SPECIAL PROBLEMS OF SYNDICATED LOANS AND MULTI-TIERED FINANCINGS

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Syndication continues to grow in popularity among lenders.[1] This article will explain the significant legal issues surrounding such transactions.

According to a recent report, commercial real estate and multifamily mortgage borrowing and lending totaled $816 billion in 2022.[2] The multifamily property category accounted for $437 billion of that total, leading all real estate loan originations in dollar volume.[3] Due to the rapid growth in volume and the escalating size and complexity of mortgage loans and the projects securing such loans, lenders have been forced to further develop methods to adequately diversify their risk. While most mortgage loans are sold into the commercial mortgage-backed securitization (CMBS) market, mortgage loans held for syndication still represent a significant share of the loans made by many real estate lenders. The syndication market provides mortgage originators with an opportunity to create a customized lending product which extends beyond the standard requirements of the rating agencies. The syndication market has recently gained significant momentum for "value-added" lenders who are willing to: (i) incur above-average risk by placing loans in higher-leveraged loan positions in the capital stack; or (ii) provide financing outside a conduit structure for construction projects, land acquisitions, and/or lease-up projects.

The primary incentive for syndicating loans in today's market is diversifying risk and, thus, increasing the granularity of a lender's loan portfolio. Other considerations for lenders who sell loan participations include leveraging income and reducing capital weight while building and maintaining relationships with clients. Access to the know-how and deal flow of established real estate lenders is an incentive for lenders who purchase loan participations to join a syndicate group. Most key players in real estate loan syndication in the United States include US lenders and international lenders from such countries as Germany, France, Canada, and England, serving in roles of both agent lenders and participant lenders.

As these trends continue, it becomes increasingly important for real estate lawyers and their clients, whether they be agent banks or participants, to understand not only the driving forces behind syndication, but also the legal issues that arise in connection with these transactions, including issues often negotiated between members of the syndicate group. The respective interests among loan participants vary to the extent that pari-passu loan shares, subordinate loan shares, A/B loan structures, or mezzanine loan interests are involved in the capital stack.

Similarly, since $728 billion of outstanding mortgage loan debt will mature in 2023, the need for mezzanine financing will increase.[4] As the mezzanine market continues to expand to feed the ever-growing demand, it is necessary for lawyers and clients alike to understand the special relationship which exists among the mortgage and mezzanine lenders in multi-tiered financings. In particular, lawyers and clients need to have an intricate understanding of the single document which codifies the senior-junior class relationship— the intercreditor agreement.

DRIVING FORCES BEHIND LOAN SYNDICATION

The major benefit of loan syndication is that it allows arranging lenders (who are often the loan originators) to diversify risk while maintaining close relationships with their customers. In order to minimize credit risk and to ensure acceptable levels of diversification, lenders monitor and impose limits on their exposure with regard to a particular project as well as the amount of loans made to a particular sponsor. As development projects become more complex and expensive, developers require larger loans, which may exceed a particular lender's loan exposure limits or the maximum amount that a particular lender is willing to extend to a sponsor.

By creating a syndication group and, thus, dividing the obligations to lend the entire loan amount among several lenders, participating lenders are more likely to be able to stay within their credit exposure limits. The participating lenders also can access the expertise, business relationships, and deal-flow of arranging lenders, allowing the participants to extend their customer base without investing large amounts for marketing costs and administrative capabilities.

Lenders that arrange the syndication group or serve as the administrative agent for the participants (oftentimes the same lender) can enhance their own profitability by charging additional fees and other compensation for arranging and administering the loan without the need for committing capital for the entire loan amount. To a certain extent, agent lenders may also expect their participant banks to bring future syndication deals back to the agent lender. All the lenders in the syndicate group benefit financially from their loan participation by collecting pro-rata interest and fees, particularly commitment fees.

Mezzanine debt is the level of debt between the senior secured debt and the equity. Mezzanine debt was typically used by borrowers to fund development projects. However, as mortgage lenders have been reluctant in recent years to finance projects with high loan-to-value ratios, borrowers have increasingly turned to mezzanine debt to bridge the gap between the levels of debt desired by such borrowers and the amount of financing offered by mortgage lenders.

