CONSTRUCTION LOAN SYNDICATION AND PARTICIPATION ISSUES

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Construction Loan Syndication and Participation Issues*

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1. <u>Making Borrowers and Lenders Comfortable in Construction Loan Syndications and Participations</u>. The purpose of this paper is to examine issues that are unique to construction loan syndications and participations as opposed to unsecured loan syndications and participations. Syndicated construction loans are still a relatively new product. Borrowers and lenders sometimes bandy about the terms "syndication", "participation", "sale by assignment", and the like as generic terms for a sale of a portion of a loan. It is important to determine whether the loan sale structure will be a participation or a syndication. Even some large borrowers may not accept a construction loan syndication. Even some small lenders may not accept a construction loan participation. So long as the loan agreement allows for participations and the lenders will accept participations, a portion of the loan can be sold by a separate participation agreement. The participants own a portion of the loan, with all the rights and obligations specified in the participation agreement, without becoming a party to the loan agreement, which is between the borrower and the lead lender. The borrower may not even be aware that a participation has been sold. Unlike participations, a syndication is not transparent to the borrower, and the syndicate lender becomes a party to the loan agreement. In order for syndicated construction loans to be marketed successfully and operate smoothly, borrowers must be comfortable that (1) the lenders will fund and (2) they will be able to deal with the administrative agent in much the same way they deal with the lead lender in a participated construction loan. Syndicate lenders must be comfortable that they can leave the day-to-day decision making (much of which is not ministerial) to the administrative agent, in much the same way they do when purchasing a participation, without insisting on foisting additional duties or obligations on the administrative agent.

1.1 <u>Shift to Syndications in the late 1990's</u>. In the mid to late 1990's secured real estate construction loans typically were made by a single lender, and sometimes participated to or occasionally syndicated with other lenders. During that time I prepared and negotiated hundreds of participation agreements for NationsBank, N.A. (now Bank of America, N.A., as a result of mergers involving Bank of America N.T.&S.A. and NationsBank, N.A.). Smaller loans may continue to be participated. Although some larger loans will also continue to be participated, in the past three years there has been a gradual market shift to prefer the syndication of as opposed to the participation of construction loans. I finalized the Bank of America, N.A. Construction Loan Agreement (Syndication) form in 2000.

1.2 <u>Basic Legal Differences</u>. As a <u>legal</u> matter, construction loan participations and syndications are quite different. In a <u>participation</u> all of the obligations between the lenders and the lead lender are in the participation agreement(s). The borrower and the "lead lender" are only

obligated to each other under the loan agreement and other loan documents. The borrower can only look to the lead lender for both parties' legal obligations, including the legal obligation to fund the construction loan. In a syndication, the obligations among the lenders, and between each lender and the administrative agent, are contained in the loan agreement (or the loan agreement and a separate intercreditor agreement). The obligations under the loan agreement and other loan documents are among the borrower, the administrative agent and all the lenders, including the lenders' legal obligation to fund the construction loan. Lenders sometimes view a syndication as more prestigious than a participation, and that they are in a better position as a syndicate lender than as a participant. In some ways that is true. In others it is not.

1.3 Basic Practical Differences. As a practical matter, construction loan participations and syndications can operate in much the same manner. Nevertheless, borrowers and their counsel who are inexperienced with syndicated loans are very apprehensive about syndications. The perception among borrowers and some lenders is that somehow a syndication confers more rights upon lenders and imposes more risks on borrowers and administrative agents. With a properly designed syndicated construction loan agreement prepared by experienced counsel, and a sophisticated group of lenders, these fears are unwarranted. A successful syndicated construction loan requires that the counsel for the administrative agent address both borrowers' and syndicated lenders' questions and fears, yet distinguish the administrative agent's less risky role in a syndication from a lead lender's more risky role in a participation.

2. The Funding Issue. What if one or more of the lenders refuses to fund? This is often the borrower's and occasionally a lender's fear.

2.1 The Practical Perspective. As a practical matter it is unlikely to occur. Assume you have a $100,000,000.00 loan with four lenders. At any point in the construction, each will have lent millions of dollars, with likely more invested in the project than the borrower. If one lender refuses to fund it is highly unlikely that the other lenders are going to allow the collateral to deteriorate or construction to get off schedule, particularly if it would jeopardize a permanent loan or purchaser commitment that is in place as an exit strategy.

