- Transfers and new club interests raise securities issues.
- Possible taxable gains.
- LPAC consent virtually always, often full LP consent.

***Sneak Peek for our next Goodwin Dialogue Series*:**

GP-led secondary: continuation vehicle

- **New vehicle:** GP creates a continuation fund (CV) to hold selected assets.
- **LP choice:** Take liquidity from a secondary buyer at a discount to NAV, or roll into the CV at the same NAV.
- **Secondary buyer:** Funds liquidity and often anchors the CV as a new LP.
- **Carry reset:** GP typically resets carried interest, a contentious negotiation point.
- **Conflicts and process:** Manage conflicts scrupulously. Established ILPA guidelines and process requirements are increasingly required by LPs.

TOPIC 3

RECAPITALIZATION AND PREFERRED EQUITY: HELPING ASSETS RISE FROM THE DEAD

Structures and use cases with special attention to Preferred Equity

The Recapitalization Toolkit: Structures and Use Cases

Revival structures for assets that aren't quite dead

A recapitalization is a structural reset that requires careful design.

What is a recapitalization?

New equity or quasi-equity enters an asset or fund to cure defaults, fund capex, stabilize operations, or bridge a sale or refinancing, typically alongside a reset of the existing capital stack and governance.

- **Common Equity Recap.** New capital enters at the same level and dilutes existing LPs. Simple but rare: LPs resist dilution without compensation. Use case: Strong sponsor relationship, moderate distress, and a fund still within its investment period.
- **Preferred Equity Injection (Asset Level).** Preferred equity in the property-owning entity ranks above common equity. Fixed return (can be 12–18% or more), liquidation preference and accruing or current pay. Underperformance can shift control to the preferred holder, the new capital-stack "fulcrum." Can also be done at the Fund level. Use case: Cure loan default, fund capex, or bridge refinancing.
- **Preferred Equity Injection (Fund Level).** Preferred equity can also be issued in the Fund, giving preference to the preferred equity investors above the existing Fund LPs. Use case: As with asset level issuance, cure loan default, fund capex, or bridge refinancing and/or other near-term funding needs to the Fund.
- **GP-Led Recapitalization (Fund Level).** LPs roll into a continuation vehicle at agreed NAV or take liquidity at a discount. Secondary buyers or co-investors join rolling LPs. Use case: Fund nearing end of life, assets not ready for sale, and a need to extend the hold period. [*To be discussed at our next Goodwin dialogue series*]
- **Rescue Capital / Emergency Equity.** A new investor takes a significant, often controlling interest at a deep discount. The sponsor retains a minority promote or earnout. Use case: Severe distress and existing LPs unwilling to contribute further.

YOUR SURVIVAL TERMS TO NEGOTIATE: Entry valuation / deemed NAV; Preferred return and compounding; PIK versus current pay; Change-of-control and removal rights; Promote / carry reset or clawback

Structuring a Recapitalization: Reviving Value without Creating a Monster

The deal terms matter, but the process by which you get there matters just as much. The process will depend on the asset class.

The recapitalization process

1. **Mandate and engagement.** Engage legal counsel and possibly a financial advisor. Consider establishing a restructuring committee with appropriate authority.
2. **Confidential marketing.** Run a structured or targeted investor process. Share the data room under NDA.
3. **Term sheet negotiation.** Agree on economics, governance and exit mechanics before drafting definitive documents.
4. **LP / LPAC notification and consent.** Carefully assess fund LPA consent requirements. Provide required notices and disclosures. Consider an IR factors.
5. **Lender consent.** Senior mortgage lender consent is almost always required. Engage early with a business plan.
6. **Definitive documentation.** Restated LLC operating agreement. Subscription and intercreditor agreements and possibly side letters.
7. **Closing and funding.** Execute capital call mechanics and wire funds. Update the cap table.

Common pitfalls

- **Late lender consent:** Debt and transfer covenants can block or invalidate improperly structured preferred equity.
- **LP dilution disputes:** LPs denied pro rata participation rights in a recap may have litigation claims.
- **Accrual modeling errors:** Sponsors can underestimate how compounding preferred returns erode their promote.
- **Change of control triggers:** A recap can trigger provisions in management and franchise agreements or ground leases.
- **Tax structuring:** Distressed-debt contributions and certain preferred equity structures can have significant tax implications. Engage tax counsel early.

Investor protections

- **Approval rights:** Major decisions: sales, additional financing and capex above a threshold.
- **Financial reporting:** Quarterly / monthly reporting.
- **Information access:** Property-level information rights.
- **Anti-dilution:** Protection against dilution.
- **Drag-along rights:** Rights in a forced sale.

Preferred Equity – Hard v. Soft Structures

Maintaining a Pulse

The term "Preferred Equity" is broad and can mean different things. Sometimes it refers to what is effectively a mezzanine loan equivalent ("hard"). Other times it refers to equity with a stated preferred return, but that is in many other ways the same as common equity ("soft").

