

The Banking Law Journal

Established 1889

An A.S. Pratt™ PUBLICATION

October 2026

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ISBN: 978-0-7698-7878-2 (print)

ISSN: 0005-5506 (Print)

Cite this publication as:

The Banking Law Journal (LexisNexis A.S. Pratt)

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POSTMASTER: Send address changes to THE BANKING LAW JOURNAL, LexisNexis Matthew Bender, 230 Park Ave, 7th Floor, New York, NY 10169.

POSTMASTER: Send address changes to THE BANKING LAW JOURNAL, A.S. Pratt & Sons, 805 Fifteenth Street, NW, Third Floor, Washington, DC 20005-2207.

Volume 143, Number 9

THE BANKING LAW JOURNAL October 2026

Editor's Note Strategies

*By Victoria Prussen Spears**

In a rapidly changing world, what should banks and other financial institutions do to protect their interests? Articles in this issue of *The Banking Law Journal* discuss a number of steps that they should consider taking, as well as explain new notable developments.

DISTRESSED NOTE SALES

The lead article, titled, “Distressed Note Sales: A Strategy for Buyers and Sellers,” is by David L. Zive and Jacob Trachtenberg, attorneys with Ballard Spahr LLP.

In this article, the authors examine the distressed note sale market from the perspectives of both buyers and sellers. They provide current market context, analyze the legal and transactional frameworks governing note sales, and offer practical guidance for participants seeking to navigate this complex landscape.

SEA WAYBILLS

The article that follows, titled, “Navigating Potential Risks When Lending Against Goods on the Water Covered by Sea Waybills, Rather Than Bills of Lading,” is the first part of a two-part article by Peter J. Lahny, IV, a partner resident in the New York office of Wiggin and Dana LLP.

* Victoria Prussen Spears is Senior Vice President of Meyerowitz Communications Inc. A graduate of Sarah Lawrence College and Brooklyn Law School, Ms. Spears was an attorney at a leading New York City law firm before joining Meyerowitz Communications. Ms. Spears, who is Editor of *The Banking Law Journal*, *Pratt's Journal of Bankruptcy Law*, *Pratt's Energy Law Report*, and *Pratt's Privacy & Cybersecurity Law Report*, can be reached at vpspears@meyerowitzcommunications.com.

Here, the author addresses how secured creditors might try to mitigate the risks associated with lending against goods in transit located in international waters covered by a sea waybill rather than by a bill of lading. In this first part, the author briefly addresses the differences between bills of lading and sea waybills and then discusses in detail the issues created for secured creditors in lending against such goods covered by sea waybills. In the conclusion, to be published in the next issue of *The Banking Law Journal*, the author will make specific suggestions to try to mitigate certain risks created by the use of sea waybills.

DIGITAL ASSETS

Then, in the article titled, “Lending Against Digital Assets: Five Key Takeaways for Lenders After a Year of Regulatory and UCC Change,” Cristina Diaz, Scott A. Lessne, Carlton Greene and Anand Sithian, attorneys with Crowell & Moring LLP, survey the current landscape for banks’ crypto-asset activities, from regulatory permissibility and perfection through custody, structuring, and compliance, for institutions active in this market or considering entering it.

EQUIPMENT FINANCING

Mairi V. Luce and Klara Bradbury, attorneys with Duane Morris LLP, are the authors of the article titled, “Improperly Documented Agreement Leads to Lender’s Loss in Equipment Financing Dispute.”

In this article, the authors explain that when a vendor reserves title to financed goods before they are paid in full, a lender’s claim of a security interest in such goods, through its borrower’s interest therein, may be unsuccessful.

CAMELS

In the article titled, “Federal Financial Institutions Examination Council Proposes Comprehensive Revisions to the CAMELS Rating System,” Joseph E. Silvia, a partner in the Chicago office of Duane Morris LLP, discusses a proposal by the Federal Financial Institutions Examination Council to significantly revise the Uniform Financial Institutions Rating System, commonly referred to as the CAMELS rating system.

Enjoy the issue!

Distressed Note Sales: A Strategy for Buyers and Sellers

*By David L. Zive and Jacob Trachtenberg**

In this article, the authors examine the distressed note sale market from the perspectives of both buyers and sellers. They provide current market context, analyze the legal and transactional frameworks governing note sales, and offer practical guidance for participants seeking to navigate this complex landscape.

The commercial real estate lending market is undergoing a fundamental reset. After years of “extend and pretend” strategies during which lenders deferred losses by granting serial modifications and extensions to troubled borrowers, the era of forbearance is coming to a close.¹ As of mid-2026, commercial real estate lenders across the United States are recognizing losses, selling distressed debt at steep discounts, and moving decisively to resolve non-performing and sub-performing loans.² With approximately \$875 billion in commercial and multifamily mortgage debt maturing in 2026 alone, and over \$130 billion in distressed commercial-property debt outstanding, the market for distressed note sales has become one of the most active and consequential segments of the real estate capital markets.³

This article examines the distressed note sale market from the perspectives of both buyers and sellers. It provides current market context, analyzes the legal and transactional frameworks governing note sales, and offers practical guidance for participants seeking to navigate this complex landscape. Whether a lender is evaluating a portfolio disposition strategy or an investor is assembling capital to acquire non-performing loans, understanding the mechanics, risks, and opportunities of distressed note transactions is essential to maximizing value and managing exposure in today’s market.

* The authors, attorneys with Ballard Spahr LLP, may be contacted at zived@ballardspahr.com and trachtenbergj@ballardspahr.com, respectively.

¹ Natalie Wong, “Extend and Pretend” Era Ends as Real Estate Lenders Take Losses, *Bloomberg L.* (May 15, 2026, at 08:15 EDT) [hereinafter Wong, Extend and Pretend], <https://www.bloomberg.com/news/articles/2026-05-15/real-estate-lenders-are-eager-to-offload-troubled-loans-even-at-a-loss>.

