

Commercial Real Estate Loan Defaults and Remedies (VA)

A Practical Guidance® Practice Note by Terry L. Fox and Faisal Moghul, Fox & Moghul



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This practice note discusses borrower default and lender remedy provisions in commercial real estate financing documentation in the Commonwealth of Virginia and provides an overview of commonly used workout options. Where appropriate, this practice note includes negotiation tips for counsel to the borrower and the lender.

For further guidance, see [Commercial Foreclosure \(VA\)](#), [Commercial Foreclosure Alternatives \(VA\)](#), and [Commercial Real Estate Financing \(VA\)](#). For related templates, see [Loan Agreement \(Acquisition Financing\)](#) and [\[Leasehold\] Deed of Trust, Assignment of Leases and Rents, Security Agreement, and Fixture Filing \(Acquisition Loan\)](#).

For a commercial nonjudicial foreclosure checklist to use in Virginia, see [Commercial Nonjudicial Foreclosure Checklist \(VA\)](#). For additional guidance regarding foreclosures in Virginia, see [Foreclosure Resource Kit \(VA\)](#).

Context and Preliminary Considerations

While the terms of commercial loans are subject to some statutory and common law limitations in Virginia, lenders and creditors have wide discretion in how they negotiate and structure their relationships and respective obligations. For example, a lender may wish to have the ability to reach not only collateral placed as security for the loan, but also seek the ability to attach the borrower's personal assets, or assets under control of the borrowing entity. The recourse available to the lender is thought of as either nonrecourse (limited to the secured assets), or full recourse, which would include the personal assets of the borrower. Furthermore, cross-collateralization and cross-default provisions may be used to secure the lender's position over more than one loan or sets of loans.

Commercial loans can have guarantees containing a confession of judgment as a remedy for default. See Va. Code Ann. § 8.01-435. They can also involve debentures with no security, but merely a promise to pay. The structure of such agreements ultimately depends on the outcome of the negotiations between the lender and borrower.

For instance, where a publicly traded corporation borrows money, the terms will be less stringent than if the borrower is a sole proprietor or limited liability company formed to hold the real estate asset, referred to as a single purpose entity (SPE). SPEs rarely have sufficient assets to access in the event a default occurs, and accordingly, lenders will likely fashion stringent remedies such as guarantees that allow seizure of personal assets in the event of a default. For additional information regarding SPEs, see [Borrower as a Single Purpose Entity](#).

The types of defaults for which the lender may exercise its remedies are generally defined in the primary loan documents, including the loan agreement, deed of trust, promissory note, and guarantee agreements.

Default vs. Event of Default in Loan Documentation

If a borrower violates any provision of the loan terms, then the borrower is considered to be in default. There are three types or classes of defaults: (1) borrower fails to pay on time, (2) borrower does not perform an obligation under the loan documents, and (3) borrower does something prohibited by the loan documents.

A default exists from the date the event causing the default occurs until the expiration of any cure period. Once a default occurs, a lender may be required to notify the borrower of the default, and the borrower may then have a set period of time to cure the default. More often than not, a lender finds out about the existence of a default from the borrower. The borrower is typically obligated to notify the lender within a very short, specified time frame if it has knowledge of the existence of a default.

If a default is not timely cured during the specified period, it becomes an event of default, which triggers the availability of the lender's remedies pursuant to the loan documentation. After the expiration of the cure period, an event of default cannot technically be cured by the borrower since the cure period has expired. However, the default may still be subject to waiver by the lender.

Borrower Defaults

Borrower defaults are generally classified as either monetary or nonmonetary. Each is discussed below.

Monetary Defaults

A monetary default occurs when the borrower fails to pay interest, principal, fees, or other amounts payable to the lender under the terms of the loan documents. When representing the borrower, negotiate for a notice and cure period. Lenders, however, typically do not want to provide any notice and cure period for monetary defaults, because the borrower knows the due dates of these payments. If the lender does agree to a cure period for such defaults, it typically is short (i.e., five days from the due date), and the lender will not agree to a notice requirement. If there is a cure period, the lender may limit the borrower by not permitting it to cure a monetary default more than twice in any 12-month period.

