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The Top 11 Things About Syndicated Loans That May Surprise You

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The contemporary Syndicated Line of Credit or Loan Agreement offers a veritable cornucopia of surprises for the unwary and unsophisticated Lender who seeks to purchase a portion of a loan as a member of a Syndicate of Lenders. The items discussed below are considered "market" among large sophisticated Lenders, although modifications are sometimes allowed. It behooves any Lender entering into one of these arrangements to seek out and retain counsel that is experienced in not only addressing these issues, but also in explaining the risk to the Lender in the context of the current market environment. The Top 11 Things about Syndicated Loans that may surprise you are:

Number 11. Swing Line Loans may go on forever and are a big percentage of the overall Line of Credit.

Swing Line Loans were originally intended to allow the Borrower to borrow money under the Line of Credit within a shorter time period than would be required to request a formal borrowing under the Line of Credit from all the Lenders through the Administrative Agent. Swing Line Notes, invariably payable to the Administrative Agent as the Swing Line Lender under the Line of Credit, are executed at the same time the Line of Credit Notes are executed. The Borrower can borrow under the Swing Line, and if the Swing Line borrowing is not repaid within a certain period of time, the Administrative Agent may require the Lenders to fund their

prorata share of the outstanding Swing Line Loan amount to the Administrative Agent as an advance under their Line of Credit Note.

However, in many Line of Credit Agreements, nothing says the Administrative Agent is required to make such requests within such a time period. Some Swing Line Loan provisions even provide that the Swing Line borrowing may be extended. Some Swing Line provisions also provide that the Swing Line Lender may agree to a different rate of interest on the Swing Line Note than as stated in the Line of Credit Agreement. Further, sometimes the Swing Line Notes may be as much as 15-20% of the entire Line of Credit amount.

Thus, the Administrative Agent, as Swing Line Lender, could charge a slightly lower interest rate on a Swing Line borrowing rate for up to 15-20% of the entire Line of Credit amount. The Swing Line Note borrowing could be extended repeatedly. Interest would be payable to the Administrative Agent. When a default occurred, the Administrative Agent could demand that each Lender fund their prorata portion of the outstanding Swing Line Note amount. In effect, the Administrative Agent receives all the interest income, and the Lenders take all the risk of nonrepayment.

Recommendations: First, try to get the Administrative Agent to agree that Swing Line Loans may not be extended, and new Swing Line Loans may not be advanced to repay outstanding Swing Line Loans.

Second, try to get the Administrative Agent to agree that the interest rate on the Swing Line Note may not be reduced or otherwise modified without the consent of all the Lenders. Finally, try to get the Administrative Agent to agree that if a Swing Line Loan is not repaid by

the Borrower within a certain period of time, they must require the Lenders to fund their pro rata share of it as an advance under their Line of Credit Notes.

Number 10. After a default, Swing Line Loans are required to be repaid prior to Line of Credit Loans, and Swap Transaction Termination Payments are repaid pari passu with the Line of Credit Loans.

In the event the Administrative Agent forgets to obtain, or is somehow prevented from obtaining, a repayment of Swing Line Note borrowing from the Borrower or the Lenders, the Line of Credit Agreement usually provides that Swing Line Loans will be paid prior to any other type of Loan. Further, the Line of Credit Agreements usually provide that, upon default, Swap Transaction Termination payments are paid with equal priority to Line of Credit Note payments.

Swap Transaction products are typically interest rate "swaps," "caps" and/or "collars" designed to provide a hedge against rising interest rates, and perhaps other credit derivative type products. While all Lenders are typically allowed to provide Swap Transaction products to the Borrower, these products are often provided only by the Administrative Agent. They are not part of the Line of the Credit (although an interest rate hedge may be required as a condition to the extension of the Line of Credit), but are typically secured by any collateral. Sales of these products may or may not be disclosed to the Lenders. Nevertheless, after default the unsuspecting Lender may find that payments required to terminate these transactions must be paid by the Borrower, and any payments received from the Borrower for payment of the Line of Credit Notes must be shared on a prorata basis with the Administrative Agent or Lender who is owed Swap Termination Payments. These payments typically include mark-to-market amounts based on the value of the Swap Transaction at the time of termination.

