SUMMER/2013

RE SOURCE™

A GOODWIN PROCTER PUBLICATION FOR THE REAL ESTATE INDUSTRY

NEW & IMPROVED?

REAL ESTATE 2013

The CMBS Market Reboot: A Balancing Act

AIFMD: What Non-European Managers Must Know

Stage Two: California Redevelopment Agencies Prepare to Sell Property

Syndication Nation: Borrower Issues in Syndicated Loans

SUMMER/2013

RE SOURCE

A Goodwin Procter Publication
For The Real Estate Industry

Editor-in-Chief
Robert M. Haight, Jr.

Editors
Lewis G. Feldman
John M. Ferguson
John T. Haggerty
Douglas A. Praw
Christopher B. Price
Andrew C. Sucoff

Production
Jessica Hekmatjah
Nathan G. Leonard

Design
The Castle Press

www.goodwinprocter.com

Copyright© 2013 by Goodwin Procter LLP. All rights reserved. Reproduction, in whole or part, without permission is prohibited. This publication may be considered advertising under the ethical rules of certain jurisdictions and should not be considered legal advice.

To ensure compliance with requirements under Treasury Department Circular 230, we inform you that the contents of this publication are not intended or written to be used, and may not be used, for the purpose of (i) avoiding U.S. federal tax penalties or (ii) promoting, marketing or recommending to another party any matter addressed herein. Each taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax adviser.

GOOD NEWS

Milken Institute Global Conference

Goodwin Procter was a proud sponsor of this year's 16th Annual Milken Institute Global Conference, April 28 - May 1, 2013 in Los Angeles, California. Our attorneys and clients were alongside 3,000 participants from more than 50 countries who engaged with 550 panelists covering the worlds of finance, real estate, government, education, energy/environment, health/medical research and media. Partner and Chair of the Los Angeles Office, Lew Feldman moderated a powerhouse panel of real estate industry leaders who shared their candid views of today's commercial real estate market's recovery. Visit GoodwinProcter.com to watch the panel and learn more about our involvement in the community.

GOODWIN PROCTER

In 1985, after almost 100 years, The Coca-Cola Company replaced the original formula for its namesake soft drink for a new formula dubbed "New Coke." It is unclear why the company replaced its century-old formula, but one thing is clear: the new and improved brand was a bust. Less than three months later, the company announced the return of the original formula, which was rebranded as Coke Classic until New Coke was officially discontinued in 2002.

The Ford Motor Company was founded in 1903, survived the Great Depression, and has been a national and worldwide leader in automobile manufacturing. In its first 50 years, Ford introduced several dozen different makes of cars, each with varying levels of success. But, in 1957, Ford decided that its newest product — the Edsel — was worthy of Ford's most elaborate product launch in its 50-year history. September 4, 1957 was dubbed "E Day" to introduce the new brand to the U.S. market. On October 13, 1957, Ford sponsored *The Edsel Show* to showcase its new car. It flopped. Ford ceased production of the Edsel in 1960, having lost $350 million on the car (in 1950 dollars!).

"New and Improved" is sometimes neither.

Emerging from the crash of 2008 and the difficult years that followed, the real estate market is attempting its comeback. Unlike a product that is improved with new packaging, taste, or color, we explore in these pages whether real estate is improved through new regulations and stricter underwriting. The four articles in this edition of *REsource* highlight the various changes that make up a portion of the "new and improved" real estate market.

Chris Price and Mark Lochiatto describe the new CMBS market with a comparison to the prior CMBS market that suffered so much during the recession. Samantha Lake Coghlan and Glynn Barwick explore European legislation impacting the marketing and managing of real estate funds, providing helpful information to those non-European managers seeking to invest overseas.

California reacted to the recession by eliminating redevelopment agencies and Lew Feldman and Doug Praw illustrate the opportunity that awaits investors as the former redevelopment agencies sell their real property assets. Syndication of loans is a way of reducing the risks of holding loans on the books and Dean Pappas and Alison Wais discuss borrower issues in these syndicated loans.

The real estate market is attempting to fix the perceived problems that led to, or was a consequence of, the recession by rolling out its "new and improved" products. Will these products fly off the shelves causing us to celebrate a stronger, more prosperous market? Or will we be sipping New Coke in our Edsels? Only time will tell.

