How to Ride High on the Loan-Modification Wave

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The success of a borrower's proposal for a loan waiver or amendment will depend on how easy it is for the lender to say yes.
By Meg Waters

As companies of all shapes and sizes face the prospect of **challenges with loan covenants** in the wake of the **Covid-19** pandemic, many are considering requesting waivers or amendments from their lenders. Last week, we had a conversation with Reuben Daniels, founder and CEO of **loan arranger** EA Markets, about the **loan modifications companies are likely to request** and the concessions their lenders will probably expect in order to offer that relief.

Today, in the final installment in this series, we are talking to Daniels about the approach and tone companies should take in presenting their loan-modification proposal to lenders, as well as the process they should use to guide development of their presentation.

Meg Waters: ***Last time****, we were discussing the different types of loan modifications a company might ask for in this climate, as well as the concessions their lenders might require. Developing a waiver or amendment proposal is complex, isn't it?*

Reuben Daniels: You may think, 'It's a bank waiver; how hard could it be?' And truthfully, it doesn't have to be hard, but it does require careful consideration from a number of angles. If you think about the drivers of all the involved parties—what motivates each of them—there is a lot of depth to that. And understanding those motivations determines your optimal path. You might approach the process differently if your lender is JPMorgan than if it's a local business development corporation.

MW: *Why?*

RD: Well, you need to know your lenders and understand how they think about their own position. For the global money-center banks, the market seems confident, even in this environment, that they will have sufficient liquidity and financial strength to honor any bank draw commitments they have made. Those institutions' focus is going to be on moving volume through the system, because they have an enormous number and variety of clients to manage. That means the modification requests that don't require too much effort, too much negotiation, are the most likely to be successful. Additional ancillary relationship and transaction activity will also be really important to them.

The non-bank direct lenders generally have fewer sources of funding, so I'd be more inclined to draw on credit revolvers with non-bank lenders. At the same time, a non-bank lender may be more likely to lend me additional money to protect its existing loan. In working with a non-bank lender, I would focus on the aligned objective of making sure my business survives this crisis. The non-bank lender can typically be more creative and flexible than a traditional lender, but it's also likely to want more direct economic concessions from me.

Practically speaking, the traditional lenders can resemble an assembly line, in that they need to push as much volume as possible through the system. They can't afford to spend a lot of time finding the perfect solution for every company that crosses their desk.

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MW: *So, as a borrower puts together its proposal for loan modifications, it should consider the resources the bank will have to dedicate to evaluating and enacting the proposal?*

RD: **With the tsunami of modification requests that I see on the horizon**, resource efficiency is going to be a huge issue, across the board.

Consider a company that goes to its bank asking to remove the leverage test for a period of time. Before the bank agrees to that change, it will want to make sure that removing the leverage test won't create an undue amount of risk. In normal times, lenders can dedicate adequate attention to this process. But right now, all of a sudden, lenders are going to be evaluating these issues for hundreds—maybe thousands—of borrowers in a very compressed period of time. If every company from GM to a $100 million manufacturer is going to need a loan modification this quarter, that will place an enormous strain on the system.

If you approach your bank with a very simple waiver, where **the combination of risks and rewards is right for the bank**, your use of proceeds is right, and you're sharing the burden—all the things we talked about in our last conversation—*and* the lender can get it done quickly and efficiently, then that waiver has a significantly higher probability of success. In contrast, if you go in wanting a laundry list of every modification you can think of to benefit your business, and you're not suggesting any concessions that you might make, and a huge amount of resources will be required to reach an agreement, then your odds of success will be considerably lower.

MW: *The simpler requests are most likely to get approved?*

RD: I would say the simpler requests, with a clear path to success, are the most likely to be approved. The transactions that come to the lender with a bow on them are going to be easier to process. And few lenders over the next quarter or two are going to have the appetite for multiple rounds of negotiations to figure out what's in the realm of the possible.

There will certainly be a high volume of requests in the near future for complicated amendments and for more coercive amend-and-extend transactions as well. These are more comprehensive than waivers, and they are more time-intensive for both borrowers and lenders. That means they may be more contentious to get done today, considering lenders' strained resources, than in the past.

Borrowers will need to make a risk assessment before pursuing any particular strategy, and resource efficiency should be part of that assessment.

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MW: *In addition to considering resource efficiency, can the borrower increase its chance of success by adjusting the tone with which it approaches the lender?*

RD: Absolutely. If you go to your bank with a well-reasoned, thoughtful proposal for a loan modification, you are more likely to have a lender that is responsive than if you go to them with something totally unreasonable that will leave the lender saying, 'OK, obviously, I'm going to have to protect my interests first.'

