SQUIRE PATTON BOGGS

How Could COVID-19 Contaminate Your Financing Arrangements?

Introduction

Australian businesses are facing unprecedented challenges as the consequences of the coronavirus disease 2019 (COVID-19) pandemic unfold. At this difficult time, it is critical to take measures to ensure that your business has sufficient working capital for at least three to six months and the risk of being required to repay or restructure your existing financing arrangements is mitigated to the maximum extent possible.

Australian borrowers should be actively reviewing their existing financing arrangements to assess the existing and potential impact of COVID-19.

In general, we suggest that appropriate communication, transparency and good faith discussions with your lenders should assist in gaining their support through the current crisis.

Liquidity Considerations

Solutions for liquidity concerns include utilisation of undrawn credit facilities and/or deferral of loan repayments if possible.

Utilisation of Undrawn Credit Facilities

While it is generally expected that banks should try to meet their existing commitments to support customers, their willingness to do so may soon be constrained. Accordingly, it is advisable that you assess the business' funding needs and determine if any headroom in your existing credit facilities should be utilised as soon as possible, well ahead of a credit crunch.

The current economic downturn may have a material adverse effect (MAE) on your business and financial condition, which is of itself likely to be an event of default under most credit facilities. Such MAE event of default or any other default or potential default, could technically be relied on by the lender as a draw-stop to any additional funding. The definition of MAE in your credit facility agreement should be reviewed and consideration to whether any other default or potential default has occurred or is expected to occur during this crisis. At this stage, we anticipate that lenders will be less likely to excuse themselves for not providing funding on the basis of the MAE event of default. However, when faced with credit constraints, they may legally do so.

If the term of your credit facility will expire soon, you should approach lenders to discuss an extension or a refinancing plan without delay.

Deferral of Loan Repayments

Deferring loan repayments would help alleviate liquidity shortages. You should engage in commercial discussions with your lenders to seek their support by allowing for interest to be capitalised and principal amortisations to be suspended during the COVID-19 pandemic.

Australian banks have agreed to defer loan repayments for small businesses affected by COVID-19 for six months. You should consider if your business is eligible for this relief and make an application quickly.

In addition, commercial landlords with total business loan facilities of up to AU$10 million (up from the AU$3 million small business threshold) will now be able to defer repayments for loans attached to their business for six months. Where the AU$10 million threshold is exceeded, the relief may be available on a case-by-case basis. A key condition of the relief is that the landlord provides an undertaking to the bank not to terminate leases or evict current tenants for rent arrears as a result of COVID-19.

Mitigation of Default and Forced Debt Restructuring Risks

While we anticipate that lenders will act sensibly with a view to supporting businesses through the COVID-19 crisis, we recommend that a thorough review of your finance agreements be undertaken to determine what should be done to mitigate the risk of defaults or being required to restructure your financing arrangements. We would be pleased to assist your business in this regard.

We have set out below high-level examples of some areas within finance agreements, which may be relevant in the current context.

Financial Covenants and Other Default Triggers

COVID-19 may impact your business or assets to such an extent that your financial covenants may be breached under your financing terms.

It is advisable that you conduct a stress test on such financial covenants to determine how likely, and when, they may be breached. An early discussion with your lender may be required to relax or suspend compliance with certain financial covenants. Alternatively, you may consider injecting additional equity or raising intra-group debt to pre-empt or cure a financial covenant breach.

A likely breach of a financial covenant may constitute a potential event of default, which needs to be notified to the lender (as discussed below). It may prevent further facility drawdowns.

Certain other defaults may have been, or are likely to be, triggered by the current crisis. For example:

- A default or termination event has occurred under a material contract for your business
- An actual or threatened cessation or suspension of a material part of your business
- An MAE on your business, assets or financial condition (however, based on the experience during the GFC, we expect that lenders will be reluctant to rely solely on this event of default)

Restrictions on Responses to COVID-19

Certain steps proposed to be taken as a business response to COVID-19, such as the standing down of employees, may be subject to restrictions under the terms of your financing arrangements and, thus, may require the lender's prior consent.

Notification and Waiver

Most credit facilities require notification of a default or potential default to the lenders. The terms of this obligation should be reviewed to determine when such notification is required. It should be noted that a breach of the notification obligation could itself result in an event of default.

It is advisable that the representations, undertakings and events of default in credit facility agreements be reviewed to assess your ongoing compliance and identify defaults or potential defaults.

An early approach to the lender with a remedial action plan or waiver request would assist in mitigating the risk of seeing unfavourable actions taken by the lender.

How We Can Help

Our experienced banking and finance team would be pleased to assist you in reviewing your financing arrangements and navigating through some of the issues discussed above.

Please also contact us if you need other assistance in relation to your existing or future financing arrangements.

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