2.2 Participations. In a participation, failure of a participant to fund is the lead lender's problem. The participation agreement can provide protections for the lead lender similar to those in subsections 2.3.2.1 – 2.3.2.4 below. The borrower and the participants can take some comfort in that the lead lender is obligated to fund the entire loan to the borrower, regardless if one of the participants does not fund. If the lead lender does not fund, however, the borrower cannot look to the participants for funding of even the participant's portions of the obligations. A participant cannot look to another participant for the funding of the other participant's obligations. In most circumstances, however, the participants could agree with the borrower to repay the loan with the proceeds of another loan made by the participants.

2.3 Dealing with the Defaulting Lender in a Syndication. In a syndication, failure of a lender to fund is a problem for the borrowers. It is also a problem for the lenders, because each lender is obligated to the borrower for its portion of the loan regardless of the failure of other lenders to fund. Understandably the borrower is concerned because there is no lead lender that is 100% obligated to make the loan. As opposed to an unsecured syndicated loan to a large borrower for operational purposes, construction loan borrowers tend to be smaller and less sophisticated, and the need for funding of the project loan more immediate. A syndicated construction loan agreement can address this issue for the protection of the borrower and the lenders.

2.3.1 Administrative Agent Advances. If a lender threatens not to fund, it is usually because they want to declare a default, or that the borrower is not meeting loan or advance conditions. First, the loan agreement can allow the administrative agent to authorize, and if necessary, make an advance, if at the time the advance conditions have been satisfied to the extent the administrative agent determines are necessary. (See also Section 3 below on "The Day-to-Day Management Issue") Typically, the administrative agent is only allowed a few days between the time it receives an advance request from the borrower and the time the borrower must have an advance of the loan to pay contractors and other vendors for the project. In that few days the administrative agent must evaluate the request, determine the amount that will be funded, notify each lender of their portion and receive such portions from each lender. If the loan is not timely advanced so that the borrower can pay contractors and other vendors, the project will invariably be delayed. Allowing individual lenders to object, in whole or part, to each advance request would put the borrower, the loan and the lenders in peril on a monthly basis. If for some reason one of the lenders refuses to fund, the resulting delay could cause serious losses for the construction project. Requiring the administrative agent to wait for fundings from the other lenders to make up for a defaulting lender could jeopardize the project in this situation.

2.3.2 Defaulting Lender Provisions. Second, if for some reason a lender does not fund, the loan agreement can also contain particularly strong "defaulting lender" provisions designed to:

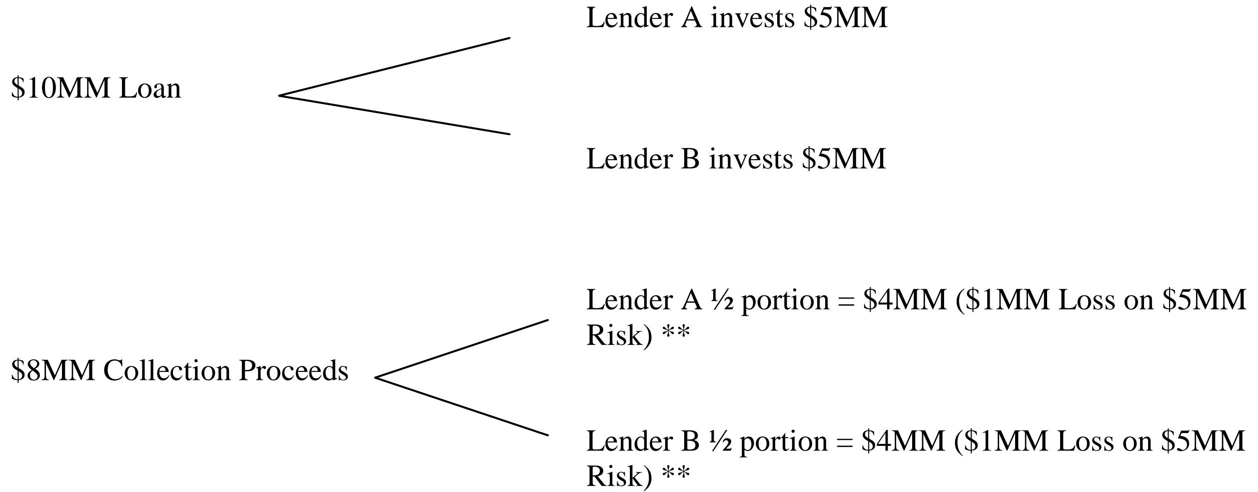
2.3.2.1 Quick Default Determination. Make a quick determination of whether a lender has defaulted. While the administrative agent may have advanced a defaulting lender's portion, the administrative agent in its capacity as agent is not a lender. If the lender does not meet the timetable for funding, then that lender can be quickly adjudged in default.