Nonmonetary Defaults

A nonmonetary default occurs when the borrower breaches a covenant. A failure by the borrower to perform or forbear from performing a certain act, categorized as affirmative and negative covenants in the loan agreement, is a nonmonetary default.

Typical affirmative covenants include:

- Financial reporting to the lender
- Compliance with financial covenants
- Maintenance of SPE status
- Compliance with applicable law
- Maintaining insurance on the real property
- Paying and complying with third-party obligations, such as other debt, real estate taxes, insurance, and contractual obligations
- Allowing the lender to physically inspect the premises and conduct environmental testing —and—
- Notifying the lender of a default, event of default, or litigation

Typical negative covenants prohibit the borrower from:

- Incurring additional debt
- Incurring any additional liens or encumbrances
- Selling or transferring any ownership interests
- Entering into additional leases or amending existing leases, except pursuant to preapproved guidelines or with lender approval
- Amending its organizational documents
- Failing to maintain certain financial covenants such as debt service coverage ratio, guarantor liquidity, loan-to-value ratio, and debt yield —and—
- Experiencing a material adverse change in financial condition

A nonmonetary default can also occur if the borrower has breached a representation and warranty contained in the loan documentation.

Typical representations and warranties include that:

- Borrower has the necessary right, power, and authority to enter into the loan documents
 - Borrower holds the title to the property, free from any liens and encumbrances other than as disclosed to the lender
 - There are no material defaults on the borrower's other indebtedness
 - Borrower has all permits necessary to own, occupy, and operate the real property —and—
 - Real property complies with applicable law
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For further guidance on acquisition loan agreement covenants and representations and warranties, see [Acquisition Loan Agreements](#), [Mortgaged Property Covenant Clauses \(Acquisition Loan Agreement, Commercial Real Estate\)](#), [Insurance Covenants and Requirements Clauses: Acquisition Loan Agreement](#), [Financial Covenants and Reporting Requirements Clauses: Acquisition Loan Agreement](#), and [Borrower as a Single Purpose Entity](#).

Cross-Default

Lenders typically seek to include provisions where if the borrower defaults under other debt, it gives rise to an event of default. The rationale is that if the borrower cannot make payments under one agreement, it will also not be able to make payments on the subject loan. When representing a borrower, you should attempt to limit cross defaults to monetary defaults or material nonmonetary defaults. An extremely broad cross-default provision can cause significant headaches for a borrower as it could be forced to deal with multiple lenders in a workout scenario.

Uncured Default becomes Event of Default

Lenders are often willing to provide a borrower with notice of a default and a cure period (e.g., 30 days) for nonmonetary defaults. For certain nonmonetary defaults, lenders may even grant extension rights to the cure period, if the borrower is actively pursuing a cure. The lender's primary goal is to get paid what the borrower promised, not as much as obtaining possession of the secured collateral. The borrower generally also wants to maintain the relationship, pay the debt, and be released. Consequently, these are typically heavily negotiated clauses that provide time in which either party can perform before the overall transaction is endangered with a foreclosure, or suit for breach of contract. However, when the cure period has lapsed, the opportunity for a lender to seek its remedies is triggered, and the event of default has occurred.

Workouts

As noted above, lenders do not want to hold defaulted loans on their books. Thus, they will typically pursue a workout solution before pursuing other costly and lengthy remedies. The parties may negotiate:

- Restructuring of the loan, such as increasing the term and lowering the interest rate
- Waiver of the event giving rise to the event of default
- Forbearance agreement, in which a lender agrees not to exercise any remedies under the loan agreement for a specified time, subject to certain conditions (e.g., no other events of default occurring or a payment of fixed sum from the borrower) –and/or–

- Amendment to the loan agreement, revising a provision that may no longer be appropriate, such as a financial covenant

For a detailed discussion of workouts and foreclosure alternatives, see [Workouts of Commercial Real Estate Loans](#) and [Commercial Foreclosure Alternatives \(VA\)](#). For a template of a forbearance agreement, see [Forbearance Agreement \(Commercial Real Estate Loan\)](#).

