Don't Assume It's Assumable

by Francis N. Mastroianni and Matthew S. Tisdale

Francis N. Mastroianni is an associate in the Boston office of Goodwin Procter and can be reached at (617) 570-8715 or fmastroianni@goodwinprocter.com.

Matthew S. Tisdale is an associate in the Boston office of Goodwin Procter and can be reached at (617) 570-1813 or mtisdale@goodwinprocter.com.

In today's uncertain real estate debt market, a seller's ability to assign and a buyer's ability to assume existing fixed-rate loans can add value to a transaction for each party. Given the recent spike in interest rates, any fixed-rate borrowing within the last few years likely carries a lower interest rate than the rates available today. To the extent the outstanding debt is assumable, additional value exists in a property commensurate with the spread between the rate on the outstanding debt and the current market rate. This additional value would be shared in some proportion between the seller and the buyer in the transaction. A seller should see some increase in the sale price of its property; a buyer qualified to assume an existing loan should enjoy a competitive advantage in a bidding contest for the property because it would be willing to pay more for the property as a result of the lower debt cost. These benefits to both a seller and a buyer should motivate an original borrower to negotiate favorable assumption provisions when taking out a loan.

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To include assumption provisions in loan documentation, however, lenders must be accommodated. Typically, this includes a fee – usually between 50-100 basis points, plus costs. But, the accommodation can also come in the form of consent rights. Eliminating or, more likely, limiting lenders' discretion to withhold consent to a loan assumption is an important aspect of loan negotiation, and there are several specific provisions that a borrower should address during the loan commitment negotiation to maximize the flexibility of the loan assumption provisions.

QUALIFIED TRANSFEREES. Lenders require that any potential assignee of the existing debt meet certain creditworthiness and experience criteria prior to considering whether to consent to an assumption. Typically referred to as "Qualified Transferee" or "Eligible Assignee" clauses, these provisions give lenders the unfettered right to withhold consent to an assumption if a transferee is not qualified within the terms of the loan agreement. The clauses are often quite broad, requiring lender satisfaction with the proposed transferee's identity, experience, management ability, and creditworthiness. A borrower should negotiate this standard to one that is as objective as possible; to the extent subjective elements are included, the standard should be limited to one of reasonable satisfaction on the part of lenders. For example, lenders should consent if the reasonableness test is met and an appraisal supports a certain valuation of the property (e.g., if the appraised value is 120% of the price the seller paid).

In a push toward making the standards as objective as possible, a borrower can go even further by including specific criteria deemed to constitute a "qualified transferee," which do not require lender analysis or discretion. For example, a qualified transferee might be required to be a pension fund, pension fund advisor, insurance company, or public or private company, and have significant assets, properties under management, or net worth. In securitized loans, common requirements include the potential assignee: (i) having a long-term unsecured debt rating of at least investment-grade from an acceptable rating agency; (ii) owning and operating a certain amount of comparable property (e.g., 5 million square feet or 10 class-A office buildings); (iii) having a net worth of at least $500 million; and (iv) controlling real estate equity assets of at least $1 billion. The required monetary values and amounts of comparable property will vary from loan to loan and borrower to borrower, but in almost all cases, the numbers are high.

In some cases, lenders may include so-called "morality" clauses. A typical morality clause states that the prospective transferee (and its principals and affiliates) must have never defaulted on a loan or committed any "bad acts" in order to be eligible for consideration as a qualified transferee. Obviously, such clauses should be resisted during negotiations. In other instances, lenders require that a qualified transferee be a single-purpose, bankruptcy remote entity with independent directors, while also reserving rights to approve a qualified transferee's organizational documents.

REPLACEMENT GUARANTORS. For loans that are guaranteed, lenders will also require an assigning borrower to find a qualified replacement guarantor of the loan before releasing the assigning borrower and any original guarantor from personal recourse for liabilities arising after the assignment. Lenders typically seek to reserve sole discretion to approve a replacement guarantor. However, a borrower's goal is to afford lenders little or no ability to deny the assumption of the loan in the future. Again, a borrower should try to make the requirements as objective as possible; the replacement guarantor provision should limit lender discretion and affix specific criteria, such as a minimum net worth test, as to what constitutes a qualified replacement guarantor.

OTHER CONSIDERATIONS. There are several other things to consider when negotiating a loan assumption provision. With securitized debt, rating agency confirmation is often required for a loan assumption. Though not typically negotiated, the lead time for obtaining confirmation can be 2-4 months. The challenge is to secure enough time to obtain rating agency confirmation when negotiating deadlines with the seller of the property. In addition, for a borrower that wants to ensure assumability, it must not allow its loan to be cross-defaulted with multiple properties or other loans.

Currently, the turbulent market lacks the readily-available access to low interest rate debt that was characteristic of recent years. As a result, the stage is set for a seller that obtains readily assumable loans to capitalize on the accretive value of these loans to its real estate assets when the time comes to sell. No matter what turn the market takes, a savvy borrower can maximize value and flexibility through the assumption provisions it negotiates in its loan documents.