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REAL ESTATE FINANCE news and views

# Set for Summer?

# June 29, 2023

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# Forbearance Agreements: I Can't Help You With Your Troubles If You Won't Help With Mine

**June 29, 2023**

Given the current state of the market and many prognosticators writing about impending distress and doom and gloom, I thought it would be appropriate to dust off the topic of forbearance agreements. Forbearance agreements are sometimes used when a loan has gone into default or more often when a loan has matured and the parties want to discuss a potential refinancing, workout or restructuring without the uncertainty of an impending exercise of remedies.

So let's set the stage. A loan has gone into default or matured and the borrower wants to talk about an extension, imminent refinancing with the current or another lender, a workout or restructuring of the loan or other accommodation, and both the lender and the borrower are amenable to these discussions. However, the borrower insists that the only way they will engage in discussions is if the lender forbears from exercising its remedies for a period of time. Or the borrower just needs a short extension of time to arrange for a refinancing, and the lender is amenable to same rather than its exercise of remedies currently. There are many fact patterns where a forbearance agreement may be useful or appropriate, but caution should be taken to ensure that inadvertent consequences don't happen when this "simple" short-term arrangement is implemented.

First off, if a pre-negotiation agreement has not already been implemented, then the substance of such an agreement should be incorporated into the forbearance agreement. These parameters are typically noncontroversial and should not result in much or any negotiation. The pre-negotiation terms protect all parties and have over time become quite customary and accepted practice. Since the lender is agreeing not to exercise remedies, it is appropriate for the borrower to acknowledge the outstanding debt, acknowledge the event of default and/or maturity and ratify and confirm the loan documents. In addition, it is not unusual for the borrower to provide fairly robust representations and warranties which would include – in addition to the typical representations of formation, authority, no violation, reaffirmation of the loan document representations and enforceability – that there are no defenses to the borrower's obligations, in addition to others.

Now to the meat and potatoes: the forbearance. This is an agreement by the lender to forbear and refrain from its exercise of remedies pursuant to the loan documents against the borrower, guarantor or the property. The most important provision in a forbearance agreement is a specific date – a hard-and-fast outside date whereby the forbearance will end regardless of anything else that the document contains. Typically, the forbearance provision will have various events which will accelerate any conclusion of the forbearance, and many of these can be subject to competing claims. Consequently, there MUST be a specific, enumerated outside date that, regardless of any dispute, the forbearance will end. Unfortunately, over the years I have seen some agreements which fail to adhere to this maxim and consequently end up in protracted litigation as to whether a lender can even exercise its remedies when there has clearly been a breakdown in negotiations. Some of the more typical provisions whereby the outside date of forbearance would be accelerated would include: the further breach of the loan documents; any impact on material agreements such as ground leases, franchise agreements and the like; mezzanine lenders continuing to play ball; no further breach of representations; and no bankruptcy. Some of these provisions can tend to be drafted with a reasonableness or other standard where it may not be definitive absent a court determination whether the acceleration of the end of the forbearance has occurred. Consequently, care should be given that provisions whereby a forbearance ends are explicit without the need or ability of someone (*i.e.*, the borrower) to contest or dispute the acceleration. No lender should be in a situation where it is mired in months (or longer) of litigation as to whether it can exercise its remedies. Consequently, the agreement should be explicitly clear that if the forbearance ends, then the lender is free to exercise all remedies. Again this should not be left to implication but should be explicitly spelled out. Further to the forbearance period is that the lender should require that any statute of limitations period should be tolled by the relevant forbearance period.

Relevant to any forbearance agreement is how interest and default interest will accrue and be paid, and while these terms and provisions are the subject of much negotiation, there is some sympathy to the default portion of interest accruing since the parties are agreeing to forbear and maintain the status quo. In addition to interest provisions, it is not uncommon for forbearance agreements to contain various deal specific modifications, whether deferrals of payments, inclusion or waiver of financial tests or implementation or modification of cash management provisions.

It is also typical for these agreements to contain exhaustive bankruptcy provisions and waivers and detailed provisions attempting to streamline a lender's remedies upon an Event of Default. While seemingly onerous on their face, these provisions have become commonplace and are a reasonable accommodation for a negotiated delay and forbearance of the exercise of remedies by a lender.

