Structural and Contractual Subordination

A comparison of the investment and financing structures set out in the Intercreditor Agreements for Real Estate Finance transactions of the LMA

Financial Markets Legal Update
18 May 2017

Jan-Joost van Rijsbergen
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- Analysis of Transaction Structures of the LMA Intercreditor Agreements
Introducing Jan-Joost van Rijsbergen

- A Dutch law qualified finance lawyer (University of Amsterdam, Grotius, ASRE)
- Previously at Clifford Chance, with secondments at Clifford Chance London and ING Bank
- Almost 16 years of experience in all areas of international finance transactions
- Specialises in all relevant asset classes of real estate finance (residential, retail, offices, logistics), including construction an development, alternative financing structures (A/B, NPL, Loan-on-loan) and the financing of hotels, healthcare and student housing
- Acted for Dutch banks, international and other (non-bank) lenders, as well as real estate and real estate debt investors
- Regular speaker at industry events and regularly involved in client education, presentations and trainings.
Benefits of using subordinated debt

- **Subordinated Lender:**
  - Higher risk, higher return
  - Providing a tailored solution for specific clients

- **Borrower / Investor:**
  - Ability to borrow more (higher LTV) may increase return on investment
  - Hybrid structures: shareholder loans treated as debt or equity?

- **Senior Lender:**
  - Reducing risk by creating and selling a junior tranche
  - Freeing up the loan book – enabling it to provide financing for other projects and/or to lend to other clients
  - Freeing up the balance sheet – enabling it to meet regulatory requirements and/or internal policy/strategy
Subordination under Dutch law I – claims I

- Key principle:
  - equality of creditors (*paritas creditorum*)
  - with only a limited number of deviations

- Artikel 3:277 lid 1 BW:

  *Schuldeisers hebben onderling een gelijk recht om, na voldoening van de kosten van executie, uit de netto-opbrengst van de goederen van hun schuldenaar te worden voldaan naar evenredigheid van ieders vordering, behoudens de door de wet erkende redenen van voorrang.*
Subordination under Dutch law II – claims II

- Subordination if agreed between parties (the debtor and (a particular) creditor)

- Artikel 3:277 lid 2 BW:

  Bij een overeenkomst van een schuldeiser met de schuldenaar kan worden bepaald dat zijn vordering jegens alle of bepaalde andere schuldeisers een lagere rang neemt dan de wet hem toekent.

- Claims of the junior creditor on the debtor will rank junior (are subordinated) to claims of a (group of) senior creditors on the debtor
Subordination under Dutch law III – security I

- Ranking of security determined by the moment of perfection:

- For example: Artikel 3:21 lid 1 BW:

*De rangorde van inschrijvingen die op een zelfde registergoed betrekking hebben wordt bepaald door de volgorde der tijdstippen van inschrijving, tenzij uit de wet een andere rangorde voortvloeit.*
Subordination under Dutch law IV – security II

- Change of ranking of mortgages:

- Artikel 3:262 lid 1 BW:

*Bij een notariële akte die in de registers wordt ingeschreven, kan worden bepaald dat een hypotheek ten aanzien van een of meer hypotheken op hetzelfde goed een hogere rang heeft dan haar volgens het tijdstip van haar inschrijving toekomt, mits uit de akte blijkt dat de gerechtigden tot die andere hypotheek of hypotheken daarin toestemmen.*
Overview of LMA publications for real estate finance

- April 2012: Loan Market Association publishes the form of “Single Currency Term Facility Agreement for Real Estate Finance Multiproperty Investment Transactions” and a users guide.


- June 2014: Loan Market Association publishes form of “Intercreditor Agreement for Real Estate Finance Transactions (Senior / Mezzanine)” and a users guide.

- November 2014: Loan Market Association publishes form of “Term Sheet for Real Estate Finance Multiproperty Investment Transactions (Senior / Mezzanine)”.

- August 2016: Loan Market Association publishes form of “Intercreditor Agreement for Real Estate Finance Transactions (contractual subordination only)” and a users guide.
Key intercreditor topics

- The “Acquisition”: step-in rights for the mezzanine lender and conditions for exercising step in rights (without triggering a (repayment obligation pursuant to a) Change of Control)
- Entrenched rights and decision making (amendments, waivers and consents)
- Cash controls
- Enforcement rights and standstill periods
- Distressed Disposals and Contractual value protection
- Distressed Property Management Initiatives
- Transferability
- Purchase & cure rights
- Hedging and the role and position of the hedge counterparty.
Transaction Structures I

Original LMA REF Intercreditor Agreement

The original LMA REF Intercreditor Agreement assumes a corporate structure as follows:

- The “Investor” owns the shares in the “Mezzanine Shareholder”
- The “Mezzanine Shareholder” owns the shares in the “Mezzanine Borrower”
- The “Mezzanine Borrower” owns the shares in the “Senior Shareholder”
- The “Senior Shareholder” owns the shares in the “Company”
- The “Company” owns the shares in the “Senior Borrowers”
- The “Senior Borrowers” own the “Properties”.

