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Structuring Real Estate Mortgage Covenants, Event of Default Provisions, Representations and Warranties

Drafting Provisions That Balance Borrower Protections With Lender Remedies

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Today's faculty features:

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Structuring Real Estate Loan Covenants, Event of Default Provisions, and Representations and Warranties

Drafting Loan Provisions that Balance Borrower
Protections With Lender Remedies

August 24, 2021

Ankush R. Israni
Attorney

Key Questions

- What are the standard property representations found in most loan facility agreements and what limitations do borrowers typically seek concerning representations?
- What are borrowers' and lenders' best tactics for mitigating risk when negotiating and drafting financial covenants?
- What financial covenants do lenders insist be included?
- How can the borrower and lender each minimize risk when drafting or relying on default provisions?

Recent Experiences

- Recent loan – saw 52 separate representation and warranty clauses, and 43 covenants (both affirmative and negative).
- For many new and mid-level lawyers, this is confusing, especially since many provisions appear duplicative.
- Generally lender's lawyers take the position that more is better than less; if two reps appear similar but do not necessarily cover the same ground, the general approach is to include both. Many representation and warranty clauses are based on legal decisions in different jurisdictions; as another side note, many representation and warranty clauses stem from CMBS loan documents and are included in non-CMBS loans.
- Downside is that when faced with an aggressive borrower's lawyer, the lender's lawyer may delete the more material provision.

Common Approaches

- Generally, borrower's lawyers either gloss over many loan provisions on the grounds that "this is standard language" or "this is generally right, if there is any inaccuracy, it is probably de minimis" or negotiate the provisions to "death".
- Both these approaches have pitfalls – glossing over means that borrower is not properly advised of potential defaults and issues; over-negotiation of loan documents means that loan may not close on time, cost of transaction increases, and parties get locked into legal battles that may not have any practical impact. There may also be a possible breach of the covenants before the loan closes or shortly after loan closes.
- Look at reps and covenants (and hence defaults) in broad categories. Borrowers should understand why lenders need each rep and covenant. Lenders should understand why, in many cases, the standard provision does not work or have unintended consequences.

Representations and Warranties

- **Why do we need representations and warranties?**
 - Representations and warranties serve to allocate risk between the parties to an agreement and create a direct claim against the maker if the representations are inaccurate or warranties are breached

Representations and Warranties – Borrower Organization

- Borrower's organization, existence, good standing, qualification to do business in the place where the property is located.
- Borrower's possession of power and authority, and rights, licenses, permits, etc., to own its property, conduct its business, and to enter into the loan.
- Due authorization, execution and delivery of loan documents.
- Binding nature of loan documents on borrower
- Loan documents do not conflict with any law or regulation applicable to borrower.
- No consent of third parties required for borrower to enter into the loan.

Purpose: Allows lender to verify that borrower duly exists and that there are no restrictions on borrower's ability or right to enter into the loan, and that borrower has undertaken all action necessary to properly enter into the loan.

Representations and Warranties – Borrower Organization

- **Practice Tips:**

- Order certified formation and good standing documents for borrower.
- Review organizational documents.
- Obtain and review necessary consents – including internal and external consents.
- Prepare affidavit for borrower that states attached to this affidavit are true and correct copies of the organizational documents.
- Borrower's counsel will be required to draft an opinion – opinion will also address these representations as opinion matters.

Representations and Warranties – Litigation/Legal Actions and Claims

- No litigation against borrower, any guarantor or affiliated parties, or the property, that, if adversely determined, would [materially affect] the condition or business of borrower, guarantor or affiliate, or the property.
- No bankruptcy actions against borrower, guarantor or affiliated parties
- No actions against borrower from any governmental authority.
- No condemnation/or casualty against the property and borrower has no knowledge of any contemplated taking.

Purpose: Allows lender to verify that there are no claims against borrower, guarantor, affiliated parties or the property that may impact the ability to repay the loan, or that would result in a claim or lien against the property.