You see this in real estate right now. Some commercial tenants are going to their landlord and saying, 'I can't pay you, and I'm not going to pay you.' Well, that probably gets a different response than a tenant that approaches its landlord saying, 'Our business is not able to operate during the shutdown, so we will not have any income this month. Can we take this month's rent and append it to the end of the lease, in order to manage the cash flow crunch until

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we can open again?' Those are two very different paths.

We always want to get the best outcome for our clients, and sometimes being aggressive is the right path, but the reality is that sometimes the best result is achieved by quickly getting to the right solution for the given circumstances. Right now, people's patience is thin, resources are spread thin, and banks' capital is thin. It is more important than ever to find solutions that don't antagonize the other side.

MW: *How should the treasury person who needs a waiver decide how hard to push?*

RD: As we discussed last time, it all goes back not just to the **modifications and concessions being offered**, but to what motivations are driving the lender. You need to understand what type of proposal the lender will see as protecting its interests.

You should start the process of developing a proposal by articulating what you, as the borrower, want to get. What is the relief you're looking for? And then determine what concessions you are willing to suggest that might be meaningful for the banks but less difficult for you. So, internally assess what you're asking for and what you're prepared to give. (See the sidebar **7 Workstreams for Loan Modifications**.)

Then, you also need to be aware of what's happening in the marketplace. Understanding what lenders are prepared to do—and have recently done for other companies—is an important input in figuring out what your proposal should be. Once you have those comparables, you can apply them to your own set of desired modifications and concessions.

MW: *Where can a company see what others have done?*

RD: That can actually be really challenging because a lot of loan transactions are privately negotiated. Sometimes there are public disclosures through filings or press releases, but many private companies don't need to disclose loan modification details.

Still, you can find lawyers and advisers who are involved in the market and have the experience and information about what loan modifications have been happening. Banks can be data sources, as well. It's often a good idea to ask your banks what waivers or amendments they're seeing in the market, and to use that feedback to understand what comparable businesses are doing.

MW: *Once companies have figured out what they will ask for and what they will offer, and have seen what the comps are doing, then what?*

RD: The third step is to look at how you can package the proposal in an easily digestible fashion. What I mean by that is: Have your financial model prepared. Have the ask, in conjunction with the concessions, organized and described in a straightforward way. An effective proposal often has a cadence like this:

'Here's the change that I am requesting. Here is my financial forecast, which incorporates several recovery scenarios. Here's the use of proceeds and the concession I'm prepared to make. Here's a description of the additional business that I expect to bring to you if you agree to this. And, by the way, here are three other companies for whom you've made a similar modification in the past three weeks.'

That's the kind of preparation that should get you through the queue to a successful outcome more quickly.

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MW: *I can see how this proposal would fit what you mentioned earlier—the transactions that come to the* *lender with a bow on them, making them easy for lenders to say 'yes' to if the risk/reward ratio is right.*

RD: Another approach that borrowers might be able to use to their advantage is to create a competitive dynamic by expanding the lender group. If you propose adding a new lender to a loan facility, that suggestion might help change the dynamic and the motivation of your existing lender.

If you say, 'Hey, I'm working on a loan modification right now, and one of your big competitors has come to us and asked to join the facility. We're thinking of engaging them in a conversation,' your lender's reaction might be: 'Oh, I don't want that bank around. Let me go back to my credit committee and see what I can get done on this loan modification.' Conversely, the lender's reaction might be, 'Oh, that would be great because that new lender might reduce my current exposure and help get this loan modification approved.'

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Either way, this all goes back to tapping into the lender's underlying motivations and objectives.

MW: *Are there any other lender motivations that a borrower should consider in developing a plan for presenting a loan-modification request?*

RD: There are many others. One I've noticed recently is that some bankers love to be the hero. That's not how they would put it, of course. But there are some lenders that avoid being involved in lending facilities during normal times—but, when there's a crisis, they'll show up and say, 'We'll put our money to work now because you really need us.' It's always helpful to find the lenders that want to be the hero.

We are each facing all types of challenges in this environment, and I am concerned that this impending wave of loan waivers and amendments is a lot more serious than some treasury teams and their lenders might be expecting. Nearly every company will need to grapple with this issue, and the loan markets just aren't built to handle it. The competition that results—for time, capital, and human resources—could truly be overwhelming for borrowers, lenders, and private equity sponsors.

For everyone affected by the tsunami, the key to managing the unprecedented volume of loan modifications will be to follow a methodology that can be applied repeatedly and effectively. Hopefully, adopting an efficient process will enable us all to successfully ride this wave together.

Reuben Daniels is founder and Managing Partner of EA Markets. He leads the firm's client service activities in addition to his business development and day-to-day management responsibilities. Prior to EA, Reuben served as Co-Head of U.S. Investment Banking with Barclays Capital, Managing Director with Deutsche Bank, Head of U.S. Corporate Swaps Marketing with J.P. Morgan, and he began his career as a senior consultant with Price Waterhouse. **reuben.daniels@eamarkets.com**

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