– Robert M. Haight, Jr.
Editor-in-Chief

CMBS 2.0

The CMBS Market Reboot: A Balancing Act

by Christopher B. Price and Mark J. Lochiatto

At its peak in 2007 — prior to the meltdown of 2008 — the market for commercial mortgage-backed securities ("CMBS") was funding more than 40% of commercial real estate mortgage lending in the United States, including more than $200 billion in that year alone. As loans from the pre-meltdown period, which is often referred to as CMBS 1.0, begin to reach maturity, there will be significant and increasing demand by borrowers for refinancing proceeds. A reset, healthy, and growing CMBS market will be important to address this borrower demand. Will the CMBS market in its current configuration, i.e., CMBS 2.0, continue to grow and avoid the excesses of CMBS 1.0? This growth will be critical for continued improvement of the real estate market generally.

So-called conduit lenders in the CMBS market originate mortgage loans to borrowers that are then bundled and carved up into multiple levels or "tranches" of debt for which public and private securities are issued and sold to investors. A significant amount of the blame for the 2008 market meltdown was placed with the CMBS market. Lax underwriting resulted in excessive froth which allowed originators to receive origination fees and then pass along risk to the investors. A comparison of CMBS 1.0 and CMBS 2.0 reflects the various attempts in the market to better align risks, promote growth of conduit lending, and avoid the excesses of CMBS 1.0, all of which will affect the ability of borrowers to tap into the market. Changes include more stringent underwriting and revised borrower and loan documentation requirements, as well as increased regulatory oversight.

> *"In addition to facing more stringent underwriting, sponsors of borrowers of CMBS 2.0 debt will face expanded recourse obligations under non-recourse carveout guaranties. The list of so-called 'bad acts' that could trigger liability under non-recourse carveout guaranties has been expanded from what was seen in CMBS 1.0."*

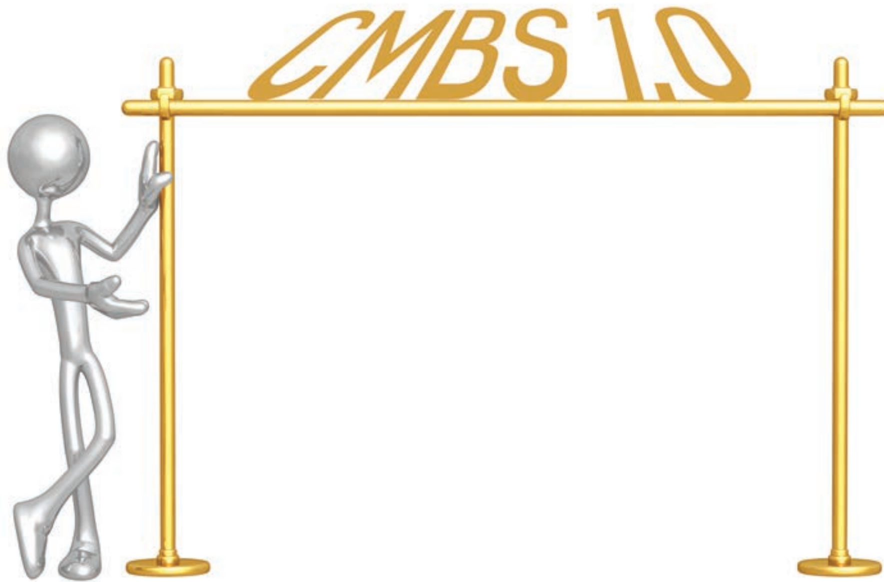
More Stringent Underwriting

More conservative underwriting is a key feature of CMBS 2.0. The table below provides a comparison of typical underwriting standards under CMBS 1.0 versus those under CMBS 2.0 (the data in the table do not reflect variations attributable to property types and markets).

