

Guidelines for intercreditor agreements in UK commercial real estate finance transactions

Paper 1 – Structured Lending – Real Estate Finance

A glossary of terms and some example structures

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CREFC Europe

This is the first of a series of papers, in which CREFC Europe members share their experiences in relation to a selection of the structures that are being used to finance commercial real estate, some of the commonly negotiated provisions found in intercreditor agreements and some of the traps for the unwary. The experiences are from a variety of transactions, but it is clearly the case (i) that the category of real estate asset; (ii) the leverage (and split between lenders); and (iii) the type of lender (debt fund, insurer, pension fund, bank..) as well as the funding structure, will all have bearing on the outcome of the intercreditor relationship.

The focus of this paper is on a selection of the structures that are being used to finance commercial real estate, including:

1. structural subordination (senior/mezzanine);
2. disclosed A/B loans and undisclosed A/B Loans (whole loans);
3. separate loan agreements with shared or separate security packages but no structural subordination; and
4. warehousing of whole loans with provision for co-operation on putting a senior/mezzanine structure in place.

We also provide a glossary of terms of art that are often used, and often misunderstood, in relation to structured lending.

Subsequent papers will focus on:

1. The subordination of payments to the junior finance parties and the concepts of property protection loans, senior headroom, cash trap events, junior payment stop events and escrow of monies that would otherwise have been available to pay amounts due to the junior finance parties (absent the junior payment stop event).
2. Intercreditor agreements where structural subordination is not available, including whole loan structures, will be explored, including where the obligors themselves are not party to the intercreditor arrangements (for example a "behind the scenes" intercreditor arrangement, or "agreement amongst lenders") and as such the tranching and pricing is not transparent to the obligors.
3. The security package available to the junior finance parties and their enforcement rights in relation to the same, including concepts of waivers of mandatory prepayment on change of control, use of control valuation events, fair value and credit bidding.
4. Voting rights for the junior lenders in relation to certain changes to the senior finance documents and also in relation to consents, waivers and amendments required or requested under the facility agreements.
5. Some of the other tools in the junior lender's tool kit such as cure rights, the right to purchase the senior debt and options on the property.
6. Intercreditor agreements that involve obligors who are not incorporated in the UK, or whose assets are not situs in the UK.

Each paper will focus on the negotiating stance of the lenders, drawing on experience of CREFC Europe members and will also cover some of the tax and regulatory points that should be considered.

The structures detailed in this paper focus on (i) who borrows the debt; (ii) how that is recorded (one facility agreement or more); and (iii) the guarantee and security packages. For the purpose of this paper, hedging is ignored.

1. GLOSSARY OF TERMS

"A/B loan" – a loan facility documented in a single facility agreement where the loan has been tranching into an "A Loan" and a "B Loan". Sometimes that tranching is borrower facing, such that the borrower is party to the agreement amongst lenders as to subordination and voting rights and also pricing (a "disclosed A/B Loan"). Contrast to where the term **"whole loan"** is used where such tranching is generally undisclosed (see below).

"acquisition right" or **"equity switch right"** – the right of the junior lenders to enforce over share security granted in favour of the junior security agent (commonly under a junior only security package) coupled with a conditional waiver by the senior lenders of the mandatory prepayment event triggered by such change of control.

"bifurcate" – to split up or divide into different parts (different tranches or different loans).

"contractual subordination" - involves the junior creditor and the debtor agreeing that the debtor will make no payments in respect of the junior debt unless and until the senior debt has been paid in full.

"common security" or **"common asset security"** – used to describe a security package held by a single security agent as agent for more than one class of lenders, for example in senior/mezzanine transaction where the [common] security agent holds the propco level security for the benefit of both the senior lenders and the mezzanine lenders.

"common security agent" – a security agent that holds security for the benefit of the various classes of lenders.

"equity switch right" – see "acquisition right" above.

"junior" - used to describe a lender group which is subordinated in terms of order of payment relative to another lender group. This includes mezzanine lenders and B lenders etc..

"junior security" or **"junior common asset security"** – used to describe security over the propco level assets where a junior security agent holds a separate (but equivalent) security package for the benefit of the junior lenders, separate to that held by the security agent for the senior lenders.

"junior only security" – used to describe security over the assets held by a junior security agent for the benefit of only the junior lenders, where no equivalent prior ranking security is given to any other lender group, for example the **mezzanine only security** in a structurally subordinated structure where the mezzanine lenders may benefit from security over the shares in Holdco 2 and the accounts and assets of Holdco 3 and Holdco 4 (see

diagrams below), and such security (or any equivalent) is not available for the benefit of the senior lenders.

