



**THE NEW LMA INTERCREDITOR  
AGREEMENT FOR USE IN  
REAL ESTATE FINANCE TRANSACTIONS**



## ON 10 JUNE 2014, THE LOAN MARKET ASSOCIATION ("LMA") LAUNCHED ITS NEW RECOMMENDED FORM OF INTERCREDITOR AGREEMENT FOR USE IN REAL ESTATE FINANCE TRANSACTIONS TOGETHER WITH A HELPFUL SET OF USER GUIDELINES

### INTRODUCTION

The LMA's Real Estate Finance Intercreditor Agreement ("ICA") is intended to be used in conjunction with the LMA's recommended form of single currency term facility agreement for real estate finance multi-property investment transactions launched in April 2012. It was put together by a working party consisting of representatives from banks, mezzanine finance providers and major City law firms, including DLA Piper.

It is important to note that the ICA is not a standard form to be followed slavishly for each deal. In particular, mezzanine finance providers may look to negotiate a greater degree of rights than those currently provided for under the ICA. Intercreditor principles should be agreed upfront between the parties and prior to the documentation process. We at DLA Piper would be happy to assist you in negotiating and drafting these principles.

Similar to the draft guidelines for intercreditor agreements in European commercial real estate finance transactions published by the Commercial Real Estate Finance Council (Europe) in November 2012, the aim of the ICA is to increase efficiency through standardising boilerplate terms and provisions and to reflect current market practice.

The starting point for the preparation of the ICA was the LMA recommended form of intercreditor agreement for leveraged acquisition finance transactions (senior/mezzanine) and has been prepared on the basis of an assumed corporate, loan and guarantee, security and subordination structure. However, there are differences in approach between that leveraged intercreditor agreement and the ICA to be aware of.

In the following briefing note, we have highlighted those differences and have also summarised:

- (a) the lending structure assumed in the ICA;
- (b) the key provisions; and
- (c) new, optional clauses for the parties to consider using.

### HOW CAN WE HELP?

DLA Piper's real estate finance team has a proven track record in acting for major international financial institutions, including investment banks, commercial banks, institutional lenders, insurance companies, private equity houses, pension funds and other lenders and investors in the property industry, as well as for sponsors and developers raising finance.

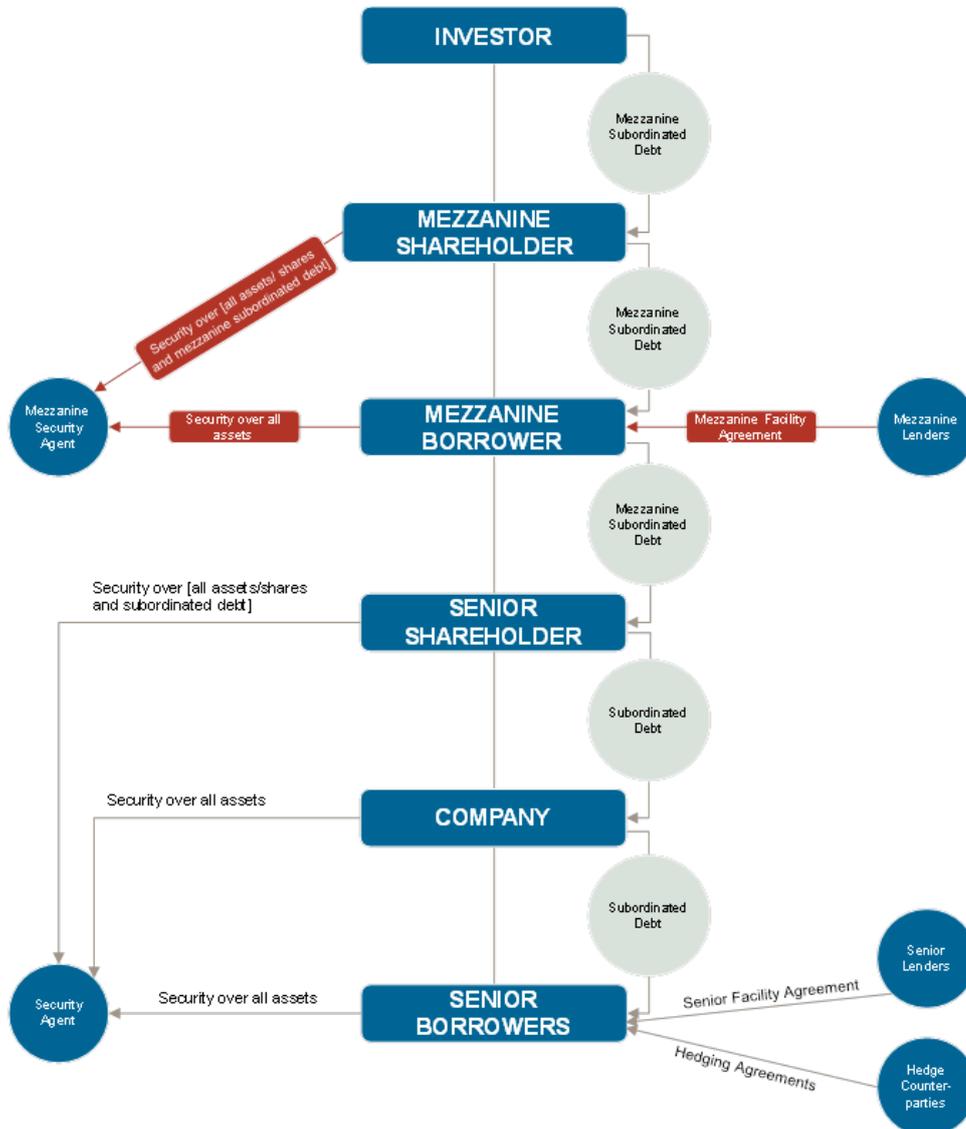
Our practice is a mix of structured, syndicated and bilateral lending nationally and internationally. We regularly guide our clients through some of the most complex and challenging intercreditor arrangements in the UK and Europe.