Lender Remedies

If a workout is not feasible, lenders typically have remedies available under the loan documents, including acceleration, setoff, foreclosure, deficiency judgment, deed in lieu of foreclosure, and appointment of a receiver. In addition, there are financial remedies that a lender can impose. For example, most loan documents specify a default rate of interest and late fees. When coupled with acceleration, these financial remedies can wipe out any theoretical equity in the property. The following discusses the structure of the loan documentation and the remedies included for lenders to pursue against borrowers.

Acceleration

Acceleration is typically the lender's first step before proceeding with the other enforcement remedies. The lender should provide notice of default and acceleration of the debt secured by the deed of trust. The form and manner of this notice will be prescribed in the deed of trust and by state law. In Virginia, the lender or trustee under the deed of trust must strictly comply with the notice of default and acceleration provisions of the deed of trust. See *Bayview Loan Servicing, LLC v. Simmons*, 275 Va. 114, 654 S.E.2d 898 (2008). Absent an acceleration provision, a lender would either have to foreclose each installment as it comes due or wait until the amortization period expires to foreclose on account of the entire loan obligation.

The Tools of Security

A commercial loan transaction can be documented with an extensive number of documents. Violation of obligations for any of these agreements, can result in an event of default. The primary loan agreement will generally contain the manner and timing of payments, description of the collateral such as real property, stocks, bonds, or other valuable assets. In addition, the loan agreement and other loan documents contain the events of default, cure provisions, remedies, as well as the parties' covenants and representations and warranties regarding the transaction.

Main Documents

The primary documents are the loan agreement, promissory note, deeds of trust, guarantees, and assignments of rents and leases. For checklists of typical acquisition loan closing documents and the closing process, see [Acquisition Loan Closing Checklist \(Word Version\)](#) and [Commercial Deed of Trust Loan Process Checklist \(Pro-lender\) \(VA\)](#).

Loan Agreement

The loan agreement is the primary document that memorializes the terms of the loan to the borrower from the lender. Typically, the loan agreement describes the purpose of the loan, any collateral agreements that are incorporated into the loan agreement, and the related authorizations, certifications, promissory notes, guarantees, assignments of leases and rents, requirements for operation of the property, security agreements and financing statements, deeds of trust, and prior lienholder agreements. Each loan agreement, of course, contains its own obligations which if not adhered to would constitute a breach of the contract, and possible default. The loan agreement will also include the requirement that the borrower only use the loan proceeds for the use of proceeds specified in the loan agreement.

The loan agreement typically includes a notice provision requiring the borrower to notify the lender within a certain number of days of any occurrence that would constitute a default or an event of default under the terms of the loan agreement. Of course, any misrepresentation by the borrower to the terms in the loan agreement will constitute a breach and will give rise to a possible event of default as discussed above.

Deed of Trust

In Virginia, a deed of trust is the primary document used to secure a loan with real property. See Va. Code Ann. § 55.1-316. Typically, after an event of default, the deed of trust allows the lender to take control of the property, perform work on it, and charge the costs as additional sums secured by the deed of trust. If there are bills or liens, they can be paid by the lender and charged to the borrower. There is also the ability for the lender to act as attorney-in-fact to accomplish these tasks. This includes settling claims that could constitute liens, execute official documents related to the property, and manage the property, including anything which borrower or guarantor would do in its own behalf. Furthermore, since this power is agreed upon and coupled with an interest, it cannot be revoked.

In Virginia, deeds of trust may be foreclosed through either judicial or nonjudicial procedures. As the nonjudicial foreclosure option is far easier to accomplish, it is rare to see a deed of trust without an acceleration clause and power of sale provision allowing a public auction without judicial action. The deed of trust will dictate the notice procedures and availability of an option to cure for the borrower.