"mezzanine capital" - a layer of debt or preferred equity that represents a claim on a company's assets which is senior only to that of the ordinary shares. The rights of the mezzanine lenders to receive payments are subordinated to the right of the senior lenders to receive payments.

Traditionally, even when structured as debt, it was unsecured, and benefited from share warrants and observer rights, but over time mezzanine debt used in structured real estate finance has become more commonly secured by security over the shares in a Holdco and/or by second priority or subordination lien security over the propco level assets (and share warrants and observer rights are less common). The mezzanine creditors will be limited in their right of enforcement (and there will be specific release requirements). Mezzanine debt will always be recorded in a separate document to the senior debt.

"priority" - used to describe how two or more *separate* security interests are ranked. Sometimes used also to describe how the proceeds from a single security interest are to be shared between creditors, although this is more correctly described as subordination of one debt to another or "subordinated liens".

"ranking" – see "priority" above.

"second lien" – a layer of debt which is secured on a subordinated lien basis by (more or less) the same security package that secures a more senior layer of debt. The first and second lien lenders agree that the first lien lenders will be paid in full from the proceeds of any security enforcement before the second lien lenders receive any realisation proceeds, and that the second lien lenders have very few voting rights in relation to the security package. The second lien lender was not traditionally subject to payment subordination, only "lien subordination" (in contrast to a mezzanine lender, which if secured, would be subject to both). However payment stop events and enforcement standstills have become more common (at least in the European market where the second lien debt has taken on characteristics of secured mezzanine debt). Second lien could be one of the tranches of a loan (commonly the D tranche in a leveraged finance transactions) or could be documented in a separate loan agreement. Sometimes referred to as "*stretched senior*" although stretched senior can confer a different package of rights.

"senior" – used to describe a lender group which is not subordinated in terms of order of payment relative to another lender group.

"senior security" or **"senior common asset security"** - used to describe security over assets where a senior security agent holds a separate security package for the benefit of the senior

lenders, separate (but equivalent) to that held by the junior security agent for the junior lenders.

"subordination" – includes turnover subordination, contractual subordination and structural subordination. The intention of subordination is to create a preferred class of creditor. The acid test of subordination is when the debtor goes into an insolvency procedure. Therefore, one of the fundamental issues is whether the subordination arrangements will stand up against the insolvency regime applicable to the debtor.

"subordinated liens" – used to describe a security package which is held for the benefit of more than one class of creditor where the proceeds of enforcement are used to pay one creditor in full prior to the other (subordinated creditor). Also see **"second lien"**.

"structural subordination" - involves the senior lenders lending on a secured basis to the propco level companies (or to a holdco only one company removed from the propcos) and junior (subordinated) creditors lending to a more remote holding company and therefore only having recourse to the shares in the subsidiaries (i.e. what is left after the creditors of the subsidiaries have been paid). Certain classes of subordinated creditor e.g. mezzanine lenders and high yield bondholders, may also get a guarantee from the propco level companies. Whilst that guarantee would itself be subordinated, this gives the subordinated creditors equal ranking with the unsecured creditors of the company which has given the guarantee. Mezzanine creditors may also receive security (on a second priority or subordinated lien basis) over the propco level assets.

"tranche" - where a loan facility is split into sub loans or tranches, each tranche with different rights, primarily as to payment and voting (including on enforcement).

"turnover subordination" - involves the junior creditor agreeing to turnover to the senior creditor all receipts up to the amount of the senior debt. Until turnover the junior creditor agrees that it will hold those receipts on trust for the senior creditor. Following any turnover, any resultant right of subrogation or indemnity should also be postponed to the senior creditors' claims.

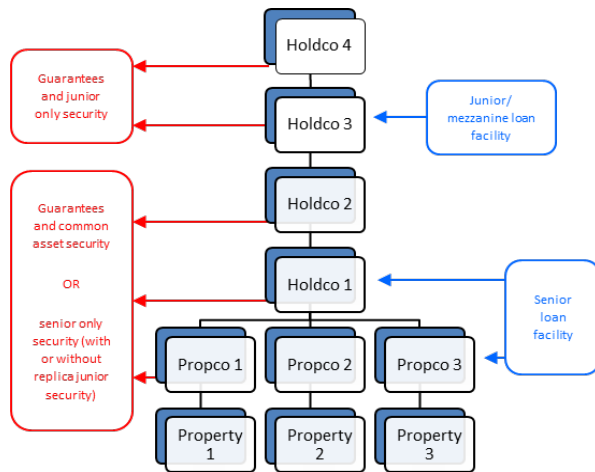
"unitranche" –similar to a "whole loan" but this is the term is used in the leverage finance world it is often mis-used in the real estate world interchangeably with "whole loan". In Europe it typically refers to a non-bank lender (such as a credit fund) entering into a loan facility agreement that offers one tranche of loan to the Borrower(s) (and often with a super senior RCF provided by a bank) with no amortisation, and with prepayment fees. It is attractive to borrowers because non-bank lenders may be willing to lend more than banks, allowing the borrower to access higher overall