2.3.2.2 Electing Lenders. Determine how the defaulted payments will be handled by one or more of the other lenders. The loan agreement can contain a specific method for the administrative agent to notify the non-defaulting lenders of the default and allow for them to elect to fund all or a portion of the defaulting payment.

2.3.2.3 Application of Payments/Indemnification. Provide that the defaulting lender will not receive any payments until the nondefaulting lenders have been paid in full. However, typically administrative agents and lenders consider requiring the defaulting lender to receive no payment until the non-defaulting lenders have been paid in full as too harsh a remedy. Instead, if the loan agreement contains a repayment sequence, it typically provides that the non-defaulting lenders must be paid in full, for any portion they have funded of the defaulting lender's obligations, out of the defaulting lender's portion of any collection proceeds, prior to the defaulting lender receiving any part of its portion of the proceeds. Excluding interest, which admittedly can be a significant factor, the defaulting lender will have a larger percentage loss, but the same dollar loss regardless of whether it fully funds or fails to fund a portion of its obligation.

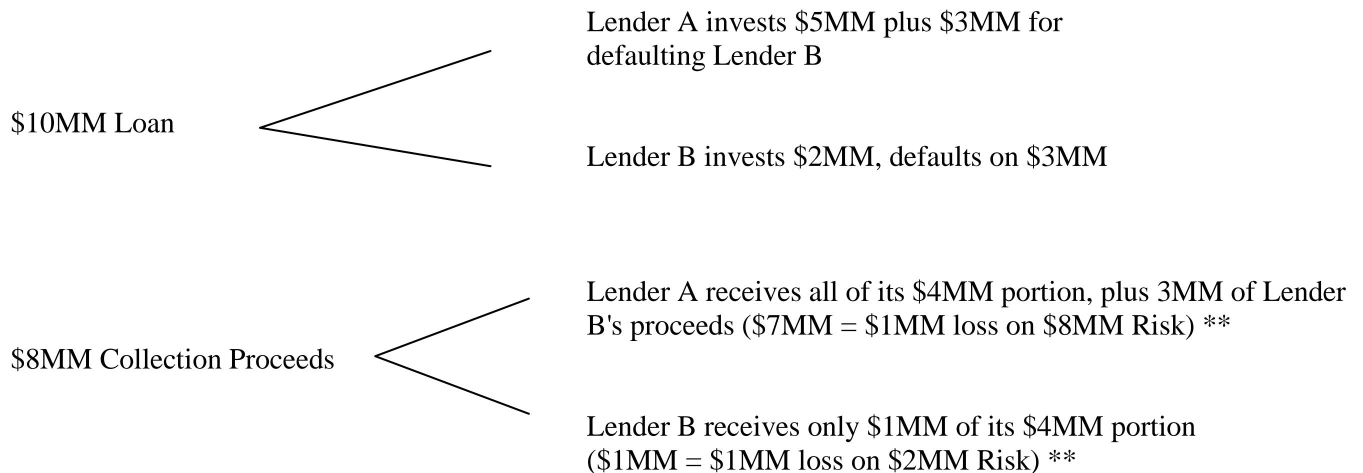
For example, assume a $10MM dollar loan with only two lenders, each committing to fund fifty percent ($5MM). If both lenders funded fully and only $8MM was received in collection proceeds, each would receive $4MM and each would have a 1/5 or $1MM dollar loss on their $5MM investment.

NON-DEFAULTING LENDER



Alternatively, assume one of the lenders funded $2MM but failed to fund its remaining $3MM, and the other lender funds that $3MM defaulted payment plus its $5MM obligation, or $8MM. Each lender would still be entitled to receive $4MM of the $8MM collection proceeds, but $3MM would first be deducted from the defaulting lender's proceeds, to reimburse the non-defaulting lender. Thus, the defaulting lender who had only risked $2MM would receive $1MM resulting in a 1/2 loss, but a dollar loss of $1MM, the same loss it would have had if it had fully funded. The non-defaulting lender, who risked $8MM, would receive its $4MM portion of the foreclosure proceeds, plus $3MM of the defaulting lender's portion, or $7MM for a 1/8 loss, but a dollar loss of $1MM, the same amount it would have lost had it only funded the $5MM it was originally obligated to fund.

