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Putting Capital To Work

COVER STORY

Assessing The Bankruptcy Environment

THE EXPERTS WEIGH IN

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SHAPING THE FUTURE

Planning for an Evolving World

One year into the global health crisis, we can see how the effects of the pandemic will have an enduring impact on the way we do business. According to a McKinsey Global Survey of executives, companies have accelerated the digitization of their customer and supply-chain interactions and of their internal operations by three to four years. Executives also indicated that the share of digital or digitally-enabled products in their portfolios has accelerated by a staggering seven years. And social changes brought on by work at home environments will be long-lasting. This is true for SFNet as well.

As I write this, in late February, we are seeing early signs of light at the end of the tunnel. Although the vaccine rollout has had its stumbling blocks, predictions for increased deliveries and falling hospitalizations are encouraging. Looking beyond the crisis, our role is to help you lead the change in this new world — and provide the resources to help you adapt.

Like many of our retail borrowers, our association's future will involve an omni-channel engagement model that includes a combination of in-person meetings, on-demand accessibility and real-time virtual programming. We have been deploying this new model since the start of the crisis with very positive results. Our Crucial Conversation Webinars and live online meetings using SFNet Connect have been a resounding success. And SFNet's Member Forums that kicked off in February have been a big hit with several hundred participating in these free exchanges.

All told, thousands of members of our community have been able to engage in ways not previously available. Net promoter scores, a key measure of satisfaction and loyalty, are higher than ever according to our recent member survey. You rated SFNet's response to the pandemic and our relevance as materially better than other trade associations with whom you interact. You asked us to keep doing more — and we will.

As SFNet continues to do our part to shape our future, our chapters will lead the way in holding safe, in-person gatherings. And we expect to introduce our first in-person/virtual national event by late summer/early fall. These hybrid events will be part of our DNA going forward, increasing accessibility and saving our community time and money.

In the short term, as the economic fallout from COVID-19 continues, this is our first TSL issue focused on bankruptcy. According to data from Epiq, commercial Chapter 11 filings grew year-over-year, up 29% in 2020 compared to 2019. On page 16, Myra Thomas speaks with bankruptcy experts about assessing the bankruptcy environment in this dynamic economic landscape.

On page 20, David Morse and Dan Fiorillo of Otterbourg, discuss how 2020 brought a significant shift in the role of the asset-based lender in the larger bankruptcies that occurred, posing real challenges for lenders in figuring out how to protect their position and enhance the likelihood of a successful outcome.

In *Aftershocks Coming? Anticipating Borrower Defaults and Defenses When Stimulus Ends* on page 26, partners from Parker Hudson Rainer &

Dobbs discuss how lender enforcement activity will increase once the government's pandemic intervention, including bank regulatory easing, ends.

In *How Financial Advisors Can Facilitate the Best Possible Outcomes in a Bankruptcy* on page 40, Clear Thinking Group's Pat Diercks discusses how partnering with a financial advisor can protect lenders' interests.

Partners from Waller's bankruptcy group warn of a possible new line of storms for secured lenders active in the healthcare space — especially lenders working with healthcare companies that have received COVID-19 relief funds from the government or depend heavily on Medicare reimbursement. Turn to page 42 for *The Government's COVID-19 Relief Programs Create New Challenges for Healthcare*.

Looking beyond the fallout, as we seek new channels of growth, on page 30 Armstrong Teasdale partners provide lenders with up-to-date information on the complexities of lending to the legalized marijuana industry. Perhaps the most frequently-asked question by growth-oriented lenders is "How and when can we lend into the rapidly growing and already major industry of legalized marijuana?" The answer is: "It is not so simple."

Throughout this tumultuous year, the secured finance industry has stepped up and continued doing what it has always done, delivering much-needed capital to businesses. The world is evolving, as are expectations for how we work and engage. I look forward to joining with you in helping to shape our future.

Warmest regards,

Rich Gumbrecht
CEO, Secured Finance Network



■ **RICHARD D. GUMBRECHT**
SFNet Chief Executive Officer

COVER STORY

ASSESSING THE BANKRUPTCY ENVIRONMENT: THE EXPERTS WEIGH IN P.16



Assessing The Bankruptcy Environment: The Experts Weigh In

A changing and unpredictable economic landscape is never a welcomed environment for secured lenders or their borrowers. However, more than a year into the COVID-19 pandemic, worries about a wave of business liquidations have not yet materialized as some might have feared. **16**

BY MYRA THOMAS

FEATURE STORIES

What Happened in 2020? The New Paradigm for Asset-Based Lenders in a Chapter 11 Case and What Should (Can) They Do About It?

To say a lot happened in 2020 doesn't to begin to capture what the year brought. **20**

BY DAVID W. MORSE, ESQ. AND DANIEL F. FIORILLO, ESQ.

Aftershocks Coming? Anticipating Borrower Defaults and Defenses When Stimulus Ends

When the world turned upside-down a year ago, many predicted that the severity of the damage to the U.S. economy would usher in a period of borrower defaults, business failures and bank foreclosures. **26**

BY BRYAN E. BATES AND ERIC W. ANDERSON

Is Cannabis Lending In Your Future?

Armstrong Teasdale partners provide lenders with up-to-date information on the complexities of lending to the legalized marijuana industry. **30**

BY JEFFREY A. WURST AND PAUL J. CAMBRIDGE



FEATURED STORY

WHAT HAPPENED IN 2020? P20



FEATURED STORY

IS CANNABIS LENDING IN YOUR FUTURE? P30

The Best of Both Worlds: How Community Banks and Asset-Based Lenders Partner to Serve SMEs

Community banks play a vital role in enabling local businesses and communities to thrive. By either offering asset-based lending as part of their product offerings or partnering with a nonbank asset-based lender, community banks can offer the best of both worlds to small and mid-sized businesses. The Secured Finance Network interviewed several of its members who shared their experiences and perspectives. **34**

BY MICHELE OCEJO

Articles BANKRUPTCY INSIGHTS

How Financial Advisors Can Facilitate the Best Possible Outcomes in a Bankruptcy

Despite lenders' best efforts, the bankruptcy of a borrower is faced by most lenders. Learn how partnering with a financial advisor can protect your interests. **40**

BY PAT DIERCKS

LEGAL INSIGHTS

The Government's COVID-19 Relief Programs Create New Challenges for Healthcare Lenders

Lenders have weathered a storm of uncertainty brought on by the global pandemic and the economic damage left in its wake. There could be a new line of storms, however, for secured lenders that are active in the healthcare space – especially lenders working with healthcare companies that have received COVID-19 relief funds from the government or depend heavily on Medicare reimbursement. **42**

BY JOHN TISHLER AND BETH PITMAN

Departments

TOUCHING BASE 1

NETWORK NOTES 4

INDUSTRY DEALS 6

SFNET MEMBER PROFILE

Ready Capital: Partnering with ABL To Benefit Borrowers

Ready Capital enables ABLs to close more transactions, monetize more inquiries and attract more business from their referral networks. **45**

BY MICHELE OCEJO

PUTTING CAPITAL TO WORK

Polaris Pharmacy Services

Siena Healthcare Finance supports financing during COVID-19. **47**

BY JENNIFER SHEASGREEN AND EDWARD KAUFFMAN



An association of professionals putting capital to work

The Secured Finance Network is the trade group for the asset-based lending arms of domestic and foreign commercial banks, small and large independent finance companies, floor plan financing organizations, factoring organizations and financing subsidiaries of major industrial corporations.

The objectives of the Association are to provide, through discussion and publication, a forum for the consideration of inter- and intra-industry ideas and opportunities; to make available current information on legislation and court decisions relating to asset-based financial services; to improve legal and operational procedures employed by the industry; to furnish to the general public information on the function and significance of the industry in the credit structure of the country; to encourage the Association's members, and their personnel, in the performance of their social and community responsibilities; and to promote, through education, the sound development of asset-based financial services.

The opinions and views expressed by *The Secured Lender's* contributing editors and authors are their own and do not necessarily express the magazine's viewpoint or position. Reprinting of any material is prohibited without the express written permission of *The Secured Lender*.

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Chris Szopa Joins 36th Street Capital as Director of Capital Markets and In-House Counsel

36th Street Capital Partners, LLC announced the appointment of **Christopher Szopa** as director of Capital Markets and In-House Counsel. The addition of Szopa increases 36th Street Capital's client service and capital markets capabilities.

Wayne Tentler joins 36th Street Capital as EVP of Sales

36th Street Capital Partners LLC announced the appointment of **Wayne Tentler** as executive vice president of Sales. The addition of Tentler provides 36th Street Capital an opportunity to develop new client relationships while expanding the company's position in the marketplace..

Accord Financial Adds to Leadership Team Strengthening Commitment to Simplify Access to Capital

Accord Financial Corp. announced two new members of the executive leadership. **Barrett Carlson**, senior vice president, Corporate Development, will oversee all aspects of the company's growth, development, and marketing. **Eric Starr**, senior vice president, Program Operations and Risk, is spearheading Accord's strategic and digital transformation.

Armstrong Teasdale Opens in Delaware

Armstrong Teasdale proudly announces its intent to establish a physical presence in Wilmington, DE. This marks the firm's seventh office opening in the past two and a half years. Armstrong Teasdale will initially welcome a team of four partners, with plans to expand in the market. Partners **Shelley A. Kinsella**, **Jonathan M. Sterman**, **Eric M. Sutty** and **Rafael X. Zahraiddin** joined the firm.

Axiom Bank, N.A. Welcomes Vanessa Lopez

Vanessa Lopez was appointed VP, Controller, at Axiom Bank, N.A., a Maitland-based, leading community bank. Lopez brings nearly two decades of experience in accounting and banking to her new role.

CapFlow Funding Hires Tom Harris, Chicago-based Business Development Officer

Based in Chicago, IL, Harris will drive new business efforts in both the Midwest and nationwide. "Tom brings 25 years of commercial finance experience to CapFlow, where he will continue to provide innovative financing solutions to his clients. We are pleased to have Tom join our sales team," said CEO Andrew Coon.

Clear Thinking Group LLC Promotes Brian Allen to Partner

Brian Allen has over 25 years of experience serving in senior finance positions with both public and private companies. As a consultant for the past 13 years, Allen has been engaged by numerous companies in the consumer product, retail, and manufacturing industries to improve financial operations and performance through strategic and financial alternatives.

Clear Thinking Group Awarded Restructuring Advisory Firm of the Year by Finance Monthly

Clear Thinking Group announced that it has been named "Restructuring Advisory Firm of the Year - USA" as part of *Finance Monthly's* 2020 Global Awards. The Global Awards highlight the outstanding work done by financial advisors and organizations at an international level.

Dwight Funding Expands Business Development Team

Dwight Funding is pleased to announce that **Duy Nguyen** has joined the firm as director of Business Development. In this position, Nguyen will be responsible for maintaining and strengthening relationships with bank partners, other finance companies, referral sources and clients directly.

eCapital Corp. Elevates Jaime Gillespie to Chief Human Resources Officer

eCapital Corp., a leading alternative finance provider in North America, announced that it has promoted **Jaime Gillespie** to chief human resources officer. In her new role, Gillespie will oversee employee

engagement, talent management and leadership development, as well as alignment of the company's diverse workforce and establishment of a unified corporate culture.

Fifth Third Completes Acquisition of Hammond Hanlon Camp LLC

Fifth Third Bancorp announced that Fifth Third Acquisition Holdings, LLC has closed on the acquisition of Hammond Hanlon Camp LLC (H2C). Founded in 2011, H2C is a premier strategic advisory and investment banking firm with an emphasis on healthcare organizations, including specialized expertise in the not-for-profit sector.

Geoffrey Hiscock to Join FrontWell Capital Partners as Senior Vice President, Originations

Geoffrey Hiscock joined from Canadian asset-based lender Waygar Capital, where he served as managing director, head of originations. Hiscock, who brings more than 25 years of experience in origination, underwriting and portfolio management to FrontWell, will be based in the firm's Toronto headquarters.

Huntington Bancshares And TCF Financial Corporation Announce Merger to Create Top 10 U.S. Regional Bank

Huntington Bancshares Incorporated, the parent company of The Huntington National Bank, and TCF Financial Corporation, the parent company of TCF National Bank, announced the signing of a definitive agreement under which the companies will combine in an all-stock merger with a total market value of approximately \$22 billion to create a top 10 U.S. regional bank with dual headquarters in Detroit, MI, and Columbus, OH.

JPMorgan Names James Roddy to Run Corporate Client Banking

JPMorgan Chase & Co. named **James Roddy** as global head of corporate client banking and specialized industries in its commercial banking unit. Roddy was previously co-head of diversified industries investment banking and will report to Doug Petno, chief executive officer of JPMorgan's commercial bank.

Albert M. Schenck Joins KeyBank's Commercial Banking Team

KeyBank continues to grow Commercial Banking resources in its Connecticut and Massachusetts market with the addition of **Albert M. Schenck**, who has joined Key as a senior relationship manager.

Moritt Hock & Hamroff Announces 2021 Attorney Promotions

Moritt Hock & Hamroff has announced that **Jill T. Braunstein**, formerly counsel of the firm, has been elevated to partner; **Brian P. Boland** and **Christine H. Price**, formerly associates of the firm, have each been elevated to counsel, and **Stephen Breidenbach**, formerly an associate of the firm, has been elevated to assistant general counsel-technology.

Peapack-Gladstone Bank Hires New Senior Managing Director, Commercial Private Banker

Peapack-Gladstone Financial Corporation and Peapack-Gladstone Bank are proud

to announce the appointment of **Maureen O'Hara**, senior managing director, commercial private banker, Commercial & Industrial (C&I).

Former U.S. Congressman Harold Ford Jr. Joins PNC Corporate and Institutional Banking

The PNC Financial Services Group, Inc. announced that **Harold Ford, Jr.** has assumed the role of vice chairman, Corporate and Institutional Banking (C&IB), reporting to Michael Lyons, head of C&IB.

John Owen to Retire as Regions Financial Corp.'s Chief Operating Officer Following 38-Year Career in Business and Banking

John Owen will retire effective March 15, 2021, following a nearly 38-year career in business and banking, the last 13 of which have been at Regions.

SG Credit Opens Denver, CO Office

SG Credit Partners announced that **Spencer Brown** has been promoted to managing

director and has opened a Colorado office.

Signature Bank Expands Executive Management Team with Appointment of Two Executives

Lisa Bond was named to the newly created position of senior vice president and chief corporate social impact officer, which encompasses Diversity & Inclusion (D&I) and Environmental, Social and Governance (ESG) initiatives, areas in which the Bank is expanding its efforts companywide. Ana Harris, Signature Bank senior vice president and director of Human Resources, was also promoted to the post of senior vice president and chief human resources officer (CHRO). Concurrent with these appointments, Signature Bank's Board of Directors created a Corporate Social Responsibility (D&I and ESG) Committee.



Things aren't always as they seem

One must comprehend the whole picture before arriving at conclusions.

Tiger's ABL appraisers are never satisfied taking just one look at a problem.

They take a second, third, and fourth - until they see the true picture.

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Take a closer look.