leverage without the added complexity of separate subordinated debt facilities. In the US it more widely refers to a term facility which from a borrower's perspective contains only one class of lenders (and one tranche of loan) and under which a common interest rate is charged, but in respect of which the lenders have entered into an agreement among themselves 'behind the scenes' as to (i) which of them will have priority claims to any enforcement proceeds; (ii) allocation of interest received on a non-pro rata basis (with those lenders who do not have first priority claims against enforcement proceeds receiving a higher rate of interest to better reflect the relative risks to various lenders); and (iii) setting out which class of lenders control enforcement in certain circumstances and adjusting their relative voting rights under the SFA to give effect to that.

"whole loan" – similar to *"unitranche"* as used in the US. Used in the real estate finance world to describe an undisclosed A/B loan, which from a borrower's perspective contains only one class of lenders (and one tranche of loan) and under which a common interest rate is charged, but in respect of which the lenders have entered into an agreement among themselves 'behind the scenes' as to (i) which of them will have priority claims to any enforcement proceeds; (ii) allocation of voluntary and mandatory prepayments on a non-pro rata basis; (iii) allocation of interest received on a non-pro rata basis (with those lenders who do not have first priority claims against enforcement proceeds receiving a higher rate of interest to better reflect the relative risks to various lenders); (iv) payment stop events; and (v) voting rights. Not always advanced by credit funds and not often coupled with a super senior RCF.

EXAMPLE STRUCTURES

1. STRUCTURAL SUBORDINATION



- 1.1 In a typical structural subordination structure (senior/mezzanine structure) in the real estate world, the senior loan is advanced to propcos (or their holding company) and the junior loan (known as the mezzanine loan) is advanced, pursuant to a separate loan facility agreement, to a structurally subordinate entity.
- 1.2 The number of intermediate companies is dependent on deal specifics including jurisdiction of the parent of the propcos and the number of propcos. The desire is to ensure separate senior (or common) security packages can be given (including security over subordinated receivables) by entities who do not grant any other security, for example security that is only for the benefit of the junior finance parties (known as the mezzanine finance parties).
- 1.3 Contractual subordination is often used in addition to the structural subordination present in the structure as the junior lenders will usually require the benefit of guarantees from the propcos and parent of the propcos (and often a replica security package to that given to the senior lenders whether on a second ranking or subordinated lien basis).
- 1.4 Asset level security interests and security over the shares in the propcos (and, depending on the structure, the parent of the propcos) together with associated receivables security is held either by:

- (a) a common security agent (with rights to instruct enforcement governed by the intercreditor agreement) (i.e. subordinated lien);
- (b) a senior security agent with (where feasible in the relevant jurisdiction) a replica second ranking package given to a junior security agent (known as the mezzanine security agent) (i.e. second ranking security); or
- (c) where the senior finance parties are not prepared to share common security with the junior finance parties or permit a second ranking security for the benefit of the junior finance parties, a senior security agent with no second ranking replica package given to a junior/mezzanine security agent.

- 1.5 Often, and always in the case outlined in 1.4(c) above, the mezzanine security agent will be granted share security and other ancillary security at a level above the common security or, if relevant, the senior security (the "**mezzanine only security**"). The circumstances in which the mezzanine finance parties are permitted to instruct enforcement of the mezzanine only security (if any restriction is indeed considered appropriate) and the conditions for any agreed waiver of mandatory prepayment on change of control rights/waiver of any resulting events of default resulting from enforcement of the mezzanine only security will be governed by the intercreditor agreement.
- 1.6 Where asset level security is granted to the mezzanine lenders (options 1.4(a) and (b)), the senior obligors commonly grant guarantees to the mezzanine finance parties in the junior facility agreement (known as the mezzanine facility agreement).
- 1.7 Shareholder/subordinated loans should preferably be advanced linearly through the senior holdco and not bypass the structure. This assists a clean share security enforcement route for the senior lenders (including rights to waive/transfer/release such debt) without the need for security over receivables from, and consents to waivers or transfers to be granted by, an otherwise "mezzanine only" obligor to the common (or senior) security agent. However, if this is not possible, any direct loans from subordinated creditors direct to the propcos will need to be

