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Avoiding and remedying loan covenant compliance review problems

If you have a commercial real estate loan, you probably already know that most are subject to loan-covenant compliance reviews to ensure that the borrower adheres to the terms of the original lending contract. The reviews are often conducted annually, but some financing agreements allow for less-frequent inspections.

Though the reviews are typically performed by an independent accounting firm, you can make the process move as quickly (and painlessly) as possible by following these tips:

Review your loan contract in advance. Many accountants say they have uncovered covenant breaches related to conditions that the borrower didn't even know were included in the loan documents. Unless you review your loan documents, you may not be aware, for example, that you are prohibited from making changes in management or undertaking a merger without prior approval from the lender.

Contact the review team before its work begins. A simple phone call can help set the ground rules for the review and also is an opportunity to establish a good rapport with the people who will be examining your books and records.

Make sure your records are up-to-date. Nothing can drag out a review longer than a borrower's failure to have a complete and updated set of financial statements, leases and related documents available for the review team. That's why the reviews are often scheduled to take place after the borrower has completed its year end accounting.

Check your insurance policy. Every loan requires the borrower to have a proper amount of insurance, but the recent rise in construction costs has left some owners without enough coverage to replace their buildings if disaster strikes. Failing to maintain adequate insurance will put you into default and can allow the lender to begin foreclosure proceedings.

Finally, make sure you keep an upbeat and cooperative attitude during the review process. The sooner it's over, the sooner you can go back to focusing on running your business.