DEFAULTING LENDER

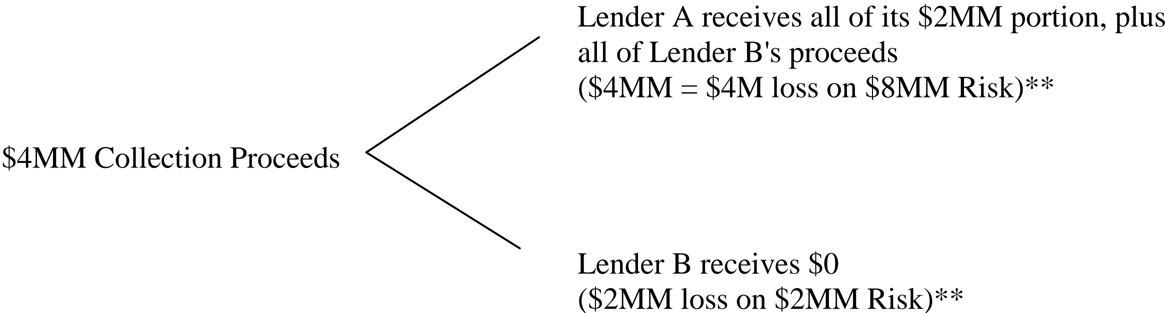


Interest could change these numbers significantly since the defaulting lender's portion will be reduced by the amount necessary to pay the non-defaulting lender interest on

the defaulted amount in the amount the borrower was obligated under the loan. Thus, in a typical clause the non-defaulting lender is assured of payment in full for both the principal of and interest on the defaulted amount it funds, to the extent they can be satisfied from the defaulting lender's portion of the collection proceeds.

<u>However</u>, in the event the defaulting lender's portion of the collection proceeds are insufficient to repay the non-defaulting lender for principal of and interest on the defaulted amount, the non-defaulting lender is taking a greater risk, yet may have a greater loss.

** Excluding interest



To mitigate this risk, the loan agreement can require the defaulting lender to indemnify the non-defaulting lender for such amounts.

2.3.2.4 <u>Voting and Ownership Percentage Adjustments</u>. Adjust voting rights to deny the defaulting lender voting rights, while increasing the voting rights of nondefaulting lenders which have assumed the defaulting lenders' obligations. Denial of voting rights is one of the strongest incentives to fund, particularly in a deal where there are only two lenders. The defaulting lender gives up its right to vote on major changes to the loan documents or actions the administrative agent will take in the event of a default by the borrower. The loan may be extended, the collateral may be released, borrowers and guarantors may be released from liability, loan amounts may be forgiven, and foreclosed collateral may be sold, without a defaulting lender having any say in such matters. Usually, the nondefaulting lenders will also want the right to adjust the commitment amounts. This is an incentive to the electing lender. Their percentage voting rights increase, but the additional dollars (and interest) investment is paid 100% from the defaulting lender's portion and indemnified by the defaulting lender. If not all of the lenders have elected to fund the defaulting lender's payments in proportion to their interest in the loan, the electing lenders will want their voting rights increased to reflect their additional percentage investment. Nevertheless, the loan agreement can provide that the defaulting lender is still obligated to the electing lenders for amounts the electing lenders have funded on behalf of the defaulting lender. Care can be taken that any assignment or adjustment which increases the electing lender's ownership interest and obligations under the loan also provides for the defaulting lender's continued obligation to the electing lender with respect to such assigned interest.

2.3.2.5 <u>Removal and Replacement</u>. Considering giving the borrower the right to remove and replace a defaulting lender with a lender acceptable to the administrative agent. The electing lenders can have the right to assume the entire

defaulting lender's obligation. They could also have a non-syndicate lender pre-approved, to which they could assign the defaulting lender's portion they assumed. The borrower, however, may be skeptical of the syndicate lender's desire and ability to do so. Therefore, if the non-defaulting lenders do not elect to assume the defaulting lender's obligations, the loan agreement can allow the borrower to replace the defaulting lender with a non-syndicate lender acceptable to the administrative agent, even though the syndicate lenders do not have to approve such replacement lender.

2.3.2.6 Extreme Protection. Even with all the protections above, unless they are very comfortable with each of the lenders in the syndicate, unsophisticated borrowers still may be reluctant to proceed without some assurances that the lenders will fund on behalf of the defaulting lender, at least for a short period of time, in order to keep the project going until a replacement lender is found. Before borrower's counsel insists on these type of protections for the borrower, they should be aware that lenders are typically prohibited by internal policy from agreeing to fund more than the amount they have committed on the loan. Any requests for these types of protections may likely increase the lenders' risks, and result in an increased cost to the borrower for the lenders to bear that risk. Hopefully, as more construction loan syndications are successfully completed, borrowers will not overreact, and will become as sophisticated as borrowers in the unsecured syndicated market in understanding the true magnitude of these risks both from the borrower's and lender's perspective. It is usually much easier for a lender to justify an increase in its funding commitment when another lender has defaulted in the middle of a project, than upfront in loan negotiations.