- specifically regulated pursuant to the terms of the intercreditor agreement, and in particular it should be ensured that whether by way of a security granted over such receivable or in the intercreditor, such receivable can be: (a) waived or released; or (b) sold pursuant to enforcement action taken by the senior/common security agent.
- 1.8 The obligors are commonly party to the intercreditor agreement.
- 1.9 Some advantages of using a structural subordination model include:
- (a) The mezzanine only security gives the mezzanine lenders a separate right of enforcement, without risk of precipitating an insolvency event at the senior (common) obligor level, and often without restriction from the senior lenders. This can be used to effect a sale of the shares in (for example) the mezzanine borrower to itself or a related entity (an "equity switch" or "acquisition right") (and if the senior lenders have granted a waiver of the mandatory prepayment event, this can be done with the senior debt in tact).
 - (b) If the mezzanine lenders feel they have a viable equity switch right (that gives them a right to cure events of default, prevent enforcement action from the senior and stabilise the group), they may be less concerned about their rights (or restriction of rights) at the senior (common) obligor/asset level, so making negotiations of the intercreditor terms easier.
 - (c) Separate loan agreements means separate covenants, events of default and consent rights (subject to any deemed consents or waivers that may be agreed in the intercreditor agreement) making cross-default and deemed consents easier to manage than when both loans are recorded in one document.
 - (d) The mezzanine loan relationship is kept outside of the senior security structure enabling a restructuring involving any release or assignment of such mezzanine loan to take place without any risk of a taxable credit (profit) being incurred within the senior security structure.
- (e) The structure and pricing is transparent to the obligors and no imbalances in the obligor facing debt position and vis a vis intra lender positions are created.
- 1.10 Some of the perceived disadvantages include:
- (a) The need for a number of holdcos, that may not be required in alternative structures, such holdcos imposing an administrative burden and cost on the sponsors.
 - (b) Two loan agreements, higher legal fees and slower execution.
 - (c) The requirement to know the quantum of debt that will fall into the mezzanine loan (and the pricing thereof) at the time of the original closing, rather than being able to tranche and price subsequently.
 - (d) The requirement to agree intercreditor terms at original closing rather than having more time to put these in place outside the hullabaloo of closing. However this can sometimes be mitigated by providing that other than certain intercreditor terms that are also for the benefit of the obligors, the intercreditor terms can be bilaterally changed by the senior and mezzanine lenders with no requirement for consent from the obligors.
- 1.11 Some traps for the unwary include:
- (a) Where the mezzanine lender benefits from guarantees from the senior (common) obligors, the rights to take any action under such guarantees will need to be restricted such that the mezzanine lenders would not be able to call on the guarantees and precipitate an enforcement action at the senior (common) obligor/assets level.
 - (b) Where the mezzanine lender benefits from guarantees from the senior (common) obligors and/or asset level security, the effect that this may have on slotting and regulatory capital requirements will need to be considered.
 - (c) Where the security described in paragraph 1.4 (b) is used (with a separate replica security package

being given to the mezzanine lenders) special care will need to be taken to ensure that rights to enforce such separate security are restricted in the intercreditor agreement (rather than just provisions controlling who instructs the common security agent) and that the release mechanics cover the ability for the senior lenders to procure a release of the separate security (including ability to remove restrictions at the land registry) in addition to the release of the guarantee liabilities and the rights of contribution/indemnity and subrogation. Further, any unintended consequences where the senior security may fail but the mezzanine equivalent survives, should be addressed.

- (d) The structure will need to be analysed from a withholding tax perspective to ensure funds can flow up the structure to service the mezzanine loan, without withholding.
- (e) From a mezzanine lenders perspective, the ability of the senior lenders to procure a cash trap at the senior (common) obligor level will need to be analysed carefully to ensure that payments can be made to service the mezzanine loan absent a mezzanine payment stop event.
- (f) If the mezzanine lender is related to the sponsor the effect that this may have on the common security package should be considered.

2.1 There is not one generally accepted structure currently used to achieve contractual subordination in the real estate world. In the above structure, the senior loan is advanced to the propcos (or their holding company) and the junior loan is advanced, pursuant a separate loan facility agreement, to the same entities.

2.2 The number of intermediate companies is dependent on deal specifics including jurisdiction of the parent of the propcos and the propcos and number of propcos. Where there is only one propco, or the propcos are all in the same jurisdiction, it is possible that a second holdco is not required.

