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Your lenders have called – What should you do now? Insights for US businesses navigating the impact of the coronavirus

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Recent uncertain times have brought with them, among other things, unpredictable customer orders and reduced cash flow, leaving many companies unable to pay ongoing expenses such as their rent, mortgages or business loans. You may be expecting calls from one or more of your lenders—or they may have already called. What should you do to manage the situation, and possibly defer or reduce past and future rent, interest and principal payments? Don't panic—many companies are in a similar position; in some cases, federal and/or state law may prevent a lender or other creditor from taking any actions during the Covid 19 virus pandemic, and solutions do exist for those facing loan-related issues. Four key actions taken now can help you to determine whether you can realistically meet your obligations, and to assess your options.

4 Key Actions

- **Gather All Loan and Related Documents:** Many people will only review the direct loan agreement when their lender reaches out, ignoring other corresponding documents that may be critical to understanding their legal position. Gather all of the documents you have for all of your loans, not just the ones about which you are concerned. Such documents include loan agreements, deeds of trust, guarantees, inter-creditor agreements, UCC-1 filings, and pledge agreements. Review the Event of Default and Remedies provisions; do any of the documents contain "cross default" provisions, such that a default under one of your loan agreements gives rise to an event of default on other loans even if you are current on those other loans? Evaluate the debt coverage ratio, debt to asset ratio and other covenants in all agreements to ensure that actions taken in respect of one lender won't trigger a default on another loan or otherwise violate other agreements. Importantly, drops in asset values could lead to a violation of the terms of an agreement, and this needs be monitored on an ongoing basis, particularly in the current environment.
- **Identify Borrower, Guarantors and Collateral:** For each loan, determine who the borrower is and whether one or more loans are secured. Is the borrower a corporation, a limited liability company, a partnership, or you personally? The type of borrower can have tax implications if the loan is ultimately restructured or paid off at a discount, as discussed further below. Are there any guarantors and, if so, must you give them notice that you are late with payments and that the lenders have contacted you? Are any of the loans secured? If so, what property has been pledged as collateral for the loans, and has any of the property been pledged as collateral for more than one loan? If yes, then you will need to review any inter-creditor agreements that set out the rights of the different lenders to the collateral. Has the value of collateral dropped due to recent market conditions? Additionally, identifying assets which can be pledged in the future as collateral could be helpful, should loans need to be renegotiated.
- **Model Out Cash Flow and Debt Service Related Payments:** Are any cash flow disruptions likely to be short-term or might they linger, even as the economy begins to open up? Do you simply need a deferral of the interest and principal payments for a period of months? Do you need to have part or all of the loan forgiven once you turn over the collateral? The answers to these questions will determine whether you renegotiate the terms of a loan to reduce payments or whether you may need to have the loan written off.
- **Address Tax Issues Upfront:** What are the tax implications of any proposed loan restructurings? Reductions in interest rates, reductions in principal, deferral of payments, changes to the collateral, or certain other changes to a loan agreement can be treated as a taxable exchange of the "old" loan for a "new" loan. Such a deemed exchange can give rise to cancellation of debt income for the borrower(s), taxable at ordinary income rates. Additionally, if a loan is secured and you pay off the loan in part by turning over the collateral, you could end up with a capital loss (to the extent the value of the collateral has declined below its adjusted cost basis) and ordinary income from the cancellation of the debt. Under current tax law, there are exclusions available under which cancellation of debt income may either not be taxable at all, or can be deferred to a later date.

COVID-19 has obviously proven very disruptive for many businesses, and your response should be proactive to ensure that related damage is minimized and solutions put in place immediately. Even if your lender hasn't yet called, running a lien search on yourself can help identify problems early, and taking the actions discussed above can mitigate downside and potentially save your business.

For more details, please contact your regular Withers attorney or any of the authors listed on this page.

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