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ASSET INTELLIGENT

Lender/Participant	Lender Type	Amount	Borrower	Industry	Structure	Service Provider (Type)
ABN AMRO and Société Générale	Bank	€1 Billion	Ahold Delhaize, a world-leading food retailer, Zaandam, Netherlands	Retail: Food	Sustainability-linked revolving credit facility	
Angelo Gordon	Non-bank	\$145 Million	Exela Technologies, Inc., a location-agnostic global business process automation leader	Technology	Term loan facility	
Antares	Non-bank	N/A	To support the acquisition of Logibec, Montreal, Canada, a Montreal-based healthcare software company, by Novacap	Software	Senior secured credit facilities	
Antares	Non-bank	\$1.4 Billion	To support the recapitalization of Galway Insurance Holdings, the holding company for EPIC Brokers & Consultants and JenCap Holdings by Harvest Partners, LP and its affiliates	Insurance	Senior secured credit facilities	
Arrowroot Capital and Runway Growth Capital	Non-bank	\$160 Million	FiscalNote, a global technology company that provides software and political intelligence around legislative and regulatory risk, Washington, D.C.	Technology	Growth capital and debt financing	
Assembled Brands	Non-bank	\$1 Million	Rider Spirits Co. a high-quality, health-focused, canned tequila cocktail brand	Spirits	Senior secured credit facility	
Atlantic Park Strategic Capital Fund, L.P. and Citibank, N.A.	Non-bank/ Bank	\$400 Million	Team, Inc., a global leading provider of integrated, digitally-enabled asset performance assurance and optimization solutions, Sugar Land, TX	Technology	Consisting of a \$250 million senior secured term loan due 2026 led by Atlantic Park Strategic Capital Fund, L.P. and \$150 million senior secured ABL credit facility due 202 led by Citibank, N.A.	
Audax Private Debt, Adams Street Partners, Varagon Capital Partners, Madison Capital Funding and Willow Tree Credit Partners	Non-bank	N/A	To support Freeman Spogli's acquisition of US Med-Equip, a value-added distributor and rental provider of movable medical equipment	Medical equipment	Unitranche credit facility	
Audax Private Debt	Non-bank		Refinancing for Metalmark Capital's portfolio company, Innovetive Petcare, a leading acquirer and operator of specialty and general practice veterinary hospitals and clinics for companion animals, Austin, TX	Petcare	Second lien credit facility	
Austin Financial Services, Inc. (AFS)	Non-bank	\$1.3 Million	Private equity-owned technology manufacturing and engineering company	Manufacturing	Revolving A/R and inventory facility	
Bank of America	Bank	\$500 Million	Uniti Group Inc., an internally managed real estate investment trust, Little Rock, AR	Real Estate	Senior secured revolving credit facility	

Lender/Participant	Lender Type	Amount	Borrower	Industry	Structure	Service Provider (Type)
Bank of China Limited, Singapore Branch, Coöperatieve Rabobank U.A. Singapore Branch, DBS Bank Ltd., Emirates NBD Capital Limited, Emirates NBD Bank (P.J.S.C), Singapore Branch, Industrial and Commercial Bank of China Limited, London Branch, ING Bank N.V. Singapore Branch, Mizuho Bank, Ltd., MUFG Bank, Ltd., Oversea-Chinese Banking Corporation Limited, Société Générale, Hong Kong Branch, and Sumitomo Mitsui Banking Corporation Singapore Branch	Bank	\$720 Million	Mercuria Energy Group Ltd., the global energy and commodities group	Energy	Credit facilities	
Bank of Montreal, CIBC and BNP Paribas	Bank	\$200 Million	Victoria Gold Corp.	Gold	Consisting of a \$100 million term loan and a \$100 million revolving facility	The Company would like to thank Cassels Brock & Blackwell LLP (Legal Counsel) and Auramet International (Financial Advisor) for their practical and valuable assistance throughout this process. The Banks were assisted by Fasken Martineau DuMoulin LLP (Legal Counsel).
Bank of Montreal (BMO) The Toronto-Dominion Bank, ATB Financial and Canadian Imperial Bank of Commerce	Bank	\$250 Million	Bird Construction Inc.	Construction	Syndicated credit facility consisting of a \$165 million committed, revolving credit facility and a \$35 million committed, non-revolving term debt facility. There is also an additional accordion for up to an additional \$50 million. BMO served as the lead arranger, bookrunner and administrative agent, and The Toronto-Dominion Bank, ATB Financial and Canadian Imperial Bank of Commerce as syndicate lenders.	

Lender/Participant	Lender Type	Amount	Borrower	Industry	Structure	Service Provider (Type)
Bank of Nova Scotia, National Bank Financial Markets and HSBC Canada Bank	Non-bank/ Bank	\$600 Million	Centerra Gold Inc., a Canadian-based gold mining company focused on operating, developing, exploring, and acquiring gold properties in North America, Asia, and other markets worldwide and is one of the largest Western-based gold producers in Central Asia	Mining	Includes a \$400 million four-year revolving credit facility and \$200 accordion feature ("Credit Facility")	
BHI	Bank	\$15 Million	Hotwire Communications, a national fiber optics internet cable provider for residential and commercial buildings, Fort Lauderdale, FL	Telecommunications	Credit facility	
Big Shoulders Capital	Non-bank	N/A	Third generation driller and oilfield services provider to continue operations after Covid-19 depressed the global energy market	Oilfield services	Funding	
Business Development of Canada	Non-bank	\$2 Million	Stampede Drilling Inc.	Drilling	Secured credit facility	
Celtic Capital Corporation	Non-bank	\$4.1 Million	Wood mill and veneer manufacturer, Colorado	Manufacturing: Wood mills	Consisting of \$1.6 million term loan against the company's equipment, a \$2 million accounts receivable line of credit and a \$500,000 line on its inventory	
CIBC Innovation Banking	Non-bank	\$13 Million	EZTexting, a cloud-based platform that enables small and medium sized businesses to confidently grow and keep their customers through their innovative messaging platform, Santa Monica, CA	Technology	Growth capital financing	
CIT Group Inc.	Bank	\$38 Million	Acquisition of an apartment complex in Winter Park, FL	Real estate	Senior secured loan	

Lender/Participant	Lender Type	Amount	Borrower	Industry	Structure	Service Provider (Type)
CIT Group Inc.	Bank	\$20 Million	Laurel Grocery Company LLC, a wholesale distributor of grocery products to more than 160 independent grocers in Georgia, Indiana, Kentucky, Ohio, Tennessee and West Virginia, headquartered in London, KY	Grocery	Senior secured credit facility	
CIT Group Inc.	Bank	\$256 Million	250-megawatt (MW) Taygete I Energy Project owned by 7X Energy, Inc (7X) and located in Pecos County, TX	Solar energy	Financing	
Citizens Bank, N.A., Wells Fargo Bank, National Association and Silicon Valley Bank	Bank	\$65 Million	Harvard Bioscience, Inc.		Credit facility to refinance debt, a leading developer, manufacturer and seller of technologies, products and services that enable fundamental research, discovery, and pre-clinical testing for drug development.	
Citizens Financial Group, Inc.	Bank	N/A	W. Atlee Burpee Company, engaged in the wholesale distribution, direct marketing and retail sale of vegetable and flower seeds, plants, horticultural and other related products, Warminster, PA	Horticulture	Asset-based revolving loan	
Citizens Financial Group, Inc.	Bank	\$30 Million	Ross-Simons, a leader in direct-to-consumer sales, specializing in offering unique and proprietary fine jewelry designs alongside a deep selection of classics such as diamond tennis bracelets and gold necklaces, Cranston, RI	Retail: Jewelry	Asset-based revolving line of credit	
Citigroup Global Markets Inc., BofA Securities, Inc., PNC Capital Markets, LLC, U.S. Bank National Association and Wells Fargo Securities, LLC	Bank	\$200 Million	TravelCenters of America Inc., the nation's largest publicly traded full-service travel center network, Westlake, OH	Hospitality	Senior secured term loan facility	

Lender/Participant	Lender Type	Amount	Borrower	Industry	Structure	Service Provider (Type)
Credit Suisse and Hudson Cove Capital	Bank/ Non-bank	\$100 Million	ClickLease LLC, an innovator in the commercial equipment finance industry, Salt Lake City, UT	Commercial equipment finance	Credit facility	
Credit Agricole, Credit Suisse, Deutsche Bank, DBS Bank, ING Bank, Rabobank, Banco do Brasil, Banque Cantonale Vaudoise, Erste and UniCredit	Bank	\$150 Million	Gerald Group, the world's largest independent, employee-owned metals trading house	Metals	Revolving credit facility	
Crestmark's Asset-Based Lending Division	Bank	\$50,000	Transportation company, Indiana	Transportation	Accounts receivable purchase facility	
Crestmark's Asset-Based Lending Division	Bank	\$150,000	Dry van transportation company, Florida	Transportation	Accounts receivable purchase facility	
Crestmark's Asset-Based Lending Division	Bank	\$700,000	Mechanical-systems parts manufacturer, Indiana	Manufacturing	Term loan facility	
Crestmark's Asset-Based Lending Division	Bank	\$300,000	Freight all kinds trucking company, Ohio	Trucking	Accounts receivable purchase facility	
Crystal Financial LLC	Non-bank	\$40 Million	Basic Fun, a dynamic global marketer of classic and innovative children's entertainment products for today's kids	Manufacturing: Children's toys	Senior credit facility, comprised of a \$20 million revolving line of credit and a \$20 million term loan for Basic Fun	
Desjardins Capital Markets with participation from Investissement Québec	Non-bank	\$46 Million	Goodfood Market Corp., a leading online grocery company in Canada	Grocery	Syndicated bank financing, including a \$27.5 million revolving facility, a \$12.5 million term loan facility, and \$6 million in additional short-term financing.	
Deutsche Bank AG, KeyBank National Association, TIAA, FSB, MUFG Union Bank, N.A., Hitachi Capital America Corporation, NBH Bank and Customers Bank	Bank		TriplePoint Venture Growth BDC Corp., the leading financing provider to venture growth stage companies backed by a select group of venture capital firms in the technology and other high growth industries	Venture Finance	Revolving credit facility	
eCapital Commercial Finance	Non-bank	\$2 Million	Hard seltzer provider	Food & Beverage	Factoring facility	
Eastern Bank	Bank	\$7.5 Million	Curate Partners LLC and its subsidiaries Curate Partners LLC, II and Curate Insights, LLC, Woburn, MA	Staffing	Loan facility	

Lender/Participant	Lender Type	Amount	Borrower	Industry	Structure	Service Provider (Type)
Energy Impact Credit Fund, CION Investment Corporation, CrowdOut Capital, PNC Bank	Non-bank/ Bank	\$80 Million	Williams Industrial Services Group Inc., a construction and maintenance services company	Construction	Includes a \$50.0 million term loan facility with Energy Impact Credit Fund, an affiliate of Energy Impact Partners, as agent to the term loan, CION Investment Corporation, and CrowdOut Capital, which consists of a \$35.0 million initial term loan and a \$15.0 million delayed draw facility, and a \$30.0 million revolving credit facility with PNC Bank	
Feenix Venture Partners	Non-bank	\$1 Million	Blackboxstocks Inc., a financial technology and social media hybrid platform	Technology	Senior secured loan	
Fifth Third Business Capital	Bank	\$8.5 Million	BlastOne International, a privately held company specializing in the provision of leading products and services to the corrosion control industry throughout North American and Asia Pacific, Columbus, OH			
Fifth Third Business Capital	Bank	N/A	HB&G Building Products, Inc., a leading manufacturer of specialty millwork consisting primarily of synthetic exterior and interior columns as well as synthetic posts and rails for porch and deck applications	Construction	Revolving credit facility	
Gemino Healthcare Finance	Non-bank	\$44 Million	Provider of mental health and substance use disorder treatment	Healthcare	Asset-based revolving line of credit	
Gerber Finance	Non-bank	N/A	ABC Carpet & Home	Home furnishings	N/A	
Goldman Sachs Specialty Lending Group, L.P., Guggenheim Credit Services, LLC and BMO Harris Bank N.A.	Non-Bank/ Bank	\$245.0 Million	Landec Corporation, a diversified health and wellness company with two operating businesses, Curation Foods, Inc. and Lifecore Biomedical, Inc.	Health and wellness	The new structure includes a five-year \$170.0 million uni-tranche term loan agented by Goldman Sachs Specialty Lending Group, L.P. and split equally with Guggenheim Credit Services, LLC and a \$75.0 million asset-based line of credit provided by BMO Harris Bank N.A.	The Company's financial advisor for the comprehensive refinancing was Armory Securities, LLC.

Lender/Participant	Lender Type	Amount	Borrower	Industry	Structure	Service Provider (Type)
Great Rock Capital	Non-bank	\$30 Million	An industry-leading full-service equipment rental supplier	Equipment rental	Senior secured term loan	
Great Rock Capital	Non-bank	CAN\$10 Million	Smart Employee Benefits, Inc. (SEB), a Canadian-based technology company that builds, customizes, implements, integrates, and manages data-processing solutions	Technology	Senior secured revolving credit facility	
Great Rock Capital	Non-bank	\$11.8 Million	One of North America's leading providers of high-quality catalog solutions	Publishing	Senior secured credit facility	
Horizon Technology Finance Corporation and Silicon Valley Bank	Non-bank	\$20 Million	Canary Medical, Inc., a medical data company improving healthcare outcomes with its proprietary smart medical devices	Medical equipment	Venture loan facility	
Huntington Business Credit	Bank	\$15 Million	The Miller Company, Meriden, CT, an acquirer of scrap bronze and copper and operates as a processor and distributor supplying the North American automotive and electronics industries	Scrap metal	Credit facility	
Huntington Business Credit	Bank	\$24 Million	Elk Lighting, Inc., a designer and wholesale distributor of indoor and outdoor residential and commercial lighting fixtures, LED lighting, decorative accessories and furniture, Nesquehoning, PA	Lighting	Credit facilities	
InterNex Capital	Non-bank	\$1.5 Million	Company that helps organizations bring drug treatments to the market through health research services, Maryland	Healthcare	Line of credit (VelocityLOC)	
J D Factors	Non-bank	\$150,000	Transportation company, Illinois	Transportation	Factoring facility	

Lender/Participant	Lender Type	Amount	Borrower	Industry	Structure	Service Provider (Type)
JD Factors	Non-bank	\$250,000	Transportation company, Alberta	Transportation	Factoring facility	
JD Factors	Non-bank	\$100,000	Transportation company, Alberta	Transportation	Factoring facility	
JD Factors	Non-bank	\$1 Million	Transportation company, Illinois	Transportation	Factoring facility	
JD Factors	Non-bank	\$75,000	Transportation company, Ontario	Transportation	Factoring facility	
JD Factors	Non-bank	\$250,000	Wholesale clothing distribution company, California	Clothing distribution	Factoring facility	
JD Factors	Non-bank	\$100,000	Transportation company, Alberta	Transportation	Factoring facility	
JD Factors	Non-bank	\$1 Million	Transportation company, Ontario	Transportation	Factoring facility	
JD Factors	Non-bank	\$150,000	Transportation company, Quebec	Transportation	Factoring facility	
JD Factors	Non-bank	\$50,000	Transportation company, Illinois	Transportation	Factoring facility	
JD Factors	Non-bank	\$100,000	Transportation company, Ontario	Transportation	Factoring facility	
JD Factors	Non-bank	\$250,000	Transportation company, Manitoba	Transportation	Factoring facility	
JD Factors	Non-bank	\$120,000	Transportation company, Illinois	Transportation	Factoring facility	
JD Factors	Non-bank	\$1.5 Million	Transportation company, British Columbia	Transportation	Factoring facility	
JD Factors	Non-bank	"	\$200,000 "	Transportation company, New Jersey	Transportation	Senior credit facility
JPMorgan Chase Bank, N.A.	Bank	\$200 Million	ORBCOMM Inc. a global provider of Machine-to-Machine (M2M) and Internet of Things (IoT) solutions	Technology	Consisting of a \$200 million five-year term loan facility and a \$50 million revolving credit facility.	
KeyBank Specialty Finance Lending, MUFG Union Bank N.A., Bank of Hope and First Foundation Bank	Bank	\$215 Million	Runway Growth Credit Fund Inc., a leading provider of growth loans to both venture and non-venture backed companies seeking an alternative to raising equity	Finance	Expanded and amended revolving credit facility that provides for borrowings up to a maximum aggregate principal amount of \$215M, with an accordion feature that enables Runway Growth to increase the aggregate commitments up to \$300M.	
LSQ	Non-bank	\$6 Million	Digital security company	Digital security	Credit facility	

Lender/Participant	Lender Type	Amount	Borrower	Industry	Structure	Service Provider (Type)
Macquarie Bank Limited	Bank	\$40 Million	Battle North Gold Corporation, to fund the construction of the 100%-owned, shovel-ready Bateman Gold Project in Red Lake, Ontario, Canada	Gold exploration	Senior secured term loan facility	
Monroe Capital LLC	Non-bank	N/A	To support the growth of 3Cloud, LLC, Downers Grove, IL, a portfolio company of Gryphon Investors	Technology	Senior credit facility	
Monroe Capital LLC	Non-bank	N/A	To support the majority investment in Identity Intelligence Group, LLC ("IDIQ") by private equity sponsor Corsair Capital LLC	Technology	Senior credit facility	
Monroe Capital LLC	Non-bank	N/A	To support the investment in Relevate Health Group Inc., Cincinnati, OH, by private equity sponsor Mountaingate Capital and Relevate's strategic combination with Arteric	Marketing	Senior credit facility	
Monroe Capital LLC	Non-bank	N/A	To support the acquisition of Confirm Solutions Limited by Dude Solutions, Inc., an existing portfolio company of Clearlake Capital Group, L.P.	Software	Senior credit facility	
Oxford Finance LLC	Non-bank	\$60 Million	RxSight, Inc., a privately-held, medical technology company that has commercialized the world's first and only FDA-approved adjustable intraocular lens ("IOL") that is customized after cataract surgery	Healthcare	Senior secured term loan	
Oxford Finance LLC	Non-bank	\$7.4 Million	REACH LTC, a provider of short and long-term skilled care options, Town and Country, MO	Healthcare	Senior credit facility and revolving line of credit	