Representations and Warranties – Litigation/Legal Actions and Claims

- **Practice Tips:**

- Order applicable “UCC searches” – meaning searches of UCC records, tax lien records, and bankruptcy and litigation dockets.
- Make inquiry of borrower.
- Review title report – some litigation may be disclosed in the title report as may be evidenced by lis pendens or judgment liens.
- If there is information that it discovered that contradicts the standard representations, the information has to be disclosed and set out in the loan documents as an exception.
- Depending on the nature of the litigation, legal action or claim, lender may require borrower to reserve funds until the issue is resolved. This will result in fewer loan proceeds to borrower (plus the cost, i.e., interest, of the reserve funds).

Representations and Warranties – Legal Aspects of the Property

- Borrower's title to the property (fee, leasehold or other).
- No other property is required for the use of the property (e.g., for parking or access).
- The property has all easements required for the property to be operated.
- The only easements and encumbrances affecting the property are the ones shown on the lender's title policy
- The property is properly subdivided and that there are no gaps in the boundary of the property.
- The property is on its own lot and is not part of a larger lot.

Purpose: Allows lender to verify that borrower owns the property and that the property may be used for its purposes, that borrower has disclosed all of the encumbrances against the property, and that there no other property will be able to impact the value of the property.

Representations and Warranties – Legal Aspects of the Property

- **Practice Tips:**

- Order and review title and survey of the property.
- In addition to general review, each specific easement and CCR has to be reviewed in detail and if permitted or necessary, an estoppel should be obtained from each counterparty to such documents.
- Borrower may be required to reserve funds to address outstanding items such as unpaid maintenance charges, unpaid taxes or costs of subdivision of the property. This will result in fewer loan proceeds to borrower (plus the cost, i.e., interest, of the reserve funds).

Representations and Warranties – Physical Aspects of the Property

- Zoning for the property allows for it to be used for the current or intended purpose.
- There are no violations of building codes regarding the property and Borrower knows of no conditions that would result in building code violations.
- The property has no adverse conditions.
- The property is not located in a flood or earthquake zone.
- The buildings of the property lie within the boundaries of the property.
- Borrower has all requisite licenses and permits to own, use and operate the property.

Purpose: Allows lender to verify that the property's physical condition is satisfactory and that there is no condition that would result in funds being required for borrow to correct, or that would result in a claim against the property.

Representations and Warranties – Physical Aspects of the Property

- **Practice Tips:**

- Order and review zoning report for the property.
- Obtain and review municipal building (and other) department clearance letters and certificates of occupancy (typically included in zoning report). Also, for certain types of property, there will be other certificates that will be required, such as occupancy licenses (hotels), food and liquor licenses (restaurants, hotels), elevator licenses, etc.
- Note that in some municipalities, it is customary to obtain additional clearance letters, including from the fire department and health department – in NYC, this is produced by the title company.
- The survey typically includes a flood certificate.

Representations and Warranties – Leases

- List of leases affecting the property and rent roll.
- No pending unsigned leases.
- No defaults under the leases by landlord or tenant, and no knowledge of any pending defaults or any request for forbearance amendment or waiver pursuant to a force majeure clause with respect to a pandemic or COVID-19.
- No knowledge of any tenant bankruptcies.
- No options by any tenant to purchase or terminate any leases.
- No unpaid tenant improvements or leasing commissions for the leases.

Purpose: Allows lender to verify primary source of income for repayment of the loan and other operating expenses. Leases typically treated differently from other contracts because leases are prime source of income for real estate (other than real estate to be sold).

Representations and Warranties – Leases

- **Practice Tips:**

- Obtain copies of leases, with all lease amendments
- Lender will require tenant estoppels from tenants. Number of tenant estoppels required depends on the property - office buildings based on percentage of rentable area under lease, and for retail properties, estoppels from major tenants and from a percentage of the rest. Residential rental properties do not typically require estoppels from the tenants.
- For properties with major leases, for example retail properties with anchor tenants, or office properties with tenants occupying multiple floors, counsel should review the applicable leases.
- If there is information that it discovered that contradicts the standard representations, the information has to be disclosed and set out in the loan documents.
- Borrower may be required to reserve funds to address outstanding leasing costs. This will result in fewer loan proceeds to borrower (plus the cost, i.e., interest, of the reserve funds).

Representations and Warranties – Third Party Agreements

- No material third party agreements affecting the property other than disclosed
- No defaults under third party agreements by landlord or counterparty, and no knowledge of any pending defaults.
- If there is a construction project, there will be separate representations required for the general contractor's contract, which may include those relating to the status of the project and payments to the general contractor as well as subcontractor representations.
- Typically there are separate representations for the property management agreement, especially if the property management agreement is with an affiliate.
- Contracts with affiliates will usually require representations that the contracts are on arms' length terms.

