CADWALADER

The Start of Summer

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We Can Work It Out: The Need for Pre-Negotiation Agreements

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In light of the current economic climate, real estate lenders and borrowers will certainly be communicating with one another frequently concerning potential loan modifications and accommodations. It is prudent for lenders to require that the parties enter into a pre-negotiation agreement, or a "PNA," as a sine qua non to having such communications.

A PNA is an agreement between a borrower and lender which sets forth the framework that will govern discussions surrounding potential loan modifications, accommodations or restructuring, without the lender forfeiting its ability to enforce the loan documents. Upon executing a PNA, the parties thereto are not bound by the ensuing discussions unless and until the terms of a proposed modification have been documented in a formal written agreement executed by the necessary parties. In addition, a PNA provides comfort to a lender that the borrower will acknowledge the validity and enforceability of the loan documents.

The main purpose of a PNA is to maintain the status quo between the parties and ensure that the borrower cannot use the negotiations to oppose any of the lender's efforts to enforce the loan documents or assert any claims against the lender on the basis that throughout the course of negotiations, the lender committed to modifying the loan documents or that the parties' correspondence itself constitutes a modification. Without a PNA, the parties may be hesitant to engage in productive discussion for fear that correspondence, emails, representations or statements made in the course of negotiations could be used in future litigation. Even if ultimately unsuccessful, a borrower claiming that it relied on lender's statements to its detriment in believing the lender committed to any modifications would be prejudicial for the lender.

The obvious parties to a PNA are the borrower and lender, but it is also typical for lenders to require existing guarantors under the loan to join or acknowledge the PNA. From the lender's perspective, it is crucial to prevent guarantors from making any claims similar to those of the borrower against the lender. In addition, lenders are always careful to protect against claims by guarantors that they are discharged due to suretyship arguments that the underlying transaction was modified without their consent. A PNA serves as a potential defense to lender liability claims and could thus save lenders from time-consuming and costly litigation.

PNAs will include provisions necessary to maintain the status quo throughout the course of negotiations. This normally takes the form of an agreement that negotiations, including all communications, discussions, meetings, e-mail or other correspondence, are non-binding until a formal, written agreement is executed by all parties and that either borrower or lender may terminate the discussions at any time. Lenders should also have the borrower acknowledge its current obligations under the loan documents, agree that the loan documents remain in full force and

effect, and that neither party waives any of their rights, remedies or obligations under the loan documents.

While a forbearance agreement may be entered into in the course of workout discussions, it is imperative that lenders do not agree to forbear loan enforcement or otherwise modify existing loan terms by the PNA itself. Having entered into a PNA prior to the negotiations surrounding a forbearance agreement provides those discussions with the same protections of the PNA.

PNAs can also include confirmation of who has the authority to negotiate and agree to terms on behalf of the borrower and guarantors. In the context of a syndicated loan, the administrative agent enters into the PNA, which would cover discussions between both borrower and the administrative agent or the other lenders in the syndicate, but typically provides that borrower can only discuss the loan with the administrative agent. If an asset is financed by both mortgage and mezzanine loans, each of the mortgage and mezzanine lenders should enter into separate PNAs with their respective borrowers and potentially with each other.

Some additional provisions that are beneficial to lenders and often included in a PNA are confirmation of the amount of debt, a release of claims against the lender caused by or arising out of the PNA, if the subject loan is in default, an acknowledgement of such default and waiver of defenses, confidentiality of discussions, and authorization for the lender to deal with other lienors without the possibility of raising the defense of tortious interference.

While seemingly adversarial, our experience is that PNAs have become fairly standard practice and do not engender significant negotiation. They have thankfully become a commonplace protection for all parties to workout negotiations and are, for the most part, universally accepted without excessive negotiation.

Given the present state of economic conditions, and the corresponding increase in potentially distressed commercial real estate loans, borrowers and lenders will likely be considering or already in the midst of discussions surrounding workouts or accommodations. Lenders should be prioritizing a PNA as a first step as soon as negotiations are anticipated and should endeavor to defer conversations until the PNA is entered into to limit their risk exposure.

The foregoing does not address all provisions contained in a PNA and only highlights some salient points. Care should be taken in the preparation, negotiation, execution and delivery of PNAs as a condition to any substantial workout discussion.