3. The Day-to-Day Management Issue. Will the borrower have to deal with multiple lenders to satisfy closing conditions, advance conditions and lease approvals? They only have to deal with the lead lender in a participation, and the loan agreement can require they only have to deal with the administrative agent in a syndication, for these matters. This is one of the most significant and valid concerns of a borrower.

3.1. The Problem with Multiple Lender Approval. The loan documents usually provide an expansive list of conditions to loan closing and each loan advance. While lenders act in a similar matter with respect to loans they originate, a lender that is not involved with the day to day administration of the loan may not be in the best position to determine which conditions should be more strictly construed than others. Usually the reason behind a syndication or participation is to diversify exposure, not to duplicate the burden of administering construction loan agreement requirements upon multiple lenders, which would likely result in a nightmare of timing problems and approval conditions, both for the lenders and the borrower.

3.2 Lead Lender/Administrative Agent Role/Discretion. In a participation, the loan agreement is between the lead lender and the borrower. The participation agreement provides that the lead lender administers all advance requests, including determining the amount of the advance funding, typically providing certain minimal documentation to the participant, and providing a timetable for funding. The participant must only consent to specific major loan changes and the lead lender has discretion with other loan matters, including day-to-day management of the loan. In an unsecured syndicated loan, the administrative agent handles the ministerial tasks of communicating the borrower's advance request to the lenders and except for major loan changes, the day-to-day management of the loan. In a construction loan syndication, the administration of an advance request is much more complex, and the loan agreement can contain provisions similar to a

participation agreement with regard to the mechanics of administering a borrower's advance request. The administrative agent can also have discretion with other loan matters, including the day-to-day management of the construction loan. Unfortunately, the day-to-day management matters are more numerous and complex than in an unsecured syndicated loan. One lender's determination of what day-to-day management means may be different from another's. Care can be taken to distinguish the roles and obligations of the administrative agent and the lenders throughout the loan agreement to make sure the lenders are not overly involved. The administrative agent's role and discretion can be extensive, explicit and clear in the agreement, to guide the administrative agent and lenders in the variety of complex construction loan matters, and to avoid spurious claims that the administrative agent has done something more than day-to-day management. This is somewhat of a departure from the concept that the administrative agent's day-to-day management function is merely ministerial and is sometimes difficult for syndicate lenders and their counsel to understand. However, it is hard to conceive of marketing a construction loan syndication to borrowers in any other manner. Construction and construction lending are risky enough for both the borrower and lenders without multiple lenders making individual evaluations and determinations on anything other than significant, material loan requirements.

3.3 Participant/Syndicate Lender Concerns/Approval Rights. Regardless, at the outset of the loan all lenders must be satisfied with the overall loan structure. They may require that the lead lender or the lender that is also in the role of administrative agent hold a certain dollar amount of the loan. It may be in both the borrower's and the lenders' interest that the lender who also serves in the capacity of the administrative agent have a substantial investment risk in the loan. More than any threat of lawsuit, this direct risk of loss can ensure that the administrative agent will remain focused on rational business decision-making in the event there are any problems with the loan. Majority lenders or all lenders can insist on having approval rights to (1) consent to foreclosure lawsuits (2) extend or increase the commitment of the lenders, (3) postpone payment dates, (4) reduce principal or interest, (5) change specific financial covenants, or (6) release the borrower, any guarantor or loan collateral, except as permitted in the documents. In certain situations they may also want to have input into decisions about individual leases over a certain size, budget reallocations that would violate a permanent loan or purchase commitment, or certain other material and significant loan matters. Although it may be impossible to identify every important matter in which lenders may want to have input, it is important for the lenders to read the entire loan agreement with regard to specific items and sections that the lender would want to require all of the lenders or the majority lenders to consent. However, in the midst of loan agreement negotiations it also is important to keep in mind that it is in the best interest of the lenders and the borrower that the loan be funded without micromanagement by the lenders.

4. The Liability and Removal Issue. How is the lead lender's role in a participation different from an administrative agent's role in a syndication? Can they be held liable or removed?