Purpose: Allows lender to verify that the borrower has all of the contracts required to own, manage and operate the property.

Representations and Warranties – Third-Party Agreements

- **Practice Tips:**

- Obtain copies of third-party agreements, especially material agreements such as a general contractor's agreement, property management agreement and leasing agreements.
- Counsel should also review all third-party agreements to confirm that none will incur material termination fees or require extended termination periods.
- For material agreements, lender may require an acknowledgment from the counterparty agreeing, among other things, to recognize the lender in a foreclosure, and that the foreclosing lender has the right to terminate the agreement without penalty.

Representations and Warranties – Taxes and Environmental

- All taxes have been paid current and in full and no other taxes except as shown on the title report.
- No knowledge of any reassessment or pending tax appeals.
- Only environmental matters are those shown on the environmental report. No knowledge of any other adverse environmental condition.
- No actual environmental claims, and no knowledge of any potential environmental claims, against the property or any tenants or third-parties.

Purpose: Lenders typically have separate representations covering taxes and environmental matters. In part because these have specific governing authorities (for example taxes may be imposed by the municipality, the school district and by the sewer authority, all at the same time), in part because different statutory requirements may apply (for example federal, state and local environmental laws may apply), and failure to pay taxes or to pay any environmental charge typically results in a lien on the property that supersedes the mortgage lien. Accordingly, greater focus is placed on these matters.

Representations and Warranties – Taxes and Environmental

- **Practice Tips:**

- Obtain tax records and review. Ensure that at closing, taxes are paid through the next payment date after the closing.
- Order and review environmental report.
- Properties that are subject to remediation or that are located in brownfield sites may require additional provisions or documents to address these matters.
- Note that loan documents may require that borrower fund future taxes into escrow on a monthly or other basis. This will be covered in separate provisions in the loan documents.
- Borrower may be required to reserve funds to address outstanding environmental costs, such as remediation.

Representations and Warranties – Financial

- Financial statements provided by borrower as to the property, borrower and guarantor are true, correct and complete (note this ties into rent roll representation as well).
- Property budget provided to lender is true, correct and complete.
- Borrower may be asked to represent that the property income satisfies lender's required financial ratios (e.g. LTV, DSCR, DY).
- Borrower has invested stated amount into the property to date (or will provide equity in the stated amount).
- Guarantor has net worth and liquidity in the stated amounts.
- Use of funds are solely for the property and other disclosed purposes.

Purpose: Financial representations permit lender to verify the sources of borrower's equity and uses of the loan funds, that the property has adequate cash flow, that the guarantor has adequate wherewithal to support any required payments, and that in general, the financial aspects of the transaction comport with lender's underwriting of the loan.

Representations and Warranties – Financial

- **Practice Tips:**

- Financial representations are probably most key representations of the transaction, and most ignored by attorneys, in particular because there is tendency to defer financial analyses to the client.
- Counsel should be familiar with basic finance concepts, and their definitions in the loan documents. For instance, what is included in and excluded from income and expenses and how various financial ratios are defined.
- Counsel should be sensitive to timing of transaction and whether information provided is historical, current or prospective.
- For instance, if borrower is entering into the loan to acquire a property, counsel should be careful whether borrower has the capacity to make any representations about property income or expenses.
- Note that representations pertaining to guarantor may be separately required under the guarantees and should be reviewed for consistency (oftentimes overlooked).

Representations and Warranties – Miscellaneous

- Mechanics' Liens.
- Bankruptcy-remote, single purpose nature of borrower.
- Patriot Act.
- Insurance coverage.
- ERISA
- Enforceability of loan documents.
- Filing and Recording Taxes.

Purpose: Generally, these are representations that are found in almost every loan agreement. Wording of these representations vary according to the lender and the nature of the loan. Borrower's counsel typically push back against borrower providing any representations that relate to a conclusion of law (as opposed to a conclusion of fact).