² *Id.*

³ Reggie Booker, Chart of the Week: Commercial Real Estate Loan Maturity Volumes, *Mortg. Bankers Ass’n* (Mar. 2, 2026), <https://www.mba.org/news-and-research/newsroom/blog-post/commercial-real-estate-loan-maturity-volumes>; Natalie Wong, Big Lenders Finally Swallow Huge Losses on Distressed Commercial Real Estate, *L.A. Times* (May 18, 2026, at 06:42 PT), <https://www.latimes.com/business/story/2026-05-18/big-lenders-finally-swallow-huge-losses-on-distressed-commercial-real-estate>.

THE CURRENT MARKET LANDSCAPE

The End of “Extend and Pretend”

For the better part of three years following the onset of the Federal Reserve’s aggressive interest rate tightening cycle that began in 2022, commercial real estate lenders employed a strategy widely characterized as “extend and pretend.”⁴ Rather than recognizing impairments and forcing resolution of troubled loans, lenders granted serial modifications by extending maturities, deferring amortization, and accepting below-market interest rates in the hope that declining interest rates and recovering property values would eventually cure the distress.⁵ As Bloomberg reported in May 2026, that era is coming to a close.⁶

The catalyst for this shift is multifaceted. Interest rates have remained elevated far longer than most market participants anticipated. The Federal Reserve’s benchmark rate, while modestly reduced from its 2023 peak, remains well above the levels at which most commercial real estate loans originated during the 2019-2022 period.⁷ Borrowers are now confronting a rate environment upon refinancing at spreads 150 to 250 basis points higher than their original loans, fundamentally altering property economics and debt service coverage ratios.⁸

Many major institutional lenders have recognized the potential futility of further delay, and money center banks, national banks, as well as regional and community banks are now willing to foreclose on troubled properties in order to clear balance sheets and redeploy capital.⁹ Other lenders are willing to write down loans by as much as 85% of the loan’s payoff amount to accomplish the same overall goals.¹⁰ This willingness to accept losses reflects a pragmatic assessment: further extensions only compound the problem, and the opportunity cost of tying up capital in non-performing assets has become untenable.¹¹

⁴ Wong, *Extend and Pretend*, *supra* note 1.

⁵ *Id.*

⁶ *Id.*

⁷ Effective Federal Funds Rate, Federal Reserve Bank of New York, <https://www.newyorkfed.org/markets/reference-rates/effr> (last visited July 14, 2026).

⁸ See *id.*

⁹ Wong, *Extend and Pretend*, *supra* note 1.

¹⁰ *Id.*

¹¹ See generally *id.*

The Maturity Wall

The scale of the refinancing challenge facing the commercial real estate market is staggering. According to the Mortgage Bankers Association, approximately \$875 billion in commercial and multifamily mortgage debt is scheduled to mature in 2026, representing 17% of the \$5 trillion outstanding.¹² This figure is down 9% from the \$957 billion that matured in 2025, but remains historically elevated.¹³ S&P Global estimates the 2026 figure may be as high as \$936 billion when accounting for all loan types and structures.¹⁴

According to Forvis Mazars, the 2025-2026 maturity cohort includes an estimated \$400 billion in loans that were previously extended through “extend and pretend” strategies during 2023-2024.¹⁵ These loans, having already received one or more modifications, face an even more constrained set of options upon their current maturities. Borrowers who were granted short term extensions in 2023 and 2024 are now arriving at maturity dates with properties that have not recovered sufficient value (and in many cases have declined further) to support conventional refinancing.¹⁶

Regional and community banks are particularly exposed. Of the approximately \$957 billion in 2025 CRE maturities, as estimated by the Mortgage Bankers Association, 27% was held by regional and community banks, and of the approximately \$871 billion in 2026 CRE maturities, a staggering 43% was held by regional and community banks.¹⁷

¹² Booker, *supra* note 3.

¹³ *Id.*

¹⁴ Extensions Shift the CRE Maturity Wall, but 2026 Could Now Be a Tougher Year, S&P Glob. Mkt. Intel. Rsch., <https://pages.marketintelligence.spglobal.com/14792-CRE-Maturity-Wall-Research-Content-Download.html> (last visited July 14, 2026).

¹⁵ Navigating Distressed Property in Commercial Real Estate, FORVIS MAZARS (Mar. 23, 2026), <https://www.forvismazars.us/forsights/2026/03/navigating-distressed-properties-in-commercial-real-estate> (last visited 7/14/2026).

¹⁶ The 2026 Maturity Wall: A Quantitative Framework for Identifying Distressed Acquisition Targets, Realty Cap. Analytics [hereinafter 2026 Maturity Wall], <https://www.realcapanalytics.com/blog/the-2026-maturity-wall-a-quantitative-framework-for-identifying-distressed-acquisition-targets> (last visited July 14, 2026).

¹⁷ Beth Mattson-Teig, Economist Snapshot: Is Bank Stress Contained?, *Urb. Land* (Nov. 3, 2025), <https://urbanland.uli.org/capital-markets-and-finance/economist-snapshot-is-bank-stress-contained#:~:text=Of%20the%20%24900%2Dplus%20billion%20of%20commercial%20real%20estate%20loans%20set%20to%20mature%20in%202025%2C%20it%20appears%20up%20to%20%24600%20billion%20have%20been%20pushed%20to%20between%202026%20and%202028.%0ABank%20loans%20represent%2040%20percent%20of%20this%2C%20with%20national%20banks%20representing%2013%20percent%20and%20regional%20banks%2020%20>

CMBS and Special Servicing Distress

The commercial mortgage-backed securities market provides a useful barometer of distress levels across the broader CRE lending universe. According to Trepp's Spring 2026 Quarterly Data Review, CMBS hard maturities will reach \$76.6 billion in 2026.¹⁸ The CMBS special servicing rate stood at 10.86% in May 2026, with the office sector leading distress by a wide margin.¹⁹ Office CMBS delinquency rates reached an all-time high of 12.34% in January 2026.²⁰