Finally, in addition to extensive boilerplate provisions which should not be controversial, these documents will also contain typical ratifications and consents by any guarantors or other third-party affiliates such as a pledge by a related entity.

The foregoing is a short summary of forbearance agreements and does not purport to cover all relevant provisions. It is simply an overview of  important terms. As with everything, the devil is in the details.

# New EPC Regulations: What You Need to Know

**June 29, 2023**

By **Duncan Hubbard**
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Nearly 40% of global carbon dioxide **emissions** come from the real estate sector. With the rising focus on carbon emissions reduction and improving energy efficiency, it was inevitable that the UK government would turn to Energy Performance Certificate ("EPC") improvements as a vital element in achieving the goal of "net zero" by 2050.

In pursuit of this, new regulations regarding EPC requirements for existing commercial tenancies have now come into effect in the UK under the new Minimum Energy Efficiency Standard ("MEES") Regulations. This article explores what you need to know about the changes introduced by MEES.

**The Current EPC Position**

The current EPC rating system ranges from A to G, with "A" indicating high energy efficiency and "G" being the lowest rating. When MEES first came into effect in October 2016, it made it illegal for landlords to grant new leases on commercial properties with an EPC rating below "E."

**What's Changing**

As of 1 April 2023, the minimum "E" requirement applies to all "non-domestic private rented property." This means that it will be applicable to existing leases, not just newly granted ones.

In respect of all existing commercial tenancies, landlords will be prohibited from continuing to lease properties with a valid EPC rating of "F" or "G." That said, if the EPC rating of a leased commercial property was "F" or "G" but the term of that lease is continuing, even if the 10-year EPC certificate has expired the liability to carry out upgrade works up to a minimum "E" standard may not kick in until a new EPC is triggered. A new EPC is typically required where there is a new lease or renewal of an existing lease, when there is significant alternations or modifications made to a property, or during the sale of a property.

**Exemptions to These Changes**

There are **exemptions** to these new rules, and whether these apply will depend on the circumstances. If an exemption applies, the landlord (or an agent for the landlord) must register the exemption on the PRS Exemptions Register before it can be relied upon.

The exemptions include:

(a) <u>7-year payback exemption:</u> If the cost of necessary works to bring the property up to the minimum EPC standard would exceed the expected energy bill savings over a period of seven years.

(b) <u>Consent exemption:</u> Certain energy efficiency improvements, such as solar panels or external wall insulation, may legally require consent from local authorities or other third parties. Consent from superior landlord may be required where the landlord is themselves a tenant. If the landlord has made reasonable efforts to obtain consent but it has been refused or granted with conditions that cannot be complied with, this exemption may apply.

(c) <u>Devaluation exemption:</u> If a report from an independent RICS registered surveyor advises that implementing the relevant energy-efficiency measures would reduce the market value of the property (or the building it is a part of) by more than 5%, this exemption may be applicable.

(d) <u>New landlord exemption:</u> The regulation acknowledges that in certain circumstances a person may become a landlord suddenly. Examples of these include circumstances where the tenant becomes insolvent and the landlord has been the tenant's guarantor, a new lease has been deemed created by operation of law, or a lease has been granted due to a contractual obligation on a contingent basis. It therefore recognises that it would be inappropriate or unreasonable for them to be required to comply with the regulations immediately. Such exemption will last for six months, allowing landlords to bring their properties up to the required standard within the period.

Other than (d) above, these exemptions typically last for five years. It's crucial to note the expiry date and review the situation in time to avoid future penalties. Once the exemption expires, landlords must make efforts to improve the EPC rating to “E.” If achieving an “E” rating is still not possible, landlords must register another exemption and provide reasons why it was not feasible to attain the “E” rating.

**Where Properties Are Exempt from an EPC Altogether**

There are also certain circumstances where an EPC certificate is not needed at all. This applies if the landlord can demonstrate that the building is:

(a) Listed or officially protected, and to conform to the MEES requirements would “unacceptably alter it.”

(b) A temporary building used for 2 years or less.

(c) A detached building where the total floor space is under 50 sq m.

(d) Due to be demolished by the Seller/Landlord who holds all the relevant planning and building consents.

(e) Vacant and is:

(i) due to be sold or rented out;

(ii) suitable for demolition and the site can be redeveloped; or

(iii) if your buyer or tenant has applied for planning permission to demolish it.