Representations and Warranties – Miscellaneous

- **Practice Tips:**

- Despite the common view that these representations are “boilerplate” these representations have to be carefully reviewed.
- Mechanics’ lien representations are particularly problematic, especially if there is work recently performed at the property, as there may be work that has been performed, for which payment is due or not yet due, and for which no lien has been filed against the property. Due inquiry has to be made of borrower to determine whether there is a potential for mechanic lien filings and to obtain lien waivers and releases as needed.
- Bankruptcy-remote, single purpose business entity representations have to be carefully reviewed with borrower – for instance, there will be representations on not having shared office space with related business entities, joint accounts or consolidated books and records, as well as those related to trade debt and affiliate contracts

Affirmative Covenants

- **What is an Affirmative Covenant?**
 - An affirmative covenant is a covenant that requires the borrower to adhere to certain terms in order to maintain the health of their business, the property and the financials.

Affirmative Covenants – Loan Performance and Financial Covenants

- Timely payment of loan
- Performance of other loan obligations
- If the loan is required to comply with certain financial ratios (e.g., loan-to-value or debt service coverage ratio), and does not do so, to take requisite action to bring the loan into compliance.
- Timely pay taxes, insurance and other similar charges.
- Timely pay into insurance, tax, TI/LC or other reserves.
- If loan has lockbox or cash management feature, comply with requirements

Affirmative Covenants – Loan Performance and Financial Covenants

- **Practice Tips:**

- Counsel should ensure that the time of performance should always occur on a business day.
- Counsel should go over the factors going into financial ratios (such as gross income, net income, net operating income, debt service, operating expenses, etc.) are reviewed by the clients and help resolve any ambiguity in the language.
- With respect to scheduled payment obligations to third parties (e.g., taxes, insurance premiums) to the extent that evidence of payment is required, counsel should confirm what evidence is available and the timing to obtain the evidence.
- Payment into reserves on a periodic basis may be in a fixed amount. To the extent possible, the fixed amount may need to be adjusted to account for amounts already on deposit and/or changes to the annual amounts required.
- Lockbox or cash requirements typically will have a waterfall of how income may be used before deposit into the lockbox, or the order in which cash in the lockbox may be disbursed. Counsel will need to understand the waterfall and also the requirements for amounts to be withdrawn.

Affirmative Covenants – Compliance with Law

- Borrower (and applicable constituent parties and guarantor):
 - maintains existence
 - continues its business and operations
 - keeps in effect all requisite licenses and permits
 - complies with law
 - maintains trade names
 - causes the property to comply with law
 - maintains all policies of insurance required under the loan
 - complies with the Patriot Act.

Affirmative Covenants – Property Related Matters

- Maintain the property and cause the property to comply with law.
- Grant lender and its consultant's access (try to get reasonable notice, not less than 24-hour notice) to the property.
- Defend title to the property.
- Obtain lender's approval for any major alterations (or if non-major alterations, covenant that such non-major alterations comply with required parameters).
- Obtain lender's approval for any new major contracts (or if non-major contracts, covenant that such non-major contracts comply with required parameters). Also, obtain lender's approval if any major contracts are to be amended or terminated.
- Grant lender a first priority lien on any after acquired property.
- Maintain required insurance.
- Maintain property ownership structure (i.e., condominium, etc.) and cause compliance with all requirements.

Affirmative Covenants – Leasing/Sales

- Obtain lender's approval for any new major leases (or if non-major leases, covenant that such non-major leases comply with required parameters; may also want to have lender's waiver of approval if major leases comply with required parameters). Also obtain lender's approval (or waiver of approval) if any major leases are to be amended or terminated.
- Obtain lender's approval for form lease, and for any changes to approved form lease.
- Obtain estoppels from tenants, if required by lender.
- Enforce leases.

Affirmative Covenants – Leasing/Sales

- **Practice Tips:**

- Leasing requirements should be consistent with the type and size of property. For instance, in retail properties, a major lease will include anchor tenants and relatively large leases. In office properties, a major lease will include full floor leases.
- Borrower and lender should have the form lease pre-approved. Borrower should have the right to make minor, non-substantive, changes, to the form lease.
- Tenant estoppels requirement should be negotiated. Typically, lenders should not require tenant estoppels more than once a year.
- Some lenders have a minimum lease rental amount per rentable square foot – discuss ability to enter into leases with lesser rental amounts, depending on market conditions.