Recommendation: It is doubtful that an Administrative Agent will ever agree to change the priority of repayment for the Swing Line Note. However, an Administrative Agent may agree that payments on Swap Transaction products will be subordinate to payments on Line of Credit Notes.

Number 9. The Administrative Agent can resign but cannot be removed.

Historically, syndicated Line of Credit Agreements have afforded the Administrative Agent the unilateral right to resign. They have also allowed a majority of the Lenders to remove the Administrative Agent after a standard for removal is violated, such as for "cause" or "good cause," or upon the "negligence" or "gross negligence or a willful misconduct" of the Administrative Agent. However, many modern syndicated Line of Credit Agreements provide that the Administrative Agent can resign, but that the Lenders cannot remove them for any reason. Arguably, the rationale for not being able to remove the Administrative Agent is that their duties are strictly ministerial. However, financial covenants have become increasingly more complex. Even construction loans are being syndicated. Credit Agreements often allow the Administrative Agent to make unilateral decisions on arguably material matters.

Some Administrative Agents may also argue that the Borrower is depending on a particular Lender serving as Administrative Agent on the Loan as a reason for not allowing removal by the Lenders. However, why then can the Administrative Agent resign? Further, Credit Agreements allowing for removal of the Administrative Agent usually require the consent of the Borrower anyway, so long as the Borrower is not in default.

Recommendation: If the Administrative Agent's actions are purely ministerial, an Administrative Agent may be reluctant to change this provision, however remote the possibility

of its exercise. However, if the Loan involves any sort of discretion in material matters by the Administrative Agent, try to have the Administrative Agent agree to removal by a majority of Lenders, using at least a "gross negligence or willful misconduct" standard.

Number 8. The Line of Credit can be increased without all Lenders' consents.

Many Line of Credit Agreements provide for an "accordion" feature, which allows the Borrower to increase or decrease the amount of the Loan by a specified amount. Outside of this normal provision, sometimes the Amendments section of the Credit Agreement provides that the amount of the Loan can be increased so long as an individual Lender's portion of the Loan is not increased. To some Lenders this is not a concern, but other Lenders do not want their percentage ownership (and thus their voting power) decreased without their consent. Many amendments to a Line of Credit Agreement may be made, or provisions of a Line of Credit Agreement may be waived, by a required percentage of the Lenders, usually three-quarters, two-thirds or a majority of all Lenders. If a Lender's percentage ownership amount of the Loan is reduced, the likelihood that the Lender will have to be a voting member of that required group of Lenders may also be reduced. Further, some Lenders see the overall increase of the Line of Credit amount as an increased credit risk that impacts all the Lenders.

Recommendation: "Accordion" provisions are usually important to the Borrower. At the very least, the Lender should have a right of first refusal to participate, in any increase of the Loan due to the exercise of this provision, before new Lenders are added. If all existing Lenders want to participate, each individual Lender may be limited to its pro rata portion of the increase. With regard to provisions that allow for an increase in the Loan so long as the individual Lender's portion of the dollar amount of the Loan is not increased, some Administrative Agents

will strike this provision upon request. Alternatively, the Administrative Agent may agree to (1) give the Lender a right of first refusal to participate in any increase, or (2) limit the total dollar amount of the increase to an amount which will least disadvantage the voting strength of your Lender client, in view of the dilution of its voting percentage as a result of such dollar amount increase.

Number 7. The Administrative Agent is not required to be a Lender.

Oftentimes the Assignment provision of the Line of Credit Agreement requires that any assignment be of a certain dollar portion of the Loan. None of the Administrative Agent, the Borrower or the Lenders wants too many Lenders as owners of portions of the Line of Credit, nor do they want any Lender to own or sell a very small portion of the Line of Credit. These provisions usually provide that unless the Lender is selling all of its portion of the Line of Credit, it must sell at least a certain minimum dollar amount.

However, nothing prevents any Lender, even the Administrative Agent, from selling all its ownership interest in the Line of Credit. Therefore, the Administrative Agent may have no economic interest in the Loan, yet may be making decisions that impact the Lenders. Further, they could be making Swing Line Loans which ultimately must be repaid by the Lenders. Also, they could be issuing Letters of Credit including receiving a "fronting" fee for issuing the Letter of Credit, under a Line of Credit Agreement which provides that all Lenders participate pro rata in any Letter of Credit exposure.

