

Facing a Default? What to Know About Entering into a Forbearance Agreement

Businesses across the country are already feeling the impact of the coronavirus, and with many communities already implementing quarantines and lockdowns, things are only expected to get worse. While many lenders have been more than willing to work with their customers through deferred payment plans or other accommodations, defaults on loans will be an inevitable reality for many businesses. Even if a business can continue to make its scheduled payments, it may violate a financial covenant or suffer a material adverse change, thereby triggering a default event. While certain relief programs are being put into place to help consumers deal with these issues, many businesses will be forced to work through the problems directly with their lenders.

While it may be tempting to address the issues in an informal manner, through a phone call or simple letter, committing the agreement to writing is a crucial step and will help avoid disputes in the future. In such a case, it is likely that a lender will be willing to enter into a forbearance agreement, and temporarily forbear from exercising its rights under the applicable loan documents, subject to satisfaction of certain conditions. In negotiating such agreements, it is important to remember that this is a difficult time for everyone involved. While borrowers need access to capital in order to keep their businesses afloat, lenders need to properly assess credit risks to protect their assets and ongoing business.

Below are important provisions that should be considered when entering into a forbearance agreement, particularly in light of the unique issues brought on by the coronavirus:

- **Timing.** In a traditional forbearance agreement, the lender and borrower will agree to certain dates by which payments must be made or covenants must be satisfied. As it stands today, no one knows how long the shutdowns and quarantines will last. Further, the effects of the coronavirus will be felt long after things get back to business as usual. As such, it is important to build some flexibility into your forbearance agreement. For example, you can request that certain payments be due within 90 days after the National State of Emergency has ended or that financial covenants be loosened significantly to start and then tightened on a gradual scale. Ultimately, with the uncertainty of things moving forward, it is important to negotiate provisions that allow some

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flexibility based on the events that will occur down the road.

- **Interest and Fees.** Lenders may require an increase in rates in exchange for entering into the forbearance agreement. Borrowers should be aware of exactly the rates they are agreeing to and the agreement should address the lender's right to default interest, which may already be accruing. Oftentimes, borrowers may be unaware that in addition to a rate increase, they are also being charged default interest. Further, it is important to be aware of potential volatility in rates when negotiating the agreement. Finally, a lender will also likely request a forbearance fee. Forbearance fees vary widely based on the amount of the loan, but typically range between 1 and 3 percent of the overall credit commitment.
- **Defaults.** Typically, a forbearance agreement only applies to defaults known to the lender at the time the agreement is entered into. Because of the unpredictability of things moving forward, it is important for the borrower to communicate to the lender the current state of its business and potential for additional changes. For example, if an extension of a lockdown would cause the borrower to violate an additional covenant, lenders may be willing to account for such possibilities in the forbearance agreement. Some lenders may even be willing to include default events that can be closely tied to the coronavirus.

There are several other provisions that will need to be negotiated when entering into a forbearance agreement such as decreases in available credit, tighter covenant restrictions and requests for additional collateral. If you have any questions or need assistance with a workout or forbearance, please contact any attorney in Reinhart's [Business Reorganization Practice](#).

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