

# Top 11 Tips for Lenders Navigating Commercial Loan Modifications in Response to the COVID-19 Outbreak

March 24, 2020

## **Managing Borrower Expectations**

In the immediate term, most Lenders are considering modifications that offer (usually on request only and subject to normal underwriting and credit review) a 60–90 day deferral of payments for principal reductions or both principal and interest. These modifications are typically being enacted only to give the parties (and everyone else) an opportunity to better assess how the COVID-19 outbreak evolves and what impact the government’s response to the outbreak may or may not have on the Borrower’s business going forward. To avoid establishing a course of dealing, Lenders should be clear in communicating that this accommodation is (as of right now) a one-time event and that future accommodations may not be granted. Lenders should consider (a) developing a standard/formal communication to Borrowers which explains the context in which and why the accommodation is being granted and (b) implementing policies to prevent loan officers from over-promising to Borrowers via informal communications such as phone calls, social media, emails, and texts. It is certainly okay (and natural) to empathize with a Borrower’s challenges, but individuals dealing directly with customers should avoid over-committing to another round of accommodations if the outbreak lasts longer than anticipated.

## **Dealing with Deferred Payments and Interest Accrual**

Lenders should consider how interest will be treated during any period of deferral. Will interest continue to accrue during the deferral period? If so, when will that interest be due for payment and how? How will deferred payments be repaid? At maturity? Will the maturity date itself be extended as part of the accommodation? If interest will be accruing during the deferment period, representations that the number of payments being deferred will be added to the maturity date should be avoided, unless the amortization in the loan supports the ability to make such promises. Regardless of how the Lender decides to manage deferred payments and interest accrual, the Lender should take the time to clearly explain the same to the Borrower to avoid any confusion down the line. Additionally, once payment accommodations have been made and clearly documented, Lenders should ensure that their internal accounting/payment systems are set up to properly track the terms of any modification.

## Covenant and Reporting Requirements

In the intermediate term, another important consideration Lenders are grappling with is how to manage covenant and reporting requirements going forward. For instance, if a Borrower agrees to payment deferrals for its customers, what impact will those deferrals have on the Borrower's borrowing base? What about inventory or accounts that become aged and are not replenished due to a longer than expected shutdown? Most Borrowers will have a difficult time complying with their financial covenants going forward as well due to the economic impacts of the crisis. Lenders will need to re-think how to measure a Borrower's financial health during this crisis. In anticipation of these issues, modifications done in the immediate term should contain standard reservation of rights language. Additionally, Lenders should consider developing a form reservation of rights letter that can be used (as needed) to document covenant and reporting defaults during the crisis when enforcement action may not be desired and/or may be legally prohibited.

## Refinancing and Tapping Into Equity

Some Borrowers may seek to tap into collateral equity to manage their way through an extended crisis. While a plausible short term solution, there are many issues to consider in documenting and closing any such transaction:

- **Ensuring Clear Title.** There is a lot of uncertainty at this time as to how title issues will be dealt with in the face of closures of county offices where title information is stored. Some may have access to real property information online, in which case a title search may still be possible. However, other counties do not have such online access, which limits title searches in those areas. We are starting to see directives issued by various title companies regarding what they will accept in these scenarios in order to issue title policies. Some directives include searching for lawsuits and court cases, including bankruptcy filings, that could result in the filing of a judgment and including an exception in the policy for any liens attaching between a date certain and the policy date (for those records that cannot be searched online through the date of the policy). Gap title insurance may also be available.
- **Appraisals.** Determining the value of collateral during this time may also become increasingly more difficult as in-person surveys, environmental inspections, and property reviews may not be possible. Additionally, this outbreak could have a disproportionate, negative impact on future property values for types of property such as brick and mortar retail buildings. Thus, even if a valuation can be obtained, this valuation may not be reliable more than six months or even a year from now.
- **Proper Documentation for Later Enforcement of Loan Documents.** Many states have witness and notary requirements. Congress is actively working now on a bipartisan bill to accommodate electronic notarizations going forward. More information on this ongoing effort can be found [here](#).
- **Perfection Through Recordation.** Assuming document formalities can be met or worked around, Lenders will need to think through perfecting their collateral interests through recordation. In light of the large-scale closure of recording offices around the county, title insurance companies have started to issue certain directives in connection with what they will accept to close mortgage loans when recording offices are closed. As noted above, most involve some type of gap insurance to cover the period between the signing of the documents and the time that recordation can occur. Others require an indemnification by the Borrower, which is acknowledged by the Lender, in the event that liens are filed before the mortgage can be filed. These directives are subject to change and are being amended almost daily, so it is best to follow up with