	"Hard" / Debt Equivalent	"Soft" / True Equity
Payment Terms	Fixed monthly distributions to be paid regardless of cash flow (either accrual or current pay). Failure of timely distribution results in default.	Often a stated return, paid first, but only out of cash flow.
Redemption	Fixed, mandatory redemption date, generally co-terminous with the mortgage loan/mezz loan maturity date.	No mandatory redemption right, though PE member will typically have exit rights (e.g., a put or forced sale) after stated lock-out period.
Guaranties	Sponsor carve-out guaranty, environmental indemnity and completion guaranty in favor of PE member on substantially the same terms as loan guaranties.	JV agreement will address responsibility for guaranties under loan documents (and indemnification by the JV and members w/r/t such guaranties). Sponsor may be required to provide a funding guaranty.
Governance	Major decisions requiring PE member approval similar to mezzanine loan covenants.	Major decisions, though vary more widely in terms of scope.
Collateral	PE member may negotiate to receive a pledge of the sponsor's equity in the JV. Possible forfeiture of Sponsor's interest if PE not redeemed by mandatory redemption date.	Typically none.
Sponsor removal rights	PE member has broad removal rights tied to property performance (including failure to pay timely distributions), loss of key people, breach of obligations (e.g., failure to obtain necessary approval) and "bad boy" acts.	Removal right for "bad acts"; may also have default or performance-based removal, but standards not as severe as "hard" structures.
Share of gains/losses	Generally, PE member has no share in residual income or increased property value and has no share of losses (outside of reversal of prior allocated income).	PE member participates in profits and losses and PE member shares in the residual (allocated based on relative capital contributions, with sponsor typically receiving a promote).

Players in Asset-Specific Preferred Equity Structure

Who is keeping the deal alive

- **Mortgage Borrower.** The property owner. Must be a single purpose, bankruptcy-remote entity.
- **Sole Member (if applicable).** Owns the equity interests in the mortgage borrower. Must be a single-purpose, bankruptcy-remote entity.
- **Common Member.** Owns 100% of the common equity of the sole member. Sponsor side of ownership.
- **Mortgage Lender.** Holds a first lien security interest in the mortgaged property. Involved in the preferred equity transaction through a recognition agreement (if applicable) with the preferred equity investor.
- **Preferred Equity Investor.** Makes an equity investment in the sole member (or, if no sole member, in the mortgage borrower) and owns 100% of preferred equity. May take a pledge of the common member's equity interests in the sole member.

Benefits of Preferred Equity Structure – Preventing a Zombie

- Easier to obtain mortgage lender consent than for mezzanine loans and in some instances may allow borrower to avoid restrictions under mortgage loan documents on additional debt.
- Direct right to prevent bankruptcy (not creditor; bankruptcy can be ultra vires).
- Do not need to follow statutory foreclosure procedures (i.e., investor is not bound by the requirements for a commercially reasonable sale under the UCC).
- Avoids many lender liability concerns including in most cases state usury laws.
- Major decisions can be as extensive as they can be negotiated.
- Structures are flexible – investor can negotiate for equity-type controls and/or rights if consistent with its tax treatment.
- May allow preferred equity investor to avoid restrictions in its fund documents that limit making debt investments.

The Beyond the Grave Concerns of Preferred Equity Structure

- Not a creditor and therefore no creditor rights.
- Exercise of remedies may result in common equity remaining in structure for residual rights:
  - Managing member – basic fiduciary duties; and
  - Forced Sale – if the property is sold the preferred equity does not retain any interest (e.g., it cannot credit bid) and may receive less than its investment
- Need permitted transfer rights negotiated in mortgage loan documents up front (or in a recognition agreement) because in equity from Day 1.
- Usually no security interest in common equity.

TOPIC 4

DEBT SOLUTIONS, AMENDMENTS AND LENDER NEGOTIATIONS



The Debt Restructuring Toolkit: From Waivers to Loan Sales

A Survival Guide to the Assets that are not the Walking Dead

Know the full menu before you sit down at the negotiating table.

The spectrum of debt solutions

Least to most disruptive, top to bottom

Solution	Description	When appropriate	Lender motivation
Waiver / Covenant Reset	Waive an existing default or reset financial covenants	Technical default with sound fundamentals	Avoid NPL classification and maintain relationship
Maturity Extension	Extend 6–24 months, typically with a fee and enhanced covenants	Near-term maturity. Business plan needs more time.	Avoid foreclosure while property is not stabilized
Interest Reserve / Partial PIK	Defer part of interest into principal to reduce the current cash burden	Cash-flow shortfall during a transitional period	Preserve debt service and performing status
A/B Loan Split	Split into a performing A-note and B-note (hope note). B-note may face write-down or sale.	Significant impairment. Need to right-size debt.	A-note lender gets a clean performing loan
Loan Modification	Change economic terms: rate, amortization or maturity	Fundamental change in business plan	Better outcome than foreclosure
DIP Financing	Debtor-in-possession financing in bankruptcy	Chapter 11 filing	Senior secured super-priority position
Deed-in-Lieu	Sponsor transfers title to lender in exchange for release	No equity and willing lender. Avoid foreclosure costs.	Clean title, avoid litigation and reduce holding costs
Discounted Payoff (DPO)	Lender accepts less than full payoff for immediate release	Sponsor has capital. Lender wants out.	Certain recovery and a clean balance sheet
Note Sale	Lender sells loan at a discount to a third party	Lender wants to exit a non-core loan	Immediate liquidity and reduced balance-sheet risk

Lender Negotiation Strategy

Leverage, tactics and the lender's perspective

Effective negotiation requires understanding what the lender actually wants, which may differ from what they say they want.

