Kingsley Napley

The A-Z of Secured Lending

We are often asked about the meaning of certain terms used in lending transactions. As such, we thought it would be useful to publish a helpful guide to some of the key terms of a secured lending transaction in a handy A-Z format.

Amortisation

This term refers to the way in which the debt is to be repaid. If a loan is amortised, it means that it will be repaid during the term of the loan in regular instalments.

Break Costs and Break Gains

Break costs are the costs to a lender of a borrower repaying or prepaying a loan on a date other than the last day of an interest period and which represents the difference between (i) the amount a lender should have received for the period from the date of receipt of all or part of a loan to the last day of the interest period and (ii) the amount which a lender can obtain from placing the amount equal to the loan repayment on deposit with a leading bank for the same period. Break gains, are the converse.

Covenants

In the context of a facility agreement, the borrower will usually agree to certain covenants with the lender, which are promises to do (or not to do) specific things during the term of the loan. The covenants are intended to protect the lender's investment and/or the value or adequacy of their security and will often include a 'negative pledge' provision (see 'N' below), an obligation to notify the lender of any Event of Default (see 'E' below) and compliance with certain financial covenants such as an obligation to ensure that the total loan amount does not exceed a certain percentage of the value of the underlying security asset (commonly called the 'loan to value ratio' or 'LTV') (see 'V' below).

Development Finance

Development finance is a loan which is specifically advanced to a borrower for the purpose of the development of certain property. A development finance facility agreement will differ from a standard property investment facility agreement because the lender will want to retain some control over the development. The lender will often appoint its own monitoring surveyor to keep track of the progress of the development and may make the loan available in tranches, only advancing a further tranche when certain development milestones have been achieved. The borrower will also usually give development undertakings such as to ensure that the development is carried out in accordance with an agreed specification, and to obtain lender consent before appointing professional contractors.

Events of Default

Events of Default are a defined set of circumstances which the lender and borrower agree will trigger a default under the loan. Examples of these include non-payment, insolvency, cross default and breach of obligations. When a default has been triggered under the loan the lender will then usually have the right to demand immediate repayment of the loan and/or enforce its security. Please see our previous blog on events of default.

Fees

The borrower will almost always be responsible for certain fees under a facility agreement, payable on top of any interest charged on the loan. Such fees may include:

- an arrangement fee payable to the lender on initial drawdown of the loan;
- a commitment fee, which is sometimes payable in respect of any part of the facility which has not yet been advanced to the borrower but is still available. The intention is to compensate the lender for keeping the funds 'committed' to lend;
- an exit or prepayment fee, which would be payable on the borrower prepaying or repaying the loan.

Sometimes the fees are set out in a separate Fee Letter, rather than in the body of the facility agreement. This is usually in the context of a syndicated loan and will often also include:

- an agency fee (usually payable to one of the lenders, who will act as agent on behalf of all the lenders); and / or
- a security trustee fee (usually payable to one of the lenders, who will act as security trustee on behalf of all the lenders).

Green Loan

Typically, this will be a loan which has been advanced in order to fund a 'green project'. Green loans will usually allow the borrower to benefit from more advantages lending terms such as a lower interest rate, on the basis that the proceeds of the loan will be utilised for a 'green' purpose. Guidance as to what constitutes a 'green project' can be found in the Loan Market Association latest note on green principles (the Green Loan Principles) but includes projects involving renewable energy, pollution prevention, sustainable water and waste management and green buildings (which meet certain recognised green standards).

Hedging Agreement

A hedging agreement in the context of a facility agreement will ordinarily relate to an interest rate swap between the borrower and a hedging counterparty (which could also be the lender, or an affiliate of the lender) pursuant to which the borrower will swap its floating rate of interest under the facility agreement for a fixed rate with the hedging counterparty to guard itself against changes to the floating rate.

Intercreditor Agreement

An intercreditor agreement (otherwise known as a deed of priority) is an agreement between two or more creditors of the same borrower which ranks the priority of the creditors and sets out how any proceeds will be distributed between them.

Jurisdiction

In some finance transactions, advice will be required to be sought from alternative jurisdictions if any of the Obligors (see 'O' below) are incorporated outside of England and Wales.

For example, if the borrower group structure is multi-jurisdictional and third party security is to be granted by other entities within the structure, it may be that off-shore counsel will need to be instructed to review security documentation which is governed outside of England and Wales, and/or to prepare corporate authorisations in line with the appropriate company law.

KYC

This stands for 'Know Your Customer' and any regulated lender will want to ensure that the borrower has provided adequate KYC documentation and information before a lending transaction can be completed. This is so that the lender can properly identify their client, assess the risk associated with lending to that client and highlight any potential dishonest or fraudulent activity.

