Lender negotiations

How to protect your business when negotiating troubled loans

INTERVIEWED BY ROGER VOZAR

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If your business has a loan, your lender might classify it as “troubled” without your knowledge.

“You may still be dealing with a credit officer, but that person is being coached by a workout specialist while you remain unaware,” says Suzana K. Koch, a partner at Brouse McDowell.

Smart Business spoke with Koch and Alan M. Koschik, a partner at Brouse McDowell, about how the business/lender relationship has changed.

How did lenders previously handle missed payments or other problems, and what has changed?

Prior to the Great Recession, lenders would contact borrowers that experienced trouble, such as missing a payment, being out of formula on covenants or experiencing decreased sales, to schedule a meeting to discuss the default. At that time, banks typically referred troubled loans to the special assets or workout department. The bank would assign a workout officer to maximize value by liquidating collateral or other means. The borrower might not always work out troubled loans to its satisfaction, but at least it knew that its banking relationship had changed.

This clear transition to workout is no longer as common. Traditional lenders now assign workout officers to shadow credit personnel on loans classified as troubled without the borrower’s knowledge. Participants in this process, such as accountants and bankers, report that they are frequently avoiding the borrower’s attorneys.

The borrower often is unaware that the banking relationship has changed. Previously, borrowers received a default letter and a workout officer was assigned to them when they were transferred to special assets. Now, borrowers find themselves talking to their original loan officers, who may cajole them by saying, ‘You’re a little out of formula, so let’s see what we can do to revise the loan documents.’ In this common scenario, the borrower negotiates without representation, unaware that the ground rules of the relationship have changed.

Why is this occurring?

Lenders prefer that borrowers not have counsel advising them of their rights. It is much cheaper for the bank, and it receives much better workout terms if the process does not involve the borrower’s legal counsel. A sophisticated attorney representing the borrower would know about the various options that are available and when the lender is asking for more than it should.

Frequently, lenders ask borrowers to waive rights, offer additional collateral and provide personal guaranties. In exchange for these concessions, borrowers often receive meager benefits such as short-term extensions of maturity or standstill periods. With counsel, borrowers would often be able to obtain more favorable terms in these workout negotiations.

Is this practice widespread?

This pattern appears to be happening with most of the region’s banks as a result of the Great Recession. In shoring up workout departments, banks enlisted bankers from other areas to help with troubled loans. As a result, more bankers are now familiar with the workout process. With the easing of the recession, workout departments are shrinking and those bankers are returning to their traditional jobs. However, the effect of this temporary reassignment is that front-end bankers are more comfortable doing the workouts themselves.

What can I do to protect my business?

Borrowers should be cognizant of their loan terms, including their loans’ financial covenants and reporting requirements, and any possible defaults of these provisions. Despite this vigilance, a default may become inevitable, even if they are only technical defaults.

If you are concerned that you are out of compliance on your covenants, or if you miss a loan payment, contact a workout attorney immediately. Communication with your bank is also important. However, if you are negotiating with your lender, you need representation, preferably from the beginning of the process. ●