4.1. Lead Lender in a Participation. In a participation, the participant lenders do not have a legal, contractual relationship with the borrower, and may have little or no other relationship with the borrower. Because the lead lender is 100% liable to borrower, usually the lead lender requires that it propose all actions and remedies upon a borrower's default for consent by the participant lenders. Often the lead lender requires that it be part of the voting majority to take any kind of action. Rarely, if ever, can lead lenders be removed from their role as lead lender. As a result, lead lenders are often subject to a standard of care in which they agree to treat the loan the same way they would treat similar loans for their own account. Sometimes they will insist that within this standard of care their liability will be limited to their gross negligence or willful misconduct, or they may only insist that outside of this standard of care their liability will be limited to gross negligence or willful misconduct.

4.2 Administrative Agent in a Syndication. In a construction loan syndication the roles of the lender and administrative agent are distinct. Each lender is only liable for their respective portion of the loan. The administrative agent is not liable for any portion of the loan. Although the agent may propose remedies upon default, it typically is required to take action or refrain from taking action as directed by the majority of lenders, even if the lender that also happens to be serving in the role as administrative agent is not part of that majority. Most importantly, lenders often insist on the ability to remove and replace the administrative agent. (Borrowers are concerned about the possibility that the administrative agent could be removed, and usually insist, so long as they are not in default, on the right to approve any replacement administrative agent.) As a result, administrative agents in construction loan syndications, like their counterparts in unsecured loan syndications, resist being held to any standard of care, and are usually indemnified by the borrower and lenders, except to the extent the administrative agent has committed gross negligence or engaged in willful misconduct. Because of the fundamental differences between these two roles of lead lender and administrative agent, the administrative agent is typically not expected to be liable to the lenders for its decisions, absent gross negligence or willful misconduct. There are simply too many matters in construction loans that lend themselves to second guessing after the fact. Even reasonable lenders may differ on the precise way they would handle a particular situation. Forcing the administrative agent into a standard of care encourages them to unload their administrative decision making burden on lenders who may not be in the best position to make those decisions.

4.3 The 50/50 Deal Problem. More problematic is the 50/50 deal, where there are only two lenders, each owning 50% of the loan, and which comes up more often in construction loan syndications and participations than in other types of syndications and participations. In the 50/50 deal both lenders have an equal stake in the transaction, even though one of the lenders is the lead lender or administrative agent. All this can have little effect on major changes to the loan transaction (both lenders are typically required to consent). Invariably there will be some aspect of the loan transaction that the lender, who is the lead lender in a participation, or who also serves in the role of the administrative agent in a syndication, will view as day-to-day management, and which the other lender will view as significant enough to merit the consent of both lenders. The knee jerk reaction of a lender that disagrees with an action taken or not taken by the administrative agent where a borrower has defaulted is to refuse to fund. (See also Subsection 2.2 above on "The Funding Issue" relative to Participations)

4.4 The Administrative Agent is not the Lender's "Deep Pocket". Some participants, syndicate lenders or their counsel blithely demand a representation by the administrative agent that they will administer the loan in accordance with the loan documents, or that they certify that all loan closing conditions and advance conditions are satisfied prior to closing the loan and authorizing each advance. This demand fails to take into account the complexity and subjectivity of these conditions in a modern construction loan agreement, and the reality that many of these conditions are in place for enforcement as the construction situation dictates. No administrative agent is compensated for these risks, nor is any borrower in a construction loan typically expected to meet every condition to the full extent, even if the subjective nature of some of the conditions could be realistically determined. For example, usually all advance requests allow the administrative agent to require lien waivers from all contractors, subcontractors and material suppliers to a project. Rarely can or does a lender determine every such lien waiver that could be obtained, much less demand it. Instead, based on the loan status, the lender obtains lien waivers to the point it is satisfied that the risk of lien is minimal. So many documents and requirements are subjectively satisfactory and subject to negotiation (environmental reports, survey certifications, construction contract requirements, etc…). This discretion can be left to the administrative agent without having to make unreasonable representations or certifications to the lenders. An alternative is to weaken the closing and advance

conditions to purely simple, objective criteria, which would weaken the protection afforded to the lenders in the loan agreement. Lenders should have confidence in the ability of the lender that is also in the role of the administrative agent to make the decisions in the interests of all the lenders. If they do not have this confidence, they should not be doing business with the administrative agent.