PARTICIPATION STRUCTURES FOR REAL ESTATE LOANS

Direct participation

In a loan involving direct participation, each participant lender acts as co-underwriter and becomes a party to the loan documents at the closing of the loan. Although each participant lender has its own contractual relationship with the borrower (and, thus, is called a co-lender), typically one of the lenders (in most cases the originator of the mortgage) will serve as the administrative agent for a group of participants. Such deals may be executed in a "club" format, in which several lenders partner to form a small lender group for transactions that exceed the risk appetite of each individual lender. The agent lender is responsible for administering the loan and maintaining the day-to-day relationship with the borrower. Each of the co-lenders owns its respective portion of the loan, which obligates the co-lender to fund to the borrower the amount to which it has committed to lend and entitles such co-lender to the benefits (i.e., interest and fees) arising out of its portion.

Each co-lender often acquires a promissory note in the amount of its share of the loan, made by the borrower payable to the order of such co-lender, as payee. However, the notes often provide that the payments made under the note be sent to the agent lender, who collects the payments and distributes to each co-lender its respective share of the funds.

Regular participation

In a loan involving regular participation, direct participants join as participant lenders *after* the initial closing of the loan. An existing lender—often the arranging lender who typically also serves as the administrative agent—sells a portion of the loan to the incoming participant lender (who is also called a co-lender). This sale is documented by an assignment and assumption agreement (or assignment and acceptance agreement) between the selling lender and the co-lender. The co-lender will acquire by assignment an undivided participation interest in the loan on a pro-rata basis, which means that it will accept the obligation to advance its portion of the loan and will receive a direct interest in the amount of its participation in the right to repayment of the loan and the collateral given to secure the loan. In most other respects, the rights and obligations of the lenders in a regular participation are similar to those in a direct participation.

Indirect participation

If a loan is syndicated through indirect participation, the participant lenders are not and do not become parties to the loan documents. An indirect participant enters into an agreement with the selling lender to purchase interests and obligations under the loan and receives a participation certificate executed by the lead lender, and not a note executed by the borrower. The participant lender incurs only a guarantee-like funding obligation and must reimburse the selling lender for any loan expense in connection with the loan documents. As a result, the borrower may not have knowledge of an indirect participant's existence. Certain lenders' regulations or internal guidelines require a direct claim against the borrower and the collateral and therefore such lenders are prohibited from purchasing indirect participation interests in loans. Some loan structures involve a combination of direct and indirect participations, and some structures have varying levels of priority among participants in terms of rights to receipt of payments and ability to exercise remedies.

In a co-lending arrangement, the lead lender has certain duties to the other members of the loan group, known as the Servicing Standard. The Servicing Standard requires the lead lender to service the loan (or manage the property) in "a commercially reasonable manner" that benefits all co-lenders, without regard to its relationships with or ownership of any other parties to the agreement.[5] It is sometimes stated as the higher of these standards: (i) the standard by which the lead lender services its own loans; and (ii) the customary standard for servicing in the industry.

DOCUMENTING SYNDICATION RELATIONSHIPS

Because syndication involves multiple parties, it is very important that the primary and syndication loan documents clearly define the role of each party and set forth the relative rights, obligations, and priorities among the parties. Many provisions are standard, but some may be heavily negotiated or modified by side letters between the agent lender and a co-lender.

Although loan syndication enables lenders to increase diversification and engage in transactions they might otherwise be obligated to turn down, lenders within a syndicate group give up the flexibility to make decisions with respect to the loan independently. Although the agent lender is generally granted the power to make the day-to-day decisions alone, loan documents often require consent and/or approval from some or all participant lenders for certain decisions.

In some syndications, co-lenders execute the primary loan documents with the borrower at the closing of the loan. More commonly, in a secured mortgage loan, the loan agreement, the promissory note, the mortgage, and the other ancillary documents executed in connection with the closing of the loan are executed by the main underwriter. The main underwriter, as agent, is the only lender at the closing and intends to sell portions of the loan in the secondary market. To facilitate the future sale interests in the loan, the agent lender must consider market pricing, loan terms, and reasonable agent/co-lender provisions at loan closing. The co-lenders do not have a real-time opportunity to review or comment on the primary loan documents or participate in negotiations with the borrower even though many provisions regarding the agency/participant lender relationship are contained in the loan agreement.

