


Nonprofit Finance Fund & Self Help Credit Union/Venture Fund 

**Managing Delinquency: Commercial and Facilities
(or How to Make the Best out of a Bad Situation)**


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Agenda 



- Early Warning Signs
- Due Diligence and Evaluation
- Objectives
- Options and Strategies
- Considerations
- Timelines
- Questions and Answers

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Early Warning Signs 

(refer to handout)



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Due Diligence and Evaluation  

Loan Documentation

- Review all loan documents:
 - Are they fully executed with original signatures?
 - Are security interests perfected?
 - Is the Mortgage/Deed of Trust recorded?
 - What are the defined events of default?
 - Aside from non payment what other events of default are described in the loan documents?
 - What are the remedies available?
 - What are the notice provisions?

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Due Diligence and Evaluation  

Loan Documents: Events of Default

Loan (& Security) Agreement:

- Note the difference between events of default with a "grace period" (i.e. time that the Borrower can cure vs. the events of default without a "grace period"
 - Borrower fails to maintain insurance
 - Borrower fails to provide notice of management change
- The events without a grace period are those which lender wants the right to immediately accelerate the loan as these events affect the Borrower's ability to repay the loans
 - Borrower fails to repay the debt,
 - Borrower files for bankruptcy protection or becomes insolvent
 - Borrower defaults on other debt and/or the other debt is accelerated
- The events negatively affect lender's credit risk
 - Failure of collateral to be valid and/or lien perfected
 - Sale of the collateral
 - Proceeding against the collateral

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Due Diligence and Evaluation  


Loan Documents: Events of Default (cont.)

Mortgage or Deed of Trust:

- Any default under the Note, Loan Agreement, Loan Documents
- Failure to perform covenants in Mortgage
- Failure to discharge judgment greater than defined amount/days
- Filing for appointment of receiver or bankruptcy protection
- Filing of judgment against Mortgagor or property

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**Due Diligence and Evaluation
Loan Documents: Remedies**



Loan & Security Agreement:


- Increase the interest rate by the default rate
- Collect on the collateral
- Sell the collateral and collect the proceeds

Mortgage or Deed of Trust:

- Take possession of the property
- Collect rents and lease property
- Institute an action of foreclosure
- Apply to court for appointment of Receiver

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**Due Diligence and Evaluation
(cont.)**




Lien & Litigation status

- Obtain updated lien, judgment, litigation searches
 - Taxes outstanding incl. payroll, real estate
 - Liens on record
 - Are your liens on record? Were continuations filed?
 - Has the IRS filed any liens for unpaid taxes?
 - Has the state filed any liens for unpaid taxes?
 - Has the municipality or city filed liens for taxes or assessments?
 - What other creditors have filed liens?
 - What are the priorities?
 - Have any mechanics liens been filed?
 - Are assessments outstanding (eg. water and sewer)

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**Due Diligence and Evaluation
(cont.)**



Other Creditors

- What are the rights, priorities, notice requirements defined in the Inter-creditor agreement? Subordination agreement? Participation agreement?
- Who are the other creditors?
- What are the lien and payment priorities?

Leases

- Is there a current lease or rent roll available?
- Is borrower current on lease payments?
- If elect to replace the tenant, what is the market rent? Can tenant be replaced at a rate greater than what is due to landlord under lease?

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Due Diligence and Evaluation (cont.)

Collateral

- Quality & Condition
 - When was the collateral last inspected?
 - What is the physical condition of the property?
- Net realizable value
 - Is there a recent collateral valuation and what was the value indicated?
 - What is the net realizable value after all collection, legal, and carrying costs?
- Market
 - How long will it take to market and sell the property?
- Environmental
 - What is the environmental condition of the property?
 - Is there a recent Phase 1 and possibly Phase 2 environmental assessments?

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Due Diligence and Evaluation (cont.)

Correspondence & Notices

- What representations have been made by borrower? By lender?

Insurance

- What is the expiration of coverage?
- What are the amounts of coverage?
- Is lender reflected as Mortgage Loss Payee
- Are the coverage types appropriate: Liability, Hazard, Business interruption, Builders Risk

Guarantees

- Is the guaranty limited?
- What type of guaranty? Payment or collection?
- Is current financial information available on the guarantor?


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Objectives

Exit or Retain?

- Minimize loss
- Stabilize credit – prevent non-performing loan
- Reduce exposure
- Maximize recovery
- Maintain relationship

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Options and Strategies 


Restructure:

- Defines and documents amendments of terms of the note, loan agreement, and security agreements.
- Success is dependant on viability of borrower plan and reliability of source of repayment.