Promissory Note / Debenture / Demand Note

There are three forms of notes used for typical commercial loans in Virginia. One is the normal promissory note that is joined with the deed of trust as security. A second form of note is a debenture used by the lender to borrow funds from third-party sources. Debentures are guaranteed but not always secured. A third form is a demand note which is a promissory note that becomes payable any time the holder of the note requests payment. This differs from notes that are due by a certain date or have a repayment schedule. Sometimes, banks are willing to issue demand loans to customers who have a well-established credit history with them. A demand note means that the balance owed does not have to be repaid until it is demanded by the lender and the note does not have a specific end date listed.

Guarantee

Lenders commonly require a guarantee of the real estate acquisition loan, whereby an individual or entity will provide a credit enhancement for the borrower. Some acquisition loans are nonrecourse meaning the lender may only look to the SPE borrower and its assets for repayment. For a nonrecourse loan, a guarantee will still cover situations where the borrower commits “bad acts” (nonrecourse carve-outs) resulting in the loan becoming recourse. For a discussion of guarantee agreements in real estate acquisition loans, see [Guaranty and Indemnification Agreements in Acquisition Loan Transactions](#). For a template of a guaranty, see [Guaranty Agreement \(Repayment Obligations\) \(Acquisition Loan\)](#).

Virginia permits a confession of judgment to be included in a guarantee. See Va. Code Ann. § 8.01-435. In the event of a default, the guarantor allows the lender to appoint its own agent as attorney-in-fact to appear in the clerk’s office of the county in which the property is located and file a confessed judgment for all principal and interest and any other amounts due and payable under the guarantee. It is deemed to be coupled with an interest and therefore irrevocable. In addition to granting the lender the right to file the judgment, the guarantor waives all rights of appeal, stay of execution, and the benefit of all exemption laws. Additionally, no single exercise of the right will exhaust rights to file more confessed judgments that may be necessary.

The guarantor waives several rights and defenses in a typical guarantee. These include waiver of rights to require presentment, protest, or demand upon the borrower, to redeem any collateral before or after lender disposes of it, requirement of advertising disposition of collateral, or requirement of appraisal or valuation of collateral before or after disposition. Further, the guarantor waives notice of default, presentment, execution of the note, notice of any actions related to the note or collateral, and change in the financial condition of the borrower or other guarantor.

The guarantor also waives any right to any changes in the terms of the note or loan documents, except increases in the amount owed.

Assignment of Rents and Leases

One of the many remedies of the lender is embodied in the assignment of leases and rents. Through this document, the borrower is allowed to collect the rents from all leases on the property, until the lender elects to collect them pursuant to an event of default. The assignment will contain restrictions on the borrower's operation of the properties, obligations to report any default of the leases, and requirements that, in the event the lender takes over, amounts received will be applied to the debts in a specific order.

Cross-Collateralization

At times, several properties may serve as collateral for more than one loan. In that case, where a borrower has more than one loan with a lender, a provision may be included to state that in the event a borrower defaults on one of the loans, that default will constitute an event of default on all other loans bringing into effect the lender's rights to exercise all remedies for all the loans.

Setoff

The lender may set off amounts due to it under the loan documents against any and all accounts, credits, money, securities, or other property of the borrower on deposit with or in the possession or control of the lender. To the extent that the borrower's operating accounts are with the lender, this remedy can significantly impede the borrower's ability to continue to operate the real estate.

Appointment of Receiver

Typically, the commercial real estate loan documents will permit the appointment of a receiver to protect the value of the property. A lender may seek the appointment of a receiver at the time a foreclosure action is commenced to collect rent and preserve the property through the time of the foreclosure sale. Alternatively, a receiver may be used to conduct a private sale of the property as a going concern without going through a foreclosure process.

Receivers are appointed through a court pursuant to Va. Code Ann. § 8.01-591 et seq. Once a special receiver is appointed by a court, the receiver will manage and preserve the property and have control over any bank accounts regarding the property. The property may then proceed through foreclosure or private sale. For further discussion of receivership, see [Receivership in Real Estate Transactions](#) and [Commercial Foreclosure \(VA\)](#).