Recommendation: One solution is to require the Administrative Agent to be a Lender owing a certain minimum dollar amount portion of the Line of Credit, a so-called "minimum hold." This may be a sensitive issue that could be a "deal breaker" for an Administrative Agent

or a Lender. Some Administrative Agents will absolutely refuse to agree to a minimal hold, arguing that their duties are merely ministerial. Some Lenders will not want to be part of a Line of Credit where the Administrative Agent is not a Lender. Some Administrative Agents may agree to hold as much as the same amount as the Lender holding the highest amount of the Line of Credit. Others may agree to hold a minimum specified dollar amount, but may also require all Lenders to maintain the same minimum hold amount. However, the market reality is that competition is sometimes so stiff to receive a portion of the allocations of a desired Line of Credit that the likelihood that the Administrative Agent would sell its entire interest is not very high. Regardless, if the credit quality changes or if the Borrower defaults, the Administrative Agent will probably want to retain the same right as any other Lender to sell all or a portion of its allocated Line of Credit amount.

Number 6. Participations under the Line of Credit may not qualify for sale treatment under Financial Accounting Standards Board Statement 140 ("FASB 140"), and may be deemed a loan by the Lender that participates in a portion of an interest in the Line of Credit from another Lender.

A Participation is a transfer of a portion of a Loan in which the Participant and Borrower have no direct obligation to each other. The Participant is obligated to fund its portion of the Loan to the Lender and the Lender is obligated to pay the Participant its portion of payments from the Borrower on the Loan. A Lender wants to show a Participation on its books as a sale of a portion of the Loan amount to the Participant, and not as a loan from the Participant to the Lender secured by an interest in a portion of the proceeds from the Loan.

One of the factors in determining that a Participation is deemed a sale under FASB 140 is that the "Lead" Lender (Seller) not be granted "unfettered discretion as to all matters" under the loan being participated. (See Minutes of the September 22, 2004 Board meeting of the Financial

Accounting Standard Board, Statement 140 Amendment Team, regarding isolation of Financial Assets, www.fasb.org/project/qualifying_spe.shtml.) Traditionally, Syndicated Line of Credit Agreements have allowed Participants to have no more voting rights than the right to vote on matters that would require the vote of all Lenders under the Line of Credit Agreement. However, some newer Assignment provisions in Line of Credit Agreements have not allowed the Lead Lender (Seller) of a Participation of a portion of its interest in the Line of Credit to give any voting rights to the Participant, or only require the Participant's consent to increase the Lender's or Participant's ownership amount of the Line of Credit. It is questionable whether such Participation would qualify for sales treatment under FASB 140.

Recommendation: If your Lender client intends to sell all or a portion of its interest in the Line of Credit by Participation, the applicable section of the Line of Credit Agreement should be modified to allow the Participant to at least vote on matters that all Lenders in the Line of Credit Agreement must vote. Further, the Participation Agreement should satisfy the other requirements of FASB 140.

Number 5. Lenders seem to get very excited about their title.

Certainly, the title of Lead Arranger, Book Runner or Administrative Agent is important to the Lender and their Law Firm for League Table credit purposes. The Loan Pricing Corporation (www.loanpricing.com) ranks member Financial Institutions (as Lead Arranger) and their Law Firms in their League Table quarterly reports available online to the public. What is less known, however, is that members may also receive a number of publications, including weekly and quarterly Gold Sheets, with a number of League Tables ranking certain other titled Lenders and their Law Firms. In connection with those other publications, the titles of

Syndication Agent and Documentation Agent may be important to the Lenders who are purchasing a portion of these loans and their Law Firms, for League Table Credit reporting purposes or otherwise.

Recommendation: Under the Loan Pricing Corporation's 2005 Loan League Table criteria, "Tier 1" Lenders and their Law Firms receive credit. Lead Arranger League Table credit will be awarded to Lenders with the titles Administrative, Syndication, or Documentation Agent with either the Lead Arranger or Book Runner title. To receive this credit, the Lender client must be one of only two Lenders which have the Lead Arranger or Book Runner title. There can be two Lead Arrangers and no Book Runner, or a Lead Arranger and a Book Runner, but only two Lenders can have any of these titles.

