Lowenstein Sandler's Real Estate Podcast: Terra Firma

Episode 13:
Financing Term Sheets: Bring in Counsel Early, Avoid Headaches Later

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Stacey Tyler: Welcome to the Lowenstein Sandler podcast series. I'm Kevin Iredell, Chief Marketing Officer at Lowenstein Sandler. Before we begin, please take a moment to subscribe to our podcast series at lowenstein.com/podcasts. Or find us on Amazon Music, Apple Podcasts, Audible, iHeartRadio, Spotify, Soundcloud or YouTube. Now let's take a listen.

Stephen Tanico: Welcome to Terra Firma conversations on commercial real estate. I'm Steven Tanico, joined by Stacy Tyler. Stacy Tyler and I are real estate attorneys at Lowenstein Sandler. And today's episode, we're going to be taking a little bit of a different approach. And although we might be focusing a little bit more on the technical side of the law and real estate, we still hope that you enjoy it with the same kind of carefree backyard barbecue approach, that we have tried throughout all these episodes.

Joining us today to discuss the negotiation of fulsome term sheets, today in the series focusing on loan commitment letters, is Kim Lomot, a partner at Lowenstein Sandler and North Carolina's biggest Buffalo Bills fan. Thanks for joining us, Kim.

Kimberly Lomot: No problem. Happy to be here with you guys.

Stacey Tyler: So today we're starting what we are envisioning as a series on term sheets generally. So as transactional attorneys, we are used to having the first step in any kind of deal, whether it's, a loan, a purchase, a lease, be a term sheet, that's where the parties are going to frame out their initial vision of what the deal is going to look like.

So we wanted to focus with you today, Kim, since you have such amazing experience in finance generally, especially specific to real estate, to just talk through what are the real big picture points that you want to make sure it's covered in a, financing term sheet or a loan commitment? What kind of things should people be thinking about at the early stages, and how specific does it need to get before you can feel comfortable signing it and getting, into the actual nitty gritty of the loan documents?

Because I think we, as attorneys, have all been in a situation where we're handed a signed term sheet by a client and, you know, it's only a half a page, and all of a sudden, we are having to negotiate really meaty business issues as attorneys. And that makes it take longer and costs more. And that's really not the best outcome for, for the client.

So to start off, I just wanted to see if you could talk a little bit generally about the value of a term sheet, what you like it to contain, and and kind of big picture what the client should be thinking about in the early stages of a deal.

Kimberly Lomot: Yeah. So I think you kind of hit it on the head earlier. And what you said is that sometimes we do get those term sheets by the time they come to us that are only one page and honestly, that's my worst nightmare. because it leads to problems later on. It leads to problems that you don't have enough of the meet and the deal terms, and a meeting of the minds between the parties that when I get loan documents.

Now, that negotiation process is so much more time consuming and, and really can end up, you know, end up not moving the deal forward because you don't have a meeting on a mind on some of the key points that should typically be addressed in a term sheet. you know, this goes back to not, you know, touting getting your lawyer involved.

And I know a lot of farmers don't like to spend the money upfront, but trust me when I say you will save money ultimately, by getting your attorney involved early and making sure that they're a part of that commitment letter negotiation process, even to the point of talking through with them the lenders that you're thinking about approaching or seeing if they know lenders that may be able to assist you with the type of financing that you're looking for.

I do that for clients all the time, because I've done a lot of these deals, and I know which lenders are willing to give loans for certain types of businesses and asset classes in certain locations that, you know, maybe trouble, have trouble finding. So I think the key is, yes, get your attorneys involved early so that they can help with that process to make sure that by the time you have engaged a lender, you're starting to go through that commitment letter process that you actually are getting all the terms in there that will be critical to then finalizing and negotiating a deal when you get the loan documents.

I will say over the last year or two or, you know, obviously it depends on the sophistication of a deal, but I am seeing much more fulsome term sheets. And I think that is a very good place to be because when you have that, you know that a lot of the critical deal points are already built into that term sheet.

And hopefully you negotiated with the bank with your attorneys involved so that that process, when it goes to spitting out the loan documents by the bank, it is a lot easier to then get to a finish line of negotiating them. So, I do think, you know, the key is to get the attorneys involved and what a benefit that that can be, you know, at the beginning of the process to get a commitment letter that, you know, is fulsome enough to ensure that everybody knows what the deal is and what the parties are agreed to.