Lender/Participant	Lender Type	Amount	Borrower	Industry	Structure	Service Provider (Type)
Oxford Finance LLC	Non-bank	N/A	DCN Dx, a lateral flow diagnostics developer	Healthcare	Senior credit facility and revolving line of credit	
Pacific Mercantile Bank	Bank	\$2.45 Million	Simpson Sandblasting & Special Coatings, Inc., specializing in sandblasting and painting water storage reservoirs, pump stations, clarifiers, digesters, bridges, concrete reservoirs, water treatment plants as well as elevated and petroleum tanks, Fontana, CA	Construction	Credit facility	
Perceptive Advisors	Non-bank	\$100 Million	ADMA Biologics, Inc. an end-to-end commercial biopharmaceutical company dedicated to manufacturing, marketing and developing specialty plasma-derived biologics	Biopharmaceutical	Amendment to its existing senior secured term loan with Perceptive Advisors, which provides for an additional loan tranche of \$15 million, increasing the total size of the credit facility to \$100 million	
PNC Bank	Bank	\$27.5 Million	Luna Innovations Incorporated, a global leader in advanced optical technology	Technology	Secured debt facility	
Prestige Capital Finance, LLC	Non-bank	\$1.5 Million	Company that manufactures and packages frozen treats for well-known food and beverage companies, New Jersey	Manufacturing: Food	Factoring facility	
Rosenthal & Rosenthal, Inc.,	Non-bank	\$2.4 Million	To support the production financing requirements of a Florida-based minority-owned government contractor	Government Contractor	Purchase order finance facility	
Rosenthal & Rosenthal, Inc.	Non-bank	\$950,000	To support the production financing requirements of a California-based cosmetic and beauty products company	Cosmetics	Purchase order finance facility	
Sallyport Commercial Finance	Non-bank	\$500,000	Industrial safety firm providing essential medical and rescue services to the oil and gas industry	Industrial safety	Accounts receivable facility	

A hand is shown reaching up from the surface of blue water. Above the hand, a red and white life preserver is suspended in the air, with a rope trailing off to the right. The background is a plain, light color.

Assessing The Bankruptcy Environment: The Experts Weigh In

BY MYRA THOMAS

A changing and unpredictable economic landscape is never a welcomed environment for secured lenders or their borrowers. However, more than a year into the COVID-19 pandemic, worries about a wave of business liquidations have not yet materialized as some might have feared.

Roundtable Participants

The Federal Paycheck Protection Program loan funds did buy many struggling businesses time to weather the proverbial economic storm. Plus, secured lenders, not surprisingly, found it much more advantageous to work with borrowers and extend liquidity than deal with a bankrupt business. The idea was simply that the pandemic couldn't last forever and that the economy, as it is now, does appear to be on the mend.

Asset-based lenders were aware of the problems going into the pandemic. Not surprisingly, brick and mortar retailers, already facing significant financial stress before the shutdown, did take the brunt of the pandemic and many were forced to shutter stores, says Dan Karas, executive vice president of Allied Affiliated Funding, a division of Axiom Bank, N.A. Many large retailer liquidations dominated 2020, including J.C. Penney and Pier 1. The silver lining for lenders, as it turns out, is that liquidations were generally not the order of the day for most businesses, he adds. According to data from Epiq, commercial Chapter 11 filings grew year-over-year, up 29% in 2020 compared to 2019.

Ready to Respond

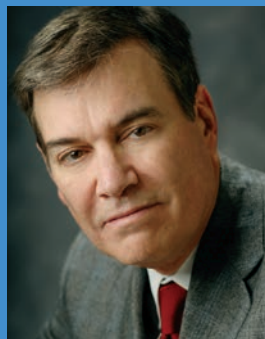
Secured lenders were more than ready to deal with an increase in Chapter 11 filings. "Banks geared up and doubled and tripled their workout groups," says Karas. "I've found that banks were encouraged to identify problems early." Rounds of PPP money from the federal government provided more liquidity than expected. Additionally, secured lenders were and remain more amenable to amending terms to help borrowers stem the proverbial tide against the lingering effects of the pandemic.

According to Karas, 2021 is likely to hold much of the same with less liquidations and more restructuring situations for borrowers in industries hardest hit during the pandemic. The expectation too is that the market for DIP financing will continue to grow, in return. Karas does express some concern about the value of collateral in these situations, given the lingering impact of COVID-19. "I am still optimistic," he adds, noting that many borrowers and the economy in general have bounced back more and quicker than expected.

A Better Understanding of Bankruptcy

For those companies needing to restructure, Chapter 11 is a business vehicle and not necessarily a sign of insecurity. Today, says Jonathan Helfat, partner at Otterbourg, P.C., the strategy is often used by businesses seeking a sale scenario or a reorganization. "Just because a company seeks relief under Chapter 11 doesn't mean the world comes to an end," he notes. "Lenders and lawyers understand that, but the public often does not." Even with the increase in Chapter 11 filings in 2020 and the pandemic, secured lenders fared well.

The bankruptcy courts were also much more lenient when it came to how they handled filings in 2020. "Some courts made the decision early on in the pandemic to hold off creditors from taking actions in some jurisdictions," says Helfat. "What was interesting



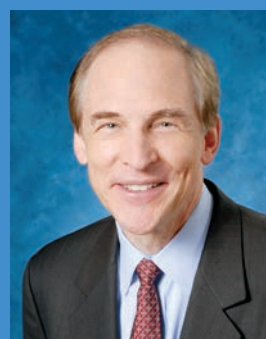
■ **JONATHAN HELFAT**
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■ **DAN KARAS**
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■ **PAUL SHARE**
Conway Mackenzie



■ **BAKER SMITH**
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■ **REGINA STANGO
KELBON**
Blank Rome



■ **MARSHALL STODDARD**
Morgan Lewis

was that some of the bankruptcy judges in certain jurisdictions were willing to give the debtors a holding period to catch their breaths." The bankruptcy judges sometimes extended deadlines, but not every jurisdiction. "We saw Chapter 11 filings where landlords wanted their Chapter 11 rent paid and judges held off these landlords," he added.

Monitoring the Situation

With the concern about restructurings ever present, the smart lenders continue to have more people on the ground than ever. “The main question for asset-based lenders will be whether their particular portfolios will recover post-Covid and whether they should continue to wait, amend, and extend their credit facilities, and ride out the turmoil until the particular industry gets back to normal, with the hope that with the return to normalcy, recoveries will be maximized,” says Regina Stango Kelbon, partner and head of Blank Rome’s bankruptcy practice. Certainly, the hardest hit industries were predictable, including retail, energy, hospitality, theaters, restaurants, and airlines. Commercial real estate will also continue to be impacted, Kelbon notes, given the ripple effect of the many shuttered retail locations across the country. For the hardest hit sectors, the stress of having to shutter operations due to the pandemic could just mean more liquidations down the road for some.

While the pandemic plays out through the economy, the realization of the cost of a bankruptcy filing may be the one thing to make restructuring a much better option for borrowers. “There have been a number of restructurings underway, such as Bed, Bath and Beyond selling off non-core units like the Christmas Tree Shops and trying to focus on their e-commerce platform or Macy’s obtaining additional liquidity through its credit facilities while planning to close more than a hundred stores.” Kelbon agrees with Karas’s assessment that, for the lender, it will continue to be a question of how much patience to have for some of their borrowers who were the hardest hit by the pandemic. “There’s no magic,” she adds. “There are many different solutions.” The impact and effective rollout of the U.S. vaccination program against COVID-19 will hopefully mean that Americans will quickly get back to the stores, theaters, and restaurants and serve to boost the economy and borrowers in turn.



“There have been a number of restructurings underway, such as Bed, Bath and Beyond selling off non-core units like the Christmas Tree Shops and trying to focus on their e-commerce platform or Macy’s obtaining additional liquidity through its credit facilities while planning to close more than a hundred stores.”

Setting the Tone

Government support, whether to businesses or consumers, played a large part in forestalling bankruptcy filings in 2020 up to now and will do much of the same in 2021. According to Marshall Stoddard, partner, transactional finance, at Morgan Lewis, this is still one of the big unknowns in the long term. “Government support on the

commercial side has probably reached its end point,” he notes. “If the government focuses on consumer rehabilitation, that was the big variable in 2020 that kept many companies afloat and prevented a more serious recession.”

With every administration change, there is always some uncertainty. President Biden has signaled that he will be much more consumer-oriented than the prior administration. “A period of stabilization, I think, is coming and that’s good for secured lenders,” says Stoddard. Uncertainty causes, in some respects, knee jerk reactions or a more conservative stance. “I see a leveling out and lenders will be able to manage credits without as much of a macro focus.”

The Takeaway

Secured lenders are still remaining smart, strengthening underwriting, tightening eligibility requirements for collateral, and requiring enhanced monitoring in deeper workout scenarios. Given the cost, time, and drama of any type of bankruptcy, the steps to file need to be considered carefully. But Paul Share, managing director at Conway MacKenzie, does offer one warning. “There’s enough cash slushing around right now that the cracks got papered over and the U.S. took the debt onto their books,” he says. Stimulus cash did enable the weaker companies to live for another day. What happens next is anyone’s guess.

For companies where bankruptcy is inevitable, Share says that it isn’t always the easiest exit. “Lenders have to evaluate the benefits and look for additional sources of protection, such as guarantees by equity sponsors or additional documentation upfront.” Since COVID-19, secured lenders are also noting increased negotiations over MAE clauses in M&A transactions. There’s also quite a bit of

push and pull on the intercreditor agreement side between senior and junior lenders.

According to Baker Smith, managing director, BDO USA LLP, the proactive clients take the initiative to come up with workout plans. Even if the workout takes time, secured lenders appear to be much happier to deal with the borrower in this situation and to keep them in the portfolio. “Lenders spend a ton of time and money to add each client and they will simply not tolerate runoff for those coming up with a realistic plan,” he adds. With secured lenders more than a year into the pandemic, they have learned how to better evaluate run rates and get more comfortable with proforma projections, given the new normal.

What Secured Lenders Need

However, Smith notes that secured lenders need to realize that a filing will not have the desired effect without having a good advisory team in place. While the borrower picks the professionals, the question is always just how much influence a lender has on the decision. “The company needs to turn to the lenders for the funds to execute the bankruptcy, so the lender can share their recommendations and opinions for the best financial advisors and attorneys,” notes Smith. This is the kind of advice that is frequently discussed prior to the commitment to funding.

One favorable development when it comes to bankruptcy filings is that there is a push to move the process along much quicker than it might have gone in the 2008 recession. “Several years ago, when companies got relief from creditors and were operating normally, there was no major push to get out of bankruptcy,” Smith notes. “Today, when the bankruptcy is filed, everyone gets the picture that it needs to move along promptly. Professionals have a sense of urgency to avoid spending too much money and not dissipate the collateral.” Smith predicts that this will continue throughout 2021. He adds that most bankruptcy court hearings and depositions in bankruptcy cases take place virtually. Courts have much better systems in place, becoming more sophisticated about the process of getting all of the parties together and having them take the oath needed to testify.

In wind-down sales, secured lenders need a timetable with milestones in place to monitor and full access to the investment

banker. It’s essential to keep on top of the situation, Smith says, making sure due diligence is started, site visits are happening, and asset purchase agreement is in place. “If nothing’s happening, the collateral is typically deteriorating as a function of time,” he adds. “If it’s a going-concern sale, it will stumble and stagger across the finish line without the proper lender financing and the various professionals that keep the wheels of progress going, whether it’s

the lender, attorneys or investment banker.” That’s why a timetable and access are essential.

Looking Ahead

Despite the past year, secured lenders are still pointing favorably to 2021 and are not predicting considerable liquidations ahead. Certain industries, Stoddard argues, are simply critical to the economy. “The airlines, for example, are going to be around,” he notes. “The economy needs the airline industry. They will survive, may restructure, and may get more government assistance, but they can’t be replaced.” The retailers that still exist have mostly or completely figured out how to stay in business and appeal

to the consumer, he notes. While secured lenders will likely see some hotel liquidations and sales, the entire industry can’t be replaced.

Stoddard predicts a leveling off of bankruptcies. “Lenders are going to make more traditional credit decisions in 2021 and will be able to look to inventory values reaching a level of stability,” he says. Inventory values and receivable collections all suffered during the

pandemic. 2021 appears to be more predictable, so secured lenders can make effective credit decisions and look at individual companies again. The consensus seems to be that, if a client has made it this far, they probably have staying power. ■



Stoddard predicts a leveling off of bankruptcies. “Lenders are going to make more traditional credit decisions in 2021 and will be able to look to inventory values reaching a level of stability.”



■ MYRA THOMAS

Myra Thomas is an award-winning editor and journalist with 20 years’ experience covering the banking and finance sector.

What Happened in 2020? The New Paradigm for Asset-Based Lenders in a Chapter 11 Case and What Should (Can) They Do About It?

BY DAVID W. MORSE, ESQ. AND DANIEL F. FIORILLO, ESQ.

To say a lot happened in 2020 doesn't begin to capture what the year brought. In the economy, this included a significant increase in Chapter 11 filings for larger businesses from filings in 2019, particularly in retail. And for asset-based lenders it included a significant shift in their role in the larger bankruptcies. Asset-based lenders faced real challenges how to best protect their position and enhance the likelihood of a successful outcome. Confronted with a landscape that requires a new map to navigate, we look at what happened, how it happened and, most importantly, what should (or can) the asset-based lender do about it?

2

2020 brought to the fore a dramatic transformation of the role of the asset-based lender in the financing of a debtor in Chapter 11. Once upon a time, not in a galaxy so far, far away, the asset-based lender rigorously negotiated the terms of the DIP financing it would provide to the debtor upon the commencement of the Chapter 11 case, with the asset-based lender having a pervasive influence over the pace and direction of the case, and a necessarily cooperative debtor company. Of course, it was never quite that simple. But the contrast of that classic paradigm with the reality confronted by the asset-based lender in 2020 provides the backdrop for the magnitude of the shift in the role of the asset-based lender in the bankruptcies of 2020. And while that classic paradigm or some version of it may still be the case in many parts of the markets that use asset-based lending, in the larger, syndicated credits, “not so much,” and certainly, at least “not as much.”



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What Happened?

The call comes in. The borrower tells the lender it is filing Chapter 11. The lender calls its lawyers.

Where once lender’s lawyers would race to draft the financing order for the debtor’s counsel to submit to the Bankruptcy Court at the outset of the case, now it is not unusual for the lender’s lawyers to be presented with a draft of a cash collateral order prepared by debtor’s counsel, or even worse, a proposed financing order to be used to approve some other lender’s Chapter 11 financing with just a select few

provisions addressing how the debtor is going to use the asset-based lender’s cash collateral.

The mantra of the asset-based lender has always been to provide the DIP financing so as to be able to approve the budget, set the milestones, get the reporting and access to information and have the Bankruptcy Court approve the ability to exercise remedies in case of a default, not to mention the “roll up” and the benefits of cross collateralization and cash dominion—all benefits that came from being the key financing source in the Chapter 11. But as we look back over the major cases of 2020, like JC Penney, Neiman Marcus, Brooks Brothers, Stage Stores and others, that no longer seems to be the prevailing scenario.

Now, the asset-based lender may be relegated to the role of a bystander while the debtor and the other parties establish the way the case will proceed. To avoid this result, it is critical for the asset-based lender to use all of the tools at its disposal to proactively establish its position in order to receive critical rights as part of the use of its cash collateral.

How Did This Happen?