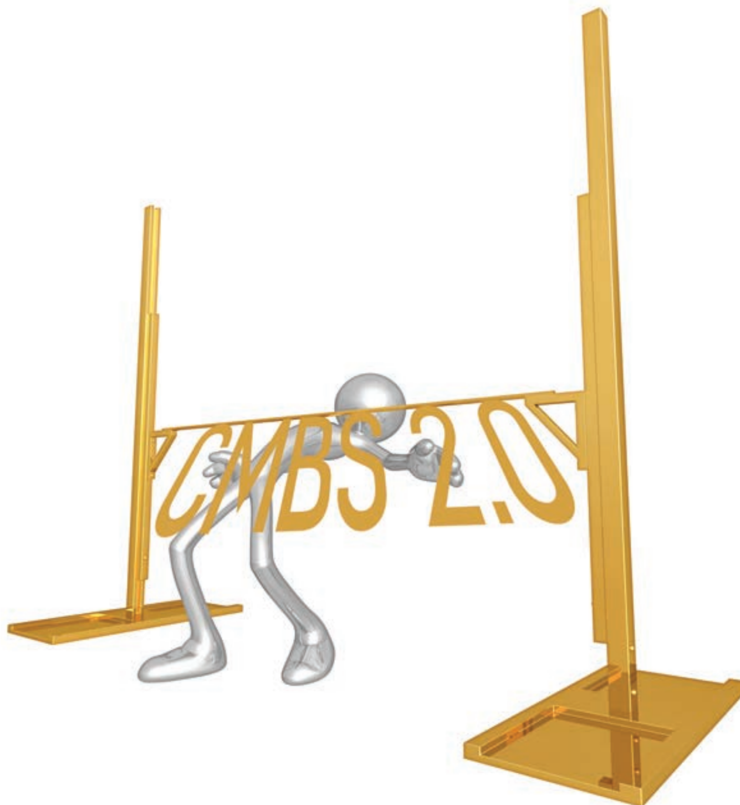
CMBS 2.0 in comparison to CMBS 1.0 generally reflects significantly lower loan-to-value ratios ("LTV"), higher debt service coverage ratios ("DSCR"), and fewer loans that are interest only without any principal amortization. The debt

CMBS 2.0 vs. CMBS 1.0

	CMBS 1.0	CMBS 2.0
Loan to Value Ratio	Often Exceeding 80%	80% or less
Debt Service Coverage Ratio	1.05x	1.25x or greater
Interest Only	55.5%	9.3%
Debt Yield	N/A	10-12%



yield standard (i.e., net operating income divided by the mortgage loan amount) was not significant in CMBS 1.0, but is playing a prominent role in CMBS 2.0 because low interest rates in the current market, cap rate fluctuation, and principal amortization limit the usefulness of the DSCR standard as a metric for comparing different CMBS issuances and for projecting the refinancing eligiblity of a mortgage loan.



Also, CMBS 2.0 only underwrites stabilized in-place income generated by a property based on trailing cash flow and excludes pro forma income based on borrowers' projections that often was included in CMBS 1.0 underwriting. Most CMBS 2.0 debt at origination has not included subordinate debt in the form of mezzanine debt or B-notes, and often prohibits future mezzanine debt.

Although CMBS 2.0 underwriting is more conservative than CMBS 1.0, it is nonetheless providing an alternative source of financing to borrowers whose primary source of mortgage financing since the market meltdown has been limited to insurance companies and commercial banks (which have more stringent underwriting than that of CMBS 2.0). Borrowers under CMBS 2.0 have the ability to access non-recourse debt with higher loan-to-value ratios (typically up to 80%) permitted by portfolio lenders (up to 70%), and to use it for property types and markets that portfolio lenders are not underwriting.

However, despite the strictures of early underwriting, with increased CMBS market volume and competition among lenders, CMBS underwriting standards have been loosening in recent years since the CMBS market resumed in the wake of the meltdown. DSCR is trending back down, LTV ratios are trending up, lenders are underwriting some pro forma income, and there is an increased use of subordinate B-note and mezzanine financing. This loosening of standards raises

"However, despite the strictures of early underwriting, with increased CMBS market volume and competition among lenders, CMBS underwriting standards have been loosening in recent years since the CMBS market resumed in the wake of the meltdown."

the question about how the market will respond and how effective the other features of CMBS 2.0 will be to control the excesses of CMBS 1.0.

Recourse Obligations and Loan Covenants

In addition to facing more stringent underwriting, sponsors of borrowers of CMBS 2.0 debt will face expanded recourse obligations under non-recourse carveout guaranties. The list of so-called "bad acts" that could trigger liability under non-recourse carveout guaranties has been expanded from what was seen in CMBS 1.0. For example, in reaction to the significant costs and delays incurred by lenders in the market meltdown as a result of borrowers "interfering" with lenders' pursuit of remedies, originators are adding such borrower interference following an event of default to the list of bad acts triggering full recourse. Other examples of actions sometimes added to the list of bad acts triggering recourse under CMBS 2.0 include failure to deliver to lender information on the property or provide lender access to the property. In addition to expanding the list of bad acts, CMBS 2.0 also affects the consequences of some bad acts. For example, in the event of a voluntary bankruptcy filing by a borrower under CMBS 1.0, recourse might through negotiation be limited to the actual losses incurred by lender, but under CMBS 2.0 full recourse would most likely be triggered for the entire amount due under the loan.

