

5 Lender Strategies When A Commercial Borrower Defaults

By **Keith Mundrick** (December 19, 2025)

When a borrower defaults on a commercial loan, the lender's initial response can often decide whether a problem will resolve smoothly or devolve into a protracted and painful collection process. Understanding the full range of options available is essential to protecting the lender's position while maintaining flexibility.

The commercial lending landscape is currently facing significant headwinds, particularly with regard to commercial real estate, a core component of nearly every lender's portfolio.



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Commercial real estate is fast approaching a predicted maturity wall, with an estimated \$2 trillion in commercial real estate loans set to mature by 2027, according to data from the Mortgage Bankers Association.

Many of these borrowers are facing refinancing challenges due to higher rates, lower occupancies (particularly in office and retail), and tighter lending standards. This convergence of factors makes it critical for lenders to have a clear understanding of their strategic options when defaults occur, which they certainly will.

Often, the worst decision a lender can make when facing a default is to make no decision at all. Inaction can give rise to an unintended waiver of rights or create a problematic course of conduct argument, which courts may deem to be the lender's acceptance of an ongoing default.

Even when a default seems minor, simply ignoring it might undermine the lender's ability to enforce certain rights at a later date.

As a general matter, lenders should be aware of how easy it can be to inadvertently waive or forfeit certain rights. The key principle is straightforward: Establish your posture early, and document your position clearly.

1. Know how to reserve your rights.

A reservation-of-rights letter enables the lender to buy time without losing ground, protecting your position when you need time to assess the situation or develop a workout strategy. An effective letter should specifically identify each known default with sufficient detail, explicitly state that the lender is not waiving any rights, and clarify that communications or delays do not constitute a waiver.

The letter should also reserve the right to identify additional defaults as they are discovered, providing protection as you conduct your file review.

2. Understand how to properly waive a default.

Waiving a default is often the smart and appropriate business decision for minor defaults, but it should always be done on purpose and on the lender's own terms. Many lenders underestimate the importance of properly documenting a waiver, particularly when the default doesn't feel concerning.

Consider a common scenario: A long-time borrower with a revolving loan just barely missed a financial covenant. The lender has discussed it with the borrower, the relationship is otherwise healthy, the collateral position is solid, and it seems like this was just a one-off financial miss that will clear up in a few months.

Now the loan is up for its annual renewal, and the lender feels confident about the credit. The natural inclination is to simply renew the facility and move forward.

However, when you modify or renew loan documents in the presence of a known default, the modification itself may operate as a waiver of all existing defaults, even those you're unaware of, in the eyes of the court.

You could be waiving more — and more serious — defaults than you realize. Furthermore, the borrower might later argue that the lender's conduct established a pattern of accepting such violations.

When done properly, the amendment or renewal documents should specifically identify and waive the known default only. This waiver language should make clear that only the specifically identified default is being waived, that this is a one-time waiver that does not establish any course of conduct, that all other provisions of the loan documents remain in force, and that the lender reserves all rights with respect to any other defaults.

A note of caution: The "form" loan documentation software often used on smaller credit relationships may not have the built-in capability to identify and waive a default in this manner without customization.

3. Embrace the power and versatility of the forbearance agreement.

A forbearance agreement represents one of the most sophisticated and versatile tools available to lenders after a default. Unlike a waiver of the default, a forbearance agreement specifically preserves the borrower's default while the lender agrees to forbear from collection for a specified period of time in exchange for accommodations from the borrower.

The agreement can be tailored based on the lender's desire for the relationship, either to help a valued borrower to work through a hopefully temporary setback, or as a means to nudge a difficult borrower to seek new financing elsewhere.

A Comprehensive File Review

Any forbearance process should begin with a comprehensive file review and collateral audit. Review loan documents, run current Uniform Commercial Code and title searches, and verify borrower entity status.

This process often reveals issues that must be corrected: Uniform Commercial Code filing errors, missing title endorsements, lapsed insurance, delinquent property taxes or issues with the loan documents themselves. The forbearance provides a unique opportunity to address these problems while leverage remains high.

Structuring the Forbearance Terms

Forbearance terms are extraordinarily customizable, and the accommodations available are limited primarily by creativity and commercial reasonableness. Financial accommodations

given by the borrower might include forbearance fees, tighter financial covenants or adjusted pricing.

Operational controls could include enhanced reporting requirements, lockbox requirements for accounts receivable, approval rights over expenditures, required expense reductions, or retention of a turnaround consultant.

Additional credit support might include new collateral or additional guarantors. The lender might also require a detailed business plan with specific milestones to be achieved during the forbearance period.

Key Protections and Benefits

Any forbearance agreement should require the borrower to release the lender from any potential claims related to the lending relationship, which cleans up liability issues before they ripen into litigation. All costs and legal fees resulting from the default should be passed to the borrower.

Most importantly, a well-drafted forbearance agreement will position the lender to move directly to collection if the borrower fails to perform, with all notices given, all defaults acknowledged, and no additional cure periods needed.

The duration of a forbearance should be calibrated to your goals, but should ideally be short — just a few months if possible. Remember, a forbearance period can always be extended if things are going well.

4. Recognize when to proceed to collection.

Collection should seldom be a commercial lender's first move upon default, but when a default is severe, the relationship is irreparably damaged, or collateral is at imminent risk, collection action may be necessary — accelerating all loans, initiating foreclosure or pursuing guarantors as may be appropriate.

Litigation is time-consuming, expensive and often uncertain, but when collection becomes necessary, moving decisively is essential to protect collateral and maintain leverage.

5. Always look at new loans through the workout lens.

The most successful workouts begin long before any default. These successes come from the lender establishing sound practices for structuring, documenting and closing loans; perfecting liens; and handling collateral due diligence as needed. This particularly includes comprehensive real estate due diligence, negotiated title insurance with appropriate endorsements, and identification and subordination of competing interests.

These early actions pay dividends when trouble arises, and the loan documents executed at closing determine your rights and options in any future default scenario. Don't be the lender who is learning expensive lessons during a workout that could have been addressed at closing.

Every action taken before closing must be with an eye on the potential worst-case scenario. If not for the bank regulations and examinations, it is true that even a handshake loan would have no consequences if it gets repaid; but not every loan will be repaid.

The 2008 financial crisis may be a distant memory to some, and many in today's workforce have no recollection of it at all (the author was just graduating college with a poorly timed degree in finance). However, increased workouts may be around the corner.

This is an opportune time to review lending practices on both the front and back ends. The lender who establishes strong front-end practices, understands these strategic options upon default, and maintains strong loan files will navigate inevitable defaults with greater success than one who simply reacts to problems as they arise.

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