New 8th Edition CLLS Certificate of Title: What You Need to Know


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The City of London Law Society ("CLLS") Certificate of Title is a standard form document that is used in real estate financings to provide lenders with an overview and certain certifications of the properties they are lending against, such as certifying title to property.

On 9th May 2023, CLLS published its new 8th edition of its Certificate of Title, replacing the previous edition that was originally launched back in 2012 and subsequently updated in 2016.

The new edition of the certificate reflects the changing landscape and current market practices by including a number of key changes. We look to explore some of these changes in this article.

Focus on sustainability

A significant aspect reflected in the new certificate is the growing importance of sustainability in real estate investments and lending. Borrowers are now required to confirm that they hold Energy Performance Certificates ("EPCs") for the entire property, including stating the ratings and expiration dates of those EPCs.

This requirement will have increasing importance as regulations on minimum energy efficiency standards are expected to tighten up, with stricter penalties for non-compliance.

The new certificate assumes that letting documents will oblige tenants to share data with the landlord related to the environmental performance of the property. Furthermore, the updated certificate also assumes that borrowers will require their tenants not to undertake alterations that could adversely impact the property's EPC. However, in practice, this may prove more challenging for borrowers and their advisors, particularly in multi-let properties. Moreover, the reference to "environmental performance" in the certificate is not defined, which may introduce some ambiguity regarding the extent of disclosure required.

Changing landscape of leases

A further notable change in the new certificate is the amendments to the assumed terms in occupational leases, which look to rebalance the dynamics in favour of the tenants. Unlike the previous version, the new certificate acknowledges the inclusion of provisions in letting documents that allow landlords to elect whether to reinstate a property damaged by uninsured risk, and that if reinstatement does not occur, termination rights are granted.

The new certificate also assumes that rent payments are to be suspended in the event of uninsured damage. The tenant's repair obligation has also been updated to carve out damage caused by uninsured risk.

It is worth noting that while these provisions have been included with a view to align with emerging market trends, they are not universally present in leases, particularly in older agreements. It is therefore worth observing whether these changes will be adopted in new leases and whether they will become the new standard.

Closing thoughts

The 8th edition of the Certificate of Title is a significant development that reflects changing market practices. It is important for property-owning professionals to be aware of these changes and to understand how they will affect their businesses.

How to Prepare for a Real Estate Enforcement in Europe, Part 2 – The Importance of Valuation in Enforcements


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Former British Prime Minister Tony Blair once famously declared that "our top priority was, is and always will be education, education, education." To adopt this mantra in an enforcement context, for lenders the top priority should always be *valuation*, *valuation*, *valuation*.

Kicking off Part 2 of our mini-series on "How to Prepare for a Real Estate Enforcement in Europe," the focus turns to valuation. In Part 1 we detailed what steps lenders should take when preparing for a real estate enforcement. A key preparatory step is obtaining robust valuation evidence.

Valuation determines who controls the enforcement

A real estate enforcement typically involves a sale by a secured lender (or security agent on behalf of a club/syndicate of lenders) of a secured asset (or more often shares in a propco) and the application of the sale proceeds to the secured debt owed to creditors. The value of that secured asset, and where that value "breaks" in the capital structure of the borrower, will determine which of the stakeholders are "in the money" and which stakeholders are "out of the money."

Why is this important? Where the value "breaks" determines which stakeholders have an economic interest in the assets and are therefore likely to be able to control the enforcement process. They can do this because of the ability to "credit bid" secured debt claims. This involves bidding a release of the debt up to the full face amount of the claim. Unless a bidder emerges who is prepared to pay the full face amount of the secured debt in cash, the credit bidder will be the winning bidder in an auction for the secured assets. Issues may arise where value breaks close to the face amount of the debt being bid that will expose the bidder to a greater risk of the sale being challenged, and it will often be prudent in those circumstances to obtain independent valuation evidence (we have included a note on valuation challenges below). Although uncommon in practice, another scenario to contemplate is if the valuation shows that the value exceeds the secured debt. In this scenario the interests of the company (or junior creditors if there are any) will need to be considered.

