# PUBLICATION

## What to Do When Your Borrower/Operator is in Financial Distress

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**It is no surprise to lenders to operators of long term care facilities that such facilities have faced what may seem an insurmountable obstacle as we transition into our second full year of a pandemic. Long term care operators can experience financial distress due to any number of factors, such as organic operating challenges, reimbursement issues, government enforcement actions, and landlord difficulties. These financial challenges have been compounded by the COV1D-19 pandemic with its unexpected additional care requirements and the attendant increased costs. Add in staffing shortages and reduced census, and lenders in this industry have good reason to monitor these loans proactively, preparing to deal with a borrower in distress.**

In response to the challenges caused by the pandemic, the federal government provided financial support to many facilities through the crisis. Under the CARES Act, more than $14 billion in Provider Relief Funds were distributed to long term care facilities. In addition, under the COVID-19 Accelerated and Advance Payments program (CAAP), the Centers for Medicare & Medicaid Services (CMS) provided accelerated or advance reimbursement payments to providers of health care services. As a result, many facilities had access to funds that not only helped offset the financial challenges of the pandemic but allowed them to defer addressing operating challenges that may have existed prior to the pandemic.

Currently, most of the COVID-19 support funds have been released or are no longer being distributed through these programs, leaving operators with fewer resources to address the increased financial burden. The challenges are more dire for those who received advances under the CAAP program, as CMS has now started to recoup the advance payments made during the pandemic. An increasing number of long term care facilities will be confronting the additional financial pressure associated with recoupment of these advances as they continue to deal with business challenges. This additional pressure may create critical situations for those who are facing reduced staffing and reduced census due to limited new admissions, as well as those who simply deferred addressing critical operational issues during the crisis.

In light of the convergence of these factors, lenders in this field should lake a critical look at their long term care borrowers. Prudent lenders will carefully assess the financial condition of their borrowers in this industry and the viability of their collateral. Lenders should take the following actions now to strengthen their collateral position:

- Review loan documents, including loan covenants and reporting obligations, to fully understand your rights. Review collateral documents, financing statements and related filings for completeness. Renew or update financing statements as appropriate. Request that the borrower execute any missing collateral instruments.

- Monitor the borrower's financial and operational reports to identify trends and be prepared to act. Check the borrower's performance under its covenants, especially if you have determined there are steps you should take to strengthen your position. The borrower's request to waive theses nonmonetary covenant failures (that you discovered above) is the perfect opportunity to seek to correct any deficiencies you discovered in your review.

- Review status and/or confirm that there are no defaults or forbearance agreements with respect to other debt or lease obligations.

- Maintain an open line of communication with your borrower. Not only does this enable you to address any issues may be raised in a consensual manner, but it will better prepare you to service the loan. By way of example, understand the manner in which the facility's staffing needs have changed and how the borrower is addressing that issue.

- Determine whether a facility's census been adversely affected. If the loan is insured by HUD or otherwise subject to agency requirements, review and comply with any additional servicing, notice or reporting requirements that are applicable.

- Evaluate issues related to any recoupment claims (due to CAAP advances, overpayments, or civil monetary penalties) that could affect the ability of the borrower to finance its debt.

If it appears that your borrower may be a candidate for a bankruptcy filing or restructuring, consider taking these additional steps:

- First and foremost, evaluate what is a successful outcome. Do you need this operator to rehabilitate and continue? Do you need a new operator for your collateral? Do you need your borrower's cooperation to get those? Do you want to foreclose? Your definition of success at this point should dictate how you approach all the other issues.

- Evaluate whether you want to take any available enforcement actions (in accordance with your loan documents) prior to a bankruptcy filing, which could enhance your position in a subsequent bankruptcy case.

- Evaluate whether you would consent to the use of your cash collateral to fund the borrower's operations in a Chapter 11 case and, if so, what type of "adequate protection" of your interests will you seek from the bankruptcy court?

- Understand the provisions regarding post-bankruptcy debtor-in-possession or "DIP" financing, which can provide enhanced lien positions for the DIP lender. The borrower may request that you agree to provide DIP financing. If the borrower requests bankruptcy court authorization to obtain DIP financing from another lender, you will want to be prepared to assert your rights with respect to lien priorities and commingling of cash collateral.

- Be prepared to act quickly in the event of a Chapter 11 filing. Although the reorganization itself may take a year or longer, several important hearings are conducted at the outset of the case that can affect the lender's rights.

A lender that takes proactive steps to understand and monitor its loan, and acts when appropriate, will be in a stronger position to achieve a positive outcome when its long term care borrower is in distress.

For more information, please contact David Folds or any member of Baker Donelson's Long Term Care Team.