According to Trepp, office properties transferred to special servicing have experienced value losses exceeding 50%. Such losses reflect both the secular decline in office demand driven by remote and hybrid work patterns and the interest rate environment that has compressed capitalization rates for institutional buyers.²¹ Debt yield has emerged as the critical metric for refinancing viability in this environment: performing CMBS loans average debt yields of 13-14%, while troubled loans average debt yields of approximately 9%, which is well below the thresholds most lenders require.²² For context, bridge lenders often accept debt yields of 7-9%, which is materially lower than that accepted by commercial banks.²³

20percent%2C%20with%20the%20remainder%20held%20by%20smaller%20community%20banks; Gerardo Culebro, CRE Debt Maturity Wall 2026: Refinancing Risk & Strategies, Smart Cap. News (June 16, 2026), <https://smartcapitalcenter.com/blog-post/emerging-trends-and-strategic-insights-from-mba-cref-24#:~:text=Regional%20and%20community%20banks%20hold%2043%25%20of%202026%20CRE%20maturities%20%E2%80%94%20the%20largest%20single%20lender%20segment.>

¹⁸ TREPP, QUARTERLY DATA REVIEW: TRACKS REMAIN BUT CRE LENDING GAINS MOMENTUM 2 (2026) [hereinafter Trepp, Spring 2026], <https://www.trepp.com/hubfs/Trepp%20CRE%20Direct%20QDR%20Q1%202026.pdf?hsCtaTracking=79538ae1-a506-4359-8a92-e759a57aca21%7C8b80afb1-97bb-4018-be0f-cec6f28b8e38> (last visited 7/14/2026).

¹⁹ Stephen Buschbom, CMBS Special Servicing Rate Declines in May Led by Office Pullback & Denominator Growth, TREPP (June 10, 2026), <https://www.trepp.com/trepptalk/cmbs-special-servicing-rate-declines-in-may.>

²⁰ Trepp, Spring 2026, *supra* note 18, at 8.

²¹ *Id.* at 14.

²² Trepp, CMBS Hard Maturity Playbook: 2024-2025 Lessons and 2026 Outlook 3 (2026), <https://www.trepp.com/hubfs/Trepp%20CMBS%20Hard%20Maturity%20Playbook%20%202024-2025%20Lessons%20and%202026%20Outlook.pdf>.

²³ What is Debt Yield in Commercial Real Estate?, Primer, <https://www.proprise.ai/primer/resources/glossary/debt-yield/#:~:text=%7CBridge%20%2F%20Debt%20Fund%20%7C7%25%20%2D%209%25%20%7CHigher%20risk%20tolerance%2C%20transitional%20assets%20%7C> (last visited July 22, 2026).

Despite the distress, CMBS' new issuance market has remained active. Private-label CMBS issuance totaled \$32.74 billion in the first quarter of 2026, the second-busiest first quarter since before the Global Financial Crisis.²⁴ This robust issuance reflects strong investor appetite for newly originated, conservatively underwritten loans, even as legacy loans continue to experience elevated defaults. CMBS lending volume recorded a 110% year-over-year increase through early 2025, suggesting that new capital formation is occurring alongside distressed resolution.²⁵

Distressed Volume and Transaction Activity

Distressed commercial real estate volume reached \$126.6 billion in the third quarter of 2025, representing an 18% increase year-over-year.²⁶ Sales of distressed commercial real estate, including both property sales and note sales, exceeded \$25 billion through the third quarter of 2025, up 5% from 2024 levels.²⁷ Overall CRE transaction volume rebounded approximately 25% year-over-year in 2025, driven in part by distressed sales and the deployment of opportunistic capital.²⁸

The Signature Bank failure in 2023, which resulted in regulators auctioning off a \$33 billion commercial real estate loan portfolio, served as both a wake-up call and a starting gun for expanded institutional note sale activity.²⁹ That transaction demonstrated that large-scale portfolio dispositions are executable and that deep pools of buyer capital exist for distressed CRE debt, even when sold at significant discounts to par.

Banks hold roughly \$1.89 trillion in CRE loans backed by income-producing properties.³⁰ With more than \$130 billion in distressed commercial-

²⁴ Orest Mandzy, Q1 2026 CMBS Issuance Stays Solid, Despite Year-Over-Year Drop, Trepp (Apr. 8, 2026), <https://www.trepp.com/trepptalk/q1-2026-cmbs-issuance-stays-solid>.

²⁵ Orest Mandzy, CMBS Issuance Jumps 110% in 1Q 2025, Driven Again by Single-Borrower Deals, Trepp (May 7, 2025), <https://www.trepp.com/trepptalk/cmbs-issuance-jumps-110-in-1q-2025-driven-again-by-sasb>.

²⁶ Distressed Multifamily is Creating Generational Buying Opportunities – a Guide for CRE Investors in 2026, BROOKMONT CAP. VENTURES (Mar. 3, 2026), <https://brookmontcapital.net/insights/distressed-multifamily-buying-opportunities-2026>.

²⁷ FORVIS MAZARS, *supra* note 15.

²⁸ 2026 Maturity Wall, *supra* note 16.

²⁹ FDIC Announces Start of Marketing Process for \$33 Billion Commercial Real Estate Loan Portfolio of Former Signature Bank, New York, FDIC (Sept. 5, 2023), <https://www.fdic.gov/news/press-releases/2023/pr23071.html>.

³⁰ Rachel Szymanski, Inside the \$5.0T CRE Debt Universe: Signs of Bank Expansion Amid

property debt outstanding, and regulatory pressure mounting, the pipeline of potential note sales is expected to remain robust through 2027 and beyond.³¹

Private Credit and Opportunistic Capital

The rise of private credit has fundamentally altered the landscape for distressed note acquisitions. Alternative debt sources accounted for 24% of U.S. commercial real estate lending volume in 2024, which is well above the 10-year average of 14%, according to Deloitte.³² The global private credit market reached \$238 billion in assets under management in 2024 and is expected to reach \$400 billion by the end of the decade.³³

Approximately \$585 billion in CRE dry powder was poised for deployment as of August 2025, representing capital committed to closed-end real estate funds but not yet invested.³⁴ Major institutional players have raised dedicated vehicles: Brookfield, for example, raised \$16 billion specifically for distressed real estate investment.³⁵ This wall of capital creates a liquid and competitive market for distressed note acquisitions, particularly for larger loan pools and institutional-quality collateral.