4.5 Rattling the Gross Negligence/Willful Misconduct Chain. Failing to fund is usually the worst thing a lender can do, whether in a multi-lender or 50/50 participation or syndication. A defaulting lender typically loses its priority in loan collection proceeds with respect to the defaulted amount, and loses its right to vote, rendering their disapproval moot. A better approach, if the matter is serious, and if the administrative agent's actions fail to follow specific, objective requirements of the loan agreement that are not subject to the administrative agent's discretion, is to point out those requirements to the lead lender or administrative agent in writing. If that fails, a more grave approach is to notify the lead lender or administrative agent that this failure may constitute gross negligence or willful misconduct, and the continued failure of the lead lender or administrative agent may give rise to a claim for gross negligence or willful misconduct.

5. The Lender Relationship Issue. What if the lenders sell their interest?

5.1 Sales and Assignments – Upfront and After the Fact. The selection of lenders participating in a syndication, is very sensitive in construction loans. Either the borrower or the administrative agent, or both, may have been highly influential in the determination of which lenders will be involved in the loan. Oftentimes it is the relationship and comfort that the parties have with each other that make these deals successful. The borrower, administrative agent and the lenders all have an interest in the number of lenders and amount of each syndicated portion. The administrative agent who works with 5 lenders usually will not want the administrative burden of working with 25 lenders. The borrower usually will not want the uncertainty of a large number of lenders as voters, each with small amounts of the loan, even if the votes are only exercised on major decisions. Lenders with large portions of the loan may be wary of allowing lenders to own a small portion of the loan, since certain loan amendments require consent by all the lenders. For example, in upfront negotiations, lenders usually agree that no lender should be required to modify the loan to extend the maturity date, reduce liability, reduce principal and/or interest, or release (or sell) collateral without each lender agreeing to do so. Sensing that lenders with larger portions have a greater investment risk, lenders with smaller portions may refuse to consent to these modifications, which are so often part of a workout. They may try to use this leverage to pressure the larger lenders into buying them out at par. After a major loan default, most lenders would be happy to be paid in full immediately. The loan documents can provide that lenders can't assign any portion of their interest, except to other lenders or affiliates, without the consent of the administrative agent and, prior to a default, the borrower. Any assignment to affiliates may even be subject to a minimum dollar amount assigned and minimum dollar amount retained after assignment. An exception may be made for the sale of participations so long as the administrative agent and borrower shall continue to deal only with the selling lender, and any approval rights granted to the participant are subject to the pre-approval of the administrative agent. A lead lender can also subject subparticipations to these or similar controls.

5.2 Different Investment Philosophies. Whether in underwriting or administering the loan, engaging in a workout or dealing with assets that are acquired, it is usually important that each of the lenders has a similar investment philosophy. Oftentimes differing philosophies are revealed in negotiations of the matters discussed in this paper. Typically, where all the lenders are national banks, or are otherwise of a similar entity structure, little inquiry needs to be made in this regard. However, if one or more of the lenders differs in philosophy on any of the above-mentioned aspects of the loan, or if they are subject to differing regulations or no regulations, inquiry can be made on whether these differences can be harmonized, particularly if the loan deteriorates. For

example, large banks may like to cut losses and dispose of assets, and redeploy collected funds. Smaller institutions may be reluctant to dispose of any asset because they keep the asset on their books at a higher value than may result from a sale. They would like to defer a sale (and potential loss) as long as possible. Non-regulated banks sometimes view a foreclosed asset as a long term investment, preferring to hold and manage the investment until the market turns. In contrast, if the lead lender or lender that serves as administrative agent is a national bank, it is subject to regulations requiring it to make a good faith effort to dispose of these assets within a finite period of time. Certain lenders may object accruing past due interest or reducing the rate of interest. They may have a policy against substituting nonrecourse liability for recourse obligations. They may believe that collection litigation is the only viable solution in a default situation.

5.3. Loan Administration versus Asset Administration. How will the collateral be handled after foreclosure? Lead lenders and administrative agents have usually structured their fee to compensate themselves for administration of a loan and not long term administration of a foreclosed asset. Some lenders want the lead lender or administrative agent to provide extensive post foreclosure services for free. In contrast to the minimal reporting required of the administrative agent during the loan, some lenders want detailed reporting by the administrative agent and participation in detailed decision-making about the asset after its acquisition by foreclosure or otherwise. Lead lenders and administrative agents resist these requirements, and it may make the borrower nervous about the ability of the lenders and administrative agent to advance the loan if these provisions are long, detailed and hotly negotiated. Most large, regulated lenders are able to distinguish loan administration from asset administration. These lenders are not in the business of real estate development or speculation. Once the asset has been foreclosed (or otherwise acquired) they typically prefer to put the collateral in the best position to maximize recovery of as much of the amount their investment as possible in an expedited sale. They further realize that while decisions about major loan modifications require the consent of all lenders, decisions about major actions with respect to preparation of the collateral for quick sale and approval of the sale are best left to the administrative agent or the majority lenders, in order to avoid the risk of an uncooperative group of minority lenders objecting to such preparations and sale.