All the New Players

As asset-based lending has become a capital markets product, it has become one layer of debt in the deeper capital structures of its larger borrowers. At the same time, the nature and character of the debt providers filling out the capital structure have changed or, if not changed in terms of the name of the institution, have developed new strategies. Multiple new players are now engaged with the capabilities and the will to participate in the Chapter 11 case in ways that reduce the leverage of the asset-based lender. Ironically, while the deep capital structures of many asset-based borrowers benefit the asset-based lender by decreasing its risk of loss and offering a greater number of alternatives for a safe exit, it has also increased the likelihood that the role of the asset-based lender will be diminished.

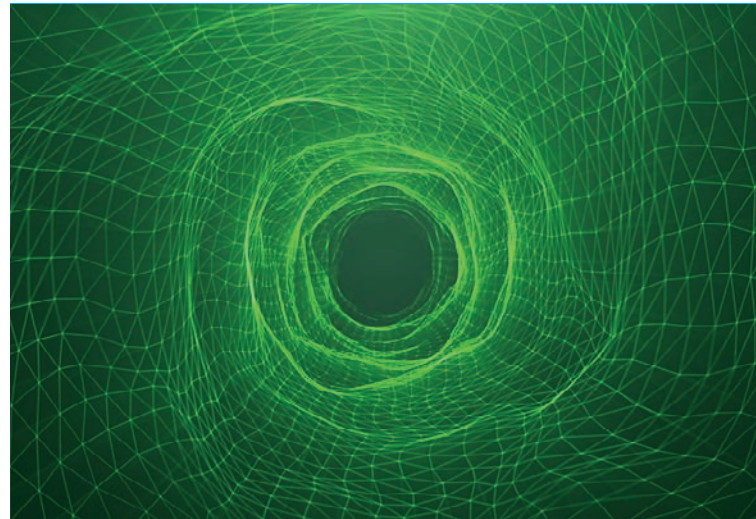
As it turns out, while having the other layers of debt may help reduce the risk of the asset-based lender, introducing other parties into the capital mix, with borrowers now having separate term loans and multiple tranches of notes, secured and unsecured, has meant that the critical role of the asset-based lender that was once a forgone conclusion—may just be gone.

And these other capital providers are not just family members or company officers. These are deep-pocketed private debt funds often affiliated with a private equity firm, with a clear willingness to use their resources in flexible ways to offer additional liquidity to the bankrupt borrower to protect their initial investment or at least to put themselves in a position of controlling the process that will determine the return on their investment. And the most common basis for this debt has become a “split collateral” structure so that the term lenders or noteholders have first liens on fixed

assets, while the asset-based lender has a first lien on current assets, which provides further leverage for the term lenders or noteholders.

The term loan lenders or noteholders are often the “fulcrum creditors” in the capital structure, so that the extent of these lenders’ recovery will depend entirely on the success or failure of the debtor’s restructuring process. As such, they have become the force to be reckoned with as a company heads to Chapter 11. Guided by their advisors, and sometimes with equity positions that give them direct insight to a company’s status, they will put together their financing proposal for the Chapter 11 early on and be fully engaged.

It may not even be the existing noteholders or term lenders that appear at the time of the filing of the Chapter 11 prepared to offer additional financing to the Chapter 11 debtor. Much as asset-based lenders discovered years ago that “DIP financing” could be a “product”, there are private debt funds looking for opportunities to obtain the significant returns available in the context of a Chapter 11 financing by providing the liquidity that will enable the debtor to ride through the Chapter 11 process to a sale or plan of reorganization. The new lender that arrives on the scene closer to the filing may also have the added benefit of a clearer picture on how the Chapter 11 is going to play out, so as to better understand its risk. And the risk may be managed with conservative financing structures imposed by the new lender that may have a good headline for the amount of funding it is prepared to provide, but with hooks and traps that make the reality less dramatic. It has always been the case in Chapter 11 that the party providing the extra liquidity is in the best position to get the control, as well as all available protections and benefits, including significant fees and pricing. As a result of providing those funds, the new lender will generally prevail over any attempts to offer a competitive financing or reduce the scope of its rights.



Another disadvantage for the asset-based lender is the current approach to “cash dominion” in larger transactions. In a traditional asset-based lending structure, the proceeds of the receivables and other collateral are paid into a bank account of the company used exclusively for receiving such proceeds, which are then transferred on a regular basis to the lender to pay down the revolving loans, with the company then borrowing as needed.

The Role of the Debtor’s Professionals

Debtor’s advisors and counsel have always played a critical role in the Chapter 11 process for a company as only makes sense, given that most management teams will not have had the same level of experience in finding their way through

the unique elements of the process, and certainly will not have the knowledge as to judges and courts and prior cases that provide the foundation for going forward into the world of Chapter 11.

The larger companies that are now commonly using asset-based lending with more widely held ownership don’t have management with the same direct level of economic investment as a smaller, family-owned business might, for example. And the fact that the nature of directors’ duties in the “zone of insolvency” are so deeply enmeshed in statutes and case law only contributes further to the deference to counsel and advisors. What does this mean for the asset-based lender? All of the pre-Chapter 11 efforts to cultivate a working relationship with the key players in

management, to develop a common understanding of how the ABL functions in the context of a particular business, is lost—leaving the asset-based lender adrift with little or no point of contact at the borrower to assert any influence or develop shared expectations for the Chapter 11 process.

Meanwhile, while not always manifest, the implicit character of the legal process as adversarial casts a shadow over how the conversations in the weeks up to filing are conducted.

The Asset-Based Lender’s Predicament

In looking at the financing needed for a Chapter 11, if returns are so good and the risk so manageable, why doesn’t the asset-based lender take the extra step and provide the liquidity itself, especially when, often relative to the total dollars involved, the actual amounts of the additional liquidity required may not be that significant?

The Borrowing Base

First, to state the obvious, the asset-based lender is tethered to its borrowing base structure, at least in the first instance. In some cases, given the competitive market, the lender may have originally gone out with particularly aggressive advance rates or less than optimal collateral as part of the borrowing base. In that context, the asset-based lender will not be keen to “stretch” further in connection with the Chapter 11.

Alternatively, as is often the case as a company heads into trouble, the asset-based lender will conscientiously “scrub” the borrowing base with a careful examination of each category of receivables and inventory and the debtor’s liabilities, looking to eliminate some of the riskier elements of the borrowing base either by the use of eligibility criteria or reserves. As a result, the asset-based lender will go into the Chapter 11 in a relatively good collateral position and an inclination not to take on more risk by loosening the reserves and eligibility criteria to create more liquidity and thereby reversing the rigorous efforts just undertaken with respect to the borrowing base.

Is it enough?

Even if the asset-based lender is prepared to offer some additional liquidity—is it enough? This has two dimensions. First, is it enough in the view of the debtor and its advisors as will be needed to give the company the “runway” to get to and through the Chapter 11? Second, is it enough relative to how much the alternative sources of capital may be offering?

In the end, one of the consequences for the asset-based lender of adhering to the fundamentals is to put it at a distinct disadvantage in the battle for control.

The Lost Benefits of Cash Dominion

Another disadvantage for the asset-based lender is the current approach to “cash dominion” in larger transactions. In a traditional asset-based lending structure, the proceeds of the receivables and other collateral are paid into a bank account of the company used exclusively for receiving such proceeds, which are then transferred on a regular basis to the lender to pay down the revolving loans, with the company then borrowing as needed. In larger transactions, the transfer of the cash to the lender only is triggered if excess availability under the borrowing base formulas falls below an agreed-upon amount set out in the credit agreement. As the amounts of excess availability that trigger “cash dominion” have been lowered over time given the leverage of borrowers in the negotiations, it is less likely to occur even as the company is in some level of distress.

There is also the possibility that a company may draw down on its asset-based credit facility using up all of its excess availability and then immediately file for Chapter 11, before the lender is in a position as a practical matter to implement cash dominion, or the company may draw just up to the threshold for

triggering cash dominion.

As a result, the company may have cash available to it so that, upon the commencement of the Chapter 11 case, it is not as critical for the company to have financing in place to get funds to operate during those early days of the Chapter 11—with the obvious shift in negotiating leverage between debtor and lender.

What About the Intercreditor Agreement? Getting “Primed” Through Cash Collateral Use

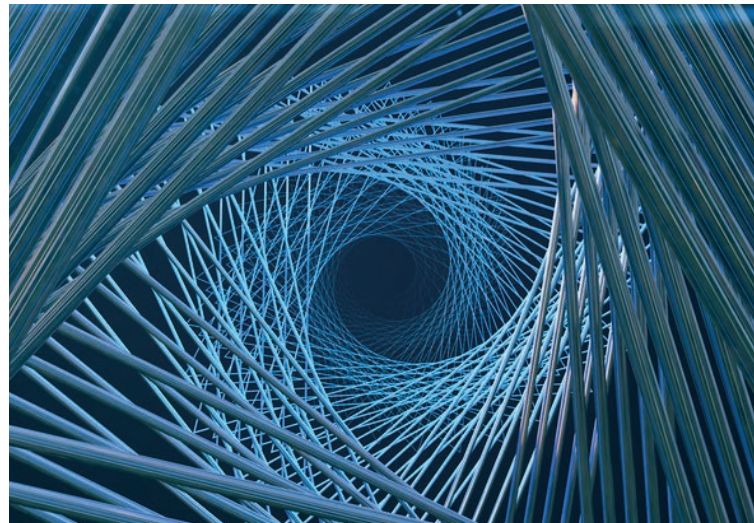
Given the other debt in the capital structure of the borrower, there is usually an intercreditor agreement. And intercreditor agreements have become much more complex. The provisions dealing with bankruptcy now go on for pages—with specific provisions tailored to deal with the run of cases concerning intercreditor agreements that arose from the 2008 financial crisis—court decisions out of the bankruptcies of Energy Future Holdings (formerly known as TXU), Momentive, Boston Generating, Ion Media, La Paloma, Radio Shack and others.

These intercreditor agreement provisions now address how a Chapter 11 financing might be provided to the common debtor in some detail.

To start, most intercreditor agreements in a customary “split collateral” arrangement include the consent by term loan lenders or noteholders to the asset-based lender providing the Chapter 11 financing, subject to certain conditions. And vice-versa. In the intercreditor agreement, the term lenders or noteholders consent in advance to the asset-based lender providing the Chapter 11 financing, secured by its first lien on the accounts, inventory and related assets (the “ABL priority collateral”), and a second lien on the intellectual property, equity interests, equipment and real estate (the “term loan priority collateral”). Similarly, the asset-based lender consents to a Chapter 11 financing provided by the term lenders or noteholders based on their first lien on term loan priority collateral and second lien on ABL priority collateral. But, a consent in advance by each side is not a prohibition on the other group of lenders providing the Chapter 11 financing. Each side is free to offer its own Chapter 11 financing and the other simply can’t object—leaving the debtor as master of its own fate in selecting the financing and leading to the “dueling” offers of DIP financing from each side.

Most intercreditor agreements will include an “anti-priming” provision, which says that no lender will offer a Chapter 11 financing secured by liens with priority over the liens of the other lender. In the most common “split collateral” structure, this means the term lenders will not seek to “prime” the asset-based lender on the ABL priority collateral, clearly, an important protection in today’s environment. So, in theory this should force the term lenders or noteholders to provide more “fresh” capital, rather than look to the ABL priority collateral to “help” finance the company during the Chapter 11. But this is not actually the case.

In fact, as we often witnessed in 2020, the term lender's DIP financing proposal assumes or even relies on the debtor's use of the asset-based lender's cash collateral (i.e., the post-petition proceeds of inventory and account receivable) to supplement the liquidity needs of the debtor. When the company gets the use of cash collateral, meaning the post-petition proceeds of the receivables and inventory that are the ABL priority collateral, through its cash collateral order, it has the benefits of this funding, leaving the asset-based lender with adequate protection in the form of either its "equity cushion" (that is the perceived value whether realistic or not of the accounts and inventory in excess of the actual asset-based loans outstanding) or replacement liens on the post-petition receivables and inventory. So, between the cash collateral and some supplemental financing from the term lender or noteholders or some third party private debt fund, the Chapter 11 debtor gets what it needs.



What Should the Asset-Based Lender Do?

In view of these developments, what should the asset-based lender be thinking about in approaching the Chapter 11?

Just to put it all in context, here's a follow-up question: Is it really all bad that another party is prepared to put up additional funds to support the distressed borrower? Isn't that a fundamental chapter in any workout playbook?

The issue here is not necessarily that the additional liquidity is provided—but how it is provided. What are the consequences to the asset-based lender of the liquidity coming in through a financing?

First, while it may not help immediately, in term of loan documentation, there is the "easily said but difficult to do" possibility of:

- setting higher excess availability thresholds for cash

- the use of anti-hoarding provisions.

Of course, in the continuing competitive market, notwithstanding the current economic environment, increasing excess availability thresholds would be great—but can it realistically be done without the risk of losing new deal opportunities?

2020 has seen the discovery by asset-based lenders of

the utility of anti-cash hoarding provisions, which have now become part of the asset-based lender's tools in a way that was never needed before because of the ability to use cash dominion. Anti-hoarding concepts have come into the asset-based lending market as a way of trying to compensate for the weakening of cash dominion triggers.

In looking at excess availability thresholds for triggering cash dominion and other rights, the ability to conduct appraisals in order to determine the actual levels of availability become important. The absence of the right to do so also adversely impacts the ability to get excess availability to the threshold to trigger cash dominion.

Second, the asset-based lender may want to

really consider the benefits of having more significant influence on the Chapter 11 case by providing additional liquidity relative to the risks, as counterintuitive as it may be to offer more financing when confronted with a borrower in distress. It may be that, in some instances, getting in early with just the right amount of "stretch" will better position the asset-based lender strategically in the process. Of course, this assumes that the asset-based lender gets the opportunity to offer such "stretch" financing. As we have seen, that opportunity is not always forthcoming, particularly given the involvement of other players and the role of the borrower's advisors.

Third, and perhaps most critically, the asset-based lender

2020 has seen the discovery by asset-based lenders of the utility of anti-cash hoarding provisions, which have now become part of the asset-based lender's tools in a way that was never needed before because of the ability to use cash dominion. Anti-hoarding concepts have come into the asset-based lending market as a way of trying to compensate for the weakening of cash dominion triggers.

may want to be proactive in looking for potential partners to provide the additional liquidity, and approaching the debtor with a Chapter 11 financing package. The challenge here is that it may require some compromises on matters of control of the financing, on such significant rights as establishing and maintaining the borrowing base and managing its components during the Chapter 11. But, with the right partner, any such limitations may be worth it. Those limitations on the asset-based lender's discretion required to address the concerns of the other lender may result in more control and better protections in the Chapter 11 than would otherwise be the case. The asset-based lender may need to carefully consider introducing a "first in last out" tranche, with its benefits and challenges.)

Finally, the asset-based lender can accept that it will be in a position of having its cash collateral used in the Chapter 11, but then think about the critical elements of the cash collateral order that it will require. For this purpose, let's go back to some of the reasons that asset-based lenders have traditionally wanted to provide the Chapter 11 financing:

- require compliance with the budget,
- establish "milestones",
- cross-collateralization through the "roll up" of pre-petition debt into post-petition debt,
- additional collateral, like leaseholds,
- ability to require consultants and advisors,
- super-priority administrative expense claim,
- the release of pre-petition claims against the lender,
- limit on time period for creditors' committee and others to challenge the lender's pre-petition liens,
- 506(c) waiver of any claim for a surcharge on the lender's collateral,
- current payment of interest, fees and expenses,
- lift stay only on notice in the event of a default by debtor.

While cross-collateralization and roll ups are not permitted with the use of cash collateral, since the lender is not making new advances so as to create post-petition debt or receiving proceeds of receivables that may be applied to pay down the pre-petition debt in order to effect the "roll up", to the extent that the asset-based lender can get the items above as part of its cash collateral order, it may mitigate the risks to the lender's recovery.

The issue becomes identifying the incentive for the debtor to include the list above in the cash collateral order and figuring out the strategy that will make it happen. Here the focus will have to be on the "adequate protection" package that the ABL lender can negotiate, or even litigate, for in the Chapter 11. The Bankruptcy Code requires, that in exchange for the debtor using its cash collateral the secured lender must receive "adequate protection" to protect the creditor from the diminution in value of its collateral as used by the debtor.