THE SELLER'S PERSPECTIVE: WHEN AND WHY LENDERS SELL DISTRESSED NOTES

Strategic Drivers for Note Sales

Lenders sell distressed loans for a variety of reasons. In the current environment, several factors are converging to accelerate note sale activity, including regulatory pressure and capital management, balance sheet optimization, and operational and litigation risk management.

The regulatory environment has intensified pressure on financial institutions holding concentrations of troubled commercial real estate debt. In June 2023, the FDIC (Federal Deposit Insurance Corporation), OCC (Office of the

Steady Non-Bank Growth, Trepp (Apr. 21, 2026), <https://www.trepp.com/trepptalk/inside-the-cre-debt-universe-q4-2025>.

³¹ Wong, Extend and Pretend, *supra* note 1.

³² Kathy Feucht, Sally Ann Flood & Tim Coy, 2026 Commercial Real Estate Outlook, DELOITTE CTR. FOR FIN. SERVS. (Sept. 20, 2025), <https://www.deloitte.com/us/en/insights/industry/financial-services/financial-services-industry-outlooks/commercialreal-estate-outlook.html>.

³³ *Id.*

³⁴ *Id.*

³⁵ Peter Grant, New Real-Estate Fund Hauls in Billions to Buy Distressed Properties, WSJ (May 6, 2025, at 07:00 ET), <https://www.wsj.com/real-estate/commercial/new-real-estate-fund-hauls-in-billions-to-buy-distressed-properties-aa2fcbd0>.

Comptroller of the Currency), Federal Reserve, and NCUA (National Credit Union Administration) issued the Interagency Policy Statement on Prudent Commercial Real Estate Loan Accommodations and Workouts, replacing the prior 2009 guidance.³⁶ This updated framework provides principles-based guidance for institutions working with borrowers experiencing financial difficulties, incorporates updated CECL accounting standards (which phased out favorable troubled debt restructuring treatment), and adds guidance on short-term accommodations informed by the COVID-19 experience.³⁷

While the interagency guidance reinforces that prudent loan accommodations and workouts are often in the best interest of both institution and borrower, it also signals heightened regulatory expectations regarding loss recognition and reserve adequacy. Banks that have extended loans multiple times without meaningful improvement in collateral value or borrower financial condition face increasing examiner scrutiny. For institutions exceeding CRE concentration thresholds, particularly regional banks with more than 54.8% of their portfolios above the 300% CRE-to-capital ratio, disposing of troubled loans through note sales may be the most efficient path to achieving acceptable capital ratios.³⁸

In December 2025, the OCC and FDIC rescinded the 2013 Interagency Leveraged Lending Guidance, and the OCC shifted to a more flexible risk-based supervision model for community banks in October 2025.³⁹ While

³⁶ Interagency Policy Statement on Prudent Commercial Real Estate Loan Accommodations and Workouts, FDIC (June 29, 2023), <https://www.fdic.gov/news/financial-institution-letters/2023/fil23034.html>.

³⁷ *Id.*

³⁸ Franz J. Hinzen, Felipe Severino & Stijn Van Nieuwerburgh, Too-Many-to-Ignore: Regional Banks and CRE Risks 6 (2025), <https://wifpr.wharton.upenn.edu/wp-content/uploads/2025/10/HSV-Regional-Banks-and-CRE-Risks.pdf#:~:text=In%202014%2C%20the%0A%0Amedian%20regional%20bank%20had%20a%20concentration%20ratio%20of%20267%25%20and%2037.7%25%20of%20institutions%20exceeded%0A%0Athe%20300%25%20threshold%20that%20can%20prompt%20heightened%20supervisory%20scrutiny.%20By%20the%20end%20of%202024%2C%0A%0Athe%20distribution%20has%20shifted%20rightward.%20Now%2C%2054.8%25%20of%20regional%20banks%20exceed%20this%20threshold%0A%0Aand%20the%20median%20concentration%20ratio%20is%20at%20312%25> (last visited July 16, 2026); see Matt Tracy, Overexposed US Regional Banks Could Sell Commercial Property Loans, Reuters (May 18, 2023), <https://www.reuters.com/business/finance/overexposed-us-regional-banks-could-sell-commercial-property-loans-2023-05-17/>.

³⁹ Interagency Statement on OCC and FDIC Withdrawal from the Interagency Leveraged Lending Guidance Issuances, Off. of the Comptroller of the Currency (Dec. 5, 2025), <https://www.occ.gov/news-issuances/news-releases/2025/nr-ia-2025-119.html>.

these developments provide banks with somewhat greater flexibility, they do not diminish the fundamental imperative to resolve non-performing CRE concentrations.

Lenders increasingly view note sales as a balance sheet management tool rather than a last resort. Selling a non-performing or sub-performing loan at a discount, even a steep discount, generates several benefits: it eliminates the carrying cost of a non-earning or low-yielding asset; it frees up capital that can be redeployed into higher-quality originations; it reduces the operational burden of workout management; and it eliminates future potential losses if collateral values decline further.

Distressed loan workouts are resource-intensive. They require specialized personnel, consume management attention, and expose the institution to litigation risk from borrowers, guarantors, and junior lienholders. When borrowers or guarantors are uncooperative (particularly borrowers and guarantors that have limited recourse liability with little, if any, incentive to cooperate) or litigious, the expected cost and timeline of resolution through workout or foreclosure may make a note sale, even at a significant discount, the economically rational choice.