Borrowers of CMBS 2.0 debt will encounter additional loan and borrower organizational documentation requirements that were present but often waived in CMBS 1.0. Originators will require detailed reporting covenants of the borrower and its sponsor as well as net worth and liquidity covenants. Driven in large part by the General Growth Properties bankruptcy case in 2009, borrowers will almost always be required to enter into a cash management arrangement that requires all cash from the property to flow to an account in which the lender has a perfected security interest. The structure may be either a "hard lockbox," meaning that the lender controls the account and the application of cash proceeds in accordance with the waterfall in the loan documents, or a "springing lockbox," which creates a hard lockbox upon certain triggering events, typically an event of default or failure to meet a DSCR test. Funding cash reserves up front at loan origination as well as during the term of the loan may also be required for capital requirements, tenant improvement costs, and leasing commissions.

Also, with respect to independent directors, whose affirmative vote is necessary to take certain material actions like a voluntary bankruptcy filing, borrowers in CMBS 2.0 are being required to use independent directors from nationally-recognized companies and to obtain lender approval prior to their removal and replacement.

Evolving Structure

CMBS loan volume was virtually non-existent in 2008 and 2009 in the wake of the downturn, but with the re-emergence of the CMBS market and the implementation of CMBS 2.0, volume has increased modestly since 2009, reaching more than $45 billion in 2012 and more than $13 billion in the first two months of 2013. It is projected to exceed $65 billion for 2013. The market will continue to test CMBS 2.0 as underwriting standards vary, securitization structuring evolves, and regulatory reforms are implemented. For CMBS 2.0 to grow as a source of mortgage financing, a proper balance between additional costs and restrictions to avoid previous excesses must be struck. ■

Christopher B. Price is a partner in the New York office of Goodwin Procter and can be reached at (212) 813-8951 or cbprice@goodwinprocter.com.

Mark J. Lochiatto is an associate in the Boston office of Goodwin Procter and can be reached at (617) 570-8159 or mlochiatto@goodwinprocter.com.

AIFMD: What Non-European Managers Must Know

by Samantha Lake Coghlan and Glynn Barwick

The Alternative Investment Fund Managers Directive ("AIFMD") is European legislation intended to create a unified regulatory framework throughout Europe for the marketing and managing of funds that will, in due course, replace the current patchwork of private placement regimes. It will affect the business of all non-European funds and their managers that wish to attract investors from the European Economic Area ("EEA"), i.e., most of Europe except Switzerland and the Channel Islands. So what do non-European managers need to know about AIFMD?

Who is the Manager?

The AIFMD applies to the manager of any fund that is being marketed to investors in the EEA. Each fund must have one, and only one, manager who is responsible for the fund's compliance with the AIFMD and who carries out at least one of the investment management and risk management functions. The manager may delegate the day-to-day functions for which it has responsibility (often investment management to a portfolio manager), provided that it nevertheless retains real substance and still carries out at least one of investment management or risk management.

In a non-European context, the manager for a fund in the form of a partnership is often the general partner ("GP"). For funds in the form of an investment company, the manager will often be the fund itself where it is self-managed. In both cases, however, it is permissible for the fund (if it wishes) to transfer the responsibility of management to a third party, in which case that entity would be the manager instead.

Care will need to be taken by funds, therefore, to ensure that the correct manager is identified, especially if the transitional provisions are to be used, as discussed below.

What Triggers the AIFMD?

The AIFMD is triggered by marketing in the EEA. The AIFMD defines marketing as "direct or indirect offering or placement at the initiative of the [manager] of units or shares in a [fund]." There are, however, different interpretations of the definition of marketing that a fund manager should fully understand.

First, the AIFMD provides that "reverse solicitation" is not marketing – that is, where the initiative for the investment comes from the investor rather than from the manager. This approach may be useful for a manager who has a small number of repeat European investors in a series of its funds, although the manager will need to be careful not to abuse the provision and to maintain proper records.

Second, the UK takes the view that a fund is marketed only when a specific offer that is capable of acceptance is made to an investor. On this basis, "soft marketing" — such as presenting draft documentation that is still subject to negotiation or a pitch book — is not marketing for the purpose of the AIFMD, and allows a manager to test the waters in a country before taking the final steps required by the AIFMD. This interpretation is specific for the UK, although other countries may follow suit.