As the largest law firm in the world by number of lawyers, we are able to call on an unparalleled range of specialist skills from the firm's real estate, debt capital markets, corporate, tax, construction, restructuring and funds practices. This enables us to draw together bespoke teams for your transactions to ensure that all aspects are resourced with the highest level of expertise.

With offices in each of the main financial centres in EMEA, we are able to draw on real estate finance and local law capability in virtually every corner of EMEA. We advise on both local and cross-border transactions, to support clients wherever they do business.

## SUMMARY OF HYPOTHETICAL STRUCTURE UTILISED FOR THE ICA

The ICA assumes a hypothetical structure as set out in the diagram below.



### Loan arrangements:

The loan arrangements comprise a separate underlying loan agreement in respect of each of the senior facility (the "**Senior Facility Agreement**") and the mezzanine facility (the "**Mezzanine Facility Agreement**").

The borrowers under the senior facility (which are expected to be the owners of the underlying assets) are referred to as the "**Senior Borrowers**", and the borrower under the mezzanine facility is referred to as the "**Mezzanine Borrower**".

The mezzanine facility will be made available to the Senior Borrowers by way of downstream intercompany loans (a) from the Mezzanine Borrower to the senior shareholder (as depicted in the above diagram, the "**Senior Shareholder**"), (b) from the Senior Shareholder to the parent of the Senior Borrower (the "**Company**") and (c) from the Company to the Senior Borrowers. These intercompany loans are referred to as the "**Interco Loans**" and should be payable on a "*pay if you can*" basis, in order to avoid the Interco Loan claims pushing the Senior Borrower and/or the Company and/or the Senior Shareholder into insolvency. The ICA

is drafted on the assumption that the Interco Loans are drafted in a separate subordination agreement.

The consequence of the senior facility being advanced to the Senior Borrowers and the mezzanine facility being advanced to the Mezzanine Borrower is that the mezzanine creditors are structurally subordinated to the senior creditors, as well as contractually subordinated through the ICA.

The ICA assumes that the Company and each Senior Borrower guarantee both (i) the obligations of each Senior Borrower and (ii) the obligations of the Mezzanine Borrower, using a guarantee clause set out in each of the Senior facility Agreement and Mezzanine Facility Agreement. However, the mezzanine creditors are prohibited from enforcing the Senior Borrowers' guarantee until the senior facility has been repaid or enforcement action is being taken under the Shared Security (as defined below). The senior facility is not guaranteed by the Mezzanine Borrower.

#### **Security structure:**

The ICA assumes a security package that will comprise of the following:

- (a) **Shared Security**
  - (i) the Senior Shareholder grants security interests in respect of all of its assets (including the shares in the Company); and
  - (ii) the Company and each Senior Borrower grants security interests in respect of all of their assets (including the shares in each Senior Borrower and over the underlying real estate),

in each case in favour of a security trustee (the "**Security Trustee**") for both the senior creditors and the mezzanine creditors.