In cases where multiple underwriters execute the loan agreement as direct co-lenders and participate in the primary closing with the borrower, these concerns do not arise. Co-lenders signing the primary loan documents at closing are granted co-underwriter privileges (such as primary market pricing and co-agent and co-underwriter titles) related to the transaction and can negotiate loan provisions to some extent, especially the sections relating to the agent/co-lender relationship.

In the absence of clear documentation, disputes can emerge regarding the roles and authority of the group vis-à-vis its individual members. The New York Court of Appeals, in *Beal Savings Bank v. Sommer*, established a presumption in one such dispute.[6] The court found that one member of a lending group could not, in contravention of the syndicate's decision, act against a guarantor of debt obligations following the default on that debt. As the court noted, if "the parties intended that an individual have a right to proceed independently, the Credit Agreement ... should have expressly so provided."[7]

Several other considerations should be accounted for in the loan documents. For instance, they may require a party to disclose the existence of any intercreditor agreements to potential assignees.[8] Loan documents should also clearly define the lead lender's authority to act as administrative agent for the syndicate and what levels of consent from co-lenders are required before the administrative agent takes various actions. Exhibit A is an example of how many lenders decide what level of consent is required for different decisions a lead lender may be called upon to make from time to time during the term of a loan. These guidelines give all members of the lending group a voice in determining key factors yet allow specific issues to be decided without "too many cooks" getting involved.[9] In addition, a lending group must determine if it would be willing to offer the seller financing for the sale of a property and, if so, on what terms and in respect of what legal and tax structuring considerations.[10]

ASSIGNMENT AND ASSUMPTION AGREEMENT

When lenders sell participations in a loan, the sale is documented by an agreement sometimes called an assignment and assumption or assignment and acceptance agreement. This document describes the purchase and sale of the participation interest and assigns to the buying lender both the obligations under and interests in the portion of the loan purchased from the selling lender. The assignment agreements usually provide sufficiently detailed true-sale language to support favorable treatment under capital adequacy rules. The purchasing lender may appoint the agent lender and authorize the agent lender to act on its behalf in the agreement. This document—usually the agent lender's standard form and possibly attached to the loan agreement—is not negotiated or revised heavily because it often refers back to the rights and obligations set forth in the loan agreement. An agent lender is very unlikely to go back to the borrower to renegotiate and amend the primary loan documents. All this has made the loan assignment the preferred participation device in today's real estate syndications market.

INFORMATION RIGHTS OF CO-LENDERS AND NOTICE PROVISIONS

Generally, the primary loan documents will require third parties and the borrower to give notices with respect to the loan to the agent lender rather than to each of the co-lenders directly. The primary and/or syndication loan documents typically address the types of information that the agent lender is obligated to provide to the co-lenders and the timeframes within which the obligations must be carried out. The co-lenders often negotiate for rights to as much information as possible relating to the loan, such as notices of borrower default, recording information, and copies of all loan documents. The agent, however, will prefer to keep the obligation to provide information to a minimum, by negotiating to exclude obligations to provide such information altogether or limit the obligation to instances in which a co-lender requests such information.

LIABILITY AND RELIANCE ON AGENT LENDERS

Agent lenders usually limit liability to co-lenders under the primary and syndication loan documents to willful misconduct or gross negligence resulting in actual damages. The agent lender is usually held to the standard that it would use in its own transactions. The courts usually accept these provisions and do not read a fiduciary relationship into the agreements between agent lender and participants. Most primary and/or syndicated loan documents provide that agent lenders have actual knowledge of a borrower's default. Some very large agent lenders, with far-flung operations, are concerned about being deemed to have knowledge because of employees' actual knowledge. Therefore, they seek to limit their liability to those defaults of which they have received written notice from either the borrower or their co-lenders. Because a borrower will not ordinarily give a lender notice of its own default, it is unlikely that the co-lender will obtain knowledge of a default before the agent lender. While it might be fair to limit imputed knowledge of the borrower's default to employees working on the subject loan transaction, large agent lenders rarely agree to that compromise. Rarely do prospective co-lenders terminate negotiations over this point.

