

REAL ESTATE FINANCE - 30 NOVEMBER 2016

The long-awaited LMA real estate finance security document

First published by LexisNexis 24/11/2016

The long-awaited Loan Market Association (LMA) security agreement for real estate finance transactions has arrived. Jacqueline Cook, member of the Lexis®PSL Banking & Finance consulting editorial board and senior professional support lawyer, in the finance practice of Stephenson Harwood, LLP, London sets out her views on the document and the key points to consider.

Original news:

Updated LMA leveraged finance documents and new REF security agreement, LNB News 18/11/2016 *The LMA has issued revised forms of term sheet, senior facilities agreement, intercreditor agreement and hedging letter for leveraged acquisition finance transactions. The LMA has also launched a new security agreement intended for use on real estate finance (REF) transactions. Both initiatives are in response to demand from participants in the syndicated loan market, who felt the projects would be beneficial for the market.*

Q: What form does the new LMA REF Security Agreement take and how does it fit into a typical REF transaction structure?

PSL practical point: *In this News Analysis, capitalised terms are terms used as definitions in the REF Security Agreement*

A: On 21 November 2016, the LMA announced that its long-awaited security agreement for REF transactions had been published on the LMA website. This is a security agreement by one chargor granting security over a number of assets using different methods of granting security to a security trustee for a syndicate of lenders governed by English law.

While it is called a 'Security Agreement' it is, in a fact, in the form of a deed and assumes that the chargor will execute as a deed but the Security Agent, as the security trustee is defined, will execute under hand. These terms reflect the current practice in the REF market. It assumes that the chargor is either a borrower or guarantor under the facility agreement so some terms are not duplicated in the security agreement itself but brought in by reference. It also assumes that the chargor has a variety of assets, so this document is effectively purporting to create security over what could be all or substantially all of the assets of the chargor, which as we know, is very important if an administrator has to be appointed at any time.

Q: What are the key charging provisions of the LMA REF Security Agreement?

A: On the whole, this is a well drafted, simple security document using plain English, which is set out in a logical manner and is pretty close to the form of security agreements in the market. The key terms on taking security are set out in clause 2 (Creation of Security).

- Clause 2 sets out the general terms applying to all the security and is fairly common now in the market, e.g. the security is granted to the Security Agent, to cover the Secured Liabilities with full title guarantee to bring in the implied covenants from the Law of Property (Miscellaneous Provisions) Act 1994.

- As expected, it then takes each type of asset in turn and sets out the most appropriate method of security for it e.g. for land, a charge by way of first legal mortgage over property including buildings, fixtures, fittings, fixed plant and machinery. For other assets there is a fall back provision, e.g. for a mortgage of shares in any member of the group, and if not secured that way, a first fixed charge over the shares and any other Investments.
- Security over credit balances and bank accounts are taken separately. This recognises that there are blocked accounts in a REF transaction which have a fixed charge created over them. While there is also a fixed charge over the General Account it is recognised that there could be a possibility of the security being recharacterised from a fixed into a floating charge depending on the actions of the parties. Book and other debts including specifically the Subordinated Debt for REF deals are also to be subject to a fixed charge.
- Assignment is the method of choice for security over Insurances, Hedging Agreements, Lease Documents, Rental Income and Relevant Contracts and other agreements and contracts, but all subject to re-assignment on redemption.
- A miscellaneous provision then casts a fixed charge over goodwill, authorisations and uncalled capital.
- A first floating charge over all assets not otherwise secured tops it off, giving the remedy of appointment of an administrator as one route to enforcement.

In some ways this is all as expected and pretty cleanly and simply drafted.

Q: Are there any nuances in the LMA REF Security Agreement that the parties should consider?

A: Floating charge

The floating charge will only crystallise automatically into a fixed charge if an administrator is appointed or the Security Agent receives notice of an intention to appoint an administrator. This is a departure from a number of security agreements in the market which list several events for automatic crystallisation many of which are linked to insolvency related events or enforcement of security. Instead the Security Agent, which of course is acting on the instructions of the Majority Lenders, will have to be more astute on giving notice to convert the floating charge into a fixed charge. It can do so when an Event Default is continuing or if it considers the assets to be in danger of being seized or sold under distress, attachment or other legal process. Now, is this a good move? I think this is a practical move. There are always questions about whether and how parties could know if a floating charge had in fact become fixed and even if it had, had the subsequent actions of the parties effectively undone the 'fixing'! This way it should be clearer to the chargor and the secured parties whether at any point a floating charge has been crystallised, principally by notice and converted into a fixed charge. Lenders and Security Agents will need to be more alive to this issue now. I would add that as the events which may have previously triggered an automatic crystallisation are likely to be within the list of Events of Default, there should in practice still be the same triggers but now they need action in the form of notice from the Security Agent to render the floating charge fixed.