For Lenders that are not Lead Arrangers or Book Runners and are only purchasing a portion of the Line of Credit, ask for a Tier 1 title. Agent-only Tier 1 League Table credit will be awarded for up to five Lenders with the titles Administrative, Syndication, or Documentation Agent. These Lenders' Law Firms may also be awarded credit. There are alternative Tier 2 through Tier 6 awards, but the Tier 1 awards are typically the most requested and prestigious. Law Firms, particularly those for Tier 1 Lenders with Agent-only League Table credit, may find it advisable to request their credit directly from the Loan Pricing Corporation.

Number 4. It is a dictatorship rather than a democracy; Lenders don't discuss their comments with each other.

One would logically expect in any arrangement where a number of Lenders are sharing responsibility for funding, that they would discuss amongst themselves their concerns about the terms and conditions of such funding. In a syndicated Line of Credit, the Administrative Agent negotiates with the Borrower and then presents such negotiations for comments by potential

purchasing Lenders, usually within a very short time frame. Lenders may find that the Line of Credit Agreements add or omit provisions, and that the Agreement may not reflect--and may actually be in conflict with--the Lender's policies or customs. For example, the Borrower's Counsel's Legal Opinion, which some Lenders view as a mandatory requirement, may be waived because the Borrower will not accept this expense. Surprisingly, Lenders rarely, if ever, lobby with other Lenders regarding concerns they have about the Line of Credit, nor do they work with other Lenders to understand confusing aspects of the Line of Credit Agreement. They also do not encourage their Lawyers to consult with Lawyers for the other Lenders. Rather, each Lender submits its comments in a vacuum, and hopes to get a small portion of them accepted by the Administrative Agent. Moreover in the current market, the Lender that is awarded the Administrative Agent role by a desired Borrower is usually in the catbird's seat and may not accept many proposed changes, because there is usually a large pool of Lenders anxious to own a portion of the Line of Credit.

Recommendation: This is a touchy subject. Occasionally, if the issue is big enough, the Lender may be firm in its request for a change in the Line of Credit Agreement. Sometimes their Lawyer will ask the Administrative Agent's Lawyer how many other Lenders have made the same comment. The Lender's officer may also make this same inquiry of the Administrative Agent. However, going to the other Lenders may put the syndication at risk, and reduce the likelihood that the Lender would ever be invited to join a syndication by that Administrative Agent again. If the issue is unfounded, it may also expose the Lender to a lawsuit. It may be more prudent for the Lender to simply decline to participate in the syndication, rather than press an issue. Administrative Agents are Lenders themselves, and are sensitive to the varying credit requirements of other Lenders that may prohibit them from joining a particular syndication.

Number 3. The Administrative Agent's fee is always secret - or is it?

Some Lenders may have an investment affiliate arm that "arranges" the Line of Credit for the Borrower and receives an "Arrangement Fee." The Arrangement Fee is usually in a separate letter and the amount is not disclosed to the Lenders, unless they somehow are able to identify it as a portion of a budget submitted with the Credit request. The Administrative Agent may also receive a separate "Administrative Agents' Fee," the disclosure of which some Administrative Agents are very reluctant to give, but other Administrative Agents disclose directly in the Term Sheet (a listing of Line of Credit terms presented to the Borrower and Lenders as a basis for documentation) or Line of Credit Agreement.

Recommendation: Disclosure of the fee is a more sensitive issue for some Lenders than others. The larger and more difficult loans to market usually are subject to an Arrangement Fee. More complex loans usually justify an Administrative Agent's Fee, particularly for sophisticated rate and funding schemes. Regardless, the Lender must be satisfied that its fee and interest compensation under the Line of Credit Agreement justifies its credit risk.

Number 2. The Lenders and their counsel really don't understand the details of the deal.

One would think a Lender who is lending \$10-50 million to a Borrower would understand every detail about the Borrower and any collateral for the Line of Credit. They would, if they were the only Lender and the Borrower was paying the entire legal fee to close the Line of Credit. Instead, in a syndicated situation, the Administrative Agent and their Lawyer prepare the documents, negotiate with the Borrower, review (*e.g.*, title review) any collateral, and determine whether the Borrower is meeting many of the covenants of the Line of Credit. The Administrative Agent's legal fees are paid by the Borrower.

The Lender's legal fees are usually paid by the Lender, not by the Borrower. Typically the Lender has reviewed the financial position of the Borrower and the financial performance of any collateral. They may have also reviewed appraisals or property condition reports of collateral. However, they do not receive the same level of fee income, nor may they be able to dedicate the same amount of time to or have the same amount of communication with the Borrower, as the Administrative Agent and their Lawyer.