Duties of secured lenders

Under English law, lenders have certain duties when selling secured assets. A key legal duty for lenders is to take reasonable care to obtain the best price reasonably

obtainable in the circumstances.[1] However, lenders are not required to delay the sale in the hope or possibility of obtaining a higher price in the future, especially if this mean the lenders would incur additional expenses by holding the asset.[2] A similar duty is imposed on receivers and administrators (although it has been argued that the duty is more stringent on these office-holders). The courts have been reluctant to prescribe what specific steps lenders need to take to satisfy the duty and, indeed, this duty will be assessed on a case-by-case basis. Despite this, lenders should always take steps to act reasonably to establish value before transacting to minimise litigation risk.

How value is established

Value is typically established either by: (i) obtaining a "book" valuation or (ii) through running an M&A/sale process of the asset. In many larger transactions the intercreditor agreement should also be reviewed, as it will typically set out certain fair value "safe harbours" that will allow the security agent to be deemed to have satisfied its duty of care to the debtor.

If a "book" valuation (sometimes called a "desktop" valuation) is obtained, the lenders should ensure that the valuation expert engaged is experienced in valuing the specific type of asset and is familiar with the market where the property is located. Demonstrating that the valuer has adequate expertise is important where the lender intends to rely on the valuer's advice. In some cases lenders will require some degree of cooperation from the borrower in order to obtain information necessary to undertake the valuation. However, lenders often have a general right to request information and often will want to make the provision of information a condition to any amendments or waivers sought by the borrower (see our discussion on waiver conditions in Part 1.) The valuation produced should be independent, supported by sound commercial judgment and able to withstand scrutiny from the company, other creditors and the court. A valuation guide such as the RICS "red book" may also be a helpful guide but is not necessarily determinative.[3]

If a sale process is pursued, this should be managed by an independent advisor (such as a real estate agent or firm of accountants). The process should be run before the enforcement is undertaken, perhaps as a condition to any waivers that may be requested by the borrower, although in some cases it may be necessary to do it in parallel or as an intermediate step following appointment of receivers or other steps to remove incumbent directors. As part of the sale process a range of trade and financial buyers should be contacted. The lenders should also seek advice on the appropriate method of sale – for example, querying whether sale by way of an auction is appropriate. The length of the process will differ depending on the financial position of the borrower. A typical sale process after enforcement might be as short as one to two weeks if there is a cash liquidity crunch. If there are no immediate liquidity issues, the process could be longer. In addition, a data room should be made available for prospective bidders.

Although there are conflicting authorities on whether book valuations or sale processes carry greater evidential value, the general consensus is that because a sale process produces a "real" valuation with real bidders invited to participate, it should generally be afforded greater weight than a book valuation, which is inevitably a theoretical exercise.

These considerations relate to the position under English law. Lenders will need to take specific advice when looking to enforce in European jurisdictions regarding their legal duties and any valuation requirements. However, the key takeaway for lenders is that to reduce litigation risk they should run an open and transparent sale process, with broad marketing of the asset and following the advice of the investment bank or accounting firm managing the process. Risks will arise when lenders try to limit the information published to bidders, or limit the universe of parties invited to bid.

Valuation challenges

When lenders take enforcement action there is always the risk of challenges from stakeholders, such as junior creditors and the borrower. Challenges in enforcement often turn on valuation. For example, a junior creditor at risk of being "out of the money" might put forward competing valuation evidence to try to establish that they are "in the money" to get a seat at the table. It will be important to analyse any such competing valuations on their merits during negotiations to assess whether the assumptions and methodology employed are appropriate for the property concerned and whether the lender's own valuation is sufficiently robust.

Another area ripe for challenge for junior creditors and borrowers relates to the lender's duty to take reasonable care to obtain the best price reasonably obtainable. While there is no legal obligation for lenders to make their valuation evidence available, there may be merit in disclosing assumptions and methodology in some cases to demonstrate the steps that the lenders have taken to discharge their duties and to quell any brewing challenges. This reinforces the importance of ensuring the lender retains suitably qualified and reputable professionals to undertake any valuation or M&A process.

Ultimately, the optimal route for lenders will be to appoint an insolvency practitioner, whether a receiver or an administrator (in the case of a propco), who will assume any risk of undervaluing the property in a sale transaction. We will look at this in more detail in our next edition.

[1] *Cuckmere Brick Co. Ltd v Mutual Finance Ltd* [1971] 1 Ch 949. Some of the cases refer to the obtaining of a "proper" price.

[2] *Silven Properties Ltd v Royal Bank of Scotland* [2003] EWCA CIV 1409.

[3] See *Swiss Cottage Properties Limited (in liquidation)* [2022] EWHC 1495 (Ch).