Where there is no marketing in the EEA, the AIFMD will not apply. This means that funds which are closed to new investors, for example, will not fall within the AIFMD even where they have European investors.

How Does a Manager Market Its Fund?

Where shares or units in a fund are marketed in the EEA, a manager must do three things under AIFMD:

1. **Make certain pre-investment disclosures to investors.** Most of these will not be controversial and likely already exist in properly prepared private placement memoranda ("PPMs"). Funds that do not have PPMs may need to prepare a separate AIFMD disclosure statement. One of the controversial pre-investment disclosure requirements is the description to investors of how other investors may receive preferential treatment under side letters.

2. **In some countries, register each fund with the applicable country's regulator.** The AIFMD does not mandate states to require this pre-marketing registration, and only the UK and Germany have introduced a pre-registration regime. The burden of pre-registration is not the administration and cost of doing so (although these should not be underestimated), but the inability of the manager to market (and therefore close the transaction) until registration has been made and approval granted by the local authority.

3. **Provide post-investment disclosure to investors and to the local authorities in each country where the fund has been marketed.** Most of the information that must be disclosed is likely already disclosed to investors, although there may be some sensitivity to disclosing general information regarding remuneration of the manager's employees and officers. This disclosure is quite similar to that required under the rules applicable to publicly-listed companies.

When is AIFMD Effective?

The implementation date of AIFMD is officially July 22, 2013 ("Implementation Date"). However, the AIFMD provides for a transitional period of one year (to 2014) for managers who are performing activities under the AIFMD as of the Implementation Date. This transitional exemption applies to funds that the manager manages on the Implementation Date and also to any new funds that the manager establishes before July 22, 2014. For a fund to take advantage of the transition rules, it is crucial, as discussed above, to identify correctly the manager of each fund on the Implementation Date. For example, where a manager is the general partner of a partnership and the practice is to create a new general partnership for each new fund, the transitional provision will not be useful for funds established after the Implementation Date since the new GP will not have been managing as of the Implementation Date.

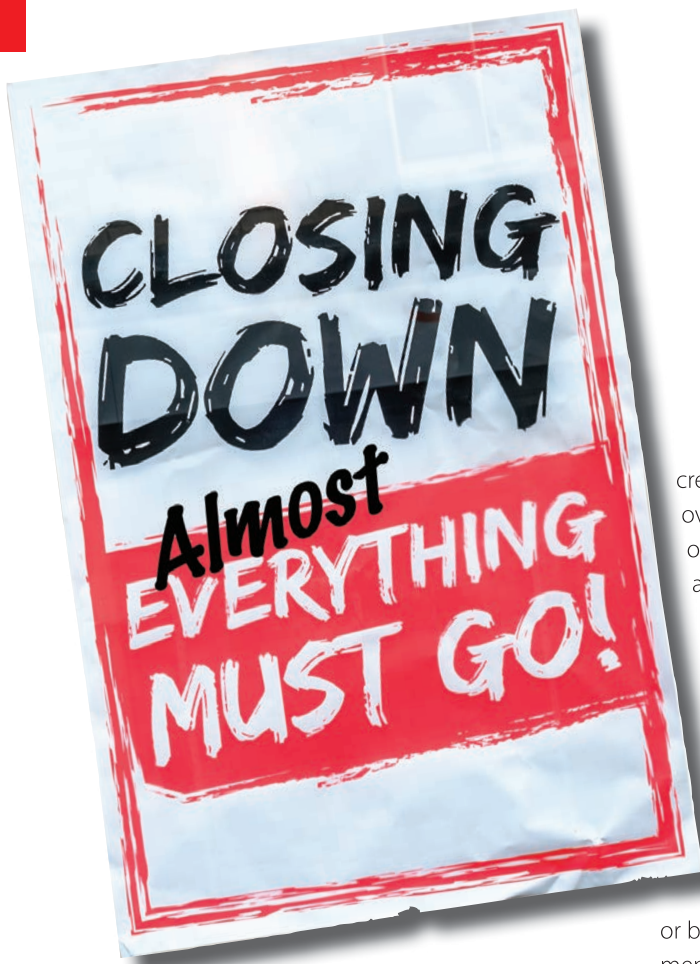
It is also not yet clear whether all member states of EEA will implement this transitional provision for non-European managers. Although the UK and Germany have said that they will, other countries have not yet committed.

