

Key Lender Considerations for Implementing Workout Agreements

Article

Amundsen Davis Banking & Finance Alert

May 18, 2023

With the economy tightening and interest rates continuing to increase to amounts greater than have been seen in the recent past, lenders are facing more requests for assistance from debtors who are unable to repay their loans in accordance with their original terms. Hence, workouts are becoming an evermore important tool for lenders seeking to protect the collectability of their loans.

Workouts are beneficial to lenders because they can help avoid loan defaults and the resulting increases to the loan loss reserves, paying carrying costs on foreclosed collateral, and potential reputational harm. Workouts are beneficial to debtors because they can help a struggling debtor keep its collateral, avoid negative credit reports, and maintain its banking relationships. Nonetheless, at the risk of making a bad situation worse, workouts must be carefully tailored to fit the debtor and its circumstances. Below are a few tips lenders should consider when contemplating entering into a workout agreement with a debtor:

1. Character and Capacity of the Debtor

Lenders should consider whether the debtor is someone who will work to get the loan back on track, or will a workout merely delay the inevitable? Further, lenders should also consider whether the debtor has the capacity to satisfy its obligations under the workout agreement. Hope springs eternal, but more harm than good can come if lenders kick the can down the road if debtors are not right for a workout or cannot satisfy the terms of the workout.

2. Confession of Judgment

The ability to act quickly is important when dealing with a debtor that has multiple unpaid creditors. While confessions of judgment are not allowed in most states (including Indiana), they are allowed in Illinois for loans other than consumer loans. A properly drafted confession of judgment clause may allow a lender to quickly obtain a judgment against a defaulted debtor.

PROFESSIONALS

Michael G. Cortina
Partner

RELATED SERVICES

Banking & Finance

3. Waiver of Exemptions

State and federal law contain exemptions to attachment that allow debtors to shield portions of their assets. Many such exemptions, such as a homestead exemption for example, can be waived. Lenders should consider including waivers of such exemptions in workout agreements so that they are able to legally pursue those assets should the debtor default.

Takeaways: With the economy tightening and interest rates continuing to increase, lenders need to be prepared to act quickly to protect the collectability of their loans. Workout agreements can be beneficial to lenders and borrowers alike but, to be the most beneficial, must be used in the proper situations and must be carefully drafted to protect the lender's interest. A default in a workout agreement should allow a lender to act with alacrity so as to be able to win the race to the courthouse should other creditors be involved.

These are important considerations when determining the benefits of entering a workout agreement. Any of these considerations can be discussed with trusted counsel when determining the right course of action for your organization.

Key Lender Considerations for Implementing Workout Agreements