Unfortunately, the Bankruptcy Code and the Bankruptcy Courts have been somewhat creative in finding what might constitute such "protection" and often it is not what the lender would find "adequate"—notwithstanding the debtor's view and the Bankruptcy Court's willingness too often to accept that view.

The approach here for the lender will be very case specific—driven by the underlying facts—with the additional hurdle of the leverage that the debtor has at the outset of the Chapter 11 case by being able to make the initial presentation to the Bankruptcy Court and establish the narrative. The lender and its counsel will have to look carefully at every element of the case to develop the reasons the debtor should agree to grant the lender the rights the lender needs to best protect its position in the Chapter 11. ▣

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Aftershocks Coming? Anticipating Borrower Defaults and Defenses When Stimulus Ends

BY BRYAN E. BATES AND ERIC W. ANDERSON

When the world turned upside-down a year ago, many predicted that the severity of the damage to the U.S. economy would usher in a period of borrower defaults, business failures and bank foreclosures. Rapid government intervention, including bank regulatory easing, has prevented that series of events, for now. Those policy measures will surely come to an end before long, at which point lender-enforcement activity will likely increase.

D

ue to the severity and novelty of the pandemic's effects on many businesses, lenders can expect that borrowers will assert myriad defenses to their defaults, claiming that their failures should be blamed on the unprecedented public health crisis. This article will examine both the current regulatory posture that is helping calm the waters and early court interpretation of several defenses raised by borrowers so far in the pandemic.

Congressional Relief Bills

At the outset of the COVID-19 pandemic in March 2020, the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") was signed into law in an effort to address public health and economic impacts of COVID-19.

Nine months later, in late December 2020—on the precipice of the sunset of certain provisions of the CARES Act protecting defaulted borrowers and tenants from remedial actions—the Coronavirus Response and Relief Supplemental Appropriations Act became law as part of the Consolidated Appropriations Act, 2021 (together with the CARES Act, the "Relief Bills"). The Relief Bills have injected unprecedented levels of economic stimulus into the U.S. economy, helping thus far avoid widespread financial calamity that many expected at the outset of the pandemic and its resultant business closures and restrictions across the country.

The Relief Bills, along with related regulatory guidance, also contain less-noticed, but very important, provisions that change how regulated lenders are permitted to account for and disclose troubled debt restructurings ("TDRs"). Generally, and



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Takeaways

- 1** Courts will focus first on the contract terms, but may take a holistic view in fashioning relief in light of the sweeping and unexpected nature of the pandemic.
- 2** Consider amending force majeure and similar contract clauses to expressly contemplate the pandemic to ensure which performance obligations are not excused.
- 3** Review your forbearance agreements for language suggesting any continued obligation to modify the loan, consider borrower proposals, or otherwise work with the borrower.
- 4** Update and formalize forbearance agreements with borrowers whose distress is continuing or worsening.
- 5** Consider written demand to return to strict compliance if the borrower's performance has deviated from forbearance terms.

at the risk of oversimplification, if a borrower is experiencing financial difficulty and the lender has granted a non-material concession, then that credit is treated as a TDR, resulting in an impairment designation and certain impacts on the valuation and reserve requirements with respect to the credit. The Relief Bills temporarily relieve lenders from certain accounting requirements under GAAP applicable to TDRs. Specifically, the bills temporarily suspend the accounting treatment that would typically apply to a TDR, provided that the loan modifications stemmed from the effects of the COVID-19 pandemic on the borrower (as determined by detailed requirements in the bills).

As a result of this relief measure, and related regulatory guidance, lenders generally have been willing to enter forbearance agreements with borrowers, particularly those borrowers whose distress is clearly linked to the COVID-19 pandemic. Currently, the rules pertaining to TDRs will remain in place until January 1, 2022, unless the COVID-19 national emergency ends sooner, in which case they will expire 60 days thereafter.

Early indications from President Biden's administration suggest continued relief measures may be implemented, but at some point the relief measures will no longer be required, and the manner in which TDRs are treated will likely revert to traditional requirements. At that point, lenders will be more likely to exercise remedial rights on a broader scale against distressed borrowers.

When that occurs, lenders can expect resistance from borrowers, who may bristle at a seemingly sudden change in course. Since the outset of the pandemic, it was widely predicted that defaulting contract counterparties would assert defenses to performance on theories of *force majeure*, impossibility/impracticability of performance, and frustration of purpose due to the impact of the pandemic. Post-pandemic, defaulting borrowers are likely to assert those same defenses, and others, against remedial actions. Three decisions discussed below, rendered during the pandemic on certain of these

defensive arguments, provide an instructive look into how courts may address these sorts of arguments as they continue to arise post-pandemic. These decisions involved commercial leases in retail settings, which predictably produced some of the earliest reported cases, given the impact of COVID on the retail sector, but the legal principles at issue extend to all contracts, including loan agreements.

Chuck E. Cheese

In the Chuck E. Cheese bankruptcy cases in the Southern District of Texas, the Bankruptcy Court rejected arguments that the debtors were excused from contractual performance obligations under their leases due to the pandemic. *In re CEC Entertainment, Inc.*, 2020 WL 7356380 (Bankr. S.D.Tex. Dec. 14, 2020). Unquestionably, as an operator of indoor venues featuring arcade games, entertainment, and dining for family gatherings and groups of children, Chuck E. Cheese suffered unprecedented, unforeseen, and devastating impacts from the pandemic and related restrictions. The Court recognized that impact, and the Court agreed that certain government-mandated restrictions qualified as *force majeure* events. That notwithstanding, the Court held that the specific *force majeure* language of the contracts, most notably the exceptions, did not provide the debtors with a defense to their contractual performance obligations.

The leases at issue contained typical *force majeure* language, such as:

if either party shall be prevented or delayed from punctually performing any obligations or satisfying any condition under this Lease by any ... act of God, unusual governmental restriction, regulation or control ... or any other condition beyond the reasonable control of such party, ... then the time to perform such obligation or to satisfy such condition shall be extended on a day-for-day basis for the period of the delay caused by such event. **This Section shall not apply to the inability to pay any sum of money due hereunder or the failure to perform any other obligation due to the lack of money or inability to raise capital or borrow for any purpose.**

Because the exception precluded application of the *force majeure* defense to excuse payment obligations due purely to financial distress, the Court ruled that the debtors were not excused from performance, even if the occurrence of the global pandemic and related government regulations qualified as *force majeure* events.

The Court also examined the debtors' arguments under the alternative theories of frustration of purpose and impossibility of performance, under applicable state law. Principally, the Court reasoned that where parties affirmatively allocate risk of unforeseen events amongst the contract parties, such as through a *force majeure* clause, then the existence of such contract provision supersedes common law theories of frustration of purpose and impossibility of performance. But even considering the merits of such theories, the Court overruled

the debtors' arguments because the *force majeure* events did not operate either to entirely frustrate the purpose of the contracts or render performance impossible.

Pier 1 Imports

By contrast, the Bankruptcy Court for the Eastern District of Virginia took a more flexible approach in the very early days of the pandemic in the Pier 1 Imports case, and permitted the debtors to delay making contract payments, noting the unforeseeability of the pandemic and related restrictions. *In re Pier 1 Imports, Inc.*, 2020 Bankr. LEXIS 1242 (Bankr. E.D. Va. May 10, 2020). The primary issue was the mandate of § 365(d)(3) of the Bankruptcy Code that debtors must continue to "timely" perform under their commercial real property leases while operating in bankruptcy.

The debtors had implemented other cost reduction measures, but sought authority to delay rent payment obligations while they pursued a sale. The Court explained that the pandemic effected a "temporary, unforeseen, and unforeseeable glitch" in the debtors' operations and restructuring efforts, and perhaps in the vein of an impossibility theory, noted that the debtors "cannot operate ... because they have been ordered to close their business," "cannot effectively liquidate the inventory while their stores remain closed," and were "unable to open their stores to conduct the sales."

The Court reasoned that the performance requirements of § 365(d)(3) did not compel payment, just the incurrence of an administrative claim to be paid in accordance with other requirements of the Bankruptcy Code. The Court noted the existence of numerous other creditor constituencies in the case, and the scarce resources available to satisfy all claims. On the whole, amidst the highly uncertain early days of the pandemic, the Court fashioned relief designed to preserve value for the benefit of all stakeholders, rather than just the direct counterparties to the contracts in question.

Hitz Restaurant Group

The Bankruptcy Court in the Hitz Restaurant Group bankruptcy took somewhat of a middle-ground approach. *In re Hitz Restaurant Group*, 616 B.R. 374 (Bankr. N.D. Ill. 2020). That Court disagreed with the analysis in *Pier 1* that § 365(d)(3) did not compel payment, reasoning that the requirement of "timely" performance compels rent payments ahead of other administrative expenses (which, incidentally, comports with the Court's analysis in *Chuck E. Cheese*). The debtor argued that its *force majeure* clause excused performance. Noting that the existence of a *force majeure* clause in a contract supersedes the common law doctrine of impossibility, the Court examined the *force majeure* clause in the Hitz lease. That clause excused performance if prevented by governmental laws/orders/actions, but excepted lack of money as a ground to excuse performance.

The Court explained that the *force majeure* clause was triggered by a government order restricting restaurant operations, which order proximately caused the debtor's inability to generate funds sufficient to pay its contract obligations. Despite the exception that the lack of money was not grounds to

excuse performance, the Court allowed the debtor to reduce its payment obligations in proportion to the debtor's reduced ability to generate revenue due to the government order.

Borrowers Asserting Pandemic as Excuse

The lender flexibility spawned by this unprecedented pandemic may well lead borrowers to become accustomed to or expect continued forbearance and flexibility going forward, and borrowers may try to claim some entitlement to that treatment. Two decisions entered during the pandemic (both in the mortgage context) highlight some borrower arguments and judicial reasoning that lenders can expect in those circumstances.

In *Reynolds v. Wells Fargo Home Mortgage*, 2020 WL 3977934 (W.D. Va. July 14, 2020), the Court denied a borrower's claim that the lender breached its implied covenant of good faith and fair dealing in refusing to modify the loan under certain programs, including the CARES Act. The Court zeroed in on the key factor that no contractual provision between the lender and borrower required the lender to do so, and absent bad faith, a lender cannot be liable for breach of an implied covenant of good faith and fair dealing if it is merely exercising its contract rights.

In another pandemic-era decision, the Court in *Foster v. Reverse Mortgage Solutions, Inc.*, 2020 WL 4390374 (C.D. Cal. May 13, 2020), similarly denied a borrower's claim stemming from the lender's refusal to grant loan modifications. But the Foster court noted an earlier contrary court decision, *Lueras v. BAC Home Loans Servicing, LP*, 221 Cal. App. 4th 49 (2013), in which the subject forbearance agreement included language that incorporated regulatory guidance that lenders "should" work with borrowers and expressly required the lender to "review" the borrower's loan to determine if additional default resolution assistance could be offered. The agreement being construed in *Foster* did not have any such language, but if it had, then the outcome could well have been different.

Lender Guidance

For lenders, these rulings offer a look into the varied forms of legal analyses at issue and potential array of relief that may be fashioned if a defaulting borrower claims the entitlement to excuse performance by virtue of a *force majeure* provision in a loan agreement or any similar common-law theories. As shown in these decisions, courts, especially bankruptcy courts, will take a holistic view, but all courts will start by examining any express *force majeure* contractual provisions, as well as any contract provisions that operate similarly (regardless of whether denominated as a "*force majeure*" clause).

Review your contracts for any language addressing *force majeure* events, any other excuses for performance, and any potential obligations to continue working with borrowers. The benefit of having these provisions is that they are likely to supersede application of alternate common-law theories, because the parties have expressly contemplated the issue and determined how to allocate risk. Many loan contracts may not

have *force majeure* clauses, which leaves open the possibility that common-law theories of impossibility, impracticability, and frustration of purpose may apply (exploration of which is beyond the scope of this article). In any event, before taking remedial action, lenders should consider documenting a demand to return to strict compliance, reasonably in advance of taking such action.

During this pandemic, lenders have entered into forbearance agreements on an extraordinary scale. The manner in which lenders documented those agreements spanned a broad spectrum, from the highly informal to painstakingly negotiated, comprehensive written agreements. Lenders should review those agreements and consider whether it may be necessary or advisable to revise or amend them to expressly contemplate the current pandemic and ensure that the language of any *force majeure* exception clearly delineates what performance obligations (e.g., payment obligations) are not excused upon the occurrence of a *force majeure* event. Lenders should also analyze their forbearance agreements regarding any terms governing continued obligations to modify loan obligations, or to even consider borrower proposals.

Taking these steps now could pay dividends in the post-pandemic return to a broader exercise of remedial rights. ▣

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Is Cannabis Lending In Your Future?

BY JEFFREY A. WURST AND PAUL J. CAMBRIDGE

Armstrong Teasdale partners provide lenders with up-to-date information on the complexities of lending to the legalized marijuana industry.

Perhaps the most frequently asked question by growth-oriented lenders is “How and when can we lend into the rapidly growing and already major industry of legalized marijuana?”

The answer is: “It is not so simple.”

Takeaways

- 1 Legalized cannabis is amongst the most rapidly growing U.S. industries, yet it is substantially unserved by lenders.
- 2 While Federal Law continues to prohibit the manufacture, possession and use of marijuana, a growing number of states have legalized adult (recreational) and medical use.
- 3 Despite the legal prohibition, Federal agencies have taken a hands-off position in enforcement in jurisdictions where state law has allowed the use and sale of cannabis products.
- 4 Despite the rumors to the contrary, financial institutions may provide services to direct and indirect marijuana-related businesses provided they comply with certain reporting requirements.
- 5 Clearly, marijuana-related businesses are ripe to become borrowers – once lenders learn how to make these loans.

It is estimated that U.S. sales of legal marijuana exceeded \$15 billion in 2020 (up from about \$10 billion in 2019), \$2 billion of which came from Colorado alone. These numbers are projected to double by 2024. The legal marijuana industry is certainly escalating, but roadblocks remain, making it difficult to lend to cannabis-related businesses.

Let's start with a review of the state of the law. There is a cacophony of state and federal laws, many of which are at odds with each other. As of this writing, medical marijuana is legal in 35 states and Washington, D.C., while 15 of these states plus Washington, D.C., have legalized adult-use (recreational) marijuana.

Federal Law

Since 1970, with the enactment of the Controlled Substances Act (CSA), the manufacture, possession or use of marijuana – even the use of marijuana for medical purposes – has been prohibited. The Money Laundering Control Act of 1986 imposed harsh penalties (fines and/or imprisonment) upon those who knowingly conducted financial transactions that involved proceeds of any unlawful activity. But, as early as August 2013, the Department of Justice (DOJ) by then-Deputy Attorney General, James Cole, in what has been referred to as the Cole Memorandum took an official hands-off policy suggesting that the U.S. Attorneys refrain from prosecuting state-authorized marijuana use provided that such use does not interfere with certain federal law enforcement. That policy, however, was rescinded in January 2018 by then-Attorney General Jeff Sessions. Prior to that, Congress adopted the Rohrabacher-Farr Amendment, which prohibited the DOJ from using federal funds to prevent implementation of state laws authorizing the use, distribution, possession or cultivation of medical marijuana.

In February 2014, the Financial Crimes Enforcement Network (FinCEN) issued guidance to clarify the Bank Secrecy Act (BSA) expectations for financial institutions providing services to



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marijuana-related businesses (MRBs). The FinCEN guidance relies heavily on the Cole Memorandum, despite it being rescinded. The FinCEN guidance is the only official federal guidance available to financial institutions regarding marijuana banking. The FinCEN guidance has two key areas of focus: (1) customer diligence and (2) suspicious activity report (SAR) filing.

As a result, when entering into a relationship with a company engaged in an MRB, financial institutions are obligated to conduct substantial customer due diligence to verify that the MRB is in compliance with state law and that there is no indicia of violations of federal law as described in the Cole Memorandum. This due diligence must continue throughout the relationship – not just at the beginning. As a result, there is a significant cost to the financial institution in accepting MRBs as customers.

In September 2019, the House of Representatives passed the Secure and Fair Enforcement (SAFE) Banking Act, which, if enacted, prohibits regulators from penalizing depository institutions for providing banking services to state-authorized MRBs. However, the Senate has not taken any action on the SAFE Banking Act.