National Security and Investment Act 2021, Part 2 – Notification and Intervention Provisions


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In this month's edition of *REF News and Views* we are going to continue our series on the National Security and Investment Act 2021 (the "NSI Act") and discuss its notification and intervention provisions.

To recap, in last month's edition of *REF News and Views* we provided some background on the NSI Act and introduced some of its key features. In particular, the NSI Act establishes a mandatory notification requirement where a change of control occurs in relation to an entity with "specified activities" within any of the 17 designated sectors (which include Artificial Intelligence, Defence and Energy) (the "sensitive sectors").

Background

The NSI Act established a hybrid regime falling into two parts:

- a "mandatory regime": requires a person that acquires a specified level of control over a certain type of entity (a "qualifying entity") that undertakes particular activities in the UK in one of the sensitive sectors to notify, and obtain approval from, before completing their acquisition; and
- a "voluntary regime": allows parties to submit transactions for approval – and also allows deals to be called-in retrospectively even if not voluntarily notified.

Notifications are made to the Investment Security Unit (the "ISU"), which sits within the Department for Business, Energy and Industrial Strategy (the "BEIS"). The ISU operates the NSI Act regime (although this is performed in the name of the Secretary of State for Business, Energy and Industrial Strategy (the "Secretary of State")).

Real estate transactions or transactions involving real estate could fall within either the mandatory regime or the voluntary regime, depending on the specific circumstances of the transaction. If there is a trigger event in relation to a property SPV qualifying entity and that SPV carries on a particular activity in one of sensitive sectors in the UK, this will fall within the mandatory regime and require notification. We will explore this in further detail later in the series.

Notification and intervention framework

Mandatory notification

The test for a mandatory notification is broadly in two parts: (a) there needs to be a trigger event; and (b) the transaction needs to involve a qualifying entity.

The trigger events for mandatory notification are where a person gains control in a qualifying entity whereby:

- the percentage of the persons shareholding or voting rights held increases:
    - from 25% or less to more than 25%;
    - from 50% or less to 50% or more; or
    - from less than 75% to 75% or more; or
- the person acquires voting rights in a qualifying entity and, as a result, is able to secure or prevent the passage of any class of resolution governing the affairs of the qualifying entity.

Voluntary notification

Whether or not a transaction involves a target entity in a sensitive sector, there are trigger events which apply under the voluntary regime (which do not require mandatory notification).

Such events are as follows:

- the acquisition of material influence over a qualifying entity's policy; or
- the acquisition of a right or interest in, or in relation to, an asset of a certain type (a "qualifying asset") providing the ability to use or control the asset (either entirely or to a greater extent). A qualifying asset can include any tangible property, land, or intellectual property. Foreign entities and assets can be caught by the NSI Act regime if they have a connection with activities carried out in the UK, or the supply of goods or services to persons in the UK.

In these cases, parties need to consider whether a voluntary notification is advisable.

Connection with the UK

To fall within the NSI Act regime, a target entity or asset must be from, in or have a sufficient connection with the UK:

- a qualifying entity must carry on activities in the UK or supply goods or services to people in the UK; and
- a qualifying asset must be used in connection with activities carried on in the UK or the supply of goods or services to people in the UK.

The BEIS has published specific guidance on when target entities and assets outside the UK are within the scope of the NSI Act regime. It should be noted that the BEIS takes a relatively broad approach when determining this scope (assessments will also be fact-specific and may not be straightforward).

Call-in power

The Secretary of State has the power to produce what is known as a “call-in” notice if:

- it reasonably suspects that a trigger event has taken place in relation to a qualifying entity or qualifying asset; or
- if there are arrangements in contemplation, which, if affirmed, will result in a trigger event taking place in relation to a qualifying entity or qualifying asset.

If a call-in notice is served by the Secretary of State then an initial 30 working days’ assessment period is triggered during which the Secretary of State will investigate the transaction.

A transaction can be called in up to six months after the Secretary of State becomes aware of it (and up to five years after completion).

Prior to an acquisition or investment, an investor can therefore elect to make a voluntary notification to the ISU.

