

Financial Covenants in Loan Documents

Now More Important Than Ever

We wanted to bring to your attention a very important issue that you should consider as you endeavor to finance or refinance in the future.

Covenant Defaults are Rising. As the financial industry slowly crawls its way out of the meltdown it has experienced over the last few years, our firm has been increasingly called upon to advise our clients on the impact of their failure to comply with financial covenants contained in their loan documents, such as minimum debt service coverage, minimum tangible net worth, limitations on owner distributions and minimum occupancy levels.

Remedies for Covenant Defaults can be Severe. Before the current adverse financial cycle, a breach of a financial covenant would typically be resolved with a simple waiver letter issued by the lender and perhaps payment of a nominal waiver fee. Now, lenders are coming down hard on borrowers and exercising remedies contained in the loan documents to impose severe conditions on borrowers such as loan amount reductions, payment of substantial waiver fees, requests to refinance the loan with another lender, and loan acceleration with demands for immediate full payment. With respect to lines of credit, we have seen financial covenant defaults trigger a non-renewal of an annual line of credit, and reducing the amount of the line or restructuring of the line to reduce availability of funds when tied to a borrowing base.

Review Existing and Proposed Loan Documents with Counsel. In the past many borrowers signed loan documents containing various financial covenants without analyzing or negotiating them and without the benefit of legal counsel. Due to the potentially severe remedies associated with a default of such covenants, however, it is important to carefully review your financial covenants when entering into new loan documents or modifications/extensions of existing loan documents, to make sure that they are drafted properly. Most financial covenants can be negotiated and working with experienced legal counsel will help you avoid problems down the road.



Fiktus@RolfLaw.com
(216) 514-1100 ext. 221

Rick Fiktus, one of the partners in our firm, has over 25 years of experience in bank financing and has assisted our clients with all stages of the financing process.

He regularly represents borrowers in commercial transactions involving new loans, refinancing, modifications and extensions and loan work-out arrangements. Rick is engaged in structuring, negotiating and documenting complex commercial financing transactions, including health-care financing, acquisition financing, subordinated debt financing and inter-creditor issues, asset-based lending, real estate acquisition, development and construction loans, working capital lines of credit, equipment financing, letters of credit, bond financing and floor plan financing.