Related Rights

Rights attaching to other assets have for some time in the security documentation been listed out or defined as, e.g. Related Rights. This Security Agreement quite neatly, in the interpretation provision, states that rights includes amounts and proceeds paid and payable, rights to make a claim and powers, security and guarantees deriving from it. For shares, of course the question relates to dividends, so again neatly, a share, stock, debenture, bond, other security or investment includes dividends and other distributions and rights of redemption, exchange, bonus and option and other rights. Voting rights are dealt with separately in the body of the document. The market position adopted is that these are exercisable by the Chargor or by the Security Agent on the directions of the Chargor, until an Event of Default is continuing which is when the Security becomes enforceable. After that the Security Agent

can exercise them. Parties may look at whether there could be an earlier trigger on a Default, or a later one on a declared Default or Acceleration but at least this Security Agreement gives a clear market position.

Power of attorney

A power of attorney is included as expected which is really essential when a Chargor is not cooperative and in Default, so that the Security Agent can act to protect the assets. As there is a power of attorney with the document, it has to be executed as a deed.

Fallback trusts

There is no fallback trust included in case any of the security fails. Personally, I think there are often questions about whether that is really needed anyway and whether it works in a particular scenario depending on the jurisdictions in the transaction. So this way this is much clearer and focusses on the asset and the appropriate security device.

Release

As the drafting of this Security Agreement is more modern, simpler and tighter, some terms you may expect to see are not there. For example, in the Release clause, there is no mention of any re-assignment for any interests which have been assigned in security. Instead it says 'the Finance Parties must...take whatever action is necessary to release the Security Assets from the Security'. This does work but when using the document, parties need to be aware of the relevant release mechanism.

Representations and warranties

There are no representations and warranties or undertakings from the Chargor in the Security Agreement as it assumes the Chargor has given these in the Facility Agreement. This means that if there are specific provisions needed for the assets being secured then these have to be negotiated as part of the Facility Agreement negotiations.

Enforcement and Jurisdiction

In the same way, the Enforcement or Jurisdiction clause submitting to the courts of England and Wales, or as the LMA REF facility agreement now says, the courts of England, has been omitted on purpose to keep the document shorter and the provision in the related Facility Agreement will apply. While this seems logical, particular drafting requirements could be missed where there is a cross border transaction or even across the different jurisdictions of the UK. Where this document may be adapted for other sectors or any cross jurisdictional transaction, it would be clearer to reinstate the jurisdiction clause to show the intention of the parties.

Notices of charges and assignments

Notices of the charges and assignments have been included as samples in the schedules, with forms of acknowledgements. Having seen a number of notices, during my career, from extremely simple to very complex which are almost additional contractual terms, I don't think there really is a market form of a notice or acknowledgement. To this end, this is a welcome position from the LMA. I do think however that this is an area where the sector, the client and even the lawyer crafting the notice and acknowledgement could affect the wording. Definitely one to review carefully in relation to practice and also to make sure that any rights or concessions given do not render a fixed charge into a floating charge.

Financial collateral provisions

Financial collateral provisions are there, as you would expect but a simpler valuation methodology is included, so in some cases, again depending on the extent of the assets constituting financial collateral, parties may look at enhancing the valuation wording and the parties involved in arranging it.

Drafting and definitions

Watch out for other changes from the LMA on definitions e.g. Security and Delegate, to make sure that the new and current definitions all fit together especially if you are already negotiating a draft when LMA changes are announced.

Q: What is likely to be the market response to this long-awaited security document? Could the LMA REF Security Agreement have a wider appeal beyond the REF market?

A: Absolutely! In my own experience lots of other sectors base documentation on LMA documents as a market position. The announcement some time ago that there would be a market LMA security document of some description was met with relief as it would be more efficient if the market (and here I think this is the wider syndicated loan market rather than just the REF market) had a standard form to reduce the time negotiating a document which should in some way be mechanical, once the commercial decision on whether security is to be given and over what had been reached.

Other sectors involved in finance transactions and taking security, I expect will take the document and link in their own definitions and main document, whether that be a facility agreement or a lease and tailor it for specific assets. I also envisage that this Security Agreement will be dissected and used for separate security documents over shares, accounts, or assignments of contracts using LMA formatting and boilerplate, and of course all the provisions relating to enforcement and receivers.

I would not be surprised if LMA drafting even starts to appear in security documents from other jurisdictions as the market looks for conformity to increase efficiencies. All in all a good job from the LMA, long-awaited yes but I think it will become a market standard and be used in REF transactions and slowly be adapted and used in lots of other finance transactions.

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Jacqueline Cook has been in practice for over twenty years in various areas of banking and finance. She is currently a member of the Lexis®PSL Banking & Finance Consulting Editorial Board and is involved with the Secured Transactions Law Reform Project.

How we can help?

For further information please contact either Jacqueline Cook or members of our real estate finance team.



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