



## Alterations Provisions in Loan Documents

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In real estate financing, most loan documents restrict a Borrower's right to alter the collateralized real property. Alterations provisions in loan documents pertain to any alterations, improvements, or demolition of any improvements to the property. Since most real estate financing is non-recourse in nature, the Lender is rightly concerned that alterations to the collateralized property may impact the Lender's only asset in the event of a Borrower default. Even when a financing is not non-recourse, a Lender is also rightly concerned with alterations to the real estate collateral since it is looking, either wholly or partially, to that collateral as security for its loan.

In a typical transaction, alterations to the property which are above a threshold or are "material" or "structural" in nature will require the Lender's prior written consent. The threshold under which the Borrower may alter the property without the consent of the Lender is defined in the loan agreement as either a dollar amount or a certain percentage of the sum of the aggregate original principal amount of the loan. In addition, many loan agreements provide that the Lender's prior written consent is not required with respect to alterations that would not reasonably be expected to result in a material adverse effect, often defined as any event or condition that has a material adverse effect on the use of the property, the business of the Borrower, the enforceability, validity, perfection or priority of the lien of the mortgage or other loan documents, or the ability of the Borrower to satisfy any of its material obligations under the loan documents. Notwithstanding this threshold, many loan documents will list specific types of alterations that do not require the Lender's consent, some of which may include the following:

- repairs based on life safety or emergency conditions or which are required to comply with applicable legal requirements;
- preapproved alterations;
- non-structural or decorative work performed in the ordinary course of the Borrower's business;
- alterations made pursuant to an approved annual budget;
- alterations with respect to any existing lease as of the closing date; and
- alterations and repairs arising out of a casualty or condemnation.

While this list is not exhaustive, the specifics of a transaction will dictate the list of alterations that do not require the Lender's consent.

If the Borrower's requested alterations exceed the threshold amount, in addition to requiring the Lender's consent, the Borrower is required to post collateral as security for the completion of the work in a lien free manner. This may be in the form of cash, acceptable government securities, a letter of credit, or a guaranty executed by a guarantor in favor of the Lender. The Borrower's requirement to post collateral is to ensure that the parties completing the alterations are paid for their work and to avoid any liens on the property. Once the alterations are complete, the collateral is returned to the Borrower after the Lender is provided with lien waivers and a clean title report of the property.

Alterations provisions in loan documents are necessary to ensure the Lender is aware and consents to any major alteration projects. Constraints to alterations in favor of the Lender include consent, as well as the Borrower's requirement to post collateral once a threshold amount is exceeded. In non-recourse lending, alterations provisions in loan documents are essential to the Lender's protection of the collateralized property.