The lender's real incentives

- **CMBS special servicers**
- **Regulatory capital:** Banks provision for non-performing loans. An extension that preserves performing status has regulatory value.
- **Origination vintage:** For example, 60% LTV versus 75%+ changes loss exposure and willingness to compromise.
- **Portfolio concentration:** Heavy sector or market exposure may increase the lender's motivation to work out a loan.
- **Loan committee dynamics:** The banker may favor extension while credit resists. Supply materials that help the banker win internally.
- **CECL accounting:** Current Expected Credit Loss reserves reflect expected losses. Better expected workout recovery reduces reserves.

Negotiation principles

- **Engage early:** Bring a plan before default. Early, proactive engagement is the most important factor.
- **Bring a credible business plan:** Bring independently supported projections.
- **Control information flow:** Organized, accurate data builds credibility. Inconsistent financials destroy it.
- **Understand the loan documents:** Know cure rights, notice requirements and each default trigger before negotiating.
- **Know your BATNA:** Your best alternative: foreclosure, bankruptcy or DPO? Compare it with the lender's fallback.
- **Separate economics and governance:** Reporting, reserves and manager replacement can matter as much as financial terms.
- **Do not negotiate against yourself:** Let the lender state requirements before volunteering concessions.

CMBS special servicers

- **Workout authority:** The special servicer, not the originating lender, controls CMBS workout decisions.
- **Duty to the trust:** Fiduciary duty runs to the trust, not the borrower or any single bondholder class.
- **Controlling class:** Usually the most subordinate class still "in the money." Directs the servicer within limits.
- **Sponsor implication:** Identify who controls the trust and understand their economic interests.
- **Track ARAs:** Appraisal reduction amounts can remove a class from control.

Loan Amendments

Key terms, negotiating points and documentation

A loan amendment is a new deal. Treat it as such.

Economic terms

- **Extension fee:** Lenders charge a fee per extension option.
- **Default interest:** Increased rates above contract rate.
- **Floating-rate spread:** SOFR-based loan margin adjustment.
- **Amortization:** Reinstate or modify the schedule?
- **Exit economics:** Exit fee or prepayment premium.

Operational / structural terms

- **Cash management:** Lender-controlled cash sweep. Springing versus hard lockbox.
- **Reserves:** Top up tax, insurance or replacement reserves. Add a debt service reserve.
- **Capex plan approval:** Lender approval / veto of the property improvement plan.
- **Leasing parameters:** Lender consent for leases above a threshold.
- **Manager replacement:** Lender replacement right upon future default.

Borrower protections: points to push back on

- **Recourse expansion:** Resist broader bad-boy guaranty carve-outs or conversion to full recourse.
- **Additional collateral:** Watch for equity pledges, additional assets or sponsor-entity guarantees.
- **Milestone covenants:** Lease-up and capex deadlines must be achievable and include cure periods.
- **Information rights:** More frequent reporting is usually acceptable. Unfettered access may not be.

Documentation checklist

- ✓ Loan modification / forbearance agreement (primary document).
- ✓ Guaranty reaffirmation: guarantor signs. Check scope carefully.
- ✓ Updated title endorsement: confirm lien priority.
- ✓ Subordinate debt / equity holder confirmation, if applicable.
- ✓ Lender counsel fee reimbursement agreement.
- ✓ Officer's certificate and entity authorizations.

The "springing recourse" trap

Bankruptcy filings, transfers without consent, or unapproved additional debt can trigger full recourse under many loan documents. Review these provisions before acting: an assumed non-recourse loan may expose the sponsor to recourse liability.

Key Takeaways Across All Four Topics

The Sponsor's response connects asset diagnosis with financing, governance and execution.

The bottom line for sponsors

Distress creates opportunities. Sponsors who understand the capital stack, act decisively and engage stakeholders proactively can turn legal and structural complexity into a competitive advantage.

Summary

Topic	Core message
Triage	Diagnose before you negotiate. Engage stakeholders before defaults escalate.
Recapitalizations	Preferred equity is a powerful tool but creates a new control risk. Structure carefully.
JV / fund restructuring	Fund and JV structures can change alongside the assets.
Debt solutions	Understand the lender's true incentives. Engage early and know your loan documents cold.




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THANK YOU FOR JOINING!
QUESTIONS?