

## GUEST COLUMN

### Reserve the Right to Appoint Your Own Special Servicer

By **Leo Leyva** and **Jordan Fisch**

Junior lenders are finding themselves confronting loans that are in default or on the verge of default at an extremely rapid pace. Before the economic downturn, when delinquencies were less prevalent, junior and mezzanine lenders had less reason and occasion to fear for their investments. But at this point in the cycle, it is a good time for junior lenders to get a handle on their rights in the special serving arena. One of the least exercised options is the ability to replace a special servicer with one with which the junior lender already has a strong business relationship.

Prior to the current downturn, a sense of complacency descended on the lending community because most loans simply were repaid. Occasionally, junior lenders knew so little about the state of some debt investments that one might hear from a senior lender or a servicer only after a borrower had already missed several interest payments. But loan payments generally flowed back into lenders' coffers without much fuss or maintenance, and many junior lenders typically let the default arrangement ride, allowing the special servicer already in place to lasso in the relatively rare stray borrower.

In 2009, however, as the market softened and borrowers found loan payments increasingly difficult to make, defaults began a steep climb and special servicers found themselves with a glut of business on their hands. With that spike in activity came an increased awareness among junior lenders that they should pay heed to their own interests rather than riding the wave of the larger lender pool.

Choosing and working with a special servicer with which a junior lender is familiar or has a prior relationship can help a lender stay ahead of the curve. Knowledgeable and informed legal representation can help a junior lender obtain rights within an intercreditor or co-lender agreement to replace the loan's appointed special servicer with a special servicer of its own choosing. Even if not acted upon, the option is one that lenders should take care to have in place.

A special servicer placed by a master servicer is certainly not a

negative option. But consider this: a special servicer appointed by a junior lender provides the additional advantages of a familiar face and may facilitate a more direct line of communication between the lender, the borrower and the special servicer. It should be noted that the option to install a special servicer on behalf of a junior lender is typically conditional on the satisfaction of certain conditions, foremost being the servicer's credit rating.

A direct connection between a lender and a special servicer is likely to leave the lender more informed. We recently represented an opportunity fund client in its effort to replace a loan's special servicer with one with which the client had a prior business relationship. The fund took these steps in an effort to ensure a friendly face in the room if and when the loan defaulted and was subsequently restructured or foreclosed upon. Without this, the fund was concerned that it would face an even more difficult road if the loan went into default and special servicing. The fund believes that the connection between the lender and the special servicer is likely to result in greater access to the borrower and information concerning both the loan and the collateral.

The lending industry can no longer rely on interest income to flow into its accounts as easily as it once did. That does not mean debt investors should change their business model and forego the extension and purchase of loans. Rather, it is time for all lenders to become more acutely aware of their rights, such as that to appoint special servicers, and to use those rights to better position themselves to protect and preserve their investments atop a stable bottom line.



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