Conclusion

The AIFMD will have significant consequences for a manager who wishes to obtain access to European investors. There are steps, however, that may be taken by a manager to reduce its burden under this new law. One strategy is to create a hybrid marketing strategy that requires different actions in different countries: agree on registration in some countries; take advantage of reverse solicitation in other countries; and test the waters through soft marketing in the rest. Like any strategy, the hybrid strategy depends on the facts applicable to a specific manager and requires careful consideration. ■

Samantha Lake Coghlan is a partner in the London office of Goodwin Procter and can be reached at +44 (0) 20 7447 4203 or slakecoghlan@goodwinprocter.com.

Glynn Barwick is a counsel in the London office of Goodwin Procter and can be reached at +44 (0) 20 7447 4226 or gbarwick@goodwinprocter.com.



STAGE TWO: C
AGENCIES PR

by Lewis G. Feldman and Douglas A. Praw

Over the next few years, recently-dissolved California Redevelopment Agencies ("RDAs") will be selling their inventory of real property assets. This presents a long-awaited opportunity for real estate developers. As has been widely published, on January 31, 2012, California Governor Jerry Brown succeeded in his campaign to eliminate over 400 California Redevelopment Agencies and, through the unwinding process, return property taxes to local taxing agencies. The final step of the process includes processing and disposing of thousands of parcels of former-RDA real estate. The characteristics and quality of these assets vary from strategic urban infill parcels with development potential to less desirable surplus or heavily blighted properties.

The sale of RDA property requires the efforts and approvals of three governmental entities. The Successor Agency ("SA") of the former RDA serves as the property liquidator, while the Oversight Board ("OB") serves as a credit committee of sorts. Both the SA and OB are creatures of State law with limited, but important, responsibilities. Since February 1, 2012, each SA has been charged with creating an inventory of all property owned by the RDA over which it and the OB have jurisdiction, examining ongoing developments, accounting for bond proceeds, and understanding the enforceable obligations to which the SA is legally bound.

The SA's and OB's roles include completing or otherwise satisfying all RDA activities and obtaining a Finding of Completion ("FOC") from the State Department of Finance ("DOF"). The FOC resembles an order lifting an automatic stay in bankruptcy since it allows an SA to (i) dispose of property in accordance with its Property Management Plan ("PMP"); (ii) spend proceeds of bonds that were issued on or before December 21, 2010; and (iii) reinstate loan agreements formerly between an RDA and its host jurisdiction. To date, the DOF has provided over 200 FOCs to the SAs of former RDAs throughout the State. With a FOC in hand, the SA moves into a post-compliance period that begins with implementing its PMP and ends with disposition of all RDA property.

What Does A PMP Look Like?

PMPs set forth the manner of disposition of each of the properties within the SA's jurisdiction. PMPs must be prepared within six months following completion of the FOC.

PMPs must divide RDA property into three buckets, and then divide the last bucket into three more:

- ***Bucket 1 - Economic Development Parcels:*** An SA can use the PMP for long range planning and continue to own property suited for economic development.
- ***Bucket 2 - Government Purpose and Enforceable Obligation Parcels:*** An SA can list property on a PMP for transfer to a city or county where there is a governmental or future development use for it. The SA can also list property under a category that allows it to retain or sell property to satisfy an enforceable obligation created by a former RDA.

ALIFORNIA REDEVELOPMENT
EPARE TO SELL PROPERTY

- **Bucket 3 - "Free Range Chicken" Parcels:** The rest of the properties will be offered for sale after being placed into one of three additional baskets:

  "A" properties are strategic properties that can be used for development. Entitlements will vary, but "A" properties may be accompanied by approved entitlements.

  "B" properties are those that require zoning approvals or other entitlements before development.

  "C" properties are the story parcels—the irregular and the blighted, with little or outdated entitlements.

A PMP should be instructive to a potential buyer because it will include specific information about each parcel for disposition, including:

- the value of the property on the date of acquisition and an estimate of the current value;
- the purpose for which the RDA originally acquired the property;
- lot size;
- current zoning;
- an estimate of lease, rental, or other revenues generated by the property and a description of the contractual requirements for the disposition of those funds;
- the history of environmental contamination, including designation as a brownfield site and the history of any remediation effort; and
- a description of the parcel's potential for transit-oriented development and a brief history of all previous development proposals and activities for the parcel.

When Will PMP Property Deal Flow Begin?

