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Alert

Private Credit Lender Considerations for Effect of COVID-19 Pandemic on Existing Financing Facilities

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The COVID-19 pandemic and the uncertainty around its scope and duration is having a negative impact on the economy, the capital markets and many businesses, including those that are borrowers under financing facilities. Lenders under such financing facilities are now faced with questions with respect to, among other things, honoring borrowing requests for revolving loans and delayed draw term loans without any clear anticipated use by the borrowers for the proceeds of such loans and the effect that the COVID-19 pandemic may have on financial covenant calculations under such financing facilities. Most often, the answers to those questions will require a careful review of the specific provisions of the loan documents. We explore these and other related issues below.

Conditions Precedent to Borrowings

As borrowers request to draw under existing available credit commitments in the form of revolving loans or delayed draw term loans, lenders should pay close attention to whether the conditions to borrowing (including notice requirements and bring-downs of the representations and warranties) have been satisfied.

Absence of a Default or an Event of Default

Borrowers are typically required to represent that no default or event of default has occurred and is continuing in connection with its borrowing request. Lenders should review the loan documents carefully to determine whether any default or event of default has occurred and is continuing.

Specific attention should be paid to (i) reporting requirements with respect to changes in the borrower's material contracts, litigation matters and defaults and (ii) cross-defaults with other agreements of the borrower.

The insolvency default provisions of the loan documents should be reviewed as such provisions are generally not limited to actual bankruptcy proceedings and may also include as an event of default the borrower generally not paying its debts as such debts become due or admitting in writing its inability to pay its debts generally. In addition, default provisions with respect to the borrower being restrained or enjoined from conducting business should be carefully examined.

Other provisions of the loan documents (including use of proceeds and anti-cash hoarding provisions) may be relevant and should also be reviewed.

No Material Adverse Change or Material Adverse Effect

Most loan documents contain a representation and warranty that there have been no events or circumstances having a material adverse effect on the assets, business or financial condition of the borrower or the loan parties since a specified date. MAC provisions are highly negotiated and the specific language of the MAC provision and the relevant facts will determine whether a MAC has occurred. The fact specific nature of such analysis makes it challenging for lenders to rely solely on the occurrence of a MAC that may be caused by the COVID-19 pandemic to refuse a borrowing request.

Effect on Financial Covenant Calculations

The COVID-19 pandemic may impact financial covenant calculations under financing facilities to the extent that the calculation of EBITDA includes add-backs to net income (or loss) for unusual, non-recurring or extraordinary items or the actual or prospective receipt of proceeds of business interruption insurance. Since financial covenants are typically lagging, the impact (and relevance) of these add-backs will not be immediate.

Unusual, Non-Recurring and Extraordinary Items

Losses, costs and expenses arising from the impact of the COVID-19 pandemic on a borrower's business may be permitted to be added back to the borrower's net income (or loss) to the extent that the EBITDA definition in the borrower's financing facility contains an add-back for unusual, non-recurring or extraordinary items (which term is not defined under GAAP). The magnitude of this add-back would depend on whether this add-back is capped (often by dollar amount or percentage of EBITDA).

Business Interruption Insurance

If the loan documents contain an add-back for proceeds of business interruption insurance, the actual or prospective receipt of proceeds of business interruption insurance by the borrower in connection with any business disruption caused by the COVID-19 pandemic may be permitted to be added back to the borrower's net income (or loss). The magnitude of this add-back would depend on whether this add-back is capped (by dollar amount, percentage of EBITDA or number of months or periods permitted), whether the add back is permitted on a prospective basis, and whether the insurance proceeds must be received within the same four fiscal quarter period as the underlying loss with respect to which it is paid.

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