In order to avoid liability to co-lenders, agent lenders require that co-lenders perform their own due diligence and credit analysis with the information provided by the agent lender. To memorialize the lack of co-lender reliance on the agent lender's analysis, the agent lender will typically require representations from each co-lender that such co-lender has not relied on the financial analysis of the agent lender and that the co-lender has done its own credit analysis and made its own decision with respect to joining the syndicate group. Therefore, the agent lender is usually protected when making day-to-day decisions with regard to a real estate loan. Liability issues do arise for an agent lender if a real estate loan requires specific skills, and the agent lender explicitly commits to apply such skills in administering the loan under the primary and/or syndication loan documents.

DECISION-MAKING

The agent lender will want the maximum amount of freedom possible with respect to administering the loan and avoiding interference or delay due to co-lender involvement in the decision-making process. For example, the agent is usually granted the right to make protective advances without co-lender consent (i.e., taxes, insurance, and ground lease payments) to maintain the value of the collateral in case of emergency. Co-lenders, on the other hand, will want some degree of control over key issues such as material amendments to the loan documents (e.g., changes in the interest rate applicable to the loan or the maturity date of the facility or increases in the facility amount). Co-lenders also want control over the management of the collateral, decisions regarding acceleration of the loan after an Event of Default, releases of any collateral, actions that affect the value of the collateral, and appointments of successor agent lenders. Co-lenders are not likely to request control over non-material issues because they also have an interest in distancing themselves from the burdens of administering the loan. Therefore, negotiations over the granting of authority to the agent to act on behalf of the co-lenders and over the decisions that will require co-lender consent are likely to be limited to material decisions affecting the loan and the collateral.

The borrower will only want to deal with one lender for payments and other day-to-day loan administration. For more material decisions and approvals, however, loan syndication documents might require that all (or a certain percentage) of the participant lenders approve an action before the borrower may act, which can be a time-consuming process causing the borrower unwanted delay. To minimize the likelihood of future issues arising within the syndicate group with respect to decision making, it is imperative to select participant lenders with adequate risk tolerance and expertise for the subject real estate project.

Primary and syndication loan documents may distinguish between decisions requiring unanimous co-lender consent and those only requiring consent from a certain percentage of the syndicate group. Again, the agent lender will generally prefer a lesser percentage of co-lender consent, while the co-lenders will want their votes to count on major decisions. Typically, all decisions regarding the extension of a maturity date, reduction in the interest rate, payment of debt service, and the release of collateral require unanimous co-lender consent. Other major decisions, such as approval of changes in the controlling interest in the borrower, a borrower's request for change orders in construction loans above certain thresholds, a borrower's request to enter into all leases with respect to the mortgage property, and any transfers of subordinate loan interests to another lender can be tied to a qualified majority of the syndicate lenders. The calculation of the majority percentage is usually based on the individual distribution of participant lenders in the bank group and their respective money at risk, rather than on a headcount of lenders. The percentage of lenders required should be more than 51 percent of the syndicate group, but typically is set at 60 percent or 66.67 percent of the aggregated amounts of all lenders.

In loan structures involving both senior lenders and subordinate lenders, the lender relationship may be arranged such that only senior lenders have the right to be involved in decision-making. The documentation for such structures typically limits the subordinate lender's right to cure existing borrower defaults and the right to buy out the senior lender to gain control of the mortgage collateral. The subordinate lender's motivation and incentive to take control in default situations varies to the extent the current market value of the mortgage collateral still supports the subordinate lender's subordinate position. A/B loan structures may allow for a shift in control of decision-making to the subordinate lender once a default with respect to the senior obligation is cured. In such cases, this shift is only valid for a period during which the subordinate lender can pursue foreclosure of the real estate and pay off the senior lender.

When a borrower makes a request which requires the consent of co-lenders, the agent lender must process the request before submitting the issue to the syndicate group for approval. The co-lenders then consider the information provided, along with any other documentation and due diligence items that may be involved, before informing the agent lender of its decision. To limit the amount of time between a borrower's request and the agent lender's response when co-lender consent is involved, agent lenders will push to limit the amount of time that the co-lenders have to consider the request and related information. Oftentimes, the primary and/or syndication loan documents will include a provision deeming consent given after a certain number of days if no co-lender response is received by the agent lender. Co-lenders will negotiate for as long a time period as possible to consider the issue.