2.3 In the above structure, asset level security interests and security over the shares in the propcos (and, depending on the structure, the parent of the propcos) together with associated receivables security are held by a common security agent (with rights to instruct enforcement governed by the intercreditor agreement).

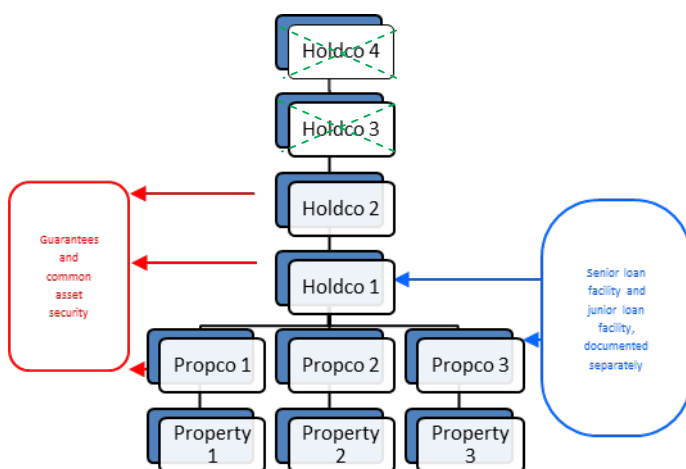
2.4 In order for the junior lenders to obtain an effective equity switch or acquisition right, the security granted by holdco 2 over holdco 1 shares may (depending on the jurisdiction of incorporation of the relevant companies) be either replicated as a separate second ranking security in favour of a junior security agent, with rights to enforce after an agreed trigger event has occurred and is continuing (and subject to certain conditions as to cures and identity of the acquirer of the shares); or the common security may be subject to a separate regime as to rights to instruct the common security agent to enforce (and control the manner of enforcement) of the share security after those trigger events (with an obligation on the ex-mezzanine lenders to grant replica replacement security once in the equity seat).

2.5 The obligors are commonly party to the intercreditor agreement.

2.6 Some advantages of using this type of contractual subordination model include:

- (a) (depending on the jurisdiction of incorporation of the obligors) Fewer holdcos are required than in the senior/mezzanine structure, so saving on cost and administrative burden for the sponsors.
- (b) Two loan agreements, higher legal fees and slower execution.

2. NO STRUCTURAL SUBORDINATION



- (c) Separate loan agreements means separate covenants, events of default and consent rights (subject to any deemed consents or waivers that may be agreed in the intercreditor agreement) making cross-default and deemed consents easier to manage than when both loans are recorded in one document.
- (d) The structure and pricing is transparent to the obligors and no imbalances in the obligor facing debt position and the intra lender positions are created.

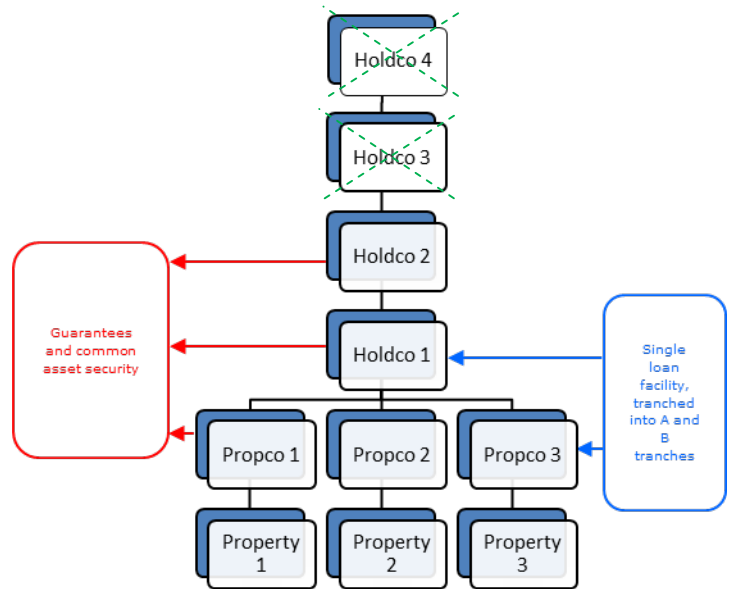
senior (common) obligors and/or asset level security, the effect that this may have on slotting and regulatory capital requirements will need to be considered.

- (c) If the mezzanine lender is related to the sponsor the effect that this may have on the common security package should be considered.