When Lenders Are Most Likely to Sell

Based on current market conditions, lenders are most likely to pursue note sales in the following circumstances:

- The loan is non-performing or deeply sub-performing with limited prospects for cure, particularly after one or more modifications have failed to produce improvement.
- The borrower or guarantor is non-responsive, uncooperative, or actively litigious, making consensual resolution impractical.
- The collateral is overleveraged relative to current market values, and the borrower lacks resources or willingness to inject additional equity.
- Environmental contamination, deferred maintenance, or operational complexity of the collateral creates risks that the lender is not equipped or willing to manage through an REO period.
- The collateral is in a non-core market or property type outside the lender's expertise or strategic focus.
- Multiple extend-and-pretend modifications have been exhausted without meaningful improvement in the loan's performance or the collateral's value trajectory.
- Regulatory pressure requires the institution to reduce its CRE concentration or improve its capital ratios, and note sales are more efficient

than loan-by-loan workouts.

- The institution needs to free balance sheet capacity for new, higher-quality originations in a more favorable lending environment.
- Headline or reputational risk from foreclosure, particularly on high-profile or politically sensitive properties, makes a quiet note sale preferable to public enforcement action.
- The collateral has been marketed for sale unsuccessfully, suggesting that the REO exit strategy is uncertain or prolonged.

Pricing Considerations for Sellers

Notes on distressed commercial real estate trade at discounts to unpaid principal balance that vary widely depending on collateral quality, property type, geographic market, loan structure, and borrower circumstances. In the current market, discounts range from modest (5-15% for performing loans with near-term maturity risk) to extreme (write-downs of 85% of payoff amount for deeply impaired office loans with limited recovery prospects).⁴⁰

Sellers must balance competing objectives: maximizing sale proceeds, minimizing representations and warranties exposure, achieving certainty of closing, and managing the transaction timeline. In competitive sale processes, lenders may achieve higher pricing by providing comprehensive loan files and property information, allowing adequate due diligence periods, and engaging experienced loan sale advisors who can effectively market the opportunity to qualified buyers.

Performing notes generally sell at smaller discounts than sub-performing and non-performing notes, reflecting lower repayment risk; and multi-family notes generally sell at smaller discounts than office or retail loans, reflecting stronger collateral fundamentals and more favorable capital markets treatment. Single-asset sales may achieve different pricing than portfolio sales, depending on buyer universe (a portfolio comprised of loans having an aggregate unpaid principal balance of \$1 billion will attract a far different, and potentially limited, class of potential buyers than a portfolio comprised of loans having an aggregate unpaid principal balance of \$10 million) as well as repayment risk and collateral fundamentals among the loans comprising the portfolio.

THE BUYER'S PERSPECTIVE: ACQUIRING DISTRESSED NOTES

Strategic Drivers for Note Purchases

For investors, acquiring distressed notes at a discount offers a fundamentally different risk-return profile than purchasing distressed real estate directly. The

⁴⁰ Wong, Extend and Pretend, *supra* note 1.

note buyer steps into the shoes of the lender, acquiring not only the debt instrument but also all attendant security interests, guaranties, and enforcement rights. This position provides multiple resolution pathways and significant optionality.

Consider an illustrative example: an investor acquires a \$100 million first mortgage loan secured by an office building for \$60 million (60 cents on the dollar). The investor now holds a \$100 million claim against the borrower and guarantors, secured by the property. If the property is worth \$70 million, the investor has \$10 million of equity protection. If the borrower can negotiate a discounted payoff at \$70.5 million, the investor realizes a \$10.5 million gain. If the investor forecloses and acquires the property, the effective purchase price is \$60 million for a \$70 million asset, immediately creating embedded equity. And if the borrower continues to pay interest on the full \$100 million face amount, the investor's yield on the \$60 million investment is significantly enhanced.

The optionality of having the ability to pursue modification, discounted payoff, foreclosure, receivership, or other resolution strategies depending on circumstances is the core strategic advantage of note purchases over direct property acquisitions.

Due Diligence for Note Buyers

Comprehensive due diligence is the foundation of a successful note acquisition. Unlike a direct property purchase, where diligence focuses primarily on the real estate asset, a note purchase requires evaluation across three dimensions: the loan, the collateral, and the borrower and guarantors.

Loan Document Review

Sound due diligence begins with a thorough review of the loan documents evidencing and/or securing the loan, including the loan agreement, promissory note, mortgage or deed of trust, guaranty agreements, and all amendments, modifications, and forbearance agreements, with particular attention on:

- Identifying unusual or non-standard provisions that could affect enforcement.
- Analyzing potential borrower defenses, including statute of limitations issues, lender liability claims, non-compliance with grace, notice and cure requirements, and waiver theories.
- Reviewing intercreditor agreements, subordination agreements, and participation agreements that may constrain the note holder's enforcement options.
- In the case of a CMBS loan, evaluating special servicer dynamics,

pooling and servicing agreement restrictions, and controlling class rights where applicable.

Collateral Analysis

In addition to loan document review, a thorough due diligence analysis would continue with the real estate collateral securing the loan, including:

- An independent property valuation using current comparable sales, income capitalization, and discounted cash flow methodologies.
- A physical condition assessment, including deferred maintenance, capital expenditure requirements, and building system obsolescence.
- An environmental site assessment.
- A title examination confirming that the mortgage is properly recorded, identifying all encumbrances, and verifying lien priority.
- A market analysis addressing vacancy rates, rental rate trends, absorption, competing supply, and demand drivers.
- A zoning and entitlement review, particularly for properties that are mid-construction.

In the context of some portfolio loan sales, such a fulsome due diligence analysis is suspended in order to facilitate a quicker bid and/or closing; however, the purchase price will often reflect the purchaser's limited due diligence review, reflecting higher repayment risk.