Closing thoughts

It is worth noting that, for real estate deals, the most important issue is whether the property is “in proximity to a sensitive site” (such as critical national infrastructure sites or government buildings or because of the intended use of the land). Assets may be subject to the regime where they are closely linked to the activities of the sensitive sectors or in other areas that are closely linked to those sectors. If so, a transaction can fall within the voluntary regime, but there is little guidance as to what comprises a sensitive site. Despite this, government guidance suggests that it rarely expects to intervene in asset transactions.

To the extent that any transaction involves a qualified entity or qualifying asset, parties and their counsel should factor in the impact of the notification requirements under the NSI Act on the deal timeline and transaction execution.

In next month’s edition of *REF News and Views* we will explore the sanctions under the NSI Act for non-compliance.

Molly Lovedale Named to Charlotte Business Journal's ‘40 Under 40’ List

Charlotte special counsel Molly Lovedale was recently named a 2023 honoree in *Charlotte Business Journal*'s 40 Under 40 program. The awards program, now in its 30th year, puts a spotlight on young professionals who are rising stars in their careers and communities.

Molly primarily represents financial institutions in connection with the origination of mortgage loans secured by commercial office buildings, retail properties, hotels, warehouses, and multifamily housing, including many multi-state, multi-property pooled transactions. She also has experience in the origination of mezzanine loans, the servicing and sale of mortgage loans, mezzanine loans and participation interests, and repurchase facilities.

In her profile published in *Charlotte Business Journal*, Molly noted that her greatest business accomplishment in 2022 was her work advising the banks on a $1.2 billion mortgage loan secured by 196 Extended Stay hotels in 22 states (including 15 hotels in North Carolina and 10 in South Carolina).

In addition, Molly listed as her greatest civic accomplishment helping her husband Andrew start a nonprofit called Access to Success (A2S), which is based in North Carolina but operates programs in Benin City, Nigeria. As Molly noted, “Last year, after years of planning and fundraising, A2S finished construction on and opened a 20,000-square-foot youth center in Benin City. The center serves 240 kids daily by providing them with a hot meal after school and extra academic support, including lessons in music, art, technology and entrepreneurship… I volunteer with A2S and support the organization with strategy, development and fundraising. In addition, some of the students that A2S works with in Nigeria have received scholarships to study at various high schools in the Charlotte area, and I serve as a mentor to these students.”

Molly also identified Cadwalader real estate partners Holly Chamberlain and Bonnie Neuman as her two most important mentors. “They are both accomplished and talented attorneys and, even more importantly, wonderful people and role models,” she said.

Exploring UK Regulatory Reform Amid Global Bank Failures

By **Alix Prentice**
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Given recent stresses in the global financial system and the associated high-profile bank failures, there has understandably been much attention focused on bank liquidity.

While this attention is clearly justified, the significant work to address issues surrounding prudential liquidity provisioning on foot since the global financial crisis of 2007/2008 should not be overlooked.
In this *Law360* article, we examine some of the prudential liquidity reforms implemented following the global financial crisis and the current status of the ongoing regulatory review in the UK.

We will also look at how, while the purpose of these measures is to ensure that banks create a "rainy day" fund to tap into in times of emergency, deploying these funds in times of stress is possibly easier said than done.

Read the article here.

LMA Publishes Model Provisions for Sustainability-Linked Loans

Cadwalader ESG Finance and Investment partner Sukhvir Basran collaborated with the Loan Market Association to create the SLL Model Provisions. Sustainability-linked loans ("SLLs") are one of the most important transition tools, and the launch of these provisions will continue to drive the growth of sustainable finance. You can read the LMA's press release here.

In addition, Cadwalader recently hosted a breakfast discussion with the LMA and LSTA with the aim of "Unlocking Sustainability-Linked Loans." During the session, Sukhvir was joined by the LMA's Gemma Lawrence-Pardew and the LSTA's Tess Virmani in a conversation addressing some of the most frequently asked questions raised by market participants in respect of SLLs. Click here to listen to the discussion. Click here to read a detailed summary.

Recent Transactions

Here is a rundown of some of Cadwalader's recent work on behalf of clients.

- Represented JPMorgan and Citi as lenders in a $140 million securitized mortgage loan to refinance the Soho Beach House, a private members club and hotel in Miami Beach.
- Represented the administrative agent in connection with a restructuring of a $280,790,000 mortgage loan secured by a hotel and casino in Las Vegas.
- Represented a bank lender on a series of structured participations that allow the senior participant to provide leverage to the junior participant in lieu of a traditional loan on loan.