With little existing law in this area, and with the agency provisions of the agreements rarely addressing issues in detail, solutions frequently depend on the judgment and consensus of the parties and their lawyers. The courts have typically deferred to the language in agreements among lenders, in particular the decision-making procedures they establish. All parties, therefore, must understand that such agreements will likely form the main, if not the only, foundation for legal judgments in the case of later disputes. The decision-making processes should be considered and established carefully.[11]

Nevertheless, it is incumbent upon the lending group's decision-making party or parties to respect the implied covenant of good faith and fair dealing. The interests of other members of the lending group should be factored in, and the decision-making party should keep all members apprised of its actions or potential actions. By keeping the decision-making process transparent, and by building consensus where possible, a lending group can head off most potential conflicts. Often, a lending group will enlist a co-agent to review and make objective recommendations on certain substantive decisions. However, in cases where the decision-making authority acts contrary to the co-agent's recommendations, this may be used as damaging evidence in future conflict issues.[12]

Finally, the lending group should bear in mind that, once it becomes a property owner, it will have to make all decisions associated with real estate ownership—leasing, management, tenant terms, ownership structure, and so forth.[13]

INTERCREDITOR AGREEMENTS

Some syndicated real estate loans involve senior and subordinate tranches within a facility that are secured by the same mortgage (A/B loan structures). Because the senior lenders and the subordinate lenders share the same collateral, the respective priorities and rights of each group of lenders must be set forth in an agreement between such parties. When various classes of lenders are involved in the capital stack, multiple intercreditor agreements may be required. Because the priority and control over the claim against the mortgage collateral is instrumental to each lender's underwriting, the intercreditor agreement is often heavily negotiated.

Likewise, in a multi-tiered financing with mortgage and mezzanine debt (and sometimes with multiple levels of mezzanine debt), the sole document governing the relationship between the two classes will be the intercreditor agreement. Given that this document acts to grant, as well as curb, the rights of each class vis-à-vis the borrowers and the collateral, the intercreditor agreement is a hotly contested document. Real estate professionals should exercise great care when negotiating an intercreditor agreement.

Generally, the senior lenders will agree to provide notice to the subordinate lenders of a borrower default either: (i) contemporaneously with delivery of such notice to borrower; or (ii) at the expiration of borrower's cure period. How much time the senior lenders will afford the subordinate lenders to cure a default remaining uncured by borrower before the senior lenders accelerate the loan or otherwise exercise remedies is heavily negotiated. Subordinate lenders should attempt to bifurcate the cure periods granted by senior lenders into two distinct categories: monetary defaults and non-monetary defaults.

When negotiating the monetary cure period terms, subordinate lenders should seek to be released from the payment of late charges or default interest in connection with their cure of any monetary default. Senior lenders, on the other hand, should limit the number of times a subordinate lender can cure a default by a borrower with respect to the payment of debt service.

When dealing with the duration of non-monetary cure periods, subordinate lenders will want a cure period that is long enough for them to effect a cure. Mezzanine lenders will also want to negotiate additional time with respect to non-monetary defaults that are of a nature that cannot be cured without the ownership of the equity. In such a case, mezzanine lenders should seek enough time under the agreement as is necessary to gain ownership of the equity and to cure such a default. Senior lenders often allow such additional periods provided there is no material impairment to value or use of the underlying collateral.

If the senior lenders commence foreclosure proceedings, accelerate the loan, or if the senior borrower is a debtor in an insolvency proceeding, the senior lender will allow the subordinate lenders the opportunity to acquire the senior loan. The purchase price will always be at least equal to the sum of the principal balance at par plus accrued, but unpaid, interest. However, in portfolio loan documents, the senior lenders will often seek to include default interest, late fees, breakage charges, yield maintenance, and the like in that purchase price.

In securitized transactions and multi-tiered financings, the convention seems to be that such additional items are foregone by the senior lenders. Still, senior lenders would be well-advised to prevent the existence of an open-ended option to buy the senior loan at par. Senior lenders can shorten the purchase option by making default interest, late charges, and other fees part of the purchase price if the subordinate lender fails to purchase the senior loan within 90 days after notice of a purchase option event.

If the borrower becomes involved in a bankruptcy proceeding, the senior lenders will generally allow the subordinate lenders to file a claim in that proceeding (in the case of mezzanine lenders, only to the extent such a claim is necessary for the mezzanine lender to preserve or realize on the mezzanine lender's collateral) but will rarely allow the subordinate lenders to vote on a plan of reorganization or otherwise act upon their claim. In fact, in most instances, the senior lender is afforded the opportunity to vote on behalf of the subordinate lenders with respect to any proposed plan of reorganization (but only if the proposed plan would result in the senior lender being "impaired" as defined in the United States Bankruptcy Code).

