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## **REAL ESTATE FINANCING – OCCURRENCE OF AN EVENT OF DEFAULT AND NEGOTIATING WITH A BANK DURING THE CORONAVIRUS**

As part of the government's further steps to reduce the restrictions associated with combating the COVID-19 pandemic, customers have returned to shopping centres over 2 weeks ago. Periodical opinion polls indicate a gradual improvement in moods and decreasing fears of coronavirus infection among Poles, resulting in, among others, at least partial withdrawal from remote work and return to offices.

Regardless of the above, optimistic signals, the commercial real estate market will be facing significant difficulties in the near future, such as the growing vacancy rate in office buildings or the expected pressure from tenants of retail space to reduce their rent.

In case a significant decrease of income from institutional lease has already been observed, or is expected to occur, the owners of facilities receiving bank financing ought to immediately verify whether any of the event of default under the loan agreements binding on them occurred.

The borrower should first assess the Debt Service Coverage Ratio (DSCR), which is used to periodically evaluate the borrower's ability to service the debt resulting from the loan, as well as the Loan to Value (LTV) ratio for the Property.

In the event of a breach of the financing conditions specified in the loan agreement, and in any case in the event of expected difficulties in servicing the debt, the borrower should immediately turn to his bank and negotiate the necessary changes.

Time is of key importance regarding actions taken, as if a breach is found, the bank will be entitled to increase the cost of financing, demand additional collateral or even call in the loan.

Signaling the expected difficulties by the borrower himself will not only often constitute fulfillment of the notification obligations provided for in the loan agreement in this respect, but will also save the time necessary for the bank to process the client's application before his financial situation further deteriorates and, perhaps most importantly, it will demonstrate the borrower's cooperative, loyal and proactive attitude towards the bank, which is important for maintaining

and strengthening mutual trust, especially important in the current extraordinary circumstances and which is likely to remain so in the near future.

The client having been properly prepared for negotiations with the bank may expect a temporary change to the financing conditions, involving not only easing the requirements for certain financial indicators of the project, but above all the implementation of payment holidays (which may take the form of temporary suspension of capital installments, or even capital and interest payments, depending on the circumstances of the case).

While considering the borrower's application, the bank is obliged to assess creditworthiness. Under the Banking Law, clients who are not creditworthy may only in exceptional cases be granted financing or change its parameters increasing bank's financial exposure. In such a case, a special collateral for the loan is required and, regardless of the above, also a presentation of an economic recovery scheme of the entity, the implementation of which will ensure the achievement of creditworthiness within a specified period, according to the bank's assessment.

The banking environment, financial supervision and ultimately the legislator recognized the potential complications associated with meeting the above strict requirements at a time of economic difficulties caused by the COVID-19 pandemic. Therefore, Article 31f was introduced to the Act on Special Solutions Related to the Prevention, Counteraction and Eradication of COVID-19, Other Infectious Diseases and Related Crises dated March 2, 2020 (Journal of Laws Items 374, 567 and 568). Its wording, introduced by the Act on Special Support Measures in Connection to the Spread of the SARS-CoV-2 Virus dated April 16, 2020, provides that in the event of declaring an epidemic emergency or a state of epidemic, **the bank may change conditions or dates of loan repayment specified in loan agreements of i.e. entrepreneurs, if: (i) the loan was granted before March 8, 2020 and (ii) such a change is justified by the assessment of the borrower's financial and economic situation performed by the bank no earlier than on September 30, 2019.** Hence, data on the financial standing of an entrepreneur from the period before the introduction of restrictions related to combating the COVID-19 pandemic is considered sufficient for the assessment of creditworthiness, thus omitting in certain cases the current (often significantly worse) financial and economic situation of entrepreneurs.

Moreover, with regard to entrepreneurs who do not meet the criteria described above (in particular those for which the banks did not carry out the assessment referred to above in the period after September 30, 2019), the Polish Financial Supervision Authority (KNF) in its positions dated March 31, 2020 and April 8, 2020, issued as part of the Supervisory Pulses Package, has proposed as the

market supervisor, a very liberal interpretation of the aforementioned provision of Article 70 section 2 of the Banking Law, allowing banks to rely on a simplified positive financial forecast (i.e. without the need to present a "full recovery scheme") and to waive, in certain cases, the requirement for borrowers to present "special collateral". An additional facilitation for entrepreneurs preparing to negotiate with a bank is the de minimis guarantee scheme in the BGK bank, the scope of which has been extended on the basis of Article 15zzzd of the above mentioned special purpose law and which, as indicated in the above mentioned position of the KNF, may be considered "special collateral", referred to in Article 70 Section 2 of the Banking Law.

In conclusion, it should be stressed that the borrower's active attitude, his initiation of negotiations with the bank at the right time, preparation of a credible projection of improvement of his financial and economic situation and, finally, skillful application of support mechanisms offered within the so-called "anti-crisis shields" set, significantly increases the chances for a positive outcome of negotiations with the bank and stabilization of the project – even in a situation of temporary reduction of income from commercial lease.

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