Deed in Lieu of Foreclosure

In some cases, a quicker and less expensive method than foreclosure for the lender to take title to the real property collateral is through a deed in lieu of foreclosure. The first

step is for the lender and borrower to negotiate a deed in lieu of foreclosure agreement with the terms of the transfer. Often, the lender agrees to waive its right to seek a deficiency judgment in exchange for the borrower deeding the property to the lender. The deed in lieu of foreclosure does not extinguish any junior liens on the property, so it may not be appropriate for every situation. If the deed in lieu of foreclosure is pursued, the lender should ensure the deed in lieu of foreclosure includes non-merger language allowing the lender to still foreclose the mortgage to eliminate junior liens.

For further discussion regarding deed in lieu of foreclosure, see [Commercial Foreclosure Alternatives \(VA\)](#). For a template relating to deed in lieu of foreclosure, see [Deed in Lieu of Foreclosure Agreement \(Commercial\) \(Pro-Lender\)](#) and [Quitclaim Deed \(Commercial Transaction\) \(VA\)](#).

Foreclosure

In Virginia, a foreclosure proceeding must be conducted in the county or city where the real property is located. A foreclosure may be done through a judicial proceeding or through a nonjudicial action if permitted by the deed of trust. For additional resources regarding foreclosures in Virginia, see [Foreclosure Resource Kit \(VA\)](#). For a detailed discussion of foreclosure, see [Foreclosure of Real Property](#).

Judicial Foreclosures

While nonjudicial foreclosures are the typical method of foreclosure in Virginia, judicial foreclosures are available. For a judicial foreclosure, the lender must file an action in the circuit court of the county or city where the real property is located. See Va. Code Ann. § 8.01-96. To initiate a judicial foreclosure, the lender must file a complaint naming all interested parties and requesting a decree for sale. The court appoints a special commissioner to conduct the foreclosure sale and determine any delinquent taxes and deficiency for judgment against the borrower. See Va. Code Ann. § 8.01-96. The commissioner will conduct the foreclosure sale in a manner similar to a nonjudicial foreclosure sale.

Nonjudicial Foreclosures

A nonjudicial foreclosure is accomplished by following the procedures detailed in the deed of trust where a lender can recover possession of the property without the need to file a civil action in court. The deed of trust typically grants the lender a power of sale. The power of sale clause authorizes the trustee, at the request of lender, to advertise and sell the real property through a public auction following an uncured event of default by the borrower. The requirements for foreclosures in Virginia are contained in Va. Code Ann. § 55.1-320 to through Va. Code Ann. § 55.1-345.

For further discussion of commercial foreclosures in Virginia, see [Commercial Foreclosure \(VA\)](#). For a checklist of steps

for nonjudicial foreclosure in Virginia, see [Commercial Nonjudicial Foreclosure Checklist \(VA\)](#).

Deficiency Judgment

Unless the commercial real estate loan is nonrecourse, the lender may be entitled to a deficiency judgment against the borrower if the sale of the property does not satisfy the balance owed on the debt secured by the property. In a judicial foreclosure, the lender typically includes a demand in the complaint for foreclosure requesting that the court determine and enter a judgment against the borrower in the amount of any deficiency. In a nonjudicial foreclosure, the lender would need to file a lawsuit against the borrower following the foreclosure to obtain a deficiency judgment. For further discussion regarding deficiency judgments in Virginia, see [Commercial Foreclosure \(VA\)](#).