While a default under the senior loan documents invariably constitutes a default under the subordinate loan documents, the reverse is almost never the case. When a default occurs under the subordinate loan documents, the senior lenders may allow the subordinate lenders to foreclose upon their collateral, but any third-party transferee at such foreclosure sale (or, if the subordinate lenders bid the collateral in or obtain a deed in lieu of foreclosure, any transferee thereof) must generally meet certain eligibility requirements negotiated into the intercreditor agreement.

By empowering senior lenders at the expense of subordinated lenders' ability to influence or oppose proposals, intercreditor agreements reduce decision-making costs in the event of default. However, it is possible for an investor to exploit this imbalance, increasing its own return by damaging other creditors. When considering intercreditor agreements that waive or assign bankruptcy rights, courts are forced to weigh the benefits to the agreements' signatories against the potential for harm to subordinated creditors and non-signatories.[14]

Second-lien lenders face a host of other considerations unique to their status. In particular, they may become a "silent second" by agreeing contractually to refrain from exercising some or all of their rights as secured creditors. The key elements usually included an intercreditor agreement which pertain to "silent second" terms are:

- Prohibitions (or limitations) on the right of the second lien holders to take enforcement actions, with respect to their liens (possibly subject to time or other limitations)

- Agreements by the holders of second liens not to challenge enforcement or foreclosure actions taken by the holders of the first liens (possibly subject to time or other limitations)
- Prohibitions on the right of the second lien holders to challenge the validity or priority of the first liens
- Waivers of (or limitations on) other secured creditor rights by the holders of second liens[.][15]

Equally, mezzanine lenders face a host of other issues which are unique to their status. Perhaps the most heavily negotiated and most important provision of the multi-tiered financing intercreditor agreement is the right of a mezzanine lender to pursue a claim against a guarantor which is also the guarantor of the senior loan. Senior lenders will often prohibit the mezzanine lender from pursuing a claim against a common guarantor while the senior loan is outstanding or, in the alternative, will require the mezzanine lender to turn over to the senior lender the proceeds of any judgment the mezzanine lender obtains from such common guarantor. Mezzanine lenders, however, should seek to eliminate any blanket prohibition on pursuing claims. They should also limit the requirement to turn over proceeds to those instances: (i) when the senior lender is simultaneously pursuing a claim against the common guarantor; or (ii) when the senior lender has notified the mezzanine lender that it has a claim against the common guarantor and thereafter pursues such claim within a negotiated time period.

Lastly, intercreditor agreements will include a fair amount of deal-specific provisions. Such deal-specific provisions generally include the right of a subordinate lender to exercise a senior borrower extension option, rights with respect to ground leases, and provisions relating to future funding obligations. The provision that receives the most deal-specific language is often the modification section of the intercreditor agreement. Since any increase in obligations on the part of a borrower of either class of debt can impact the owner of the other class of debt, the modification section of the intercreditor will prevent both the senior and the subordinate lenders from modifying key terms of their respective loan agreements without the consent of the other. Such key terms often include cash management/cash sweep terms, transfer provisions, interest rate, and other payment terms.

DEFAULTS AND PAYMENT PRIORITIES

The syndication documents typically specify both a pre-default and post-default waterfall. For A/B loan structures or senior/subordinate note structures, the senior group will be paid first. The subordinate group has taken on more risk by being subordinated to the senior group and will not be paid until after the senior group is fully repaid. Therefore, the subordinate group is usually entitled to collect a higher interest rate in exchange for taking on such risk. Losses of principal and interest due to a default can also be allocated among the senior and subordinate groups. In most cases, the losses will be allocated first to the subordinate group and then to the senior group.

Before an event of default, the agent lender will generally receive its administrative and servicing fees, as well as reimbursement for its legal or other out-of-pocket expenses before reimbursement for further payments (such as protective advances, interest, and principal payments) are distributed to lenders. Interest is paid before principal is repaid, because the primary interest of all lenders is to have the debt paid current. If there are tranches among the lenders, the senior lenders will negotiate to have their interest and principal paid before any payments are distributed to the subordinate lenders, because being paid first is consistent with their lower level of risk.