2.7 Some of the perceived disadvantages include:

- (a) The quantum of the tranching of the debt (and the pricing thereof) still needs to be established at the time of the original closing, rather than being able to tranche and price subsequently.
- (b) The requirement to agree intercreditor terms at original closing rather than having more time to put these in place outside the hullabaloo of closing. However this can be mitigated to some extent by providing that other than certain intercreditor terms that are also for the benefit of the obligors, the intercreditor terms can be bilaterally changed by the senior and junior lenders with no requirement for consent from the obligors.
- (c) It is potentially more difficult to provide for the equity switch or acquisition right without risking precipitating an insolvency event or being restricted from taking such action by the senior lenders.

3. **A/B LOAN (DISCLOSED)**



- 3.1 In the A/B Loan structure, a loan is advanced to the propcos (or their holding company). The loan may be already tranced at the time of the utilisation, or may be subsequently tranced. The loan agreement will include an obligor co-operation clause in relation to any such subsequent tranching.
- 3.2 The number of intermediate companies is dependent on deal specifics (as above).
- 3.3 As above, the asset level security interests and security over the shares in the propcos (and, depending on the structure, the parent of the propcos) together with associated receivables security are held by a common security agent (with rights to instruct enforcement governed by the intercreditor agreement).
- 3.4 The security structure will endeavour to cater for an equity switch or acquisition right, as above.
- 3.5 The obligors are commonly (but not always) party to the intercreditor agreement.

2.8 Some traps for the unwary include:

- (a) The junior loan relationship contaminates the senior security structure such that on a restructuring involving any release or assignment of such junior loan the senior lenders will need to consider the risk of a taxable credit (profit) being incurred within the senior security structure and the availability of any exemptions (corporate rescue or otherwise).
- (b) Where the mezzanine lender benefits from guarantees from the

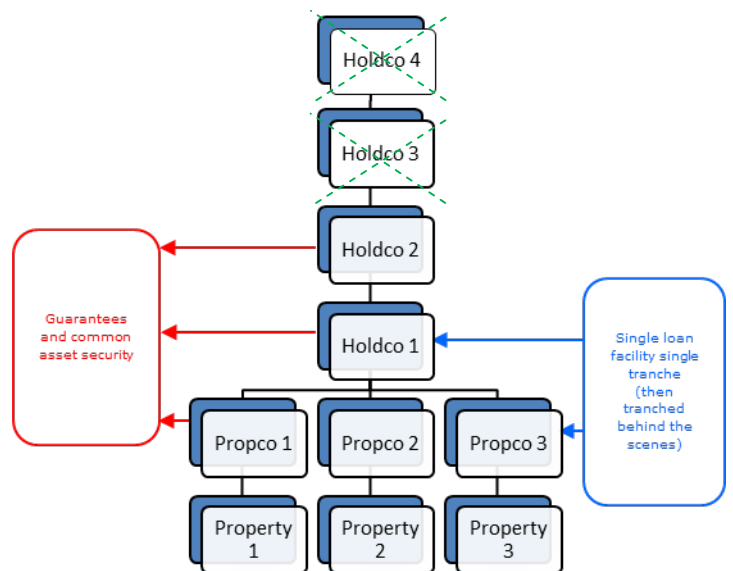
- 3.6 Some perceived advantages of using the A/B contractual subordination model include:
- (a) (depending on the jurisdiction of incorporation of the obligors) fewer holdcos are required than in the senior/mezzanine structure, so saving on cost and administrative burden for the sponsors.
 - (b) One loan agreement, lower legal fees and quicker execution.
 - (c) The quantum of the tranching of the debt (and the pricing thereof) may not need to be established at the time of the original closing, although parameters will need to be agreed.
 - (d) In a disclosed A/B Loan, the structure and pricing is transparent to the obligors and no imbalances in the obligor facing debt position and the intra lender positions should be created.
 - (e) From a reputation perspective (compared an undisclosed A/B Loan), the obligors know how the voting rights of the lenders work and no one class of lenders can be forced into a voting position that is not their own.

- 3.7 Some of the perceived disadvantages include:
- (a) The requirement to agree intercreditor terms at original closing rather than having more time to put these in place outside the hullabaloo of closing. However this can be mitigated in part by providing that other than certain intercreditor terms that are also for the benefit of the obligors, the intercreditor terms can be bilaterally changed by the senior and junior lenders with no requirement for consent from the obligors.
 - (b) It is potentially more difficult to provide for the equity switch or acquisition right (as above).
 - (c) one loan agreement means (i) no separate senior and junior covenants (and therefore no separate events of default); (ii) the consent rights will be (absent any other arrangement) work on a majority ruling basis.

