

What Happens When The Extensions Expire? Strategies For A Potential Wave Of Defaults, Workouts And Bankruptcies

Accommodations and loan re-payment deferrals have been themes during the pandemic. Pain is everywhere but some industries and borrowers are on their knees. What happens after the first (or second or third) loan extension expires? From a lending perspective, there will come a day of reckoning. Some of those borrowers fundamentally cannot pay. Lenient loan extensions and modifications authorized by the CARES Act and regulators will conflict with the need to address borrower inability to repay your loans. **Now** is the time to prepare.

What can you do now? Plenty. Below are 5 steps you should consider to prepare for Q3 and Q4 when we anticipate lenders will be facing defaults, workouts and bankruptcies. And if the wave doesn't come – Great! But detailed attention to your portfolio is not only good risk management per the regulators, it also benefits you under all circumstances.

- **Scrub the Files.** Review your files for critical items like signed documents, original promissory notes, personal guarantees, current UCC-1 filings and continuations, recorded mortgages and other instruments securing the loan.
- **Slice, Dice and Analyze the Portfolio.** Segregate loans in troubled industries, loans exhibiting warning signs, your largest loans, loans which are under multiple extensions and loans your experience just tells you to worry about.
- **Look for Warning Signs.** Just a few examples – Is borrower management returning your calls? Are there rumors of bankruptcy? Have the borrower and guarantors provided interim financials?
- **Prepare for Workout and Bankruptcy Vulnerabilities.** Are you at risk for preference or claw back lawsuits? Have you examined your collateral, and has your security interest been properly perfected or has it lapsed or otherwise been negatively impacted? Are your guaranties intact and guarantors solvent? Have you taken, or at least considered, preemptive steps available before a bankruptcy hits, e.g., key man insurance, UCC and lien searches, consents and subordinations, etc.? Have you unknowingly impaired your position?
- **Train Your Staff.** Is your staff trained on collection and bankruptcy matters? Do they understand the automatic stay and the severe penalties imposed for violating it? Are they aware of the importance of the bankruptcy petition date and the need to account carefully for pre-petition and post-petition obligations?

Bybel Rutledge LLP
1017 Mumma Road, Lemoyne, PA 17043
Phone: 717-731-1700
Fax: 717-731-8205
Website: www.bybelrutledge.com

Regulators have indicated they will be flexible in their review of loan extensions and modifications during these troubled times **as long as lenders engage in proper risk management and governance practices**. Taking these steps will demonstrate to regulators that you are engaging in proper risk management.

Summer is here, it's time to take a breath and get a break from a truly unprecedented Spring. But it's also time to prepare for an unprecedented Fall.

We are counseling lenders on these issues and more as they continue to weather COVID-19 economic uncertainty. Contact any of the attorneys listed below for information and assistance.

Eric L. Brossman, Esquire

brossman@bybelrutledge.com

(717) 525-7292

Carter D. Frantz, Esquire

frantz@bybelrutledge.com

(717) 525-7178

Louise S. Hutchinson, Esquire

hutchinson@bybelrutledge.com

(717) 731-1850

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