Affirmative Covenants – Reporting and Notices

- Notice of any default under leases or third-party contracts.
- Notices of any third-party lien.
- Notices of any litigation and claims against the property.
- Notice of any taking or insurance claim.
- Monthly, quarterly and annual reports.
- Annual operating budget and business plan.

Affirmative Covenants – Reporting and Notices

- **Practice Tips:**

- Lender's objective is to be aware of issues regarding the borrower and property. Lenders typically require that borrower provide immediate copy of a notice. Borrowers typically want to limit the notice to material matters.
- Notices of litigation and claims may be limited by a "floor" dollar amount (i.e., only notices above the floor) or those that result in a MAE.
- Counsel should be cautious whether any reports are required to be audited, certified (and by whom), and the timing for these reports to be generated (e.g., by March 15th?)

Affirmative Covenants – Liens, Litigation and Claims

- Cause any liens against the property to be discharged timely in accordance with the loan documents.
- Promptly cause litigation and claims to be defended against, and defend or indemnify lender against claims against it (if applicable)
- Comply with environmental laws relating to the property, and further take immediate action to remediate any environmental issue, and notify, defend, and indemnify lender of the same.
- Practice Tips:
 - The grace period for discharging liens is typically 30 days (may be too short in certain jurisdictions). Lender's may allow liens to be bonded over.
 - If there is litigation or claims to be defended against, typically the choice of counsel for material litigation or claims have to be preapproved by lender.

Get in Touch



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Ankush Israni advises on a broad range of commercial real estate matters, including joint ventures, senior debt and mezzanine financing, purchase and sale, loan sale agreements, fintech issues and leases. He represents institutional and non-institutional investors, including private equity funds, real estate investment companies and real estate investment trusts, in all aspects of transactions and property management.

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Drafting Provisions That Balance Borrower Protections With Lender Remedies

Presented By

Virginia Bailey “Ginger” Rolfe



Loan Covenants – Negative Covenants

What is a negative covenant?

A negative covenant, sometimes referred to as a restrictive covenant, is a covenant that prohibits one party from carrying out certain actions.

Loan Covenants – Negative Covenants

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A negative covenant, sometimes referred to as a restrictive covenant, is a covenant that prohibits one party from carrying out certain actions.

Types of negative covenants:

1. Standard
2. Transfers of the Property
3. Transfers of the Borrower
4. Borrower's Business

Loan Covenants – Negative Covenants

Standard Negative Covenants include:

- No liens on Borrower or the Property
- No change in use of the Property
- No forgiving debts owed to Borrower
- No change in zoning classification
- No engaging in transactions prohibited by ERISA

SAMPLE LANGUAGE

Change in Use.

Borrower shall not change the current use of the Property in any material respect.

Loan Covenants – Negative Covenants

Transfers of the Property

- No sale of any part
- No liens
- No new encumbrances
(includes easements and REAs)
- No granting of purchase options or preferential purchase options for the Property

Loan Covenants – Negative Covenants

Transfers of the Property

- No sale of any part
- No liens
- No new encumbrances
(includes easements and REAs)
- No granting of purchase options or preferential purchase options for the Property

SAMPLE LANGUAGE

Borrower, without the prior written consent of Lender, shall not sell, transfer, convey, mortgage, grant, bargain, encumber, pledge, assign, alienate, lease (except to Tenants under Leases that are not in violation of the terms and conditions of this Agreement), grant any option with respect to or grant any other interest in the Property or any part thereof or interest therein, whether directly or indirectly, voluntarily or involuntarily, by operation of law or otherwise.

Loan Covenants – Negative Covenants

Transfers of the Property

- Understand and negotiate provisions for any future development of property.
- Consider negotiating flexibility for standard transfers of Property.

SAMPLE LANGUAGE

Notwithstanding the foregoing or anything to the contrary herein, a prohibited transfer shall not include (i) any utility easements granted by Borrower in the ordinary course of business, provided such utility easements do not have a material adverse effect, (ii) the sale or disposal of obsolete or non-essential Personal Property as determined by Borrower in its good faith business judgment.