- (d) Obligor co-operation on tranching is required. Discussions will need to be had at the outset with the obligors regarding (i) weighted blended rate; (ii) the effect of any repayments or prepayments that are not applied pro rata; (iii) the effect of any junior payment stops; and (iv) voting rights.

- 3.8 Some traps for the unwary include:
- (a) The junior loan relationship contamination risks will be present (as above).
 - (b) The effect of payment stops (and escrowing of monies paid, and default interest) will need to be clearly addressed to avoid misunderstanding.
 - (c) Acceleration rights for each of the tranches need to be thought through and catered for in the drafting of the loan agreement/intercreditor.
 - (d) Where the mezzanine lender benefits from guarantees from the senior (common) obligors and/or asset level security, the effect that this may have on slotting and regulatory capital requirements will need to be considered.

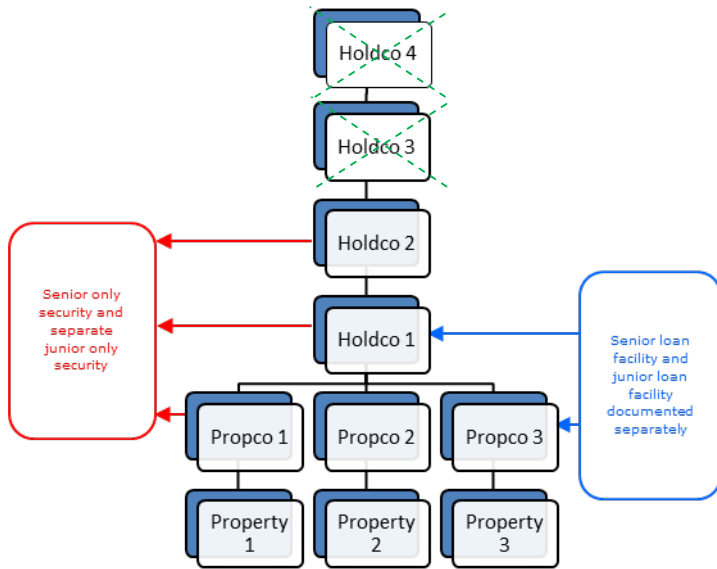
4. **WHOLE LOAN (UNDISCLOSED A/B LOAN)**



4.1 In the whole loan structure (undisclosed A/B Loan), a single loan is advanced to the propcos (or their holding company) and is subsequently syndicated. Upon syndication (where transfer or assignment rather than