**Closing Thoughts**

With the new MEES regulations in force, it is evident that the UK government is committed to driving energy efficiency and reducing carbon emissions in the commercial property sector. These regulations signal a significant shift towards achieving the “net zero” goal by 2050.

Landlords now face stricter requirements, with the minimum “E” rating applying to all non-domestic private rented properties. By prioritizing energy-efficient improvements, landlords can not only avoid penalties and adverse publicity but also contribute to a greener future.

As we move forward, it is essential for landlords to stay informed and adapt to future changes, as the government aims to further raise the EPC standards to “C” by 2027 and “B” by 2030.

# How to Prepare for a Real Estate Enforcement in Europe, Part 3 – Implementation (or Getting the Deal Done!)

**June 29, 2023**


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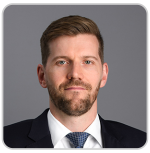

By **William Sugden**
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Having covered how to prepare for an enforcement in **Part 1** and stressed the importance of valuation evidence in enforcements in **Part 2**, the focus of our mini-series now turns to implementing the enforcement.

Let's imagine the following scenario:

There is a continuing event of default under the finance documents, negotiations between the lenders and the company have stalled, and the lenders no longer believe that the borrower can repay the loan. At this juncture, the logical next step is that lenders will be asking how they can enforce their security and how long it will take to get their money back. A headline point to stress in this situation is that implementing a real estate enforcement is not something which can be done at the drop of a hat. The planning and execution of an enforcement will always take longer than expected. Indeed, considering enforcement options for the first time when liquidity is "drying up" may disadvantage lenders. A well-planned enforcement should not be rushed.

**What Do You Need to Get the Deal Done?**

Each enforcement will look different. However, there are three key things that must be done in every lender-led enforcement:

1. Firstly, creditors need to agree what enforcement action will be taken. If there is a divergence of views between creditors, steps will need to be taken to bind in those dissenting creditors to the enforcement plan.

2. Next, the secured asset will need to be sold.

3. And lastly, to provide a "clean" sale, the claims of junior creditors (typically intercompany and shareholder loans) will need to be released.

We will now look at each of these in turn.

***Step 1: Bind Dissenting Creditors***

A key factor to iron out in the early stages of enforcement planning is working out what creditors want to do. While each creditor will want to have their debt repaid, it is not uncommon to see a divergence in opinion between creditors in how best to achieve this. The more complex the capital structure, the harder it will be to get all creditors on board with the proposed enforcement strategy, and this can have a negative impact on the ultimate recovery.

In simpler capital structures – for example, a lender club deal – getting consensus amongst all creditors to the enforcement strategy may be relatively straightforward. To minimise execution risk, best practice is for the creditors to document their agreement by way of a restructuring term sheet and a lock-up agreement. A lock-up agreement seeks to bind creditors into an agreed method of enforcement. It can be seen as something of an *agreement to agree.* The lock-up agreement and restructuring term sheet will typically address the following matters: (1) when default/acceleration notices will be issued; (2) whether, and what type of, insolvency procedure will be used to implement the enforcement; (3) funding; (4) how the asset will be sold – for example, marketing periods and the engagement of advisors; and (5) signing of key documents – for example, to release security interests.

In complex capital structures – for example, involving numerous and disparate bondholders – getting consensus will not be as easy and may not always be possible. In these situations, a way forward can be through utilising a statutory in-court restructuring procedure. In England, the two key court procedures in the restructuring "toolkit" are the Scheme of Arrangement and the Restructuring Plan. Both of these can be used to bind minority creditors who do not agree with the terms of a proposed restructuring. The Restructuring Plan can be particularly useful as it permits "cross-class cram-down." This allows a restructuring to be imposed on an entire class of dissenting creditors, providing that: (1) the court is satisfied that if the Restructuring Plan is implemented, none of the dissenting class would be "any worse off" than they would be in the "relevant alternative" (typically, the "relevant alternative" to the Restructuring Plan being implemented will be an insolvent liquidation); and (2) at least 75% in value of a class of creditors, with a genuine economic interest in the restructuring, vote in favour of the plan.