Current law does not provide the time frame by which-when the property described in a PMP will go to market. Rather, SAs are working to figure out the best way to avoid fire-sale pricing by flooding the market with former RDA parcels. Given that OBs need to approve of disposition plans, it is likely that each disposition will need to be supported by an MAI appraisal. Thus, the process for the disposition of the "A" and "B" buckets of property will take time, be heavily documented, and be highly competitive once deals hit the market. Some real estate brokerages and online auction houses are already trying to get ahead of the process and funnel PMP dispositions through auction sites. Others are meeting directly with each SA to ensure the ability to bid on property coming to market.

"Current law does not describe the time parameters of when the property described in a PMP will go to market. Rather, SAs are working to figure out the best way to avoid fire-sale pricing by flooding the market with former RDA parcels."

Unique Opportunity

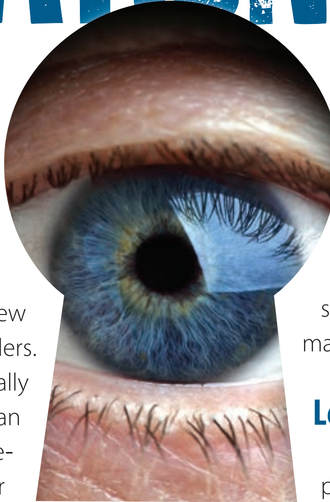
Despite the bureaucratic morass and red-tape, many RDAs hold fairly large parcels of property, which, in the right hands, could turn into significant opportunities. Developers and other real estate investment professionals are carefully watching the PMPs in the hopes of acquiring property ready for development. ■

Lewis G. Feldman is a partner in the Los Angeles office of Goodwin Procter and can be reached at (213) 426-2688 or lfeldman@goodwinprocter.com.

Douglas A. Praw is a partner in the Los Angeles office of Goodwin Procter and can be reached at (213) 426-2664 or dpraw@goodwinprocter.com.

SYNDICATION NATION:

by Dean C. Pappas and Alison J. Wais



To avoid holding loans on their balance sheets on a long-term basis, lenders will often syndicate large commercial loans through co-lender and participation arrangements. These syndications can be comprised of as few as two or as many as a dozen different lenders. The administrative agent for the loan – typically one of the syndicate lenders – handles all loan document negotiations and is the intermediary between the borrower and the lender group. However, certain critical lender decisions and actions impacting the loan require the approval (majority, supermajority, or unanimous depending upon the issue) of the lender group. Thus, for the borrower, a syndicated loan begets a host of issues that must be considered.

Know Your Lenders

The borrower should initially ask the administrative agent to identify the lenders who will co-lend or participate in the loan, as the lending group may impact the loan in a number of ways. Many times, the syndication is accomplished at closing of the loan, and the borrower can evaluate the lenders that comprise the lender group and address any concerns regarding each lender's creditworthiness or identity before the loan closes. However, the syndication is often completed *after* loan closing. In addition, even if the loan is syndicated prior to the closing, the syndicate lenders may later assign their interests in the loan to a lender unknown at the time of closing. In both situations, it behooves the borrower to negotiate provisions that address these circumstances.

The borrower may mitigate the risk of an unwanted lender joining the syndication by negotiating for certain controls on, or qualification requirements with respect to, the lenders that may acquire an interest in the loan. For example, the borrower may negotiate for approval rights with respect to any lender acquiring an interest in the loan, or impose minimum qualification requirements for such lenders. Some lenders will agree to limit the pool of potential lenders to "eligible assignees" that are defined as other lenders in the syndicate, lender affiliates, and funds managed by a lender or its affiliate.

Lender Consent

A number of decisions and actions on the part of the lenders in a syndicated loan require the majority, supermajority, or unanimous consent of the lenders in the lender group. These decisions and actions include: consent to direct and indirect equity transfers in the borrower; approval of and changes to budgets; changes in the identity of the property manager or a developer; plans and specifications; and replacement of a guarantor (particularly in cases where the guarantor is in default of its covenants in its guaranty).

When a loan involves many lenders, it is extremely important for the borrower to negotiate for the lenders' pre-approval of certain actions in the loan documents, including providing for the following:

- Flexible permitted transfer provisions allowing the borrower to make certain transfers without the consent of the administrative agent or the lenders (such as those transfers that do not result in a change of control of the borrower).
- An objective standard for the replacement of the property manager or developer upon a default to avoid problems and delays.
- Criteria for identifying and engaging replacement property managers and developers without lender consent.
- The lenders' pre-approval (based on the establishment of minimum financial requirements) of replacement

BORROWER ISSUES IN SYNDICATED LOANS

guarantors upon a default under the loan caused by a guarantor.