In some cases, the subordinate lender can negotiate for priority of its interest payments over the principal payments to the senior lender. Such concessions are justifiable in specific transactions in which the borrower does not agree to an accrued interest feature as long as no event of default exists. Such accrued interest rate features shift the multiple interest payments during the term of the loan to a one-time interest payment at the maturity date. This is usually granted in exchange for the calculation of a substantially increased interest rate throughout the term of the loan.

After an event of default occurs, the senior lenders will be even more likely to insist that their interest and principal are paid before subordinate lenders can collect any payments. Administrative and servicing fees (including special servicing fees), collection, and other out-of-pocket expenses of the agent lender will be paid before default interest, late charges, regular interest, and principal to the senior lenders. Subsequently, the interest and principal are paid, all before costs, expenses, fees, and principal of the subordinate group are paid.

Although the lead lender typically has wide latitude in addressing loan defaults, limitations still exist. Certain provisions of the loan documents may require a prescribed vote before the lead lender can act. In other cases, remedies may need to be effected within a certain time period lest the lead lender be deemed to have, through inaction, waived enforcement rights or accepted a de facto loan modification. Participation and co-lending agreements may also restrict the lead lender's options after foreclosure occurs.[16] During this period, several possible "outs" may allow the lead lender to cede its lead lender duties, including a purchase option or a buy-sell option.[17] Each specific contract must be considered and interpreted to determine what, if any, approvals may be needed before action can be taken.

Examining relevant court cases, such as *New Bank of New England, N.A. v. Toronto Dominion Bank*,[18] one paper argues that US case law preserves unaltered the contractual rights of the creditors among themselves during a debt restructuring process. A creditor's right to enforce its claim against the borrower is not affected by the problems such action may cause other lenders. Similarly, the rights of the lending group's majority are not impacted by an implicit obligation to a minority lender or its interests.[19]

LENDER DEFAULT

When one co-lender fails to perform its obligation to fund its percentage of the loan to the borrower, it has breached its agreement with the borrower (if a direct or regular participant) or with the other lenders (if an indirect participant). In lending relationships with additional funding obligations, such as construction loans or lease-up loans, the mechanism for dealing with a defaulting lender must be clearly set forth in the primary and/or syndication loan documents. Some loans are structured to allow the non-defaulting lenders to advance the defaulting lender's share in exchange for the benefits associated with that advance. In some cases, defaulting lenders must take a step-down in priority with respect to distribution of payments and fees received from the borrower. In addition, some primary and/or syndication loan documents state that a defaulting lender loses its right to have its vote counted in any decision requiring the consent of co-lenders.

SUMMARY

As syndication and multi-tiered financings continue to grow in popularity among lenders and as the number of syndicated and multi-tiered loans continue to rise, lenders and their counsel must make themselves familiar with the legal issues surrounding such transactions. Particular attention should be given, in the case of syndicated loans, to the relationship between the lenders within the syndicate group, especially between the agent lender and the participant lenders and, in the case of the multi-tiered loans, to the relationship between the senior and the subordinate lenders set forth in the intercreditor agreement.

EXHIBIT A

Example of how many lenders decide what level of consent is required for different decisions a lead lender may be called upon to make from time to time during the term of a loan

Consents and Approval.

(a) Agent shall not, without first obtaining the consent of the Banks holding Percentages totaling one hundred percent (100%) of the Loan, take any of the following actions:

(i) amend the interest rate or Maturity Date set forth in the Loan Documents (except as may be expressly permitted in the Loan Documents),

(ii) provide a written release of any material portion of the collateral for the Loan, or a written release of any obligations of Guarantor (except as set forth in the Loan Documents),

(iii) increase the Loan Amount (other than as a result of an advance which Agent directs to be made after a Potential Default or Event of Default to cure a Potential Default or Event of Default or to comply with any of Borrower's covenants or otherwise to protect the value of the Project or the priority or validity of any Lien or security interest in favor of, or purportedly in favor of, the Banks (or Agent for the benefit of the Banks),

(iv) waive, defer, forgive, or reduce any principal or interest or fees due under the Loan or extend the time for payment of any such principal or interest or fees, including, without limitation, the Maturity Date,

(v) permit Borrower to further encumber or hypothecate all or any portion of the Project, except to the extent expressly permitted under the Loan Documents,

(vi) change the Percentage or Commitment of any Bank, except in connection with a transfer of a Bank's interest permitted under this Agreement,

(vii) make any amendment to this Section or any amendment to the percentage specified in the definition of Required Banks or otherwise change the definition of Banks, or

(viii) take any action specifically requiring the consent of all the Banks under any of the other terms of this Agreement or any of the other Loan Documents.