Forbearance:

- Defines and documents the terms by which the lender will forbear from exercising its remedies for a specific period of time.
- Lender should seek improvements (position, terms, payments) in consideration.
- Does not waive or cure the default.
- Generally short term


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Options and Strategies (cont.) 

Modification:

- Defines and documents amendments to the terms of the note and loan agreement.
- Generally less formal than a Forbearance and is sometimes documented by a letter agreement.
- Generally long term

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Options and Strategies (cont.) 



Alternate Financing/Settlement :

- Borrower pursues financing or funding to satisfy debt
- Viability is dependant on borrower credit worthiness, economic and credit environment
- Incentives may be necessary (positive or negative)

Sale of the loan:

- Success is dependant on investor demand
- Net realizable value is dependant on price investor willing to pay and costs
- Deep discount may be necessary. Factors include economic environment and quality of loan



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Options and Strategies (cont.)  

Foreclosure:

- Secured creditor requires the sale of the property to satisfy amounts due.
- Judicial foreclosure is accomplished by suit for foreclosure against the borrower to force the sale of the property; state specific laws may require this in order to obtain deficiency judgment if the sale is insufficient to cover the amounts due.
- Mortgage vs Deed of Trust: Mortgage is between two parties, borrower and lender. Deed of Trust has three parties; borrower (trustor), lender (beneficiary) and a neutral party in whom title is vested (trustee).

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Options and Strategies (cont.)  

Remedies under UCC Article 9

Collection of A/R

- Payment of accounts receivable directly to lender
- Requires direct notification of security interest and invoicing for amounts due to borrower to be paid directly to lender
- Requires accurate schedule of account debtors and amounts owed to borrower
- Payment of receivables attributable to contract performance may be challenged

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Options and Strategies (cont.)  


Liquidation of inventory, other security

- Confirm net realizable value of collateral is sufficient to satisfy the debt
- Disposition means must be "commercially reasonable"
- Other liens may have priority
- Accessing collateral on-site may trigger environmental liability

Set-off of cash balances

- Some funds may be disallowed if account includes certain forms of payment (Social Security, Medicare, veteran's benefits)
- Some states limit creditor to "one form of action"; confirm balances are sufficient to satisfy the debt

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Considerations 


Management

- What is the character of the borrower? Is the management honest? cooperative? committed to honor its obligations?
- What is the quality of the financial recordkeeping and presentation?
- Can the management team execute on its plans successfully?

Viability

- If repayment is reliant on turnaround plan, is the plan viable?
- Is there an identifiable, reliable repayment source?

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Considerations (cont.) 

Timing

Turnaround:

- How long will it take management to turn things around?


Litigation:

- Can vary based on state laws
- Borrower may file affirmative defenses against lender (discussed later in Lender Liability section)
- State laws may require Borrower's right to redemption

Marketing & demand

- Market conditions can extend the holding period
- Is there demand for this type of property or collateral?
- What is the length of time willing to hold? What is impact to net realizable value if forced liquidation?


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Considerations (cont.) 

Creditors

- Is the Borrower in default on other loans?
- What are other creditors' strategies?
- Are they willing to join forces or are they adversarial?
- Is there a potential that other lenders actions will force a bankruptcy?
- What is probability other lenders will file for involuntary bankruptcy?


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Considerations (cont.) 

Monetary costs

- Litigation
 - Can vary based on state laws, counsel, borrower defenses
- Expenses to protect, repairs, utilities, security
 - Are there hazards which must be enclosed to protect the public and avoid liability?
 - Do we need to erect fences or hire on-site security to restrict trespassing?
 - Should additional insurance coverage be purchased?
- Taxes
 - What are the outstanding real estate taxes and tax liens? Do these need to be satisfied to obtain unencumbered title?


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Considerations (cont.) 

Monetary costs (cont.)

- Environmental
 - What is the cost associated with Phase 1 and possibly Phase 2 environmental assessments?
 - What is the potential cost of remediation?
 - Are there state laws that provide for damages?
- Marketing - lease &/or sale
 - What are the broker fees?
 - Is a property manager necessary?
 - What are the holding costs for the collateral while marketed?

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Considerations (cont.) 

Reputational risks

- Any internal and external relationships that should be consulted or advised? What will be the impact to reputation in community?



State & Federal statutes

- One Form of Action: some states limit creditor to one legal action

Dedicated staff

- Is there experienced staff available?
- Is there staff committed to workout responsibilities, separate from the lending staff?