- Approval of certain matters limited to that of just the administrative agent or, in limited cases, a majority of lenders. If consent of all of the lenders, a supermajority, or even a majority, of lenders is required, the borrower's ability to operate, construct, develop and manage the property can be significantly impacted. However, comprising the syndicate with lenders holding a majority or supermajority with whom the borrower has a good working relationship and regularly does business with could mitigate the impact substantially and allow the borrower maximum flexibility to operate its property.

Future Advances

Any time a borrower obtains a loan that requires future advances, such as a construction loan, the borrower takes a risk that the lenders may not be able to fund the advance. A borrower can minimize this risk by controlling the lenders who may participate in the loan, but the borrower does not always have the leverage to negotiate such controls.

In some cases, the administrative agent may make advances to the borrower on behalf of the lenders in reliance on the other lenders' agreement to pay the administrative agent. If the lenders fail to make payments to the administrative agent, it may have an unfettered right to recall the funds advanced from the borrower, together with any applicable interest thereon. The recall of the advances is problematic for the borrower who has already committed or used these funds to pay contractors, vendors, suppliers, or other third parties. To address this problem, a borrower should consider (i) requiring all lenders to fund any disbursement up front, thereby eliminating the risk that any funds would be recalled by the administrative agent, (ii) providing that the administrative agent cannot recall funds after an outside date (e.g., 30 days), and (iii) requiring immediate notice from the administrative agent if any lender fails to fund its pro rata share of any portion of the loan.

The borrower should also focus on provisions in the loan documents setting forth the consequences to a defaulting lender for a failure to fund. For example, the other lenders should be given the option to fund a defaulting lender's amount. As another example, the consequences to the defaulting lender should be severe, including provisions requiring a defaulting lender to assign its interest in the loan to an existing lender or subordinating the defaulting lender's portion of the loan to the other portions of the loan and possibly providing that the defaulting lender's loan ceases to accrue interest.

Foreign Lenders

Borrowers should be cognizant of loan assignments to foreign lenders. New laws being phased in over the next few years require significant withholding taxes imposed on foreign lenders that do not meet certain requirements. If the borrower is required under the terms of the loan documents to gross-up for withholding taxes, then the assignment to a foreign lender that is subject to such withholding tax would be very costly. The loan documents should provide for either consent to assignments over foreign lenders, or should exclude such withholding taxes from the gross-up payments owed by the borrower.

Conclusion

While borrowers may be able to obtain larger loans on more desirable terms from a syndicate of lenders that spread the exposure among the group, borrowers should carefully consider the myriad issues that arise when dealing with a consortium of lenders. With knowledge of the pitfalls, borrowers should be able to negotiate provisions to minimize, or even eliminate, the risks involved in syndicated loans. ■

Dean C. Pappas is a partner in the Los Angeles office of Goodwin Procter and can be reached at (213) 426-2525 or dpappas@goodwinprocter.com.

Alison J. Wais is an associate in the Los Angeles office of Goodwin Procter and can be reached at (213) 426-2517 or awais@goodwinprocter.com.

RE SOURCE™
A GOODWIN PROCTER PUBLICATION FOR THE REAL ESTATE INDUSTRY
601 South Figueroa Street, 41st Floor
Los Angeles, California 90017

RETURN SERVICE REQUESTED

Use your smartphone's QR scanner to sign-up & receive digital issues of REsource

GOODWIN LONDON

London Base. Global Reach.

Superior breadth and depth of market knowledge and expertise within a dedicated real estate sector offering.

Real Estate Funds and Fund Formation • Investment Management Finance • Separate Accounts • Real Estate M&A • Cross-Border Transactions • Real Estate Investment Acquisitions and Disposals (At Asset and SPVs/Unit Trust Levels) • Development, Development Funding and Lettings • Global Hospitality and Leisure • UK and Cross-Border Tax • Regulatory and Compliance

VISIT US Goodwin Procter (UK) LLP, Tower 42, 25 Old Broad Street, London EC2N 1HQ, United Kingdom | Phone: +44 20 7447 4200, Fax: +44 20 7447 4201

GOODWIN PROCTER

Boston | Hong Kong | London | Los Angeles | New York | San Francisco | Silicon Valley | Washington DC

www.goodwinprocter.com