Until recently, the English courts were the main (and really, *only*) option in Europe if companies and creditors needed to bind-in dissenting creditors to a proposed restructuring. However, similar court-driven processes have recently been implemented across Europe, and "cross-class cram-down" is now available in several jurisdictions, including in the Netherlands with the WHOA Scheme, the German StaRug, the Spanish Restructuring Plan and the French Accelerated Safeguard procedures. Indeed, we are starting to see these regimes be put to the test – for example, in Spain through the *Celsa* restructuring, France with the ongoing *Orpea* matter and *Leoni AG* in Germany.

***Step 2: Sell the Asset***

Assuming enough creditors are on board with the enforcement strategy, the next step is to sell the secured asset. The typical path to recovery for real estate lenders is to exercise their rights under the security package they hold to sell the secured real estate asset. Typically, in a real estate enforcement, the creditors will hold a legal charge or mortgage over an asset which can be enforced to recover value. This sounds simple, but of course there's always plenty that needs to be considered.

Under English law there are three key remedies for lenders wanting to sell a secured real estate asset:

1. by the lender exercising power of sale; or
2. an administration sale; or
3. a receivership sale.

The appeal in each of these methods is that lenders can enforce without any (or, in the case of administration, minimal) court involvement, theoretically facilitating a more efficient path of recovery. Deciding which remedy is most appropriate will depend upon a number of factors and is something that will need to be considered by a lender's lawyers and financial advisors. One key factor is that a seller is under a legal duty to act in good faith and take reasonable care to achieve the best sale price reasonably obtainable at the time. Due to these duties, lenders are understandably very reluctant to be the selling party and in practice lenders will usually exercise their rights under the security documents to appoint an administrator or receiver (who are subject to a similar duty). The administrator or receiver will then be tasked with marketing the asset, negotiating the key transaction documents, completing the sale, and then applying the proceeds of sale to pay down the debt.

For lenders, appointing a receiver or administrator to sell the asset can be seen as something of a "protective buffer." It allows lenders to exercise a degree of control over the process while maintaining a safe distance from the risks and duties associated with the sale of the asset. There are certain advantages and disadvantages to the receivership and administration remedies. The receivership method is more of a private remedy, as the receiver is appointed by the secured lender and owes its duties primarily to its appointor. As such, receivership can be an efficacious enforcement option if lenders are seeking to sell a specific site or building. Administration is more public as it is considered a "rescue procedure." The administrator owes its duties to all of the company's creditors and is also required to prepare reports on the conduct of the directors, and whether the company has engaged in transactions that have breached applicable insolvency laws (whereas a receiver has no such duties).

As a final point, at the outset of the deal it is important that lenders understand what their "exit route" looks like and what enforcement options are available to sell the secured asset. These may differ considerably across jurisdictions, and lenders should always seek local legal advice to understand their options.

***Step 3: Release the Claims of Junior Creditors***

Lastly, when the asset is sold, it needs to be sold free of claims. This means that security granted by the company, and claims against the company, need to be released. The senior secured lenders will often be driving the enforcement bus. However, junior and unsecured creditors (often mere passengers on the bus) may be reluctant to release their claims to facilitate a sale, particularly if they feel they are being "short-changed." It may be possible for a consensual deal to be struck between junior creditors to release their claims for less than the full amount of their debt. If this kind of deal is not possible then recourse can be sought through an appropriately drafted intercreditor agreement. In any secured financing, the intercreditor agreement is a critically important document. An intercreditor agreement will set out the powers and duties of the various lenders involved in the financing, as well as the role of the security agent and its relationship with the lenders and the borrowers and the guarantors.

A key feature of an intercreditor agreement is the distressed disposal provisions, which set out the powers granted to the security agent by the parties to facilitate an enforcement. A well-drafted distressed disposal provision will empower the security agent to release the claims of junior creditors. Certain conditions will need to be met before the security agent can effect the release. These requirements will differ from deal to deal, but often the security agent is required to show evidence of value, for example by conducting a sale process or obtaining a valuation (for more information, see Part 2 of our mini-series **here**). There may also be requirements set out regarding the treatment of non-cash consideration.

**What's Next?**

If you have followed the series to date, you should now have an insight into: (1) how to prepare for a restructuring; (2) the importance of robust valuation evidence; and (3) key implementation considerations. However – we're not yet done! In our next (and final) article, we will cover challenges to enforcement and what lenders can do to protect themselves in these situations. And for those readers that make it to the end, we will even include an "Enforcement Checklist," summarising the *dos and don'ts*!