5.4 Handling the Collateral after Foreclosure. Nevertheless, the issue can be addressed. The loan agreement can provide a brief and general structure for the ownership, management and sale of the collateral. Lenders are sometimes concerned that the lead lender or administrative agent will go on a spending spree or sell the collateral for a song. However, this is rarely a problem, since the lead lender or lender serving as administrative agent will have to pay its portion of any cost and bear its percentage of any loss. The lead lender or administrative agent typically owns the collateral for the benefit of all the lenders, and can make expenditures to pay costs for taxes and insurance, and decisions for the management, completion and operation of the collateral. In large loans a large cap on costs (particularly for completion of improvements) without majority lender approval amounts may be acceptable in order for lenders to meet internal credit requirements. The reality that lenders most often face is that the sale of the collateral will not fully repay the amount they have lent. If it could, the borrower would have sold the collateral and repaid the loan, rather than risk that the lenders would foreclose on the collateral, sell it for less, and sue the borrower for a deficiency. It is likely there are problems with the collateral or problems with the real estate market that necessitate a foreclosure. A sale at 100% of the loan amount or even 100% of the current appraised value is highly unlikely. A lender that is able to veto a sale may use that right to try to negotiate with the other lenders for a bigger portion of the sales proceeds. The participation or syndicated loan agreement can provide that collateral sales for lower than 90% of the then appraised value of the collateral may be approved by the majority lenders. If there are only two lenders, a buy-sell arrangement can solve an impasse if one but not both lenders will consent to a particular sale.

6. The Form Issue – How to Draft a Syndicated Construction Loan Agreement. How can you draft a syndicated construction loan agreement?

6.1 Start with a Construction Loan Agreement. Start with a construction loan agreement form rather than an unsecured syndicated loan agreement form. The borrower is most familiar with a construction loan agreement form. You will find it much easier to treat the loan as a construction loan that happens to be syndicated, and not as a syndicated loan that happens to be for construction.

6.2 Search the word "Lender". Next, go through each section of the loan agreement and the other loan documents and look for the word "lender." Determine what rights and obligations should be those of all lenders, the majority lenders, the administrative agent, or the administrative agent on behalf of the lenders.

6.3 Add the Administrative Agent Provisions. Finally, insert syndication provisions from a syndication loan agreement incorporating the relationship among the administrative agent and the lenders, and include those provisions uniquely applicable to construction syndication from the sections set forth above.

6.4 The Collateral Documents. A participation can be made of an existing construction loan without modifying the construction loan documents. In a syndicated loan, the loan documents, particularly the collateral documents, can be styled in favor of the administrative agent for the benefit of the lenders. A single note or multiple notes may be used, but local state counsel should be consulted. Thus, post closing assignments may, but do not have to involve the exchange of old and issuance of new replacement notes to reflect the revised commitments of each lender. Title insurance policies can be carefully drafted so that assignments will not require endorsements to the policy.

6.5 The "Existing Loan" Temptations. Lenders sometimes request that existing construction loan documents be sold by "assignment" rather than participation, because the potential purchasing lender does not want to be a participant. Lawyers are sometimes tempted to merely change the terms "participation" to "assignment" and "participant" to "assignee" in a participation form. Regardless, the document is a participation, which may not satisfy the purchaser's goals. If the document is somehow construed to be an assignment rather than a participation and the other construction loan documents are not modified accordingly, there are legal risks that the assignee's interest is not perfected. Additionally, the rights and obligations of the seller as "agent" will be ill-defined and may result in unintended liability. Lawyers are also sometimes tempted to use an intercreditor agreement (which could be similar in format to a participation or to a stand-alone intercreditor agreement sometimes used in syndicated loans) to modify the loan documents to convert them to a syndicated form. In theory, this should work. However, review the construction loan documents and examine the word "lender" in each clause. Determine if it is necessary to modify it to "majority lenders", "administrative agent" or "administrative agent on behalf of the lenders" to avoid disputes. It may be more risky and more confusing than amending and restating the loan documents (particularly the construction loan agreement), using a syndicated version of the same form that was prepared for the original construction loan. In that way the administrative agent's, lenders' and borrower's roles and authority are detailed and clear in all aspects of the loan agreement, particularly regarding day-to-day management and major decision making.