Borrower and Guarantor Analysis

Additionally, investors will often conduct an analysis of the borrower and guarantor, including:

- A financial analysis of the borrower and any guarantors, including net worth, liquidity, other assets, and potential competing claims.
- A litigation search and judgment analysis to identify potential collection challenges.
- An assessment of guarantor collectability that covers the practical ability to recover on guaranty obligations, not merely their legal enforceability.
- An evaluation of borrower sophistication and likely response to enforcement action, including propensity to file bankruptcy or pursue affirmative claims against the foreclosing lender.

Jurisdictional and Enforcement Analysis

Finally, a jurisdictional and enforcement analysis, which might include:

- A determination of whether the property is in a judicial or non-judicial

foreclosure state. This distinction affects enforcement timelines by months or years.

- An analysis of applicable redemption periods, deficiency judgment availability, and anti-deficiency statutes.
- A review of receivership availability and procedures in the relevant jurisdiction.
- An assessment of local court practices, including typical foreclosure timelines and any COVID-19-era moratorium remnants.

LEGAL FRAMEWORKS FOR DISTRESSED NOTE TRANSACTIONS

Loan Sale Documentation and Assignment Mechanics

The primary mechanism for transferring a distressed loan is an assignment of the applicable loan documents from the selling lender to the purchasing investor. The applicable documents include the loan agreement, promissory note, mortgage or deed of trust, and other instruments evidencing and/or securing the loan. This structure may offer significant advantages over a direct real estate sale: it typically does not trigger deed transfer or mortgage taxes, does not require title transfers, and can be executed more quickly than a real property conveyance.

Key transactional documents in a note sale include:

- *Loan Sale Agreement*: The primary purchase and sale agreement, which addresses purchase price, representations and warranties, closing conditions, indemnification, and servicing transition. Sellers typically provide limited representations, which are often confined to ownership, authority, and absence of prior modifications not reflected in the loan file, while resisting representations regarding collateral value, borrower financial condition, or loan enforceability. Typically, the greater the discount to par, the more limited are the Seller's representations and warranties.
- *Allonge and Assignment of Note*: The physical endorsement and transfer of the promissory note, which must comply with applicable negotiable instruments law to ensure holder-in-due-course protections where available.
- *Assignment of Mortgage*: Recorded assignment transferring the mortgage lien from seller to buyer. Proper recording is essential to maintain lien priority and enforce the mortgage against subsequent purchasers and creditors.
- *Assignment of Other Loan Documents*: A blanket assignment transferring

all ancillary loan documents, including guarantees, environmental indemnities, security agreements, and UCC financing statements.

- *Servicing Agreement or Servicing Transfer*: Arrangements for ongoing loan administration, including payment processing, escrow management, borrower communications, and default management.

Representations, Warranties, and Indemnification

The negotiation of representations and warranties is often the most contentious aspect of distressed note sale documentation. The fundamental tension is that sellers, which are typically regulated financial institutions, seek to minimize (if not eliminate) ongoing liability after closing, while buyers seek protections against undisclosed defects in the loan or collateral.

In the current market, note sale transactions often reflect a middle ground:

- Sellers typically represent as to authority, ownership, and the completeness of the loan documents provided to the buyer.
- Sellers generally disclaim any representation regarding collateral value, borrower financial condition, environmental conditions, or the enforceability of loan documents against the borrower.
- Buyers accept the loan on an “as is” basis and subject to all borrower defenses, claims, and counterclaims, whether known or unknown.
- Seller’s post-closing indemnification obligations, if provided, are typically very limited in scope and duration.
- Confidentiality and non-disclosure obligations will often survive closing and restrict buyer’s use and disclosure of borrower information obtained through the sale process.

UCC Article 9 Enforcement

For loans secured by personal property interests, including security interests in membership interests in borrower entities, Uniform Commercial Code Article 9 provides a powerful enforcement framework that may supplement or, in some cases, substitute for mortgage foreclosure.

Article 9 permits a secured creditor to repossess and dispose of collateral after default, subject to several requirements:

- *Notice*: The secured party must provide the debtor and other secured parties with reasonable authenticated notification of disposition. Most states require a minimum of 10 days’ notice for non-consumer

transactions.⁴¹

- *Commercially Reasonable Disposition*: Every aspect of the disposition, including method, manner, time, place, and terms, must be commercially reasonable. This standard, while flexible, has generated substantial litigation as debtors challenge the adequacy of marketing efforts, sale timing, and pricing.
- *Public or Private Sale*: Sales may be conducted publicly (auction) or privately (negotiated sale). Under UCC Section 9-610(b), the secured party may purchase the collateral at a public disposition or at a private disposition where the collateral is of a type customarily sold on a recognized market.⁴²
- *Proceeds Application*: Proceeds of disposition must be applied first to the reasonable expenses of collection and enforcement, then to satisfaction of the secured obligation, and then to subordinate lienholders, with any surplus paid to the debtor.

For distressed note buyers, UCC Article 9 enforcement of a pledge of membership interests in the borrower entity can provide an efficient path to obtaining control of the property-owning entity that avoids the time and expense of judicial or non-judicial mortgage foreclosure. This strategy requires careful analysis, however, as some states have adopted variations in their UCC enactments, growing case law reflects debtor challenges to procedural and substantive aspects of Article 9 sales, and strict compliance with notice and commercial reasonableness requirements is essential to the successful realization of such pledges in the borrower entity.

Bankruptcy Section 363 Sales

When the borrower files for bankruptcy protection, or when the note holder controls a borrower entity post-foreclosure and seeks to dispose of real estate, Section 363 of the Bankruptcy Code provides a framework for selling property outside the ordinary course of business, subject to court approval after notice and a hearing.⁴³

Section 363 sales offer several significant advantages:

- Competitive bidding through a court-supervised process that maximizes value and provides transparency.

⁴¹ UCC § 9-612(b); see also Garry M. Graber & Steven W. Wells, UCC Article 9 Secured Party Sales 4 (2017).

⁴² UCC §§ 9-610(b)-(c).

⁴³ 11 U.S.C. § 363.