Loan Covenants – Negative Covenants

Transfers of the Borrower

- No transfers of direct or indirect interests in Borrower
- No pledges of interests in Borrower
- Often, the language used is “no Sale or Pledge”

SAMPLE LANGUAGE

“Sale or Pledge” shall mean a voluntary or involuntary sale, conveyance, mortgage, grant, bargain, encumbrance, pledge, assignment, grant of any options with respect to, or any other transfer or disposition of (directly or indirectly, voluntarily or involuntarily, by operation of law or otherwise, and whether or not for consideration or of record) of a legal or beneficial interest.

Loan Covenants – Negative Covenants

Transfers of the Borrower

Practice Tips:

- Borrowers should be careful not to trigger direct and indirect transfer restrictions.
- Counsel for each of Borrower and Lender should review the organizational documents of Borrower to determine what the existing transfer rights and obligations of direct and indirect owners are.
- Among provisions that may impact transfer rights are preferred equity structures that include a “forced sale” and result in a change of control.
- Counsel’s inquiry should also include investigation into pledges of ownership interests to secure loans.
- If ownership is tied into ownership or control by an entity (e.g., by XYZ Corp.), counsel should be aware who the principals controlling XYZ Corp. are and how ownership among the principals may change.

Loan Covenants – Negative Covenants

Transfers of the Borrower – Permitted Equity Transfers

The exception to the prohibition on transfers of interests in the Borrower are **Permitted Equity Transfers**.

Loan Covenants – Negative Covenants

Transfers of the Borrower – Permitted Equity Transfers

The exception to the prohibition on transfers of interests in the Borrower are **Permitted Equity Transfers**.

SAMPLE LANGUAGE

Transfers of direct or indirect interests in Borrower, shall be consented to by Lender if such Transfer satisfies the following conditions:

- a. the Transfer does not cause a change in the Control of Borrower; and
- b. Guarantor maintains at least 51% of direct or indirect equity ownership interest in Borrower

Loan Covenants – Negative Covenants

Transfers of the Borrower – Permitted Equity Transfers

The exception to the prohibition on transfers of interests in the Borrower are **Permitted Equity Transfers**.

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Practice Tips:

- Estate planning transfers should be carved out (i.e. gifts to trust, spouse, lineal descendant)
- Transfers caused by death should be carved out
- Standard Lender searches are always required for transfers above certain threshold
- Pay particular attention to notice provisions

Loan Covenants – Negative Covenants

Borrower's Business

Additional negative covenants related to the Borrower's business, including:

- No dissolution
- No change in business
- No change in name or identity
- No modification of organizational documents
- No breach of any special purpose entity covenants

Defaults & Events of Default - Generally

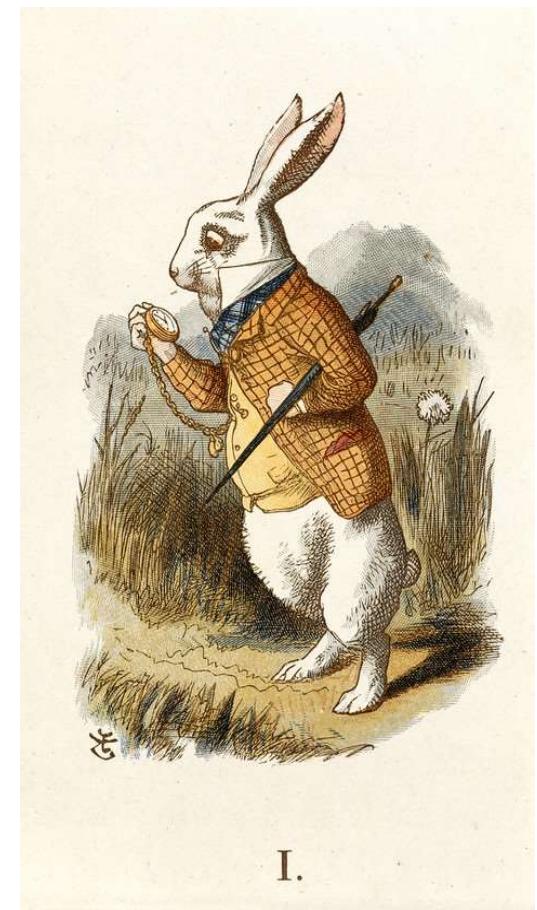
1. Defaults vs. Event of Default
2. Monetary Defaults
3. Non-Monetary Defaults
4. Cures for Events of Default
5. Cross-Default

Defaults & Events of Default - Generally

Default vs. Event of Default

“**Default**” means the occurrence of any event that, but for the giving of notice or passage of time, or both, would be an “**Event of Default**”.