LIBOR

The London Interbank Offered Rate (or LIBOR) has been used as a benchmark for lenders to set their interest rates. Every day, leading banks in London will submit to the ICE Benchmark Administration, their estimates as to what the likely cost would be to borrow from other banks, and these estimates are collated to calculate LIBOR. In a lending arrangement, LIBOR will often be used as the floating rate to which fixed margin of interest is tied (see 'M' below). LIBOR is due to be phased out by 2021 but it is not yet clear what the most likely alternative benchmark will be, to replace it.

Margin

Margin represents the lender's profit and is effectively the difference between the rate the lender borrows at (e.g. LIBOR) and the rate at which the lender lends to the borrower. Margin will often vary dependent on the risk profile of the loan, with loans secured on income generating commercial investment assets being deemed a lower risk, and secured loans on development assets being deemed a much higher risk.

Negative Pledge

A negative pledge provision will usually be set out in the covenants section of a facility agreement, and will seek to restrict the borrower's ability to create any type of new security over its assets during the term of the loan. This clause may be negotiated depending on the relationship between the parties and the broader commercial transaction but, from the lender's perspective it would ordinarily want to keep the negative pledge clause as restrictive as possible, to protect its security position.

Obligor

In a financing context, the obligor will be the borrower or any other security provider or other party which owes an obligation under the facility agreement such as a guarantor, or third party chargor.

Personal Guarantee

A personal guarantee is a guarantee given by an individual in favour of a lender to secure the obligations of another party. The guarantee may be unlimited or capped at an agreed amount. For more information about personal guarantees, please see our dedicated personal guarantee blog.

Qualifying Floating Charge

If the relevant security document contains certain specific wording confirming that a floating charge is a qualifying floating charge, this will allow the qualifying floating charge holder to appoint an administrator without going through a court process, in the event the charge has become enforceable.

Representations and Warranties

In the context of a facility agreement, the representations, and warranties are statements of fact made by the borrower to lessen the lender's potential risk as it forces the borrower to confirm that certain information is true and accurate. If these are breached or it transpires that the same were untrue, inaccurate or misleading when given, this will ordinarily trigger an event of default. (see 'E' above).

Whilst the terms 'representations' and 'warranties' are sometimes used interchangeably, the remedies when the same are breached are different, and so the statements are usually referred to as being both representations and warranties. If a borrower breaches a representation, the lender will have the right to terminate the contract and seek damages from the borrower. A breach of warranty by the borrower will entitle the lender to claim damages.

Security

Security can be provided in many different forms and by parties other than the borrower including by way of legal mortgage over property, a charge over shares, a personal guarantee from a director of the borrower, a third party corporate guarantee from a parent company, a charge over cash deposited in a bank account, an assignment of rental income and many more. The lender and borrower will usually agree at the outset what the security package will comprise, depending on the nature of the transaction and the commercial relationship between the parties.

If a loan is secured and a borrower defaults under the loan the lender will be in position to enforce its security to recover the amounts outstanding, including on the insolvency of the borrower where it will rank in priority to unsecured creditors in terms of being paid out of the realisation of the secured asset.

Term

The term of a loan is the length of time the loan remains outstanding. This may be fixed length of time or it could be contingent on certain events such as the disposal of particular assets.

Utilisation Request

A template utilisation request is usually found in one of the schedules to a facility agreement and is the form which the borrower will submit to the lender to request a loan advance. It will usually set out the amount requested, any selected interest period, the account details to which the loan should be deposited and any fees which are to be deducted at the time the loan is drawn. It is also sometimes referred to as a drawdown request.

Valuation

If a loan is secured against a property, the lender will want to be comfortable that the value of the property is sufficient to ensure they will be to be repaid in full, in the event they need to enforce their security and sell the asset (including being repaid any fees or other expenses incurred in relation to enforcement).

A lender will request a valuation prior to advancing the loan and will usually have the right to request further valuations during the term of the loan to ensure the loan to value ratio remains at an acceptable level. Often lenders will include a financial covenant which means that an event of default (see 'E' above) will be triggered if the loan to value percentage ratio exceeds a certain figure.

Withholding Tax

Withholding tax is the tax which a borrower needs to 'withhold' on any payment of income (such as interest) to a lender unless certain criteria are met. For a borrower and a lender which are both incorporated in the UK, withholding tax shouldn't be an issue but a borrower should tread carefully with an overseas lender as there is quite often an obligation to gross up a payment relating to an additional cost to a borrower.

eXit Fee

An exit fee may be payable by the borrower to a lender upon the scheduled repayment or prepayment of a loan. The details of the exit fee are likely to either be set out in the facility agreement, or in a separate fee letter (see 'F' above).

Year

Year means a calendar year of 365 days but note that interest can sometimes be calculated on a 360-day count.

Zero

Many floating rate loans are priced off LIBOR which can rise and fall but which are often subject to a floor of zero.

Meet the team

Our banking and financing advice is primarily to entrepreneurs, owner managed businesses and funds on the borrower side, though we also advise a number of smaller banks. We also advise on any related security, and in relation to acquisition finance, the leveraged loan market, and development/real estate finance. Contact one of the team below to find out more about how we can help:

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