And also, that the bank has a clear sense from an underwriting perspective of, you know, what the expectation is there. you get those half page term sheets that don't even get into enough descriptions of what the collateral is going to be. Are there going to be guarantees? I had a deal three weeks ago where I got a term sheet and it stated nothing about guarantees, and then I got the loan documents.

A week and a half later, and there were full payment and performance guarantees by individuals and corporations. That is a huge, huge business point and a point that clearly was not covered in the term sheet. And there was not a meeting of the minds on it. and it caused a huge problem with the lender. It held things up for weeks.

There was a lot of negotiating back and forth. There was a lot more underwriting that then had to be done from the credit perspective. Ultimately, they kept a corporate guarantee and dropped the individual guarantees. But, you know, it's just to say that that ensuring that all the key deal points get in a term sheet, you know, key can really just help you out and benefit you later on in that process.

Stephen Tanico: And I think there are a couple layers to this. Right. Because it's not necessarily that, you know, a term sheet needs to have every single legal term in it, but particularly the business terms, you know, the lacking of that, creates this ambiguity, right? Where then the lawyer goes to negotiate and suddenly, you're still negotiating. Major business points.

not only is a cost and time factor, but I feel like actually hurts a borrower's negotiation position because you spent so much time negotiating business points that are pure business points that could have been negotiated. The term sheet. And it ends up taking away from some of the nuance of the legal negotiation, because you end up having this dogfight over the business points.

And by the time you get to kind of the more nuance of the loan documents, everyone's so tired that you end up kind of giving and moving on just to get the deal done. Because of how long this took to negotiate relative to spending a little bit of extra time on the term sheet.

Kimberly Lomot: No, 100%. I mean, I see that all the time, unfortunately. I mean, I had an attorney tell me maybe a month or so ago on a financing deal. Well, you're going to negotiate this in the term sheet. Mind you, I didn't we didn't review the term sheet. By the time it got to us, it was here's the commit letter.

We just got draft loan documents. Now you're engaged to review them and you are you're eight ball. I mean, you're stuck because I had him say to me, well, that wasn't something that was negotiated. That's not my client's understanding. And it's almost as if I really couldn't make the argument at that point. You just lose a lot of leverage.

And you never want that, right? Especially when you're talking about, you know, risk allocation and real potential financial impact of those things. So you're right. Yeah. I mean, it puts you just in a bad spot to then try to renege, renegotiate those items.

Stacey Tyler: So so let's take a step back for a second. So I think we're talking quite generally, and I think a lot of what we're saying today is going to apply no matter what type of financing deal you're talking about, whether this is just a straight mortgage financing or maybe a construction loan. But I think probably a lot of our clients might think that once you decide on the like, the big-ticket financial terms, the rate, the term, etc., then that's kind of it.

And they can move on and they see things in a term sheet, like for instance, it might just say collateral, standard lender requirements or in accordance with lender standard practices or something like that. And they might think that's fine. those are the kinds of things that we as attorneys see and think now that it would it would help if you just spent a little time and a little paragraph there, tell me what you're really looking for.

So can you talk a little bit, Kim, about maybe those things that are one step beyond the, the right, the term, those big picture financial items and that you think really add value to the client's deal.

Kimberly Lomot: Yeah. So so one you hit on is collateral right. You want a very detailed description of the collateral. So the parties understand what's really being secured. it should be clear on the conditions, you know, in terms of the lender taking possession of the collateral, it should be clear, you know, if an assignment at least is and rents will be involved most times it is or is it going to be an all asset filing, you know, will they be will there be a security document that is also covering every asset that that company owns?

Now some people don't don't think that that's all just going to be a prerequisite, even though it's not listed in the collateral. And then we get to the loan docs and you're seeing that, okay, there is a security agreement, and you are giving it all asset filing. And maybe you have existing filings already out there. Maybe someone already has a lien against, some of your specific equipment that you needed to carve out.

You want that detail in there. So you have the full picture of what is going to be secured by this financing. and you can negotiate those things. You know, I see parties all the time, negotiate on collateral, where, okay, they're willing to give just just a mortgage and then an assignment of leases and rents because in their mind, this is just a true, you know, purchase money, mortgage financing, where you're buying a piece of commercial real estate and they're taking a win on that real property, but you are not giving in all asset filing or lien against the other assets owned by that entity.