A “**default**” is a breach that has not yet become an “**Event of Default**” because the required notice has not been provided or the necessary grace period has not run.



Defaults & Events of Default - Generally

Default vs. Event of Default

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A “**default**” is a breach that has not yet become an “**Event of Default**” because the required notice has not been provided or the necessary grace period has not run.

NOTE: Even though a “**Default**” has not ripened to a true “**Event of Default**”, Defaults can trigger some less extreme remedies if specifically provided for in the loan documents (e.g. prohibit reserve advances, prohibit future advances, prohibit loan assumption).



Defaults & Events of Default - Monetary

1. Payment of debt service
2. Payment of funds into reserves
3. Payment of other amounts due to Lender under the loan documents
4. Payment of taxes, insurance or operating expenses
5. Failure to comply with financial ratio tests or rebalancing requirements
6. Failure to comply with lockbox or cash management

Defaults & Events of Default - Monetary

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4. Payment of taxes, insurance or operating expenses
5. Failure to comply with financial ratio tests or rebalancing requirements
6. Failure to comply with lockbox or cash management

SAMPLE LANGUAGE

The following shall constitute an Event of Default . . . if Borrower shall fail to (i) ***pay when due*** (A) any sums which by the express terms of this Agreement and the other Loan Documents require immediate or prompt payment without any grace period, (B) any monthly Debt Service and any amount required to be paid into the Reserve Funds, or (C) any sums which are payable on the Maturity Date, or (ii) ***pay within 5 days when due*** any other sums payable under this Agreement or any of the other Loan Documents.

Defaults & Events of Default - Monetary

Practice Tips:

Scheduled Payments (Debt Service / Reserves): Some Lenders will provide a grace period to cure without notice before failure to pay a scheduled payment matures into an Event of Default. The grace period is negotiable (typically no more than 10 days).

Non-scheduled Payments (Fees and Costs): Typically, there is a grace period to cure non-payment after receipt of written notice from Lender. The grace period is negotiable (typically no more than 10 days).

Notice: For monetary defaults, parties can negotiate whether or not notice from Lender is required and what the period of cure is.

Compromise: A middle of the road compromise would be allowing Borrower to have a limited number of defaults (e.g., two) within a specified time period (e.g., 12 months), after which Lender will no longer be required to provide notice or grant a grace period (or longer grace period).

Defaults & Events of Default – Non-Monetary

Non-Monetary Default means a failure by Borrower to duly keep, perform and observe, any covenant, condition or agreement set forth in any of the loan documents other than an obligation to pay a sum of money.

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NOTE: Bankruptcy related Events of Default are non-monetary defaults that can be either (1) an immediate Event of Default or a, if a voluntary bankruptcy, insolvency, reorganization, etc., or (2) an Event of Default after a permitted period of discharge (not to exceed 90 days), if an involuntary bankruptcy.

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SAMPLE LANGUAGE

It shall constitute an Event of Default if Borrower continues in default under any term, covenant or condition of this Agreement not otherwise specifically designated as an Event of Default herein, (i) for more than 10 days after notice from Lender, in the case of any default which can be cured by the payment of a sum of money or (ii) for 30 days after notice from Lender, in the case of any other default (an “Other Non-Monetary Default”), provided that if, despite the fact that Borrower has promptly commenced diligent efforts to cure such Other Non-Monetary Default within such 30 day period, it cannot reasonably be cured within such initial 30 day period and if Borrower thereafter diligently and expeditiously proceeds to cure such Other Non-Monetary Default, the initial 30 day period shall be extended for so long as reasonably necessary (but not beyond an additional 60 days) to permit Borrower to cure such Other Non-Monetary Default with due diligence (subject to further extension by Lender, in Lender’s sole discretion).

Defaults & Events of Default - Cures

Can you cure an Event of Default?

Lender's View:

Events of Default are not curable
except upon written consent of Lender.