## National Security and Investment Act 2021, Part 3 – Sanctions for Non-Compliance

**June 29, 2023**

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By **Carl Hey**
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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 explore the sanctions under the NSI Act for non-compliance.

To recap, in last month's edition we discussed the notification and intervention provisions contained within the NSA Act. In particular, the NSI Act establishes a hybrid regime falling into two parts:

- a "mandatory regime," which 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 before completing their acquisition; and
- a "voluntary regime," which allows parties to submit transactions for approval, and also allows deals to be called-in retrospectively, even if not voluntarily notified.

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. As such, real estate investors should take note of the far-reaching sanctions and enforcement provisions contained in the NSA Act designed to ensure compliance.

**What Are the Sanctions for Non-Compliance?**

<u>Call-In Power</u>

As discussed last month, the UK's Secretary of State for Business, Energy and Industrial Strategy (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 of the transaction).

As a result of this risk, prior to an acquisition an investor may wish to make a voluntary notification to the Investment Security Unit of the Department for Business, Energy and Industrial Strategy. As noted above, this could include the acquisition of real estate assets.

<u>Enforcement</u>

Further, the Secretary of State has the power under the NSI Act to impose remedies to address any national security concerns or risks.

The NSI Act provides for:

- a transaction requiring mandatory notification to be void if completed without approval;
- the imposition of civil fines of up to the higher of £10 million or 5% of worldwide turnover for non-compliance, including competing a notifiable transaction without approval. This can include a "daily rate" fine (of up to £200,000

or 0.1% of turnover per day) to incentivise rapid compliance;

- civil enforcement, including injunctions to enforce compliance; and
- criminal sanctions for non-compliance (including completion of a notifiable transaction without approval, non-compliance with an order, or non-compliance with a requirement to provide information), with penalties including fines, imprisonment and disqualification as a director.

The statutory basis for offences under NSI Act can be found in **Part 3, Section 32-36 of the NSI Act**. Individual officers of a company may be guilty of an offence, as well as the corporate body itself.

Criminal Proceedings

The Secretary of State has the discretion to refer suspected offences under the NSI Act to the police for possible criminal investigation. This will usually be considered only in the most serious matters. Once a matter is referred to the police, all decisions in respect of investigation, charging and prosecution rest with the police and the Crown Prosecution Service.

**Overview of Orders Published To Date**

The UK Government has published **Guidance** on how to comply with the NSI Act and what can be expected if an individual or firm is subject to orders and notices.

Since the NSI Act came into force in January 2022, the UK Government has reviewed more than 800 transactions for possible national security concerns. The Secretary of State has **prohibited five transactions**, four of which involve Chinese investors and one involves Russian investment. At least two of the prohibitions (the acquisition of Newport Wafer Fab by Nexperia BV and the acquisition of Upp Corporation Ltd by L1T FM Holdings UK Ltd.) are reportedly under appeal.

**Closing Thoughts**

Whilst the vast majority of transactions reviewed under the new NSI Act regime are expected to be cleared without needing remedies, the new regime is far-reaching with serious consequences for non-compliance. Parties to transactions should keep this in mind and take note that a much wider national security review would be required than under the Enterprise Act regime.

In our next month's edition of *REF News and Views* we will discuss the NSI Act's impact on the real estate finance market.

# Chris Dickson and Molly Lovedale Named ALM Southeastern Award Winners

**June 29, 2023**


Cadwalader partner Chris Dickson and special counsel Molly Lovedale were named to the “On the Rise” honoree list at last week’s 2023 ALM Southeastern Legal Awards in Atlanta.

Chris was recognized for his work “as lead counsel to the lenders in transactions valued in the billions or hundreds of millions on a wide range of hospitality and other commercial real estate properties across the U.S.”

Molly’s profile noted her participation as a senior team member “in representing the lenders on multiple significant transactions – totaling $7.3 billion – across a range of high-value real estate asset classes.”

You can read about Chris, Molly and all the honorees **here**.

In addition, Finance Group co-chair Wes Misson, who also heads Cadwalader's U.S. Fund Finance practice, was named a “Most Effective Deal-Maker” by ALM. In its selection, ALM referenced Wes as being “the most prominent lender-side fund finance lawyer in the industry.” You can read Wes's profile **here**.