In December 2020, the House approved the Marijuana Opportunity Reinvestment and Expungement (MORE) Act of 2020, which, if enacted, would remove marijuana from the list of controlled substances and eliminate criminal penalties for the manufacturing, distribution or possession of marijuana. Ancillary parts of the MORE Act include a 5% federal tax on cannabis products. The bill was referred to the Senate, but no action has been taken as of the writing of this article.

In light of change in control of the Senate, one may expect significant changes in the area of federal marijuana law which could, in fact, be the game changer for which lenders have been waiting.

State Laws

Fifteen states and Washington, D.C., have enacted laws legalizing adult recreational as well as medical use of marijuana and 21 states

have legalized the use of medical marijuana. Fourteen of the states that have legalized use of medical marijuana plus Washington, D.C., have done away with jail time for possession, of small amounts, and two states that have not legalized recreational or medical use have removed jail time for possessing, small amounts. That leaves 12 states that have not legalized marijuana where jail time may be imposed for possession of even small amounts of marijuana for medicinal purposes.

States have been moved to adopt marijuana laws as a result of public pressure, the medical benefits attributed to cannabis products and especially the economic growth that comes along with it – including the tax revenues.

Banking Services to MRBs

Since 2014, FinCEN has been monitoring depository institutions actively providing banking services to MRBs based on the filing of SARs. While there was a sharp increase in such numbers during 2019, those numbers slightly declined in 2020. This is likely the result of MRBs closing due to pandemic restrictions on business operations, in general, as well as staffing reductions at depository institutions causing delays in the filing of SARs. As of September 2020, there were 677 depository institutions reporting SARs related to MRBs, a drop from 747 less than a year earlier.

We are likely at the cusp of the opportunity to enter into the marijuana lending business, providing lenders are prepared to invest in the infrastructure necessary to comply with FinCEN requirements. That infrastructure needs to be in place to monitor and report on MRB customers and may be shared by both internal and external sources.

It must be understood that MRBs come in different sizes and shapes. Unfortunately, the FinCEN guidance does not provide a comprehensive definition of what is considered an MRB for purposes of the enhanced due diligence and SAR requirements under BSA. Many financial institutions and lenders take a three-tiered approach to providing financial services to direct and indirect MRBs, with the most scrutiny applied to customers in the higher tiers.

- Tier I MRBs include growers, processors, wholesalers and dispensaries – entities that are hands-on with the cannabis products. These are the riskiest customers from a BSA compliance standpoint and the requirements of the FinCEN guidance clearly apply.
- Tier II MRBs are indirect MRBs that receive a significant portion of their revenue from Tier I MRBs, including suppliers, security and licensing consultants focused on the marijuana industry.
- And Tier III includes those that do incidental business with MRBs, such as landlords, professional service firms, banks, etc.

The FinCEN guidance indicates that for indirect MRBs, such as those in Tier II and III, the marijuana-specific SAR requirements of the FinCEN guidance do not apply and it is left to every financial institution or lender to make a risk-based decision whether it will take on those

indirect MRBs as customers.

In addition to the BSA compliance costs and risks associated with providing financial services to MRBs, a lender should consider the unique standing of MRBs, given the disconnect between federal and state law when underwriting and structuring loans. For example, when determining appropriate collateral for a loan to an MRB, a lender should consider what would happen if its customer ran into regulatory issues with its state-licensing body or federal law enforcement, including the potential effect of seizure laws if an MRB is ever charged with a crime. Also, a lender should consider how it would take possession of collateral in an event of default given that many states have complex regulatory regimes that only allow licensed business to legally operate as an MRB.

Before lending to an MRB, it is necessary to be familiar with the marijuana laws of the borrower's state. For example, some states prohibit the granting of security interests in Tier I products. Even if granting a security interest is legally permissible under applicable state law, taking possession of collateral may not be feasible for a lender if it is not licensed as an MRB by the state.

We should be in agreement that it is just a matter of time before MRBs will become a major industry serviced by lenders – both banks and commercial finance companies. Those looking to enter this market are advised to start preparing for this influx of business if they are willing to venture into it. It remains uncertain when, if ever, the diligence and reporting requirements will ease and make MRB borrowers more akin to others that are not regulated; however, it is unlikely that will be soon. Thus, lenders anxious to enter the MRB marketplace are advised to be prepared to take on the reporting requirements and to price their loan products accordingly. ■

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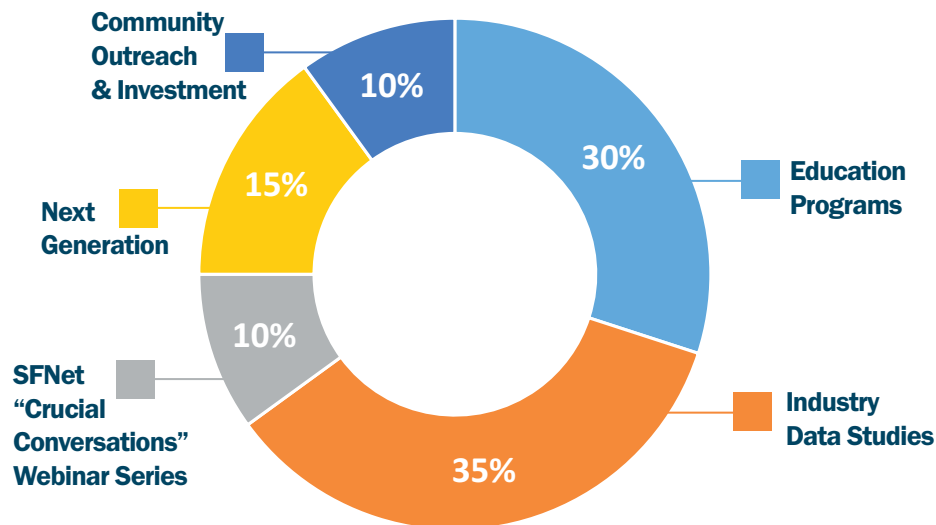
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The Best of Both Worlds: How Community Banks and Asset-Based Lenders Partner to Serve SMEs

BY MICHELE OCEJO

Community banks play a vital role in enabling local businesses and communities to thrive. By either offering asset-based lending as part of their product offerings or partnering with a nonbank asset-based lender, community banks can offer the best of both worlds to small and mid-sized businesses. The Secured Finance Network interviewed several of its members who shared their experiences and perspectives.

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Yvonne Kizner is senior vice president – asset-based lending with Cambridge Savings Bank. She provided some background on the institution: “Cambridge Savings Bank is a mutual bank. We have 17 branches located throughout the metro Boston area, and we are about \$5 billion in asset size. My partner, Keith Broyles, and I started the asset-based lending group for Cambridge Savings Bank in April of 2019.” Kizner explained that prior to the launch of the ABL business companies that were not meeting their operating cashflow needs would have been bypassed by the bank. “The asset-based lending group has allowed the bank to do more transactions and open up our geography a bit since we will take on a deal that’s in the New England area through New York and New Jersey, beyond where our middle-market team concentrates.”

In addition to expanding geographically, Kizner said ABL has allowed Cambridge to expand in terms of the types of companies they are now able to fund as well as “enabling us to diversify in terms of loans away from real estate, where a lot of community banks are heavily focused. We’re all about improving our customers’ financial wellbeing, and I think that being able to go to a bank with an asset-based formula versus a nonbank, which likely is a more expensive



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■ **DAN KARAS**
Allied Affiliated Funding



■ **DONALD LEWIS**
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■ **JEFFREY GOLDRICH**
North Mill Capital



■ **YVONNE KIZNER**
Cambridge Savings Bank

option, helps our borrowers in the long run.”

Boston-based Eastern Bank recently completed an IPO in October 2020, which formed Eastern Bankshares, Inc., the stock holding company for Eastern Bank. Donald Lewis, senior vice president and head of asset-based lending at Eastern Bank, said, “The bank today is about \$15 billion in assets. I joined a little over two years ago to head the ABL business and we’re seeing steady contributions to our overall commercial business. We look at deal sizes from \$3-to-\$30 million. I would say our sweet spot is between \$5 and \$20 million. We lend throughout New England and into New York and New Jersey.”

Lewis pointed out that ABL is certainly a growth opportunity for a community bank when done appropriately.

“It can also act as a complementary product with a C&I offering or a group with clients that may need an ABL structure for a period of time due to certain events, such as an economic downturn. To the extent ABL can be a part of lifecycle situations for a business, it helps enhance how a team within a bank can service its customers.” And even when banks deem it appropriate to refer a customer to a nonbank ABL partner, the ideal outcome is a return of that customer to the bank.

Nonbank lenders such as North Mill Capital play a key part in this process. Jeffrey Goldrich, president and CEO, North Mill Capital, said, “North Mill is a nonbank lender, 100 percent-owned by a BDC called Solar Capital. We offer both nonbank asset-based lending and factoring. Our loan sizes go from pre-revenue – we’ll do a startup in our factoring business – up to \$35 million of credit facility size in either ABL or factoring. We’ll indulge pretty challenging turnarounds and pretty challenging balance sheets and P&Ls and, if the assets are good and management is honest, we can finance those companies regardless of financial performance history.”

Goldrich indicated that most of North Mill’s referrals come

from banks throughout the country. When the loans are ready to “graduate back” to bank financing, they return to the referring bank without an early termination fee. “It gives the referring bank a huge advantage over competition when the loan is ready to go back to bank financing,” explained Goldrich.

He added that some nonbank lenders, including North Mill, will partner with banks to provide needed capital to clients that may be on the fringe of being “bankable.” “They like to downsize their exposure. We run the collateral and the credit, and then at any time the bank wants it back in full, they can pay us out. But, in the meantime, we do all the collateral monitoring.” This type of arrangement benefits both the nonbank and bank lenders, but it’s especially beneficial to the client.

Patrick Brocker, senior managing director and head of structured finance for Peapack-Gladstone Bank, noted that tremendous effort and resources were placed on providing PPP loans to clients and non-clients alike during 2020 to help companies weather the effects of Covid-19. “Peapack-Gladstone Bank is celebrating its 100th anniversary this year. Helping our communities has been part of our DNA since 1921,” said Brocker. The Bank’s parent company, Peapack-Gladstone Financial Corporation, is a New Jersey bank holding company with total assets of \$6.0 billion and AUM/AUA of \$7.6 billion as of September 30, 2020. With 19 retail locations and nine private banking and wealth management offices, Peapack-Gladstone Bank and its wealth management division, Peapack Private, provide innovative wealth management, investment banking, commercial and retail solutions, including residential lending and online platforms, to businesses and consumers. Peapack Private offers comprehensive financial, tax, fiduciary and investment advice and solutions to individuals, families, privately-held businesses, family offices and not-for-profit organizations. “Our goal is to help our clients establish, maintain and expand their legacy, while offering an unparalleled commitment to client service,” said Brocker.

Dan Karas is executive vice president of Allied Affiliated Funding,

which was acquired by Axiom Bank in 2018. Karas provided further details on his institution: “Axiom is based in Maitland, Florida. The bank was started in 1963, is privately held, and acquired by the current owner in 2003. We have 17 branches throughout central Florida. At Allied, we have a national footprint, we do transactions up to \$10 million, and support the bank strategy by financing nonbankable clients with yields that exceed those of a traditional commercial bank.” Karas listed the three advantages of offering ABL products for a bank: “We’ve broadened the product suite such that we can obtain clients at stages such as startups or high growth

or financially challenged that don’t fit a community bank risk. And, as others have mentioned, once the client’s performance improves, they graduate to the bank’s commercial lending group without having to restart the relationship. The second is we’re a defensive tool for the commercial bank client whose financial performance deteriorates, but is still acceptable for ABL or factoring. And then the third is we deliver yields that are better than traditional commercial real estate or commercial C&I loans, which helps lift the bank’s interest margin.”

Getting Started

Of course, starting up and maintaining a successful ABL division isn’t without its challenges. A key tenet is to be sure you are hiring experienced asset-based lenders rather than expecting your existing staff to just move into ABL.

Kizner shared her experience: “It’s critical that you have the right people running the shop and managing the portfolio and that you have the systems in place that can help manage availability on a daily basis. I started at Cambridge Savings with Keith Broyles a year and a half ago, and prior to that we did the same thing at Blue Hills Bank, another community bank in Massachusetts. In both cases, the banks were not looking to take this on, and we approached them and convinced them with a business plan. It’s a combination of getting both the board’s and executive management’s buy-in, which



Kizner said ABL has allowed Cambridge to expand in terms of the types of companies they are now able to fund as well as “enabling us to diversify in terms of loans away from real estate, where a lot of community banks are heavily focused. We’re all about improving our customers’ financial wellbeing, and I think that being able to go to a bank with an asset-based formula versus a nonbank, which likely is a more expensive option, helps our borrowers in the long run.”

is a huge education process.”

Part of that education, said both Kizner and Lewis, is explaining ABL’s unique aspects to those not experienced in ABL, many of whom assume that, if the yields are high, it must be risky. “We need to explain that, if it’s very well managed and well monitored, then, in fact, it’s probably the least risky piece of lending that you can do within the bank. I certainly would rather take on an asset-based loan than real estate these days,” said Kizner.

Lewis brought up the difference between traditional C&I lending and ABL. “There is such a heavy emphasis on cashflow coverage which certainly is important, but with ABL deals, having sufficient liquidity to operate a business is really what’s most important. That understanding and thought process can differ from traditional C&I transactions.”

The Benefits of Community

All of the community bank ABL executives agreed being a member of the Secured Finance Network provides them with opportunities to which they would not otherwise have access. One key benefit is exposure to a host of quality service providers, such as attorneys, turnaround firms, software providers and field examiners. Kizner recounted their experience: “We found an alternative software provider through SFNet that was much less expensive than some of the others, but offered greater functionality. And we wouldn’t have found that without being part of this network.”

Lewis spoke about the benefits of participating on SFNet conference panels. “Our Commercial Risk Management Director was on a panel during SFNet’s virtual convention in November, which helped to create awareness about his expertise, build new relationships and network with other institutions.” Lewis also spoke highly of SFNet’s Crucial Conversations webinars which were launched during the pandemic and are free to member organizations’ staff.

SFNet’s advocacy efforts were also praised by participants. Kizner is a member of SFNet’s Advocacy Committee. “I was pleased to represent institutions under \$20B, and community banks in particular, in conjunction with SFNet’s Advocacy Committee and its endeavors to ensure legislators heard from many constituents in the finance community relating to PPP. With SFNet’s contacts, I was able to secure a meeting with seven representatives of the Federal Treasury department and indicate the concerns the asset-based lending community had with the Main Street Lending Program as it was being developed. This was a perfect example of the vital role SFNet plays and one of many reasons we value our membership,” she said.

Pandemic Effects

The COVID-19 crisis has affected community banks in many ways. Kizner said, “The immediate impact was the PPP and understanding the program, getting the application out, making sure that our borrowers were included in the first round. It was a little crazy. People put in a lot of hours in a very short amount of time, and

then it was waiting to see how our borrowers fared and whose businesses would be impacted and for how long. We were deeply, deeply impacted.” Lewis agreed that banks were laser-focused on PPP. “Eastern was the third largest PPP provider in Massachusetts, helping to secure over 8,500 loans which, given our commitment to small businesses, is something we’re proud to have been able to contribute.”

Kizner also pointed out how COVID has drastically changed prospecting. Other than some rounds of golf and outdoor lunches during the summer, virtual meetings are the order of the day. She lamented the lack of face-to-face contact, which is vital to ABL.

Karas has been impressed by the industry’s ability to adapt: “I think the best example of this success is the SFNet annual convention in November. I’m confident that we’ve all learned to adapt to remote video interactions with leadership teams and clients. I like to borrow this Marine Corps slogan: we all have learned to improvise, adapt, and overcome.” Lewis agreed and added he was impressed by his bank’s technology team, which was able to get the C&I team, in addition to the entire bank, up and running remotely in just several weeks.

Brocker’s business hasn’t felt a great impact as his business is about two-thirds or more highly capitalized cashflow-oriented financings. “We didn’t have much in the way of PPP loans in our portfolio but, in addition to our banks tremendous PPP support within our communities, we actually stepped up to help a number of the SFNet nonbank members by getting their customers PPP loans. Our bank was and will continue to be extremely active and committed to providing PPP loans and saving jobs.”

