From the Washington Business Journal:
https://www.bizjournals.com/washington/news/2023/04/28/business-bankruptcies-rising-advice.html

SUBSCRIBER CONTENT:

Business bankruptcies rising, say Greater Washington experts

Apr 28, 2023, 6:00am EDT

Illustration by Maggie Lynn / WBJ; Getty Images

If you see your business finances heading the wrong direction, it's time to act fast.

Business bankruptcies — and bankruptcies overall — had been on the decline since 2010, even through the pandemic, thanks to the CARES Act and Paycheck Protection Program loans and grants managed by the Small Business Administration.

We could be in for a change this year.

The first quarter of 2023 showed a noticeable uptick in all types of bankruptcy filings, according to data collected by the American Bankruptcy Institute. And that trend so far this year has not gone unnoticed by Greater Washington's legal and accounting experts, either.

"I have more clients reaching out on bankruptcy matters than I have in several years," said Andrea Campbell Davison, a shareholder and bankruptcy attorney with Bean Kinney & Korman PC in Arlington.

Why the influx? Rising interest rates, Campbell Davison said, are pushing more businesses into bankruptcy, with government contractors, tech companies and construction firms making up many of the Chapter 7 liquidations she saw in the first quarter.

While federal stimulus programs helped many businesses stay afloat in recent years, that money is now drying up. John Sadler, a partner with Ballard Spahr LLP in D.C., primarily works with financial institutions as creditors — the other side of the bankruptcy.

“We definitely see more distress than we did this time last year,” he said. “Lenders and servicers are downgrading more loans. That likely means bankruptcy filings will continue to increase in 2023 as those loan defaults push obligors into bankruptcy.”

Not only will this get worse before it gets better, but we can also expect ripple effects throughout the economy.

“I would expect to start seeing banks tightening their lending practices as the interest rates have climbed, which will cut off access to capital for many businesses that cannot access the public or private equity markets,” said Ken DeGraw, a partner and market leader of financial distress and recovery services at Withum Smith+Brown PC in Bethesda. “We are already seeing a reduction in M&A deals as access to capital is constrained.”

Most at risk

Any business can come face-to-face with the threat of bankruptcy. But these sectors might be most at risk right now.

Commercial real estate firms

As office vacancy rates remain elevated and tenants increasingly pare back on their leased spaces, Campbell Davison predicts we’ll see more real estate companies file for bankruptcy protection as the year progresses. Property owners are most likely to try to restructure debt before going through a Chapter 7 liquidation, but as both Sadler and Michael Lichtenstein, chair of Shulman Rogers’ bankruptcy, restructuring and creditors’ rights group, pointed out, refinancing is increasingly off the table due to rising interest rates. Both are also seeing more big-box and chain retailers file for bankruptcy (ahem, Bed Bath and Beyond) and expect that to continue — which will in turn put even more stress on commercial landlords.

Financial sector

Cardell McKinstry, a transaction advisory partner with Aprio LLP, noted that the majority of business bankruptcies in 2023 so far have been Chapter 11 reorganizations, with a trend toward the financial sector. In fact, S&P Global Market Intelligence found the U.S. financial sector had the highest number of bankruptcy filings in the first quarter of this year since 2010, the result of high interest rates and inflation. “The number of Chapter 11 cases, and the volume of debt per case, is reportedly the highest it has been in several years — and has been increasing month-over-month,” said Patrick Potter, a partner with Pillsbury Winthrop Shaw Pittman LLP.

Restaurants

The threat of Covid may have eased, but many restaurants still struggle to make ends meet. Potter said he’s seeing significantly higher rates of both Chapter 7 and Chapter 11 bankruptcy filings across the restaurant industry. The differentiator is usually the size of the company, with larger chains more likely to seek Chapter 11 relief, and smaller independent restaurants more likely to liquidate. “Most financially troubled small restaurant businesses often lack the capital to sustain operations and pay for the cost of Chapter 11, and are unable to attract the interest by buyers, many of whom can just as easily and cost effectively start up a new restaurant,” Potter said.

Lessons learned

Nobody actually wants to go bankrupt. But if bankruptcy is the best course of action, there are steps to try to prevent a major disruption, or an end, to your business — or at least to handle the situation smoothly.

To do now:

Keep meticulous records, especially during difficult times. You will have a much easier time later if you can easily track the course of your assets and liabilities.
"Renegotiate burdensome contracts with vendors or landlords in advance," suggested Campbell Davison.
Undertake a 13-week cash flow projection, suggested Withum's DeGraw, and then carefully monitor the business' health through key metrics you can update.
Don't wait — if you see a negative trend in your finances, seek help, said Erik Fox, an attorney with Rees Broome PC. And "be honest with yourself when analyzing your options and holding out for help from unrealistic sources," he said.
Explore your options, "whether it's debt modification, non-bankruptcy modifications, subchapter 5, etc.," McKinstry said.
"Do not put your head in the sand," said Lichtenstein of Shulman Rogers. "If the business has problems, try and figure out how to cut expenses and improve profitability earlier rather than ignoring the problem."

To do if bankruptcy is on your horizon:

Consult a bankruptcy attorney early on so you can take the time needed to plan a good strategy together.
Inquire with a legal aid clinic if the cost of an attorney is a deterrent.
If you have fewer than $7.5 million in debts, look into the new subchapter V bankruptcy for small business reorganization, which is designed to be more streamlined and affordable than a traditional Chapter 11.
Share the full picture of your financial situation with your lender and creditors.
If you are going to seek Chapter 11 reorganization, you will need to craft a viable exit plan — and be ready to take direction. "They need to understand the costs, amount of time it will take, loss of control and required transparency, and that they will be challenged at every turn. It's a bitter pill when you're used to running your own show," DeGraw said.
Sell assets you don't need or use. Even if they aren't incredibly valuable, "if sold in advance, they could contribute significant cash flow and reduce claims against the business," Campbell Davison said.

Carolyn M. Proctor
Data Editor - *Washington Business Journal*