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Considerations: Lender Liability  

Lender Liability

- Lender liability law says lenders must treat their borrowers fairly, and when they don't, they can be subject to borrower litigation under a variety of legal claims
- Non profit lenders that provide technical assistance and financial or management advice to borrowers may leave their organizations open to such claims in an adversarial collection process



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Considerations: Lender Liability (cont.)  

Affirmative Defenses or Liability Claims by Borrowers

- Breach of Contract or Implied Covenant
 - Based on unfulfilled written or verbal promises
 - Failing to fund under the terms of the agreement
 - Refusing to advance new loans or credit extensions after promising to do so
 - Foreclosing on a borrowers assets without proper procedure and notification.
- Interference or Duress
 - Lenders influencing a Borrower's relationships (other lenders, vendors, etc.)
 - Lenders providing business or financial advice that is considered to be self serving

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Considerations: Lender Liability (cont.)  

Affirmative Defenses or Liability Claims by Borrowers (cont.)

- Estoppel Based on Prior Pattern
 - Accepting partial payments and extending cure periods, extending maturities, allowing covenant violations
- Disproportionate Harshness
 - Absence of good faith and fair dealing
- Fraud
 - Borrower may feel deceived

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Considerations: Lender Liability (cont.)

Lender Liability Risk Mitigation

- Review loan files to determine available remedies and legal path
- Document all collection efforts
- Find experienced staff or provide training
- Make no sudden moves
- Be cautious about post-default TA (Don't continue business as usual)
- Do not discuss the borrower's credit history with 3rd parties
- Seek legal advice

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Timelines

Restructure scenario

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    graph TD
      A[Borrower defaults] --> B[Lender issues Default letter]
      B --> C[Borrower & Lender agree to restructure]
      C --> D[Restructure closes]
      D --> E[Borrower repays Loan]
  
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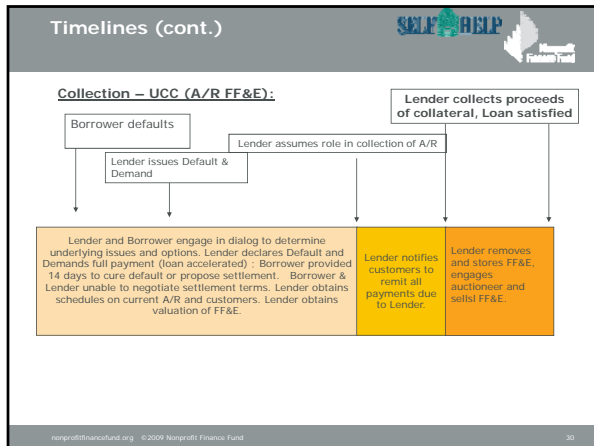
Timelines (cont.)

Litigation scenario

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    graph TD
      A[Borrower defaults] --> B[Lender issues Default & Demand]
      B --> C[Lender files claim]
      C --> D[Court awards judgment]
      D --> E[Sheriff advertises sale]
      E --> F[Sheriff sale held, Loan satisfied]
  
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Thank you.

To learn more about NFF, visit us at nonprofitfinancefund.org

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A. Financial:

- Deteriorating liquidity
- Cash flow problems
- Deteriorating trend in accounts payable (stretched payables)
- Deteriorating trend in accounts receivable
- Accelerated growth or decline in revenues
- Non-payment of taxes (eg. payroll, real estate)
- Filing of tax liens, judgments
- Changes in fiscal year end
- Changes in accounting policies
- Increasing bad debt accounts
- Waivers, extensions, restructures by creditors
- Increasing leverage, reliance on debt
- Overdrafts and uncollected fees
- Trends contrary to peers
- Increasing concentrations with customers, funders
- Delayed completion of audit
- Aged payables to auditor, accountant
- Deferred salaries to management

B. Industry:

- Changes in funder priorities
- Changes in competition
- Technology shifts
- Economic slowdown



C. Management:

- Change in key management
- Lack of good, regular financial reports
- Lack of transparency
- Barriers to access auditors, funders, creditors
- Change in business plan
- Missing important information
- Delayed reporting
- No management succession plan
- Slow to react to market changes
- Lack of balance between program and fiscal focus
- Deteriorating relationship with funders, community

D. Credit:

- Increasing payment delinquency (frequency and/or days)
- Delayed financial reports
- Overadvances, out of compliance with borrowing base
- Unplanned, offseason, or excessive borrowings
- Loan covenant defaults
- Lease defaults
- Request for deferral of payments, restructure of terms
- Request for waivers

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