(b) Agent shall not, without first obtaining the consent of the Required Banks, take any of the following actions:

(i) permit (x) Borrower to Transfer any direct or indirect interest in the Project or (y) Guarantor to transfer any direct or indirect interest in Borrower, in each case except to the extent expressly permitted under the Loan Documents,

(ii) declare the Note to be immediately due and payable following an Event of Default or any rescission of any such acceleration,

(iii) (A) bring any action to foreclose the Lien of the Mortgage; or conducting a foreclosure sale pursuant to a power of sale; or accept a deed in lieu of foreclosure, (B) appoint a receiver for the collection of rents, (C) file or approve any plan in any bankruptcy proceeding involving

Borrower or any Borrower Party or the Project or (D) bring any suit to collect any of the Obligations or to sue on the Recourse Indemnity following an Event of Default, or

(iv) approve the Post-Default Plan.

(c) As to any matter which is subject to a vote of the Banks, any of the Banks may require Agent to initiate such a vote. In such event, Agent shall be bound by the results of such vote, so long as the action voted in favor of is permissible under the Loan Documents and under applicable Legal Requirements, and subject to the obligation of each Bank to (x) contribute its Percentage of all expenses and liabilities incurred in connection therewith and (y) indemnify Agent as more fully set forth in this Agreement.

(d) In addition to the required consents or approvals referred to in this Section, Agent may at any time request instructions from the Banks with respect to any actions or approvals which, by the terms of this Agreement or of any of the other Loan Documents, Agent is permitted or required to take or to grant without instructions from any Banks, and if such instructions are promptly requested, Agent shall be absolutely entitled to take or to refrain from taking any action or to withhold any approval and shall not have any liability whatsoever to any Bank, Borrower or any Borrower Party for taking or refraining from taking any action or withholding any approval under any of the Loan Documents. In the event that Agent requests instructions from the Banks with respect to any matter as to which, pursuant to the express provisions of this Agreement, the Agent is required to act in a reasonable manner, then the Banks shall also act in a reasonable manner with respect to their instructions to Agent as to such matter. Without limiting the foregoing, no Bank, Borrower or any Borrower Party shall have any right of action whatsoever against Agent as a result of Agent acting or refraining from acting under this Agreement or any of the other Loan Documents in accordance with the instructions of the Required Banks or, as applicable, all Banks and each Bank, severally to the extent of its Percentage, hereby agrees to indemnify Agent against and hold it harmless from any and all loss it may incur by reason of taking or refraining from taking such action. Agent shall be fully justified in failing or refusing to take any action hereunder and under any other Loan Document unless it shall first be further indemnified to its satisfaction by the Banks ratably in proportion to their respective Commitments against any and all liability, cost and expense that Agent may incur by reason of taking or continuing to take any such action. If any indemnity or other assurances furnished to Agent for any purpose shall, in the reasonable opinion of Agent, be insufficient or become impaired, Agent may call for additional indemnity and cease, or not commence, to do the action indemnified against until such additional indemnity is furnished. Under no circumstances shall Agent be required to take any action that Agent in good faith believes (i) could reasonably cause it to incur any loss, or (ii) is in violation of any Legal Requirement.

(e) All communications from Agent to the Banks requesting the Banks' determination, consent, approval, or disapproval (i) shall be given in the form of a written notice to each Bank, (ii) shall be accompanied by a description of the matter as to which such determination, consent, approval or disapproval is requested, and (iii) shall include the recommendation of Agent. Each Bank shall reply within five (5) Business Days after request for approval, or such lesser time as may be reasonably determined by Agent due to time constraints in the Loan Documents (or other relevant factors) and specified in the request for approval. In the event any Bank fails to reply to a request for approval from Agent within five (5) Business Days or such lesser time, such Bank shall be deemed to have approved (and voted in favor of) Agent's recommendation with respect to any matters set forth in the request.

Notes

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