Distressed debt

How business owners can deal with having their debt sold to a third party **Interviewed by Adam Burroughs**

When a company gets into a position of missing payments on a loan, the loan originator could possibly sell your debt to a third party. Once your commercial loan is sold, the velocity of both money and information becomes critical.

"Don't panic," says Brian R. Forbes, a member with Dykema Gossett PLLC. Instead, he suggests being proactive.

"The more proactive and transparent you are, the more likely the asset manager responsible for your loan will internally advocate options that may allow opportunities for a mutually acceptable restructure," he says.

As a borrower, you have the chance to start your lending relationship over because there is no previous history with your new lender. Forbes says there is a possibility that you can restructure your debt on terms more favorable than offered by your original lender.

Smart Business spoke with Forbes about how to handle your distressed debt after it changes hands.

Brian R. Forbes
Member
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How do you define distressed debt?

Distressed debt would be any debt or credit that has one or more missing payments, either partially or in whole, or is in imminent danger of missing one or more payments without the ability to cure. If you are a borrower who has reached this critical point, there is a possibility your debt will be sold to a third party.

At what point does debt get sold?

Distressed debt can be sold at any given time. The third party that buys debt often has a different objective than the original lender because they are seeking to maximize their investment returns in a shorter time frame. Since the distressed loan frequently is purchased at a discount, an opportunity exists to negotiate terms more favorable to the borrower. The new lender could potentially offer more creative workouts, such as allowing the borrower more time to refinance, extending payments, stretching amortization or allowing a discounted payoff. A new lender is not always negative for the borrower.

How would you know your debt has been sold?

Most loan sale agreements require a borrower be notified immediately upon the closing of the loan sale. The loan buyer will contact the borrower quickly to ensure all payments due under the loan are going to the buyer and not to the seller. If the debt is in distress and there is a default, a workout specialist or asset manager will contact the borrower for updated information. In the best-case scenario, the borrower's financial statements are complete and easily reviewed and verified, which enables the asset manager to quickly assess the situation and recommend a course of action.

The anticipation from an asset manager's perspective is that information flows between parties within a month of closing. If the debt involves real estate, such as an office or apartment building, the asset manager will want to see rent rolls, pro forma financial statements and detailed budgets. The less information the asset manager receives, the more difficulty the asset manager has evaluating the credit and recommending a mutually favorable solution.

What's at risk once it has reached this point?

The velocity of money and information is critical to the third-party debt purchaser. The new lender is making a decision as to whether there is a workable solution between it and the borrower. Many third-party buyers prefer to work quickly to resolve the asset with the borrower in either a full or, if justifiable, discounted payoff. In order to do this, the asset manager needs accurate information quickly to pursue the most cost-efficient action.

The remedies third-party buyers often exercise if they are forced to operate without the requested information include foreclosure, but generally third-party buyers do not want to own the property. Third-party buyers can enforce other remedies under any guarantees of the loan and pursue their rights against the guarantors and the underlying collateral. Third-party buyers will pursue a general workout strategy if it makes sense for both parties.

What should a company do when its commercial loan gets sold to a third party?

If a third-party buyer purchases your debt, anticipate that the new lender will be proactive in exercising its remedies under the loan documents in an effort to resolve the credit and that you should provide the new lender such information required under the loan documents. Remember, many debt buyers contractually respond to investors and lenders in the same manner as the borrower responds to the lender under the loan documents. It is advisable to have your asset manager well informed of your credit and circumstances in order to facilitate the best solution. Without sufficient information, new lenders often immediately exercise remedies.

Be forthcoming. Obtain counsel and with his or her advice gather and give your accounting information to your new lender who can evaluate and understand your credit as quickly.

What are the best-case outcomes once a company has reached this point?

The best scenario is the borrower obtains the opportunity to keep its business going, resolves a current credit that by its size may be limiting opportunities for the borrower, obtains for any guarantor a release from his or her guaranty for consideration, and either purchases the debt or refinances the debt at a price discount that corresponds to the current fair-market value of the asset serving as collateral or the value of the business. Do not panic. Everyone is interested in finding the best solution, which often means the borrower refinancing the debt with another lender.

Should a borrower get counsel involved?

Retain an expert representing borrowers in this context immediately to determine whether restructuring is viable and the best option. Counsel can help structure the best solution given the facts and circumstances of the underlying credit, while identifying and minimizing potential adverse tax consequences. <<

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