So I think that's an important thing to negotiate the collateral. I think the guarantees that I mentioned earlier are really critical. you know, you obviously want, you want to have a deal, hopefully that's just secured by the real estate in a real estate context, you do not want to have to give a guarantee where either you could be on the hook personally, or, you know, a parent company or another corporate affiliate or entity is also going to be on the hook to give a guarantee because that's an exposure for them.

So I think guarantees are really important. I think if you're getting into, you know, guarantees too, are they going to be full payment and performance or are they going to be bad boy guarantees? there are a lot of different layers to types of guarantees and how and when they will come into play. That lawyers kind of become attuned to.

I think, negotiating, environmental provisions upfront and a term sheet in the event that this is an industrial site is critical. I mean, I can't tell you some of the term sheets I've negotiated where we know that there will be, you know, two industrial site that will, the operating activity will involve hazardous materials. At that point, it's really important to make sure you're honing in on, you know, what's going to be required of the lender.

You don't want to get all the way to the loan document stage and realize that they're requiring you to get a $10 million environmental insurance policy to cover their risk on a site. I, you and I, Stacy, have been there in deals. Yeah, we have seen this. you know, I've had that come up a lot. So, you know, I think that's another piece of it.

Stacey Tyler: And to be clear, every lender is going to start asking for the entire world and I think it's always important to remind our clients that the first draft of a loan commitment that you get from a lender is a starting point. Don't think that any of it is nonnegotiable and they're going to ask you to mortgage every single thing and give and all assets' filings so that everything is covered under their liens.

And like you're saying it's just important to remember you have the bargaining power to push back on that. You said you know, really this should only be you should be appropriately collateralized if you have XYZ. And if you feel uncomfortable making that argument just as a pure business person, then your attorney can help with that too. At the term sheet stage.

Kimberly Lomot: Yeah, 100%. And when you're when you're identifying potential lenders to go to, like, shop!

Shop around, make sure that you know you can do comparisons. I have a client who's so good with this and we have little matrix charts that they'll go to 2 or 3 lenders, and we will have comparisons of rate. We will have comparison of collateral. We will have comparison of financial covenants that the bank is requiring and where those levels are and what works best for the company.

And you can really think through, you know, what's important from the borrower side to make sure they get. Is it a lower rate? Is it less collateral? Is it not having to give a guarantee? All those things can come into play, and it's different for every client. And borrower, right. Because different things are important to different people. So you're right.

Like make sure that's a starting point and feel free to shop around a bit to ensure you're getting the best deal, especially if you're a credit worthy party, because banks do want to get money out the door. Obviously, underwriting is a lot more stringent these days, but they still want to do deals. So if they have a borrower or client who's coming to them that they know is creditworthy, there are going to make modifications and they will bend over backwards.

You'd be surprised when, you know, a mortgage broker or the attorney calls the party and says, listen, it's down to X and Y. You, this bank, in this bank or this private equity company in this if it's direct lending and say you give me your best and final offers here because, you know, we're going to make a decision.

I've seen a lot of changes to the benefit of the borrower come in those situations when you are able to kind of, you know, shop around a bit and play parties off each other.

Stacey Tyler: Can you talk a little bit about, so you brought up a few different types of financing sources and, you know, can you talk a little bit about the difference in negotiating posture that you can take against a, you know, typical national bank or, fund or some other kind of nontraditional financing sources?

Kimberly Lomot: Yeah. So the biggest difference I see probably. Right. So it depends why you're going to which option. Right. So institutional lenders are much more stringent under writing standards. Right. They a lot of times are like checking boxes. Right. So you're going to see much more finite requests, much more stringent. Ask but probably lower rate than if you were to go to a direct lender or a private equity company who is probably charging a higher rate but can get you around some of those institutional, somewhat archaic boxes checking requirements.

that you won't have to do there. So while you may pay a little bit of a higher rate, you may find that, that the documentation is less onerous. There require permits are less onerous, in terms of how they underwrote it because they're willing to be riskier. Right. you know, and that's why they're probably charging, you know, 1012, 14%, you know, so it's all about the appetite for that.

