Calm Before the Storm

Dealing with Secured Lenders When Times Become Tough

By JUSTIN H. DION, Esq.

Most small businesses are financially cyclical to some extent, with some days, weeks, months, and years better than others. Although good financial planning can lessen the impact of economic downturn, many businesses do experience some level of financial hardship at one time or anther. These times can be especially difficult if the business owner becomes uncertain of his ability to make a monthly payment to a secured lender.

There are ways to deal with cash flow problems as they apply to secured lender obligations. It is important to put them into perspective by way of a time line. Usually the inability to pay is not a sudden surprise discovered on the day a payment is due, but rather foreseeable at least 90 to 120 days in advance. This is generally the most crucial time period and referred to as pre-default.

The biggest mistake small business owners tend to make during the pre-default period is ignoring the imminent financial tidal wave because they unreasonably believe that a miracle correction will set things straight, so they procrastinate. However, if the issue is admitted quickly there are more options available to correct the situation. In addition, pre-default solutions are generally easier to impose and less costly than after the tidal wave hits.

Get Out Your Umbrella: Recognizing and Dealing with the Financial Problem Pre-Default

If projections demonstrate that upcoming payments due to a secured lender may be problematic, it is usually best to contact your loan officer while you are still current, as opposed to waiting for the loan officer to contact you after you are in arrears.

During tough times, it is especially crucial to maintain a strong relationship with your lender, and honesty is the best policy. Discuss the situation, including why you think the problem developed, (i.e., one bad contract that fell through, or a more serious long-term decline in business.)

Be sure to focus on how long you foresee the cash flow problem occurring and your proposal for resolving it. Remember that predicting a speedy recovery will only reduce your credibility down the road if it does not happen.

If you have a positive relationship with your lender, he or she may work with you to help you through your difficult times. For example, a lender may defer or waive interest and fees for a short time to help make your monthly payment more manageable. In addition, depending on your situation, it may even be possible to discuss a short complete payment deferral to allow you to get back on your financial feet. Some lenders may also take the additional step of referring you to a consultant to help analyze your balance sheets and see where and how future improvements can be made.

You must also be honest with yourself. In the most extreme circumstances, if you recognize early on that a financial problem is fatal, it is best to consider the option of selling the business to capture any remaining equity. Alternatively, if a fatal business is left to continue to operate at a loss month after month, by the time the secured lender forecloses and sells the assets, any equity will likely be erased or dramatically reduced.

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The Rain Begins: Dealing with Finan-cial Problems After Minimal Default

If you don't contact the lender pre-default, following a lack of payment for 30-60 days, you will likely hear from him or her. Although a default may technically permit the lender to begin foreclosure, most will send a 'friendly' reminder to make payment followed by a phone call. Although you still have negotiating options, some credibility is lost if the bank is forced to be on the offensive and contact you to address your non-payment. In turn, you will then be put on the defensive, and forced to explain your actions.

In this situation, if the cash flow issue is short term, the lender may still be willing to waive or defer some or all of the payments; however it may be for a shorter time period because you are already in arrears. At this point, a face-to-face meeting with the bank officer is generally recommended, and preparing projections and a future plan to present at the meeting is usually time well spent. Again, as you are now on the defensive, the burden is on you to convince the lender not to foreclose.

You may also want to discuss entering in to a forbearance agreement, whereas the lender agrees to withhold pursuing its foreclosure rights for a short time in exchange for either an immediate payment or some future negotiated payment. At this point, if you fail to uphold your end of the forbearance agreement, most lenders will proceed with foreclosure and may refuse to entertain further negotiations.

As an absolute last resort, if it appears that continued financial demise is imminent, in addition to trying to sell the business (now in an expedited time frame due to the lender's possible foreclosure), you may also propose to voluntarily turn over your business assets and/or deed to the lender in lieu of foreclosure. Oftentimes, this option saves the bank time and money that would normally be spend on foreclosure and may spare you from a deficiency judgment if the assets are sold for less then what is owed.

Batten Down the Hatches: Dealing with Financial Problems After Severe Default

If 90 days have expired without acceptable loan servicing, and no compromise has been reached, then the lender will generally begin the foreclosure process. You'll need to make crucial decisions quickly. If further negotiations with the lender are frivolous, yet you still want to save your business, there are at least three primary post-negotiation options.

First, you may find another lender who is willing to take a risk on your business. Then you may attempt an expedited refinance to pay off the current lender in full, thus terminating the impending foreclosure proceeding. You must be careful not to jump out of the frying pan into the fire though.

Try to obtain offers from multiple lenders to secure the lowest rates and most favorable repayment terms. Because of your circumstances, you may only be able to find lenders who are willing to refinance on less favorable terms, and if your business cannot afford to service the current lender, refinancing with larger monthly payments probably won't help.

As a second option, you may be willing and able to make a cash infusion or personal loan from your own assets. Unfortunately, many business owners have enormous sweat equity invested in their business, which tends to cloud their judgment on business viability. If a cash infusion is merely going to delay the inevitable, it is probably better to resist infusing your personal capital into a sinking ship.

Finally, the last resort to attempt to stop foreclosure is filing Chapter 11 bankruptcy. This will generally stop a foreclosure and allow your business some additional time to put together a plan of reorganization to repay certain debts over time. In most bankruptcy cases, arrangements will be made to provide the lender with some type of continued payments (cash collateral payments) during the pendancy of the Chapter 11, however the terms are often negotiable.

Brighter Days on the Horizon

At the end of the day, owning and running a small business is not easy task, and it becomes much more difficult if cash flow slows down and creditors begin getting nervous. The best advice is to be proactive and honest with secured lenders as soon as a problem is recognized, so payment arrangements can be made.

Procrastination and dishonesty will erode credibility, and ultimately may terminate a chance of obtaining some leeway to get back on your financial feet. In the end, if the storm is on the horizon, smart preparation and quick maneuvering are more likely to keep you afloat and able to sail another day.❖

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