

Negotiation points of a commercial loan

By Tyler J. Carrell

When I tell people that a good portion of my practice is devoted to drafting and negotiating loan documents for commercial real estate financing, I sometimes receive a puzzled look. For many of us, when we apply for a mortgage, home equity line of credit, or other personal loan, the terms of that loan are nonnegotiable. For those loans, the only major decision a borrower makes is what bank to choose – which usually is based on the best interest rate and repayment terms that are offered. In a commercial context, it's more complicated. Here are some of the financial and nonfinancial considerations often negotiated in a commercial finance transaction.

LOWERING COSTS

While commercial financing has a lot of moving parts, a borrower is still concerned with lowering costs. The interest rate is certainly important, but it is not the only place where a borrower can incur costs. Many commercial loans include a "commitment fee," whereby the borrower compensates the lender for providing access to a potential loan, or more particularly, setting aside the funds for the borrower when the lender cannot yet charge interest. The commitment fee is generally either a flat fee, for example \$10,000, or a percentage of the undisbursed loan amount. Since this fee is typically due at closing, the borrower often tries to negotiate this amount down. Along this same line, a borrower frequently tries to reduce closing costs. Finally, when it comes to repayment, a borrower will negotiate down any fees or penalties for prepaying the loan. Prepayment penalties are fairly infrequent in a personal loan context, but can be costly for a commercial borrower.

LIMITING RECOURSE

As with personal loans, lenders providing a commercial loan often require a personal guaranty. While a borrower usually cannot avoid a personal guaranty entirely, they may be able to negotiate a limited guaranty or what is often referred to as a "bad boy guaranty." By signing a limited guaranty, the guarantor typically promises to guarantee the borrower's loan up to a certain dollar amount, for a limited period of time, or for only certain types of losses. A "bad boy guaranty" tends to be triggered not by mere nonpayment, but more serious acts by the borrower including fraud, misapplication of funds, an unauthorized transfer of the collateral for the loan, or a bankruptcy filing.

TRANSFERABILITY

Obviously, when a lender considers whether or not to offer a loan to a borrower, it has vetting procedures to determine if the borrower is likely to repay the loan. Since the lender has specifically offered the loan because of the borrower's solvency and management, the lender frequently includes

LEGAL EASE

strict limits on transferability in the loan agreement. For example, the lender may require that the borrower promise not to transfer, sell or otherwise change the ownership of the borrowing entity. As with any business, it may be beneficial for a borrower to bring in an additional owner or investor, or some corporate disagreement may lead to a principal wanting to sell his or her interest. Consequently, borrowers often try to limit the change in control restriction; usually by asking that a change in ownership in the borrower be permissible up to a certain percentage (i.e. the borrower cannot sell more than 40 percent of its ownership interest without the lender's consent).

LIMITING DEFAULTS

If the borrower violates the restrictions on transferability, such violation may be an "event of default" under the loan agreement. An event of default can have harsh consequences including, the loan balance becoming immediately due and the borrower being held responsible for the lender's fees and costs. Due to the many conditions a borrower must abide by under the loan agreement, a borrower often tries to negotiate less severe penalties for a default or otherwise limit what constitutes a default. A common request from a borrower is that it receives one, a notice and two, an opportunity to cure a default before the lender may enforce default remedies. A borrower will also try to soften the lender's remedies, including asking for reduced late fees, or a lower default interest rate. The lender may not be willing to budge on many of these requests. However, I often see lenders be more forgiving for nonmonetary defaults, such as failing to provide financial statements when required, than for a pure monetary default, such as missing a loan payment.

In summary, simply because the lender and borrower agree to enter a commercial loan agreement does not mean the parties are finished negotiating. The borrower, the lender and their respective attorneys draft and negotiate many aspects of the loan agreement, from incidental costs, to the form of the guaranty, to the borrower's ability to change its management structure or transfer the loan, to what constitutes a default under the agreement. These negotiations require attention to detail, thoughtful language and open communication between the parties. However, if performed properly, the resulting loan documents will make both the lender and borrower comfortable with the terms and pleased they entered the transaction.

— Tyler J. Carrell is an associate at Gallagher & Kennedy. For more info about Mr. Carrell, visit gknet.com.

PAID ADVERTISEMENT

REAL ESTATE CORNER
TUCKER BLALOCK

YOUR ARCADIA AND BILTMORE REAL ESTATE SPECIALIST

Arcadia and Biltmore - 3rd Quarter Review

Friends, summer has passed and we are getting into the best part of the year.... football and fall weather. I have been a die-hard Cardinals fan as far back as I can remember. Some of my fondest childhood memories were made watching the Cards play at Sun Devil Stadium during this time of year. I was always drinking the cool-aid (still am) and defending a team that was rarely (never) better than 6 and 10 each year. The past few years have been easier on us, but I still cringe at the sight of yellow and am way too understanding when we underperform...but in Arians we trust! Lets move along to real estate before I get too riled up.

The 3rd quarter looked a lot like the previous quarter as the housing markets in the Arcadia and Biltmore areas continue to normalize from the incredible rise that we saw from 2012-2015. While prices are staying steady, it is taking a little longer to sell homes. Buyers seem to be growing more cautious by the day and have been slower in writing offers than in the past. This is a healthy market in the fact that it is digesting its gains and getting back to a normal cycle. Healthy growth is good growth.

ARCADIA PROPER	Q3 2016	Q3 2015
NUMBER OF SALES	30	23
AVG. DAYS ON MARKET	119	93
AVG. PRICE/SQ.FT.	\$353	\$365
AVG. SALES PRICE	\$1,407,815	\$1,423,054

Arcadia's 3rd quarter was steady as she goes. Prices were consistent year-over-year, but houses took about a month longer to sell. Much like last quarter, I attribute this to overpriced sellers and buyers who are less eager than in past years. Last quarter, we saw 9 homes trade over \$2,000,000 while this quarter we were back to just 4 which is average for the area. I would expect these steady data points to continue over the next few months.

BILTMORE PROPER	Q3 2016	Q3 2015
NUMBER OF SALES	21	20
AVG. DAYS ON MARKET	126	158
AVG. PRICE/SQ.FT.	\$282	\$267
AVG. SALES PRICE	\$676,179	\$737,607

As you can see above, the Biltmore market continues to plod along as well. Similar to Arcadia, prices are steady, but homes are taking an average of 126 days to sell. Sellers in this market need to be priced right and then have the patience to wait for the right buyer. Buyers in the Biltmore tend to be very picky because it is usually going to be their forever home after downsizing. On the positive side, look for the snowbirds to drive some demand to this area in the next few months.

Enjoy this amazing Arizona weather and stay safe over the coming holidays. As always, I'm available to answer any questions that you may have about the market. Feel free to call or text me anytime at 602-561-0445.

Tucker Blalock

TUCKER BLALOCK
602-ARCADIA

BESPOKE
PROPERTIES

the
Suits

REALTOR

*All facts and figures are deemed reliable, but not guaranteed.
Per MLS on 10/11/2016.