Kizner, Lewis and Brocker agreed the pandemic has increased their interaction with nonbank industry partners. Brocker said, “We have seen an increase in our referrals out to non-bank finance companies. We act as a resource for our C&I group when they feel the client needs are beyond a stand-alone bank solution. In those cases, either a joint deal between us and a nonbank that can monitor it safely, or a referral out to our nonbank partners, may be in the best interests of the client and we always put the client first.” He went on to explain, “We view ourselves as advisors to companies. We like to put capital out from our balance sheet, obviously, but if a company is better off with another solution, then we’re dutybound to send them in that direction and be a matchmaker, rather than serving our self-interest.”

“I’ve had a lot of phone calls, mainly with nonbank finance companies, that are interested to understand if there are assets that we are looking to offload. This has given me a chance to find out what kinds of deals they’re seeing in the marketplace and potentially how we could partner or refer deals back to one another. There has definitely been a lot of more interaction than pre-COVID,” Kizner said.

Karas has not seen the same increase and credits the various government stimulus programs for this. “I think the combination of regulatory guidance that was given to work with our clients and the liquidity generated by PPP loans allowed a lot of banks to hold onto their relationships. I think an exception to that is companies that had public debt or needed to address near-term securities. I

think that's going to change in 2021, and I think we'll see more interaction."

According to SFNet's latest quarterly data, utilization is down significantly among bank lenders. Kizner and Karas pointed out that utilization depends on the customers' business. "We've had a couple clients that have actually thrived during COVID. They were able to tweak their product mix and actually had some working capital issues because they were growing quickly. And then on the opposite end of the spectrum, I've had others that have been horribly impacted and the PPP was literally a lifesaver. We've seen just about everything across the spectrum," said Kizner.

On the second round of PPP, Kizner said, "It will be extremely helpful to a number of our borrowers who continue to be deeply affected by COVID, especially in the hospitality space. We plan to jump on this as soon as SBA opens the program."

Karas is also hopeful the second round of stimulus will provide a lifeline to customers. "The simplicity it provides for forgiveness of the first round of loans of \$150,000 and less, combined with the opportunity for many of our clients to obtain new loans, will be of tremendous value in continuing to move our economy forward."

The Year to Come

When discussing the challenges and opportunities for 2021, Karas said, "I'm proud to say that my counterpart at Axiom, who leads our commercial banking team, has increased both loans and deposits every month since May. We've been focused on helping clients and prospective clients to deliver creative solutions, try to be supportive through their challenges and being proactive at addressing their needs. So I don't know what we'll face in 2021, but I think, if we all continue to focus on supporting the referral partners and our clients and being proactive to help them solve their issues, then I think we're going to have a really successful 2021."

Brocker explained, "Every portion of the economic cycle creates opportunities and challenges. The challenges always revolve around the credit tail in your portfolio and your internal reputation and what you have on the books and whether it's going to perform well.

In addition, competition typically is less severe at times like this, and so those who have a good portfolio and can make really good decisions in choppy waters have tremendous opportunities to grow and help a lot of clients, prospects and referral sources who need it."

Lewis believes the increased stability can be a positive indicator for M&A activity "which, for ABL, can be very transactional and lead to some good opportunities."

Goldrich expressed concern about the unknown long-term impact

of COVID. "My concern is that we'll eventually come out of this and we'll be changed. I live in New York City and it's staggering to see the amount of restaurants, bars and stores that are closed." He pointed out these closures represent many who are now unemployed and that this is a problem reverberating throughout the country. "I think there will be really serious challenges affecting all of us. The good news is the Secured Finance Network has created a plan to assist its members with the changes to come that includes more frequent and on-demand opportunities for relationship building, accessing information and professional development."

Kizner and Lewis both acknowledged existing challenges would continue, particularly in the first half

of the year, but expressed optimism that the vaccine rollout will increase stability and improve the economy. "I'm happy that our executive team decided we are going to continue lending, we are not going to shut down prospecting, despite COVID. So clearly 2021 will be all boots on the ground. I really hope that with the vaccines we're able to resume face-to-face meetings but, as Jeff mentioned, SFNet has created ample virtual opportunities for networking and education to help its members weather the uncertainty." □

Michele Ocejo is director of communications for SFNet and editor-in-chief of The Secured Lender.

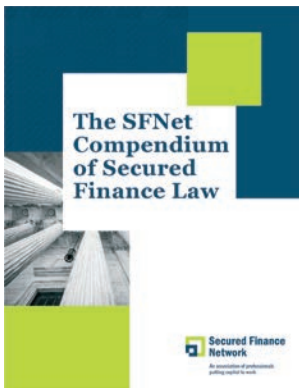


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ADVISORS CORNER

How Financial Advisors Can Facilitate the Best Possible Outcomes in a Bankruptcy

BY PAT DIERCKS

Despite lenders' best efforts, the bankruptcy of a borrower is faced by most lenders. Learn how partnering with a financial advisor can protect your interests.

Regardless of how well you vet your borrowers, there will likely be a point when you are faced with a borrower that is flirting with the need to go into a bankruptcy proceeding. The saying "knowledge is power" holds especially true in a bankruptcy case where receiving timely, accurate, relevant and unbiased information will allow you as a lender to take the appropriate actions to ensure the best outcome possible. While there are likely internal personnel and resources at most lending institutions that have had experiences with borrowers in bankruptcy, it is certainly not what they do every day, and therefore they may not be thoroughly versed in the latest changes to the Bankruptcy Code, recent rulings and other case law relevant to your borrower. When faced with this situation, it is advisable to make sure you are going into the process with professionals who have the specific expertise and up-to-date experiences of traversing the current bankruptcy landscape. Just as you would likely rely on some level of outside help in preparing to close on a new loan, having bankruptcy professionals retained prior to filing will assist you in balancing both the needs of the debtor and your own to get to the most successful outcome possible. As a lender, whether you are providing DIP financing, allowing the use of cash collateral, or are sitting in the second (or lower) position behind the senior secured lender(s), many of the decision points as to how you approach a bankruptcy will be based on the financial projections provided by the debtor and their financial advisors. Retaining a financial advisor that understands the bankruptcy process and singularly represents your interests is critical to ensuring a well-informed and smooth experience for the secured lender.

Preparation is Key

A good portion of the decision-making process and work that allows for a well-organized/prepared bankruptcy filing is typically completed in the two to three weeks leading up to the bankruptcy filing. This work sets the groundwork for how the case will proceed, the monetization of assets, and, probably most importantly, the parameters of how the debtor will access liquidity to continue through the bankruptcy process. Having financial and legal advisors in place at the start of this

process will allow the secured lender greater visibility into what the best options are for them in the process. It is extremely likely that during this preparation phase that the borrower will be undergoing complex scenario modeling in trying to determine the best course of action. Models and scenarios will be constantly changing. An astute financial advisor will be able to stay on top of this process and keep the secured lender informed as to what the best and most likely outcomes are out of each scenario. Being able to provide timely and accurate information back to your credit and underwriting teams will be essential in order to get the necessary approvals to move forward with a DIP loan or allow the borrower to utilize cash collateral while operating in bankruptcy.



■ PAT DIERCKS
Clear Thinking Group, LLC

Keeping Your Best Interest in Mind

Given the various constituents in the case (secured lenders, note holders, unsecured creditors, etc.), there will be many different views of what the best course of action will be to preserve their own interests. Many of these constituents will have their own financial advisors and legal counsel whether in a formal role such as the Unsecured Creditors Committee's advisors or less formally to ensure that their interests are specifically being represented. A bankruptcy-savvy financial advisor will be able to assist the secured lender in weighing the benefits and risks to all the possible scenarios and pointing out those that are potentially more advantageous to one party versus another. While most constituents work very hard to march in the same direction as it is the most efficient way through the bankruptcy process, there are going to be many instances where the best interest of the debtor/other creditors is not aligned with that of the secured lender. Just as you would never rely on the prospective borrower to do their own field exams or utilize their legal team to draft the loan documents when closing on a new loan, the secured lender needs to be mindful that the borrower/debtor's case professionals are exactly that. Their fiduciary responsibility is to the debtor and just because something works well for the debtor does not mean it is always the best scenario for the secured lender.

Relevant and Timely Flow of Information

Knowing what information is necessary and getting it in a timely manner is of the utmost importance while dealing with a borrower in bankruptcy. Being able to ascertain the progress of the case and making sure that the milestones set forth in the court-filed budgets are being met needs to be done in a proactive manner. There will be significant amount of information that is going to be available as the case proceeds. The court docket will contain hundreds if not thousands of documents and there will be updated budgets and other performance metrics that are provided due to the constantly evolving nature of most bankruptcy cases. To the untrained eye, there would appear to be a cumbersome amount of information to sort through and digest, but the financial and legal advisors you retain will be able to parse through all of this information relatively quickly and keep you informed as to what really matters so that you don't get bogged down in the more procedural matters that don't have any relevance to your position in the case.

In a bankruptcy case, the court does not have a real standardized requirement of the debtor to provide real-time information or any metrics around what should be supplied to the various constituents during the case. Certainly, as with a non-bankruptcy borrower, the lender will be able to dictate through the DIP loan or cash collateral agreements what information is required and when. A trusted financial advisor will be able to help you understand what information is relevant to obtain from the debtor, given the dynamics of the bankruptcy case, and make sure that they stay on top of the performance of the debtor as it relates to the budget and reduce the likelihood that there will be any unpleasant surprises. As we all know, not all things go smoothly (after all, if they did, the borrower would not be in bankruptcy) and knowing about potential issues ahead of time allows for more time for all parties to pursue other options. An advisor will also be able to help you to closely monitor your collateral and provide insight as to the best ways to monetize those assets, depending on the case.



In a bankruptcy case, the court does not have a real standardized requirement of the debtor to provide real-time information or any metrics around what should be supplied to the various constituents during the case.

Balancing Internal Workloads

Given all the issues described above, it should be fairly clear that there will be additional work created by having a borrower in bankruptcy. Depending on a multitude of factors (seasonal, industry-specific issues, micro/macro-economic trends), there are likely times when your internal workout groups can be overwhelmed with more borrowers in trouble than they can appropriately handle on a day-to-day basis. Having seasoned professionals working with your best interests in mind and taking on some of this additional work can make all the difference in ensuring a transparent and smooth process. It also puts another set of eyes on things to ensure nothing is being overlooked. Setting up a process where the professionals do the work and report back to you at regular intervals allows internal lender resources to

continue doing their normal flow of work, yet have the necessary information available on the borrower/debtor's issues to be able to make timely, appropriate decisions.

In conclusion, given the fast-paced and somewhat unpredictable nature of each individual bankruptcy case, the secured lender needs to make sure that either they have sufficient resources to manage the process from their perspective or look to hire additional resources in the form of both legal and financial professionals to assist in making sure that the bankruptcy process allows for the best possible outcome. Preparing to go into a bankruptcy process with a borrower and making

sure that you lay the proper groundwork by having the right information and resources in place can make all the difference in how the case proceeds from the secured lender's perspective. ▣

Patrick Diercks is a partner with Clear Thinking Group. He has over 15 years of experience as a consultant in the turnaround/restructuring arena dealing primarily with companies in consumer product manufacturing/distribution and retail. He has participated in numerous assignments related to cash management and operational performance improvement. Diercks is a Certified Insolvency and Restructuring Advisor through the AIRA, and has a bachelor degree in Finance from The Florida State University.

GOVERNMENT RELIEF

The Government's COVID-19 Relief Programs Create New Challenges for Healthcare Lenders

BY JOHN TISHLER AND
BETH PITMAN

Lenders have weathered a storm of uncertainty brought on by the global pandemic and the economic damage left in its wake. There could be a new line of storms, however, for secured lenders that are active in the healthcare space – especially lenders working with healthcare companies that have received COVID-19 relief funds from the government or depend heavily on Medicare reimbursement.

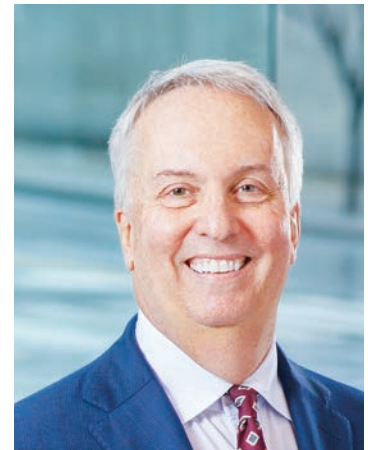
When Congress enacted the CARES Act in March 2020, the government quickly established a number of different programs to support healthcare providers and suppliers during the pandemic. Lenders should be aware of two such programs – the CARES Act Provider Relief Fund (PRF) and the Medicare Accelerated Payments Program – that could prove problematic for lenders and borrowers in the future.

Provider Relief Fund

Provider Relief Fund distributions were automatically distributed to healthcare providers by HHS and administered by its Health Resources and Services Administration (HRSA) division. These distributions are grants and not loans, and they do not have to be repaid unless the provider fails to meet the terms and conditions for acceptance of the funds. Reporting to HHS is required. If a government audit determines that the funds were received improperly or were misused, repayment will be required. If the grant funds must be repaid, it is immediate, but terms may be negotiated with the Department of Health and Human Services (HHS) and, if the government determines that fraud has occurred, the matter can be referred

to the Department of Justice or the Office of the Inspector General.

Lenders may want to monitor their borrowers for how they fare in connection with any such reporting and audits. Lenders may want to consider amendments to existing credit facilities or may want to include covenants in any new credit facilities requiring compliance with the terms and conditions and reporting requirements and requiring notice to lenders when such audits are being conducted, including results of such audits at or near the same time as the borrower learns the results. Ideally, should these loans have to be repaid and the borrower not have the means to do so, lenders will want to have the ability to position themselves for the greatest possible recovery.



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Medicare Accelerated and Advance Payment Program (MAP)

CMS expanded the scope of its Accelerated Payment Program to provide immediate cash-flow relief to healthcare providers treating COVID-19 patients. Repayment of these advance payments has been delayed until one year after the issuance of funds starting in August 2021.

Without a further repayment delay, this means in August CMS will begin reducing Medicare reimbursement to healthcare organizations and companies that received advance payments in order to recoup those payments. If not totally recouped within three years after issuance, the “loan” balance becomes immediately due and payable to CMS. We expect this will create new challenges and opportunities for secured lenders. Where borrowers previously had rosy balance sheets propped up by these advance payments, starting in August borrowing bases will begin to take hits as the government commences its recoupment of the payments. This could lead to tightening liquidity and, in some cases, defaults by borrowers.

Takeaways

Lessons Recently Learned

Waller recently provided legal counsel in the Chapter 11 bankruptcy of an investor-owned healthcare company. The lessons learned at the intersection of bankruptcy law, COVID-19 and government relief programs offer some insight into what lenders and borrowers might expect when it's time to repay those CARES Act advance payments. And it's a pretty good story, too.

It begins in 2017 when a distressed healthcare company engaged us to explore strategic alternatives. The debtor, which operated long-term acute care hospitals (LTACHs), skilled nursing facilities and freestanding medical-surgical hospitals, was struggling in the face of Medicare reimbursement rates for certain patients that were reduced from \$41,000 per stay to \$10,000. The debtor filed for Chapter 11 bankruptcy protection with more than \$350 million in liabilities, and it ultimately became clear that the company would need to sell substantially all of its assets and there would be no opportunity for restructuring.

Over a four-month period in early 2019, we negotiated and obtained court approval for the sale of all the company's healthcare facilities, including one transaction in which seven of the debtor's facilities were sold for a total purchase price of \$7.

Skip ahead to March 2020 and the early days of the pandemic when Congress enacted the CARES Act and HHS began disbursing funds in various forms and in various ways from various agencies to assist healthcare providers in treating COVID-19 patients. Provider Relief Funds were electronically transmitted with no advance notice given to the recipients.

Staring into the unknown in the early days of the pandemic, HHS calculated the funds for distribution relying on old Medicare contracts and cost reports. Healthcare entities did not apply for the PRF payments, CMS simply calculated and disbursed the funds using the best data it had available. At this point, the company we represented in bankruptcy and transactional matters described above no longer had operating assets and was moving toward confirmation of a Chapter 11 plan that would establish a liquidating trust for the benefit of its remaining creditors. Imagine everyone's surprise when the government wired approximately \$1 million in PRF funds to an entity that no longer provided healthcare services of any kind. Separately, and unbeknownst at the time to our client, additional distributions through checks totaling approximately \$600,000 were separately mailed to facilities that had been sold, made payable in the debtor's name, not the buyer's.

