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COVID-19: Avoiding Unintended Consequences Under Financing Documents

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While borrowers are dealing with many operational and financial difficulties resulting from the COVID-19 pandemic, there are a few specific bond financing document considerations that borrowers will want to keep in mind.

Liquidity – Many borrowers are looking to address liquidity issues that have arisen due to the pandemic and the resulting economic downturn by entering into a new line of credit or drawing on existing lines of credit. In addition, many borrowers have taken advantage of the Paycheck Protection Program (PPP) or have received other forms of relief funds or grants. It is important for a borrower to review its master trust indenture, if any, and existing bond financing documents to confirm whether any consents are required or other actions are needed in order to incur additional debt or draw on an existing line of credit and what impact a loan or grant proceeds will have on financial covenants. Many documents contain limitations on the incurrence of additional debt and these provisions need to be reviewed prior to entering into any type of indebtedness. Short term loans, unsecured loans, and even forgivable loans will likely still need to be “tested” to make sure they fit within the permitted types of debt. For example, while PPP loans may in the future satisfy the conditions for forgiveness, the entry into the loan is the incurrence of long-term debt that needs to be tested (it is a two-year unsecured loan). The incurrence of additional debt will also have an impact on financial covenants going forward. The debt service paid on a PPP loan will need to be taken into account in the total debt service of the organization in its debt service coverage ratio calculation. The definitions in financing documents need to be reviewed carefully to determine if the specific type of loan proceeds or grant proceeds may be included as part of revenue in a debt service coverage calculation or in cash in any sort of days cash on hand calculation.

Modifications to Financing Documents – Borrowers may find themselves in need of requesting relief from their lenders in the form of deferral of debt service payments or waivers of financial covenants. The deferral of debt service payments on tax-exempt bonds could have an adverse impact on the tax-exempt status of such bonds. The waiver of financial covenants or changes to financial covenants (whether contained in the bond documents or in a separate related covenant agreement with a bank) may also adversely affect the tax-exempt status of bonds. While waivers, deferrals and changes to bond documents are allowed, they need to be reviewed by bond counsel to determine if one or more of the changes will result in a reissuance of the tax-exempt bonds that would require certain steps and actions be taken in order to preserve the tax-exempt status of the bonds.

Material Adverse Effect Representations – In connection with financing transactions, the borrower will make certain representations and warranties to the lender that will often be recertified to the lender at certain times. For example, with draw-down bonds or lines of credit, each time additional funds are loaned, the borrower automatically recertifies that the various representations that were originally made in the applicable agreement are still true and correct. One such common representation is that there has been no material adverse change in the business, operations or financial condition of the borrower. Also, bond financing documents often contain covenants to notify parties of the occurrence of certain events, and it may include a duty to notify if there has been any material adverse event impacting the borrower. While the adverse event in and of itself may not result in an event of default or preclude the ability to draw

down on a loan, the failure to notify and/or the making of an incorrect or misleading representation to the lender may result in an event of default. Borrowers should review their financing documents carefully for any duty to notify of material adverse changes to the borrower's condition and understand what is being represented in any certificate delivered to a lender.

In order to avoid any unintended consequences resulting from actions taken to address the negative impact of COVID-19, it is important to remember to review your existing bond financing documents carefully and consult counsel experienced in such matters for advice.

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