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Transaction Structures II

The new Intercreditor Agreement (contractual subordination only)

The new LMA REF Intercreditor Agreement (contractual subordination only) assumes a corporate structure as follows:

- The “Investor” owns the shares in the “Shareholder”
- The “Shareholder” owns the shares in the “Company”
- The “Company” owns the shares in the “Borrowers”
- The “Borrowers” own the “Properties”.
Transaction Structures III

Structural Subordination

Corporate structure:
- Investor owns Parent
- Parent owns Borrower(s)
- Borrower(s) own(s) Property/ies

Financing structure:
- Junior Lender (Mezzanine Lender) finances Parent
- Senior Lender finances Borrower(s)

Security structure:
- Mezzanine Debt covered by security granted by the Parent: shares, bank accounts and shareholder loans?
- Senior Debt covered by security granted by the Borrower(s): mortgage over the Property/ies, bank accounts, rental income, insurance and other assets the Borrower(s) may have.
- Contractual arrangement between Senior Lender and Mezzanine Lender?
Transaction Structures IV

A/B Structures

Corporate structure:
- Investor owns Borrower(s)
- Borrower(s) own(s) Property/ies

Financing structure:
- A-Lender (Senior Lender) finances Borrower(s)
- B-Lender (Mezzanine Lender) also finances Borrower(s)

Security structure:
- A-Lender and B-Lender are entitled to the same security package:
  - security granted by the Borrower(s): mortgage over the Property/ies, bank accounts, rental income, insurance and other assets the Borrower(s) may have.
  - if agreed, also security by the Investor(s) over the shares in the Borrower(s)
- A-Lender and B-Lender contractually agree who is entitled to proceeds of security (but also who may enforce / require enforcement, cure, standstill, voting etc.)
Transaction Structures V

Parallel Security

Corporate structure:
- Investor owns Borrower(s)
- Borrower(s) own(s) Property/ies

Financing structure:
- Senior Lender finances Borrower(s)
- Junior Lender (Mezzanine Lender) also finances Borrower(s)

Security structure:
- Senior Lender and Junior Lender are entitled to the same security package:
  - security granted by the Borrower(s): mortgage over the Property/ies, bank accounts, rental income, insurance and other assets the Borrower(s) may have.
  - if agreed, also security by the Investor(s) over the shares in the Borrower(s)
- However, security for the Senior Lender is first ranking and security for the Junior Lender is second ranking
- Contractual arrangement between Senior Lender and Junior Lender?
Analysis of the LMA Intercreditor Agreements

Financing structure

- Original LMA REF Intercreditor Agreement
  - Mezzanine Lender finances the Mezzanine Shareholder
  - Senior Lender finances Senior Borrower(s)

- The new Intercreditor Agreement (contractual subordination only)
  - Senior Lender finances Borrower(s)
  - Mezzanine Lender also finances Borrower(s)!
Analysis of Transaction Structures of the LMA Intercreditor Agreements

Security structure

- The new Intercreditor Agreement (contractual subordination only):
  - Senior Lender and Mezzanine Lender are entitled to the same security package:
    - security granted by the Borrower(s): mortgage over the Property/ies, bank accounts, rental income, insurance and other assets the Borrower(s) may have.
    - if agreed, also security by the Investor(s) over the shares in the Borrower(s)
  - Senior Lender and Mezzanine Lender contractually agree who is entitled to proceeds of security (but also who may enforce / require enforcement, cure, standstill, voting etc.)

- Original LMA REF Intercreditor Agreement:
  - Mezzanine Debt covered by security granted by the Mezzanine Borrower: shares in the Senior Shareholder, shareholder loans and bank accounts.
  - If agreed, the Mezzanine and/or Senior Shareholder grant security over shares in the Mezzanine or Senior Borrower (as the case may be) and shareholder loans to cover the Mezzanine and Senior Debt (as the case may be).
  - Mezzanine Debt and Senior Debt covered by security granted by the Senior Borrower(s): mortgage over the Property/ies, bank accounts, rental income, insurance and other assets the Senior Borrower(s) may have: Common Security!
Contact

Jan-Joost van Rijsbergen
Partner
T +31 20 722 2364
M +31 6 29 59 71 58
E jan-joost.vanrijsbergen@simmons-simmons.com
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