

When a Commercial Borrower Defaults: Understanding the Lender's Options

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By Keith Mundrick on October 23, 2025

When a borrower defaults on a commercial loan, the lender's initial steps can make the difference between a successful workout and a drawn-out collection process. It is essential to understand the lender's options and act with purpose in addressing the default and properly documenting any further modifications to the credit relationship.

The Bad Option: Doing Nothing

When a default occurs, the worst decision can be to make no decision at all. Inaction or silence can lead to unintended waiver of the lender's rights, giving rise to a "course of conduct" argument that courts may interpret as acceptance of the default.

It is important to establish the posture of any workout or pre-workout scenario by understanding the rights and options available to the lender and weighing them up front. It is very easy to inadvertently waive or forfeit a lender's rights if its options are not well understood.

Four Strategic Options

1. INTENTIONAL WAIVER OF THE DEFAULT

If the lender decides to waive a default, which is often the appropriate decision, it should be done on specific terms and on purpose. Defaults should be waived clearly and in writing; even an email can suffice. Identifying the specific default being waived protects against arguments of broader waiver than intended. Lenders should also be aware that modifying the loan agreement with a known and pending default may act as a waiver of all defaults.

2. RESERVATION OF RIGHTS

When the lender needs time to assess the situation or negotiate a strategy, a reservation of rights letter offers protection. This formal communication identifies the specific defaults and clearly states that the lender is not waiving any rights. This provides time and documents the lender's intent to keep all

options on the table.

3. FORBEARANCE AGREEMENT

A well-drafted forbearance agreement is one of the most powerful and flexible tools available to lenders. In a forbearance, the lender agrees to delay collection action for a specified period in exchange for certain accommodations from the borrower. These accommodations can be heavily customized to suit the goals of the lender, and can include:

- Forbearance fees
- Enhanced reporting requirements or financial covenants
- Additional collateral or guarantors
- Lockbox arrangements for accounts receivable
- Required expense reductions or turnaround consultants
- Mandatory business plans

Forbearance agreements also require borrowers to waive claims against the lender and can better position the lender to proceed directly to collection if the borrower doesn't comply with the terms of the forbearance agreement.

4. COLLECTION

When the default is severe, the relationship is beyond repair, or collateral is at risk, collection proceedings may be necessary.

Carefully Review Your Loan Documents

Before any forbearance or collection action, the lender should conduct a comprehensive file review and collateral audit. Working with counsel to review loan documents, run UCC and title searches, and verify borrower entity status is essential. This critical step reveals and fixes documentary issues before they become litigation problems. Particularly if the lender is entertaining a forbearance agreement, now is the time to make sure every loan document is ironclad.

Moving Forward

A borrower default doesn't have to become a disaster. With a clear understanding of available options and strategic action, lenders can navigate these situations effectively.

Lenders will naturally consider many factors when choosing a path forward, including the nature of the default (minor technicality or concerning breach), collateral position, borrower's cooperation, and long-term value of the relationship. Regardless of your decision, an informed choice is always

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preferable to stumbling into an undesired outcome.

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