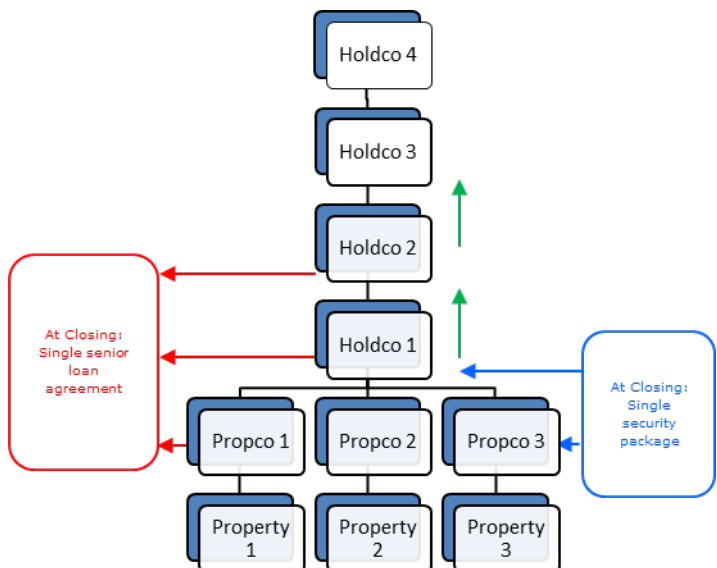
- sub-participation is used) the obligors are aware that there is more than one lender but are not aware of any differences in the rights of the various lenders.
- 4.2 The rights of the lenders are documented in a "behind the scenes" intercreditor agreement or "**agreement among lenders**". The obligors are not party to these arrangements.
- 4.3 The number of intermediate companies is dependent on deal specifics (as above).
- 4.4 As above, the asset level security interests and security over the shares in the propcos (and, depending on the structure, the parent of the propcos) together with associated receivables security are held by a common security agent (with rights to instruct enforcement governed by the intercreditor agreement).
- 4.5 The security structure will endeavour to cater for an equity switch or acquisition right, as above.
- 4.6 Some perceived advantages of using the whole loan contractual subordination model include:
- (a) (depending on the jurisdiction of incorporation of the obligors) fewer holdcos are required than in the senior/mezzanine structure, so saving on cost and administrative burden for the sponsors.
 - (b) One loan agreement, lower legal fees and quicker execution.
 - (c) The quantum of the tranching of the debt (and the pricing thereof) does not need to be established at the time of the original closing.
 - (d) No requirement to agree intercreditor terms at original closing.
 - (e) Obligor co-operation on tranching is not required.
- 4.7 Some of the perceived disadvantages include:
- (a) It is potentially more difficult to provide for the equity switch or acquisition right (as above).
 - (b) one loan agreement means (i) no separate senior and junior covenants (and therefore no separate events of default); (ii) the
- consent rights will be (absent any other arrangement) work on a majority ruling basis.
- (c) The structure and pricing is not transparent to the obligors and therefore there is a risk of imbalances in the obligor facing debt position and the intra lender positions being created where repayments and prepayments are not applied pro rata or payment stops are in play. These imbalances may result in a shortfall in payments to the junior lender (or worse, the senior lender).
 - (d) Reputational risk - the obligors do not know how the voting rights of the lenders work. Lenders with a majority vote may be expected to vote in a particular way (to support a relationship) but may not be able to control that voting).
- 4.8 Some traps for the unwary include:
- (a) The junior loan relationship contamination risks will be present (as above).
 - (b) The effect of payment stops (and escrowing of monies paid, and default interest) will need to be clearly addressed to avoid misunderstanding.
 - (c) Acceleration rights for each of the tranches need to be thought through and catered for in the drafting of the loan agreement/intercreditor.
 - (d) Addressing imbalances in obligor facing and lender facing economics.
 - (e) Lenders will need to analyse the withholding tax position where gross up applies and the borrower facing rate for the grossed up lender is different to the rate in the agreement among lenders.
 - (f) Where the mezzanine lender benefits from guarantees from the senior (common) obligors and/or asset level security, the effect that this may have on slotting and regulatory capital requirements will need to be considered.

5. **NO STRUCTURAL SUBORDINATION, SEPARATE LOAN AGREEMENTS AND SEPARATE SECURITY**



5.1 The advantages and disadvantages and traps for the unwary reflect the principles covered above as appropriate for second ranking security packages with separately documented loans.

6. **ORIGINATION AS A WHOLE LOAN WITH SUBSEQUENT BIFURCATION INTO TWO SEPARATELY DOCUMENTED LOANS COUPLED WITH ADDITIONAL JUNIOR ONLY SECURITY**



At the time that the senior loan is entered into the sponsor will agree parameters for the pricing (and quantum) of the two separate loans that are to be created from the senior loan, as well as order of payments, conditions as to prepayment of any mezzanine loan and any mezzanine payment stop events (and the effect on default interest and cash

sweeps)(the **"Agreed Principles"**). Post closing the following steps occur (this is just one variation on the steps to achieve the senior/mezzanine structure post closing):

- 6.1 HoldCo 3 and Holdco 4 are incorporated.
- 6.2 The mezzanine lender advances the mezzanine loan to HoldCo 3 and HoldCo 3 lends this to HoldCo 2, who in turn lends to HoldCo 1 who uses the proceeds to repay part of the original loan.
- 6.3 The quantum and pricing of the mezzanine loan and the conditions of prepayment as well as any mezzanine payment stop events will need to fall within the Agreed Principles.
- 6.4 HoldCo 3 and HoldCo 4 grant security over all their assets (primarily shares, accounts and intra group receivables) to the mezzanine security agent to secure the mezzanine loan.
- 6.5 The original security package is extended so as to also secure the mezzanine debt on a subordinated lien basis (or alternatively a second ranking package is agreed).
- 6.6 The obligors, the senior finance parties and the mezzanine finance parties enter into an intercreditor agreement which reflects the Agreed Principles. As part of the Agreed Principles, obligors will have no right to object to any provision relating to restriction of enforcement rights, restrictions on amendments or deemed consents and other intra lender arrangements.

7. **CONCLUSIONS**

7.1 As can be seen from the above, there is no one way to structure a multi creditor real estate finance transaction. Drivers such as whether a mezzanine lender has been identified at origination (and pricing agreed), required speed of execution, and whether the obligors are prepared to provide the Holdcos to achieve structural subordination, all have a part to play. Lenders will need to be cognisant with the pros and cons of each variable, and be alive to the effect that any second ranking security or subordination lien may have on the security package.