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SAMPLE LANGUAGE

A waiver of one Default or Event of Default with respect to Borrower shall not be construed to be a waiver of any subsequent Default or Event of Default by Borrower or to impair any remedy, right or power consequent thereon. Nothing contained herein or in the other Loan Documents shall be construed to grant Borrower any right to cure an Event of Default and each Event of Default shall continue unless and until the same is waived by Lender in writing in its sole and absolute discretion in accordance with the terms and provisions of the Loan Documents.

Defaults & Events of Default - Cures

Can you cure an Event of Default?

Borrower's View:

Some Events of Default should have notice and opportunity to cure. Monetary and non-monetary defaults should be treated differently.

When Lender enforces a remedy, the Event of Default should always "have occurred and then be continuing".

Defaults & Events of Default - Cures

Curable Non-Monetary Events of Default

Typically, Borrower has 15 to 30 days after written notice to cure a non-monetary default.

Borrowers may negotiate for an extended cure period – typically 60 to 90 days, or a “reasonable” period.

Lenders typically require that Borrower initiate the cure within the initial 15 to 30 day cure period, and that Borrower diligently prosecute the cure to completion.

Counsel on both sides of the transaction should be cautious and review each non-monetary default to determine whether Borrower should be given an extended period to cure any such non-monetary defaults.

Defaults & Events of Default - Cures

Uncurable Events of Default

Examples of Events of Defaults for which a cure period is not provided:

- Unpermitted transfers
- Failure to pay taxes when due
- Failure to pay insurance premiums when due
- Failure to discharge judgments within specified period
- Failure to timely remedy an environmental matter

Defaults & Events of Default - Cures

Uncurable Events of Default

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Practice Tip:

Typically, there's not a lot of leeway to negotiate notice or cure periods for these sorts of defaults. The immediacy of these defaults are meant as a deterrence to borrower.

Defaults & Events of Default - Recourse

Practice Tip:

Recourse Loans: In recourse loans, a Borrower's debt is secured by the real property collateral as well as the Borrower's other assets. A Guarantor will guaranty full performance and payment of the debt.

Non-Recourse Loans: In non-recourse loans, a Borrower's debt is secured solely by the real property collateral for the loan. A Guarantor will guaranty only certain recourse carveouts for "bad boy" or "dirty girl" acts.

When negotiating certain Events of Default that are important to your client, take time to differentiate what triggers a recourse carveout versus what triggers an Event of Default. There are times where it may make sense for recourse to occur immediately, but an Event of Default should be permitted a grace period (e.g. transfer violations).

Defaults & Events of Default - Cross-Default

A **cross default** is a provision in loan documents that puts a Borrower in default if the Borrower defaults on another obligation. It can be another obligation with the same Lender, an obligation of a Borrower-affiliate with the same Lender, or another obligation of Borrower with an unrelated Lender.

SAMPLE LANGUAGE

A default by Borrower under any other agreement in favor of Lender shall be a default under this loan.

A default in the payment of the principal or any interest or cost of the Loan, any Note or any of the other obligations of Borrower to Lender, as and when due and payable.

NOTE: A loan with cross default provisions is not always cross collateralized. Cross collateralization is when collateral for one loan is also collateral for another loan.

Staying Informed

Trade organizations:

- CRE Finance Counsel (CREFC) – www.crefc.org
- Mortgage Bankers Association – www.mba.org
- International Council of Shopping Centers (ICSC) – www.icsc.com
- CREW (Commercial Real Estate Women) Network – www.crewnetwork.org

Staying Informed

Recommended Podcasts:

The TreppWire™ Podcast

The TreppWire Podcast (from data analytics firm Trepp)
<https://www.trepp.com/the-treppwire-podcast>

CREative Talks! Hosted by Minjia Yan
<https://cre-media.com/podcast>



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Ginger is a real estate and finance attorney with nearly 20 years of practice in the industry. She is experienced in commercial lending, asset management, finance, leasing, and general real estate matters. She has experience in originating commercial real estate loans that are securitized and sold on the bond market (also known as commercial mortgage-backed securities or CMBS) and routinely represents banks and other lending institutions making loans on commercial properties such as office developments, retail centers, hotels, and manufactured housing complexes, among others. Ginger also works with tenants in the negotiation of a variety of leases and related issues and regional developers in the purchase and sale of commercial properties. She regularly serves as local North Carolina counsel for real estate matters. Ginger provides efficient, cost-effective and decisive legal solutions to promote smooth transactions for each of her clients.