The security interests granted to the Security Trustee are referred to as the "**Shared Security**". The Shared Security is to be held and applied according to the ranking and waterfall provisions of the ICA but the general rule is that the senior creditors rank ahead of the mezzanine creditors and the mezzanine

creditors are subordinated to the senior creditors.

- (b) **Mezzanine Security**
  - (i) The Mezzanine Borrower and its parent will grant security interests in respect of all of their assets (including the shares in the Mezzanine Borrower and the Senior Shareholder) in favour of a mezzanine security trustee (the "**Mezzanine Security Trustee**") for the mezzanine creditors.
  - (ii) The security interests granted to the Mezzanine Security Trustee are referred to as the "**Mezzanine Security**" and are granted for the benefit of the mezzanine creditors only.

### **KEY PROVISIONS OF THE ICA**

#### **Standard ICA provisions**

The ICA incorporates features that are usually included in traditional intercreditor arrangements on the basis that the starting point for drafting was the LMA's leveraged finance intercreditor agreement. These include (but are not limited to):

- (a) **Ranking of debt:**
  - *Firstly* the senior liabilities and hedging liabilities *pari passu*.
  - *Secondly* the mezzanine liabilities.
- (b) **Ranking of Shared Security:**
  - *Firstly* the senior liabilities and hedging liabilities *pari passu*.
  - *Secondly* the mezzanine liabilities.
- (c) **Mezzanine enforcement action:**
  - Not permitted unless the senior creditors have taken action in which case the mezzanine creditors may take the same action.
  - Inclusion of limited cure rights available to mezzanine creditors to

cure defaults under the Senior Facility Agreement.

- (d) ***Shared Security enforcement action:***
- In general, only on the instructions of the majority senior creditors.
- (e) ***Permitted payments to mezzanine creditors:***
- In general sums other than principal are permitted provided there is no default under the Senior Facility Agreement.
- (f) ***Payment waterfall from amounts received by the Security Trustee:***
- *Firstly*, sums owing to the Security Trustee.
  - *Secondly*, enforcement costs incurred by the senior creditors or mezzanine creditor.
  - *Thirdly*, senior liabilities and hedging liabilities in accordance with the terms of the Senior Facility Agreement.
  - *Fourthly*, mezzanine liabilities in accordance with the Mezzanine Facility Agreement.
  - *Fifthly*, any person required by law.
  - *Sixthly*, the debtors.

As an overarching principle, the ICA recognises that the mezzanine creditors are structurally subordinated to the senior creditors.

## New optional provisions

There are however some material differences to the LMA's leveraged finance intercreditor agreement, including the following options available to parties in the ICA:

- (a) ***Mezzanine creditor cure rights*** - restrict enforcement of the senior creditors to allow the mezzanine creditors to remedy certain events of default under the Senior Facility Agreement.
- (b) ***Acquisition*** - allows the mezzanine lenders during a mezzanine standstill period to enforce separate Mezzanine Security to effect an acquisition of shares in the Mezzanine Borrower or Senior Shareholder without triggering a change of control event in the Senior Facility Agreement.
- (c) ***Distressed property management initiatives*** - permits the Security Trustee to authorise certain actions which may otherwise be restricted by the terms of the Mezzanine Facility Agreement.

## Some traditional provisions omitted

Some traditional leveraged finance concepts have not found their way from the LMA's leveraged finance intercreditor agreement in the ICA such as the option for the debtors to acquire liabilities, the stopping of payments to mezzanine creditors by way of a "mezzanine stop notice regime", equalisation of recoveries as between the senior lenders and the hedge counterparties (now dealt with in the Senior Facility Agreement) and the facilitation of a refinancing of the senior liabilities.

## FURTHER INFORMATION



**Laurence Rogers**

Head of London Real Estate Finance  
T +44 (0)207 6272  
M +44 (0)7793 850 089  
[Laurence.rogers@dlapiper.com](mailto:Laurence.rogers@dlapiper.com)



**Toby Barker**

UK Head of Real Estate Finance  
T +44 (0)207 796 6778  
M +44 (0)7968 559 009  
[toby.barker@dlapiper.com](mailto:toby.barker@dlapiper.com)



**Paul Gray**

Partner, Finance & Projects  
T +44 (0)207 796 6549  
M +44 (0)7968 128 763  
[paul.gray@dlapiper.com](mailto:paul.gray@dlapiper.com)



**Christopher Chan**

Senior Associate, Real Estate Finance  
T +44 (0)207 153 7250  
M +44 (0)7971 142 303  
[christopher.chan@dlapiper.com](mailto:christopher.chan@dlapiper.com)

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UK switchboard: +44 (0) 8700 111 111

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