Waller attorneys reached out to HHS with a simple question: Should the non-operating entity send the funds to the buyer (and current operator) of the facility for which the relief funds were intended, or send the funds back to HHS? Funds for fighting the pandemic should go to those doing the fighting, so we knew our client wouldn't be keeping the money. Also, the terms of the asset purchase agreement required our client to send the funds to the buyer.

HHS, through its third-party administrator United Health

- 1** Lenders should assess whether healthcare borrowers have received COVID-19 relief funds or depend heavily on Medicare reimbursement.
- 2** The government's powers of recoupment and recovery could outweigh any reliance on a borrower's collateral with respect to COVID-19 relief funds or Medicare advance payments.
- 3** Lenders should add Provider Relief Fund and Medicare advance payments to their due diligence checklists when originating new loans to healthcare organizations.
- 4** Lenders may also want to include special provisions in their loan documents related to Medicare advance payments.
- 5** Borrowers who received advance payments may approach HHS for an extended repayment schedule, as one publicly traded health system recently did.

Care (UHC), advised us that it intended the funds to assist facilities that were struggling with virus cases and that the funds should go to the buyer of the facility. We then transmitted the \$1 million to the buyer as instructed. At about the same time, the buyer apparently deposited the checks that it had been sent (without the knowledge of the debtor).

Roughly a month later, however, HHS reversed the position provided by its representative, UHC, and published FAQs interpreting its terms and conditions to prohibit transfer of the funds to a buyer of assets out of a bankruptcy sale. HHS sought to hold the debtor responsible for returning the \$1 million. After several weeks of negotiations, and once HHS learned that the checks had been deposited without the debtor's knowledge, HHS focused its attention on the buyer. The debtor and the buyer were ultimately able to negotiate a successful solution to the situation in which the buyer took responsibility for repayment in exchange for certain considerations from the debtor.

Some of the lessons learned:

- 1) No matter how secured a lender is in accounts receivable, the government has the ultimate upper hand by using its recoupment powers. Notwithstanding the automatic stay, it is established law that the automatic stay does not prohibit HHS from recouping funds from Chapter 11 debtors. Simply put, if PRF funds were improperly received or misused, the government will want its money back. Likewise, Medicare Accelerated Payments are loans, and the government is at the front of the line for repayment.
- 2) To cushion the blow of these payment obligations, borrowers with a strong balance sheet might consider making voluntary repayments of MAP funds now rather than waiting until August. These voluntary repayments could come from proceeds of additional loans, if the borrower has additional borrowing capacity. From a collateral standpoint, repayment of these advance payments loans are not secured by liens against borrowers' accounts or other property (although, as noted above, the

powers of recoupment could outweigh any reliance on a borrower's collateral).

- 3) Another option would be to have the borrower who received advance payments approach HHS for a more generous/extended timetable. At least one publicly traded company has done this, extending payments for as many as three years, with the possibility for future extensions. The repayment timetable proposed by the government does not require repayment in the first year after receipt of the MAP and repayment is extended over a three-year period.

In year two, however, CMS will withhold 25% of Medicare reimbursements for 11 months.

In the third year, recoupment increases to 50% of reimbursements for the first six months. After that, the remaining balance must be paid in full within 30 days. A 4% fee will be applied to late payments. Notwithstanding the government's proposed timetable, the regulations specifically state that borrowers may apply to CMS for an extended repayment schedule. Secured lenders may want to begin asking their borrowers if requests for extended repayments are in the offing, if it appears their borrower needs such assistance.

- 4) Healthcare lenders should begin now assessing which of their borrowers received PRF funds or Medicare advance payments and then inquiring as to what plans the borrower is putting into place to continue to service the secured lender's debt while the government is recouping a portion of their reimbursement dollars or address the risk that an audit may require immediate repayment of the PRF. Among the things lenders should be asking their borrowers is: whether they were entitled to receive the advance payments or PRF funds; has the borrower had a change in ownership event that would impact its ability to retain or accept PRF or MAP funds; has the borrower used the PRF funds in compliance with the HHS terms and conditions and maintained documentation to support this use; has

the borrower provided reports to HHS as required; and has HHS indicated to borrower that it is not entitled to retain or use the funds. Also, lenders should ask their borrowers to model or project what the borrower's finances – including its borrowing base – will look like once recoupment of government funds commences. If making a new loan, lenders should add Provider Relief Fund and Medicare advance payments to their due diligence checklists when originating new loans to healthcare organizations. Lenders may want to build into their underwriting process a determination as to whether borrowers can withstand the

recoupment schedule it has in place with the government, and what impact it may have not only on the loan, but on the business and its ability to provide quality healthcare to its patients. Lenders may also want to provide special provisions in their loan documents related to these advance payments, including beefing up its default section to provide that it will be a default if the borrower defaults on its obligations to repay these Medicare advance payments, and to provide certain rights to the lender to monitor the impact the recoupment may have on the operations of the borrower's business. ■



Lenders may want to build into their underwriting process a determination as to whether borrowers can withstand the recoupment schedule it has in place with the government, and what impact it may have not only on the loan, but on the business and its ability to provide quality healthcare to its patients.

John C. Tishler is a partner in Waller's

Nashville office. His legal practice focuses on organizations facing financial difficulty. He advises both buyers and sellers of distressed healthcare and other assets, and he delivers creative solutions and strategic planning advice that address both immediate challenges and long-term objectives.

Beth Pitman is a partner in Waller's Birmingham office. Healthcare systems and providers turn to Beth for advice and guidance on navigating complex healthcare regulations and government reimbursement programs. She also provides operational insight regarding the impact of patient privacy and data security regulations.

Ready Capital: Partnering with ABL To Benefit Borrowers

Ready Capital enables ABLs to close more transactions, monetize more inquiries and attract more business from their referral networks.

BY MICHELE OCEJO



ANDREA PETRO
Ready Capital



GARY TAYLOR
Ready Capital

The nonbank lender delivers innovative term loan products to finance real estate, machinery and equipment, offering ABLs the opportunity for both broader client solutions and referral fees for deals transacted with Ready Capital. A new member of SFNet, Ready Capital was formed in 2011 and became a public company in 2016. Operating as a mortgage real estate investment trust (“REIT”), Ready Capital includes four subsidiaries. ReadyCap Lending and ReadyCap Commercial respectively offer SBA guaranteed loans and small-balance commercial real estate loans, while GMFS Mortgage provides residential mortgage loans and Knight Capital Funding offers short-term financing to small businesses.

“We lend nationally and have major offices in New York, Texas and New Jersey as well as a number of satellite offices throughout the country,” said Gary Taylor, chief operating officer. Ready Capital employs about 500 people.

“I think there’s been pretty dramatic growth from the more than doubling in assets and equity in the company. Most of that occurred after 2016 when we went public and that was driven by organic expansion as well as several strategic transactions. We pride ourselves on being very nimble in the capital markets,” Taylor said.

Ready Capital is externally managed by Waterfall Asset Management, a registered investment advisor. Taylor explained: “We really benefit from that relationship, from their knowledge and access to capital markets. In 2016, we merged with ZAIS Financial Corporation, and then in 2019 there was a subsequent merger with Owens Realty Mortgage, Inc. Both of those transactions substantially increased the size of the company, assets, and equity.”

Ready Capital has provided over \$7.5 billion in capital to small businesses nationwide. Moreover, Ready Capital ranks as one of the 10 most active SBA 7(a) lenders.¹ Andrea Petro, board member of Ready Capital and former SFNet president, explained how Ready Capital complements asset-based lenders: “Our business is able to finance assets that may not be acceptable collateral for ABL revolvers. We complement the revolver with long-term SBA 7(a) loans.

¹ Source: SBA.gov 100 most active SBA 7(a) lenders in the United States by FY2020 lending volume through September 30, 2020. Results are updated quarterly.

Those are secured primarily by owner-occupied real estate and machinery and equipment. It helps the borrower because it generates significantly more liquidity. One of the key benefits is that the SBA term loans go up to 25 years in maturity. Principal payments are very manageable on a 25-year amortization schedule and SBA pricing is very competitive. Generally, it will be lower than the ABL revolver pricing.”

Petro also pointed out that in many small businesses, especially in manufacturing and distribution, the owners of the business will also own the company’s facilities, but they’ll lease it to the business. “Owner-occupied property is definitely a key element to making these loans work,” she said.

This partnership allows the asset-based lender to serve a broader universe of borrowers, which means their target market expands. “We also pay referral fees for funded term loans, so it’s another source of income for an asset-based lender. Another positive is that the Ready Capital senior leadership has deep ABL experience, so we ‘speak-ABL’ and understand that when coordinating a term, loan with an ABL revolver we have to be very responsive and deliver a loan closing on a timely basis,” Petro said. “Over the years, that’s been the biggest deterrent to asset-based lenders attempting to pursue a joint closing between an SBA loan and an asset-based revolver. Ready Capital can successfully match our process to the asset-based lender’s process.”

Pandemic Effects

Of course, the pandemic has affected just about every organization. “I think it caused us to rise to the occasion and find new ways to continue to service the small businesses that comprise our customer base. In many cases we’ve moved to an almost 100 percent work-from-home model and I’m happy to say that our employees and staff have been even more productive than they were. So, it’s been quite a learning experience for us, and we think will have lasting implications going forward as to how we manage our business,” said Taylor.

Ready Capital was one of the most active PPP loan providers. “We funded approximately 40,000 PPP loans in the first round of PPP, lending to small businesses that were obviously hurt by the pandemic.

We had an average PPP loan size of approximately \$63,000, which was well below the program average.” This loan size reflects Ready Capital’s focus on the smallest of small businesses, including many retail businesses and restaurants, most of which suffered serious ramifications from the pandemic.

In October 2019, Ready Capital acquired Knight Capital Funding, which provides short-term, mostly unsecured, financing to small businesses. “It does that in a highly technology-enabled way and provides quick approvals and quick short-term funding, usually nine


months or less, which is a different target market than asset-based lenders. But just as important as the business that was acquired is the technology that came along with it, which will allow us to produce our SBA loans and our commercial real estate loans more efficiently. Proprietary technology pulls credit reports and has optical character recognition for bank statements that migrate into the loan operating system. Ready Capital has started to utilize the technology in the broader business and we’re seeing great enhancements as far as productivity, efficiency and cycle times on processing all of our loans,” said Taylor.

2021 Goals

Taylor spoke about Ready Capital’s 2021 goals: “Like

any business, we want to continue to grow, but we want to maintain our focus on helping small businesses. In doing so, we are developing new strategic partnerships, including mutually beneficial relationships with ABL lenders.”

Taylor explained Ready Capital’s competitive advantage is a high level of customer service and responsiveness. He commented, “We offer certainty of close to those partners and that’s very important for them to maintain their relationships. Our motto is Creative Solutions. Reliable Results.”

When working with an ABL, Ready Capital aims to build a relationship that is mutually beneficial, promoting growth for the ABL lender while expanding Ready Capital’s market presence. 

Michele Ocejo is director of communications for SFNet and editor-in-chief of The Secured Lender.



“Like any business, we want to continue to grow, but we want to maintain our focus on helping small businesses. In doing so, we are developing new strategic partnerships, including mutually beneficial relationships with ABL lenders.”

■ PUTTING CAPITAL TO WORK

Polaris Pharmacy Services:

Siena Healthcare Finance Supports Financing During COVID-19

BY JENNIFER SHEASGREEN AND EDWARD KAUFFMAN



■ **JENNIFER SHEASGREEN**
Siena Healthcare Finance



■ **EDWARD KAUFFMAN**
Siena Healthcare Finance

David Rombro, a natural born entrepreneur, has been in the pharmacy business for 40 years, serving as both CEO and Founder of First Choice Pharmacy Services and eventually spending part of his career working at Omnicare South Florida, leading their growth. Rombro has a deep understanding of what it takes to run a well-oiled pharmacy business.

Founded in July of 2015, by Rombro, Steve Baker, and Todd Zisek, Polaris Pharmacy Services (“Polaris”) has grown strategically from commencing operations in a single state to now serving 12 states and 41,000 patients. Polaris provides pharmaceuticals to skilled nursing and assisted living facility patients, differentiating itself from their competitors with personalized service and quality healthcare at an excellent value. Being independently owned allows Rombro and his team to make swift decisions without having to answer to shareholders.

Siena Healthcare Finance provided a \$30MM revolving line of credit and inventory line to Polaris in December of 2019. Fast forward to early 2020; the world was crippled by a pandemic and soon it would become a year unlike any other in our lifetime. Tragically, hundreds of thousands of people perished, millions lost their jobs, businesses went under, and schools were closed to keep our children safe. Local and federal agencies were learning day by day how to deal with COVID-19 and how to keep us all safe.

Despite the uncertainty and danger, hospitals, nursing homes, and home health agencies all had to remain open and operate under new additional regulation and scrutiny. Doctors, surgeons, nurses, and support staff continued to report to the frontlines to care for their patients, risking their own lives.

Lack of PPE (Personal Protective Equipment) became national headlines. PPE was required to keep frontline workers and patients safe,

and new infection protocols were initiated for healthcare facilities and employees. Each state had to work to update and meet their own new, unique guidelines which required hard work, time, and dedication from many companies.

Rombro's first instinct was to be able to address his clients' needs and he didn't think twice about doing what needed to be done to keep clients and their residents and employees safe. Rombro approached Siena Healthcare Finance in early March 2020, with a request for an increase in the inventory advance rate, which would allow additional borrowing capacity under the revolving line of credit and inventory line. Polaris was working with multiple vendors for PPE supply to meet the needs of their clients and many had made the switch to COD (Cash on Delivery), given the short PPE supply nationwide, which made this request even more crucial. Polaris needed the immediate increase in availability, and quickly, in order to finance the purchase of PPE. Siena Healthcare Finance had an approval for Polaris' increase within 24 hours of the request.

"I've been with a lot of banks over my 35 years, and for me the big difference is that the Siena Healthcare Finance team understands the healthcare industry and what we do," said Rombro, "Their team is accessible, can make decisions, and they listen to their customers' needs." Rombro further said that large banks, in his experience, lack specific industry understanding, virtually no access to decision makers, and don't respond positively to out-of-the-box requests. "Siena Healthcare Finance is the opposite of these challenges and helped me achieve my goal of getting product to clients."

From a lending perspective, some banks and lenders took a pause on new business to wait out the impacts of the pandemic. Siena Healthcare Finance made a conscious decision to support our clients, despite the lingering uncertainty. We approached each transactional challenge methodically and took time to understand the needs of both our existing and potential clients.

"100% of our focus is on the healthcare industry. You can imagine that working capital was a priority for our healthcare providers during this time," said Ed Kauffman, managing director at Siena Healthcare Finance. "Our clients needed

funding to meet payroll, purchase pharmaceuticals, hire more staff, as well as purchase PPE and other supplies. Working capital was absolutely a paramount need for our providers."

Under the CARES Act, the Federal Government stepped in and provided various stimulus programs including the PPP (Paycheck Protection Program), Deferred Employer Payroll Tax program, HHS Stimulus funding, and AAPP (Accelerated Advance Payment Program). These programs most certainly helped thousands of healthcare facilities and providers so that they could continue to care for the most vulnerable patients as well as their everyday medical needs, but it also created challenges for lenders. "As a lender, it was our immediate job

to figure out the nuances of each of these programs, how it impacted our client's financials and how our team would analyze each program as it concerned our client's borrowing bases and overall credit," said Siena Healthcare Finance President, Jennifer Sheasgreen. "We immediately put team resources into understanding the programs so that we could respond expediently to client needs."

Polaris was able to use the additional funds to provide the necessary PPE to support their clients. In

its day-to-day operations, Polaris provides pharmaceuticals to senior living facilities three times a day to ensure patients receive their morning, mid-day, and evening medication as prescribed and plays an essential role in the safekeeping of many vulnerable patients. In the middle of the pandemic, Siena Healthcare Finance provided an advance to allow the company to purchase more inventory to ensure they were not short on providing products for any of their patients. At the end of the day, our team feels satisfaction knowing that we contributed in some small way to positively impacting a lot of lives. 🍷



David Rombro, Polaris Pharmacy Services

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