Two. Right? When I'm negotiating against an institutional lender, I know there are certain things I'm not going to get out of that they're going to want to do, especially from an underwriting perspective, like diligence items. Whereas you could be negotiating with a direct lender or a private equity company, and they're they're less inclined to go through that, that headache, because they don't have some of those underwriting requirements.

They're willing to take the risk that, you know, the property is going to cover itself from a appraisal perspective, right? Maybe you could provide an old appraisal. They're not doing new ones. Maybe they're not requiring you to get a brand-new phase one. That was within the last year. you know, all of those types of things can be beneficial, you know, so it's a weighing option.

But I definitely do take a different approach if I see an institutional lender and then coming in and negotiating that term sheet versus one that is a, that is with, you know, a hard money lender or a private equity company where really, they're willing to take a little bit more risk. So I'll be a little, more pushy in asking for removal of certain items.

And sometimes they're not just asking for items that an institutional lender would say, you're already kind of past that hurdle of trying to negotiate away from some of those items. So I, I do find that there can be different approaches depending on the type of lender that it is. and those are all things, honestly, to talk about to with, with your counsel because, you know, we have experience, we can kind of explain some of those things that we know that you probably don't have to do X, Y, and z with a non-institutional lender that you would with an institutional lender.

So you can have a little bit more flexibility.

Stacey Tyler: In going off of that point. At what time do you think it makes the most sense for most clients to bring in their attorney? I mean, they probably aren't calling you nine times out of ten. I assume they're not calling you before they even start shopping. Maybe they're calling you after they get a draft. I mean, when do you recommend that they reach out to you to let you know that they're thinking of doing this, financing?

Kimberly Lomot Yeah. So it's funny, I would say you're probably right. I would say two out of ten if they're if they're thinking about it, will actually mention in some sort of conversation we're having with them, maybe even on an alternate topic where they're like, hey, you know, we're going to look to finance this property now. They have built it out.

And, you know, we're looking for construction financing. Do you have any suggestions? Well, actually I do, because not many, you know, there are only certain lenders that are going to be willing to lend in that space. Right? There are a lot of parties who are are in the construction game right now just because they're sitting on the sidelines for a bit.

So, it's rare, but, thankfully when people do that, because I do know parties that could probably put loans through somewhat quickly and or are ready to jump into that space. listen, I always say earlier is better, even if it's a six-minute conversation to say, hey, we're thinking about doing acts or we need a new, you know, credit line for a couple million dollars.

You know, we want some somebody who's more local or regional versus a national player or, or someone else casually mentioned to me on a call that they're, you know, been fighting with their lender and they may be a big player in the market. And, you know, we were thinking maybe we might switch it up then I can give suggestions to that.

So, listen, I think earlier is better sometimes it doesn't it doesn't need to be a big, long thought-out conversation. It could just be, hey, here's some ideas if you're looking for a lender. if not, and you've already shopped, or you know you want to go to an existing lender, I just like to say don't sign a commitment letter until you've just at least shown it to us.

Like, let me look at it, I will, I will do it in an hour or just give it to me. Let me at least give high level bullet point. If you don't want an expansive review. You know, I sometimes have clients just say just give it a once over and flag anything that really jumps out at you. That's either missing or not.

Like we can do those pretty quickly and the benefit will really help in the long run, I promise. So yeah, I mean listen, earlier is better that not to say everybody does that. I'm sure I'm sure it's probably more of a minority of clients. But once you learn the benefit of it, those clients always come back and do it going forward.

And I think that's, you know, a testament to the value.

Stephen Tanico: Thanks, Kim. as we about wrap up, we just have one last question, which just kind of, you know, your instant reaction, one piece of advice you would give someone, negotiating a finance term sheet would be what the first thought that comes to your head.

Kimberly Lomot: Get us involved early. Let us look at it. Don't sign it without having an attorney. Just put eyes on it. It's the most important piece, and it ties into everything else that would be in there. That we could potentially save you time, money and risk.

Stephen Tanico: Excellent. Okay. that about wraps it up for us today. Thank you, Kim, for joining us and helping us in the inaugural, episode in this series, getting a little bit more technical about term sheets. And thank you, listeners for tuning in today. Be sure to like, subscribe, and follow Terra Firma wherever you're listening to this episode. Stacey and I would love to hear from you, so feel free to reach out to us at Terra firma@lowenstein.com. Until next time.

Stacey Tyler: Ciao!

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