The Lender will receive a Term Sheet for the deal and they and/or their Lawyer will make sure the provisions in the Term Sheet conform to the Line of Credit Agreement, and that the intercreditor provisions governing the relationship between the Lenders and the Administrative Agent are satisfactory to the Lender. Further, they may have certain issues they will want to make sure are in the Line of Credit Agreement, such as the ability to (1) share information about the Line of Credit with affiliates, (2) assign all or a portion of their ownership interest in the Line of Credit (3) approve certain amendments, and (4) require the Administrative Agent to hold a minimum portion of the Line of Credit.

However, neither the Lender nor their Lawyer will often review in detail a number of matters, such as the insurance policies of the Borrower, the environmental reports of the Borrower, the condition of title to or a survey of any collateral property, or the collateral documents. Doing so would increase their legal costs significantly. Further, the Lender will expect that the Administrative Agent has retained competent legal counsel.

Recommendation: At the outset, determine the level of due diligence the Lender client expects of their Lawyer in reviewing the Line of Credit Documents. Reviewing the collateral and supporting documents will be expensive, and may not be deemed necessary, if the

Administrative Agent is represented by competent, reputable and experienced counsel. Further, some comfort may be taken in that virtually every Line of Credit Agreement holds the Administrative Agent liable for its own gross negligence or willful misconduct. Regardless, if the Term Sheet contains provisions that would affect, for example, the guaranty, that document should be reviewed. Either the Lender or their Lawyer should review the Line of Credit Agreement to make sure it conforms to the Term Sheet and related market terms. Finally, the intercreditor provisions should be reviewed to make sure that they are market, any particularly sensitive issues for the Lender should be identified, and the issues in this article should be considered.

Number 1. Big real estate issues are often forgotten even though the "credit" comes from real property cash flow.

In a typical real estate Loan Agreement, a Lender may have extensive insurance requirements and detailed environmental covenants and conditions. If property is leased, they would want to make sure that leases are financable (*e.g.*, that they have provisions for subordination, non-disturbance, attornment and notification to mortgagees of default).

For some reason, Administrative Agents and Lenders in large Syndicated Lines of Credit or Loans often lose sight of these typical requirements. Instead, the Line of Credit or Loan Agreement often looks like any other unsecured Line of Credit or Loan Agreement, even if the source of the credit strength of the customer depends on the real estate.

For example, instead of requiring that insurance be for 100% replacement value, including for acts of terrorism, a typical provision would only require "insurance as is customary and normal for similarly situated property owners." Extensive environmental provisions might be reduced to a simple representation and indemnity. The Borrower might only be required to

provide periodic financial information on themselves and their subsidiaries, as opposed to being required to provide information on the performance of their individual properties.

In one recent agreement a provision required a "negative pledge" on certain real property. Negative pledge provisions prevent the Borrower from granting a lien to another lender on specified assets. In addition, negative pledge provisions usually prohibit the Borrower from granting a negative pledge in favor of another lender. One purpose of a negative pledge is to preserve the ability of the Lenders to obtain a lien on the assets at some point in the future without violating agreements with other lenders. The Borrower successfully negotiated an exception allowing them to enter into other agreements limiting the Borrower's ability to encumber its assets above a percentage ratio so long as it did not specifically prohibit an encumbrance of specific assets. The percentage amount of the ratio was not specified. Therefore, a pledge of assets to the Lender, which assets were subject to the negative pledge provision prohibiting a pledge to other Lenders, might cause a default under the ratio requirement of another credit agreement, defeating the purpose of a typical negative pledge provision.

Recommendation: This is the area where large, sophisticated non-real estate lending and large, sophisticated real estate lending collide. It is in the province of the world of credit risk. Competent counsel with a background in traditional real estate lending should be able to identify these issues and discuss them verbally with the Lender. If the Line of Credit Agreement merits revision, oftentimes it is the simple but time-consuming task of converting traditional real estate provisions to the language of a sophisticated syndicated Line of Credit Agreement. However, in many sophisticated Lines of Credit to real estate companies, these issues are usually

addressed in the same way as they are Lines of Credit to other types of companies, rather than along the lines of traditional real estate lending.