any title insurance company you may be using to make sure that this issue is being handled appropriately and to the satisfaction of your financial institution before any loan is closed. This issue may also impact the filing of UCC financing statements, continuation statements, etc. as some municipalities still require that these documents be filed in-person rather than online. Understanding the capabilities of any jurisdiction in which you are trying to record these documents should be determined before any closing.

## **Use of Electronic Signatures**

Many Lenders are considering whether to allow electronic signatures on modification documents. It is important to recognize the state and federal law requirements for use of electronic signatures to be sure your documents conform accordingly so as to not affect later enforcement of any such document. The federal Electronic Signatures in Global and National Commerce Act (known as “ESign”) and state adoptions of the Uniform Electronic Transactions Act (known as “UETA”) allow the use of electronic signatures and electronic records instead of paper documents and traditional wet-ink signatures. The UETA has currently been adopted by 47 states, the District of Columbia, Puerto Rico, and the Virgin Islands. The three states that have not adopted the UETA (New York, Illinois, and Washington) have all adopted similar laws making electronic signatures legally enforceable.

## **Accommodating Emergency Relief Loans**

Congress and various agencies are actively working on stimulus plans to assist small businesses during the next 30–120 days. If Borrowers choose to take advantage of these plans, Lenders should understand how these types of loans will interact with the existing credit facility and whether these emergency loans will trigger contractual defaults or create more practical challenges once implemented. If a Borrower is exploring this type of relief, the Lender should ask (if not already directly involved) to be kept involved so unintended defaults/problems can be minimized.

## **Knowing Your Customer**

The brutal reality of any extended economic shutdown is that certain types of businesses will fail regardless of how many accommodations are made. This crisis has the real possibility of fundamentally changing how the U.S. economy operates. Lenders should strive to predict which businesses/industries may be the most heavily impacted and start to carefully monitor those portfolios so collateral value can be preserved in the long term. Part of that analysis is understanding how each Borrower is responding to outbreak—what accommodations are they making for their customers? What is their recovery plan? What resources are needed for that plan to succeed? Even if they do succeed, what does that success look like? Has the customer filed any insurance claims? If so, have they been paid and how will those proceeds be used?

## **Protecting Collateral**

Another important consideration is how tangible collateral will be protected during any shut-down period. How will the Lender conduct routine audits of loans secured by personal/movable collateral like inventory? Will those audits continue during any deferral period? How will they occur if the Borrower’s premises are closed or if your Borrower is attempting to minimize traffic? Some thought should be given to coming up with alternative ways to audit/check on your collateral during this time. For instance, is it possible to access your Borrower’s internet-based security systems with video cameras? Can you work with your Borrower on installing a security guard?

Keep in mind that many of these alternatives may be costly in these times, so it is best to establish who will ultimately be responsible for these amounts before they are incurred.

### **Key Man Life Insurance**

While the overall mortality rate of COVID-19 is higher than the common flu, the chances of dying or becoming incapacitated as a result of COVID-19 are still relatively low. Regardless, if loan documents already require key man insurance, now is the time to ensure that those coverages are active and in place. If not, Lenders may want to consider requiring them to be in place, within reason and within the context of the particular credit at issue.

### **Imperfect Remedies**

With the courts and cities being shut down, we are starting to see Lenders struggle with ready access to normally accessible legal remedies, such as foreclosure, receivership, replevins, and UCC auctions. It is unclear how long these types of remedies will be limited and what value they will have when they return. As a result, Lenders who were dealing with collateral collections when the outbreak hit may want to consider other alternatives to best liquidate and/or protect its collateral in the interim. If possible, Borrower cooperation should be discussed and, if necessary, incentivized.

If you have any questions, please do not hesitate to contact the authors or visit our [COVID-19 Resource Center](#).