- Ability to sell assets “free and clear” of liens, claims, encumbrances, and interests (Section 363(f)), with such interests attaching to proceeds, which is a powerful tool for eliminating title defects and junior liens.⁴⁴
- Good faith purchaser protections (Section 363(m)) that insulate the buyer from subsequent challenges to the sale on appeal, provided the buyer acted in good faith.⁴⁵
- Finality through court approval, which provides greater certainty than non-judicial sale processes.
- Credit bidding rights for secured creditors, allowing lenders to bid their debt rather than cash (though courts may limit credit bidding in certain circumstances under Section 363(k)).⁴⁶

Section 363 sales also carry risks and costs that participants must evaluate:

- Court approval is required, introducing timeline uncertainty and the possibility of objections from other parties in interest.
- Due diligence opportunities may be limited, and assets are typically sold on an “as-is, where-is” basis.
- The competitive auction process may result in the buyer being outbid by a higher competing offer.
- Buyers must demonstrate financial capacity to close quickly, as bankruptcy courts prioritize certainty of execution.
- “Stalking horse” bid procedures, while providing certain protections (break-up fees, expense reimbursement), require the initial bidder to set a floor price that may attract competition.

STRUCTURAL OPTIONS AND PRACTICAL CONSIDERATIONS

Transaction Structures

Distressed note transactions can be structured in several ways, each offering distinct advantages depending on the parties’ objectives:

- *Whole Loan Sale.* The most common structure: the seller transfers the entire loan to the buyer. The transfer includes the promissory note, mortgage or deed of trust, security agreements, guaranties, and all

⁴⁴ Id. § 363(f).

⁴⁵ Id. § 363(m).

⁴⁶ Id. § 363(k); see Jamie R. Netznik & Megan K. O’Connor, Section 363 Sales Considerations, Mayer Brown LLP (Apr. 23, 2025), <https://www.mayerbrown.com/en/insights/publications/2025/04/section-363-sales-considerations>.

enforcement rights. The buyer assumes full control of the workout, enforcement, or resolution strategy. Whole loan sales provide maximum control and flexibility to the buyer and a clean break for the seller.

- *Participation Interest.* A lender may sell a partial interest in the loan (for example, a 25% or 50% participation interest) at a discount, retaining the remaining participation interest. Participation sales allow the lender to share risk, recognize a partial loss, and maintain some economic interest in the loan's ultimate recovery. The participation terms are governed by a participation agreement that addresses decision-making authority, payment priority, and transfer restrictions.⁴⁷ Participation structures are particularly useful when the seller wants to reduce exposure without fully exiting the position or when the buyer seeks to limit its capital commitment.
- *Note-on-Note Financing.* In note-on-note financing, the investor borrows funds to finance its acquisition of a distressed loan, pledging the acquired note and mortgage as collateral for the acquisition financing. While a niche product, note-on-note financing is available from certain specialty lenders and can enhance returns by allowing the note buyer to leverage its equity investment. Some selling banks will provide financing to the note buyer as part of the sale transaction, effectively removing the loan from their balance sheet while retaining a secured position in the financing.
- *Seller Financing and Risk Retention.* A selling bank may agree to finance a portion of the note sale to facilitate the transaction. In this structure, the bank removes the distressed loan from its books, replaces it with a new performing loan to the note buyer (typically at a lower advance rate and current market terms), and achieves regulatory capital relief. The buyer benefits from reduced cash equity requirements. This structure is most common in portfolio sales where the buyer seeks leverage to acquire multiple assets.
- *Pre-Packaged Workouts.* In a pre-packaged workout, the note buyer simultaneously negotiates the note purchase from the lender and a loan modification or restructuring with the borrower. Both transactions close concurrently or in quick succession: the buyer acquires the note at a discount and immediately modifies the loan terms with the borrower. Examples of common modifications include requiring a

⁴⁷ See Daniel B. Guggenheim, Joshua N. Rudin & William J. Squires, III, Important Issues in Purchasing and Resolving Distressed Real Estate Debt 8 (2023).

principal paydown, extending the maturity, or converting a portion of debt to equity participation. This structure allows the seller to achieve a clean exit, the buyer to acquire a performing (or soon-to-be-performing) loan, and the borrower to achieve debt relief. Pre-packaged workouts require cooperation among all parties but can produce outcomes superior to adversarial resolution.

Negotiation Strategies

From the Seller's Perspective:

- Maximize purchase price through competitive bidding processes, engaging qualified loan sale advisors, and providing comprehensive loan files that enable buyers to bid with confidence.
- Minimize representations and warranties.
- Negotiate quick closing timelines to reduce execution risk and the operational burden of managing the loan during the sale process.
- Limit or eliminate holdback and escrow requirements, preferring instead to address post-closing adjustments through indemnification provisions with defined caps and survival periods.
- Maintain confidentiality throughout the process, particularly where the borrower is not aware of the pending sale and early disclosure could trigger adverse borrower actions.

From the Buyer's Perspective:

- Negotiate representations and warranties regarding loan ownership, absence of undisclosed modifications, completeness of the loan file, and accuracy of payment histories.
- Seek robust indemnification provisions, and potentially post-closing repurchase obligations, covering breaches of representations, undisclosed liabilities, and pre-closing servicing errors.
- Insist on adequate due diligence periods.
- Negotiate purchase price adjustment mechanisms tied to specific diligence findings such as reductions for material defects in title, undisclosed environmental conditions, or missing loan documents.
- Understand and negotiate the servicing transition timeline, including arrangements for escrowed funds, pending insurance claims, and ongoing borrower communications.
- Address confidentiality obligations carefully, ensuring that the buyer can share information with prospective equity partners, lenders, and

professional advisors without violating sale agreement restrictions.

Post-Acquisition Resolution Strategies

A critical element of note acquisition underwriting is the identification and evaluation of post-acquisition resolution pathways. Note buyers often want to develop a clear thesis regarding their intended exit strategy before committing capital, while maintaining flexibility to adjust those strategies based on evolving circumstances.