Related Content

For further discussion on topics relating to commercial real estate loan defaults and remedies, see:

Resource Kits

- [Foreclosure Resource Kit \(VA\)](#)

Practice Notes

- [Acquisition Loan Agreements](#)
- [Borrower as a Single Purpose Entity](#)

- [Commercial Foreclosure \(VA\)](#)
- [Commercial Foreclosure Alternatives \(VA\)](#)
- [Commercial Real Estate Financing \(VA\)](#)
- [Receivership in Real Estate Transactions](#)

Templates

- [Deed in Lieu of Foreclosure Agreement \(Commercial\) \(Pro-Lender\)](#)
- [Forbearance Agreement \(Commercial Real Estate Loan\)](#)
- [Loan Agreement \(Acquisition Financing\)](#)
- [\[Leasehold\] Deed of Trust, Assignment of Leases and Rents, Security Agreement, and Fixture Filing \(Acquisition Loan\)](#)

Clauses

- [Mortgaged Property Covenant Clauses \(Acquisition Loan Agreement, Commercial Real Estate\)](#)
- [Insurance Covenants and Requirements Clauses: Acquisition Loan Agreement](#)
- [Financial Covenants and Reporting Requirements Clauses: Acquisition Loan Agreement](#)

Checklists

- [Acquisition Loan Closing Checklist \(Word Version\)](#)
- [Commercial Deed of Trust Loan Process Checklist \(Pro-lender\) \(VA\)](#)
- [Commercial Nonjudicial Foreclosure Checklist \(VA\)](#)

Terry L. Fox, Partner, Fox & Moghul

As the recipient of the prestigious honor of 2022 Virginia Real Estate Attorney of the Year award, Mr. Fox has over two decades of experience representing developers, real estate brokers, community association boards, title companies, and commercial landlords as well as tenants on a full range of complex real estate matters, including commercial property acquisition, disposition, development and leasing, complex lien and title disputes, land use and zoning, mortgage fraud, residential and commercial purchase and sale contract disputes, construction/contractor (Classes A,B and C) disputes, easement/boundary line and adverse possession issues, partition and allotment actions, plat modifications and HOA related disputes. As a licensed settlement agent, Mr. Fox has a noted expertise in title disputes, and his Continuing Legal Education Seminars (CLEs) on [curing complex title defects with real estate](#) have received national recognition. Mr. Fox's sophistication in this subject matter is reflected in the fact that he has handled more than 3,000 commercial real estate transactions for multi-national entities like Exxon Mobil Corporation. Additionally, Mr. Fox has been practicing trademark law since 1993 and has intellectual property clients from Hawaii to Connecticut, and has successfully prevailed before the United States Patent & Trademark Appeals Board. In addition to his trademark experience, he also has extensive experience in intellectual property transfer and licensing joint ventures.

Faisal Moghul, Managing Partner, Fox & Moghul

Mr. Moghul's accomplishments in the areas of real estate and business litigation are varied and many, including his selection into the elite group of America's Top 100 Civil Defense Litigators (2021), the Virginia Lawyers Weekly "Go-To" Business Litigation Lawyers (2023), Lawyers of Distinction (2023), and the prestigious Super Lawyers Rising Stars shortlist every year since 2016.

Mr. Moghul is a widely published author whose works have received critical acclaim in both state and national media. As a regular contributor to premier legal publications like Lexis Nexis and the American Law Institute, Mr. Moghul frequently publishes practical guidance notes to educate other lawyers on cutting-edge legal issues in real estate and business law. In 2023, Mr. Moghul was also selected as the speaker for a VACLE seminar on examining a real estate broker's liability under Virginia law.

Mr. Moghul is hyper-focused on providing the best legal representation to his clients. As a seasoned trial attorney, he has obtained successful outcomes in high-stake disputes for numerous clients in state and federal courts throughout Virginia and D.C. In 2017, Mr. Moghul's representation of a client in a real estate fraud case received favorable coverage in the Virginia Lawyer's Weekly Settlements and Verdicts section. In 2019, Mr. Moghul was part of a legal team that spearheaded the dismissal of a \$7 million-dollar business partnership dispute for claims involving breach of fiduciary duty, fraud, conversion, and civil conspiracy. That same year, Mr. Moghul also obtained a high six-figure settlement in a deed fraud case in Loudoun County Circuit Court. In 2020, Mr. Moghul became one of the very few lawyers in Virginia to obtain a rare pre-filing injunction against a serial filer pro se litigant. He has also successfully defended many landlords in toxic mold poisoning lawsuits.

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