Common post-acquisition strategies include:

- *Loan Modification and Restructuring.* Working cooperatively with the borrower to restructure the loan on terms that restore debt service coverage such as a principal reduction, maturity extension, interest rate modification, conversion of a portion of debt to equity participation, or even a deed-in-lieu of foreclosure, pledge of equity in the borrower entity, or consent to appointment of a receiver to expedite remedy enforcement in the event of future default.
- *Discounted Payoff.* Negotiating a lump-sum payment from the borrower (or a new capital source) at an amount above the investor's acquisition cost but below the full loan balance. This strategy works when borrowers can access refinancing or fresh equity at levels between the investor's basis and the outstanding debt.
- *Foreclosure.* Pursuing judicial or non-judicial foreclosure to acquire the property. Timeline and cost vary significantly by jurisdiction from approximately 90 days in non-judicial foreclosure states to 18 months or more in judicial foreclosure jurisdictions. Note buyers should be wary of, and properly account for, post-foreclosure redemption periods that exist in some states, the duration of which varies from state to state.⁴⁸ Such redemption periods, where applicable, permit the borrower to redeem certain real estate collateral types for periods ranging from ten days (New Jersey) to two years (Tennessee), with six months to one year being the most common.⁴⁹
- *UCC Article 9 Sales.* Where the loan is secured by a pledge of the equity interests in the borrower entity, conducting a UCC sale of those

⁴⁸ See Foreclosure Laws and Procedures: 50-State Survey, Justia, <https://www.justia.com/foreclosure/foreclosure-laws-and-procedures-50-state-survey/> (last visited July 16, 2026); see also Baxter Dunaway, Law of Distressed Real Estate § 18:53 (2026).

⁴⁹ N.J. Rev. Stat. § 2A:50-58 (2025); Tenn. Code Ann § 66-8-101 (2024); see Justia, *supra* note 48.

interests to acquire control of the property-owning entity. This can be significantly faster than mortgage foreclosure, depending upon the jurisdiction.

- *Deed-in-Lieu of Foreclosure.* Negotiating a voluntary conveyance of the property from the borrower to the note holder in satisfaction of the debt, thereby entirely avoiding the time and expense of formal foreclosure proceedings.
- *Receivership.* Petitioning for appointment of a receiver to manage and operate the property pending foreclosure or sale, preserving property value and generating income during the resolution period.
- *Property Repositioning.* After obtaining title (through foreclosure, deed-in-lieu, or UCC sale), investing capital to reposition, stabilize, or redevelop the property before disposition.

IN SUMMARY

- *The End of Extend and Pretend:* Major lenders are selling distressed commercial real estate debt at write-downs reaching 85% of the loan's payoff amount, signaling a decisive market shift from forbearance to resolution.⁵⁰
- *Unprecedented Maturity Wall:* Approximately \$875 billion in commercial and multifamily mortgage debt is scheduled to mature in 2026,⁵¹ with an additional \$400 billion in previously extended loans, according to Forvis Mazars,⁵² creating a refinancing backlog that will drive further distress and note sale activity.
- *Office Sector Leading Distress:* CMBS (Commercial Mortgage-Backed Securities) special servicing rates reached 10.86% in May 2026, with office delinquency rates at historic highs.⁵³ Office properties transferred to special servicing have experienced value losses of 50% or more, creating significant opportunities for distressed debt investors.⁵⁴
- *Regulatory Pressure Accelerating Sales:* Updated interagency guidance, CECL (Current Expected Credit Loss) accounting requirements, and heightened examiner scrutiny of CRE (Commercial Real Estate)

⁵⁰ Wong, *Extend and Pretend*, supra note 1.

⁵¹ Booker, supra note 3.

⁵² FORVIS MAZARS, supra note 15.

⁵³ Buschbom, supra note 19.

⁵⁴ Trepp, Spring 2026, supra note 18, at 14.

concentrations are compelling banks to resolve troubled loans rather than extend them further.⁵⁵

- *Private Capital Deployment:* With \$585 billion in CRE dry powder poised for deployment and alternative debt sources accounting for 24% of U.S. CRE lending volume, private credit funds and opportunistic investors are well-positioned to acquire distressed notes at discounts.⁵⁶
- *Comprehensive Due Diligence Is Critical:* Before committing capital to a potential note sale transaction, note buyers should evaluate not only the underlying real estate and other collateral but also the loan documents evidencing and securing the loan, applicable foreclosure law, availability of borrower defenses that might interfere with post-closing collection and/or enforcement efforts, and environmental risk. In addition, note buyers should also have a sound post-acquisition resolution strategy for the loan.

CONCLUSION: NAVIGATING THE OPPORTUNITY

The confluence of forces reshaping the commercial real estate lending market – the end of extend and pretend, the massive maturity wall, elevated interest rates, remote work disruption of office demand, and intensified regulatory scrutiny – has created an environment of extraordinary activity in the distressed note market. For sellers, resolving troubled loans through note sales offers balance sheet relief, regulatory capital optimization, and the elimination of operational risk. For buyers, acquiring notes at discounts provides embedded equity, enhanced yields, multiple resolution pathways, and the optionality that direct property acquisitions cannot replicate.

Success in this market requires more than capital. It demands deep expertise in loan documentation, real estate fundamentals, workout strategy, foreclosure and bankruptcy law, UCC enforcement, and the practical realities of negotiating with distressed borrowers and regulated lenders. The transactions are complex, the timelines are compressed, and the stakes are significant.

As the market continues to clear more than \$130 billion in distressed commercial property debt over the coming quarters, participants who combine disciplined underwriting with legal and transactional sophistication will be best

⁵⁵ FDIC, *supra* note 36.

⁵⁶ Feucht et al., *supra* note 32.

positioned to capitalize on the opportunity, whether they sit on the buy side, the sell side, or both.⁵⁷

⁵⁷ Wong, *Extend and Pretend*, *supra* note 1.