

Do You Need a Lawyer When Seeking Commercial Financing?

By John Wilkerson

You have decided that you need a commercial loan either to fund the working capital needs of your company or to acquire or refinance debt on a fixed asset like equipment or real estate. The basic terms of the financing have been worked out with your banker. Even though this is a significant undertaking, you wonder if you need to have your corporate counsel involved. After all the cost of the financing has increased due to interest rate spreads; bank liquidity requirements have reduced the funds available and you assume the bank will use its “standard” documentation. Should you also bear the cost of counsel?

While all of the above is true, experienced counsel can add a great deal of value to your loan transaction. Even though commercial loan documentation is generally consistent among institutional lenders, there are a number of areas that deserve attention. You must select an interest rate. Will it be a fixed rate or variable? If a variable rate is chosen what index will be used; prime or LIBOR? What is the spread (i.e. the difference between the index and the rate you are actually required to pay)? Should you consider hedging your interest rate exposure on your variable rate loan with an interest rate swap? How will interest be calculated? Will your lender calculate interest on a 360/360 basis or on a 365/360 basis. Each of these decisions will impact the total cost and risk of your financing.

It is possible that you have loaned money to your company. The lender tells you that the insider debt must be subordinated to the lender’s senior indebtedness. But what does it mean to subordinate? Generally, the lender will require complete subordination as to payment and any lien which is given to collateralize the subordinate debt. The lender may also require a “standstill” provision which will restrict your ability to collect on the subordinate debt even in the event of a default. Knowledge of these various facets of subordination will allow you to carve out needed flexibility.

Commercial loan documents also generally restrict the ability of the beneficial owners of the borrowing entity to transfer beneficial interests, be they membership interests, shares of stock or partnership interests, during the course of the financing. For future estate planning reasons you will need to retain the flexibility to transfer these beneficial interests to family members, family limited partnerships or other affiliated entities. Experienced counsel can guide you through these requirements so that you are not prohibited from making decisions that will be important to the continuity of your business or for tax purposes.

Commercial loan documents also generally prohibit subordinate financing. You may in the future need to add additional leverage through subordinate liens, mezzanine financing or purchase money security interests for equipment purchases. Negotiating the parameters of additional leverage at the time of the senior financing will provide great benefits as your company grows or market conditions cause changes in your operating requirements. It is much better to have a properly structured senior loan in place than to go to your lender later and ask for additional considerations.

Most commercial loans will require the guaranty of the principals of the borrowing entity. But what exactly are you guaranteeing? Guaranties come in a variety of forms. A continuing guaranty will relate

to all indebtedness of the borrowing entity, whether now existing or hereafter incurred. A much better alternate for the borrower is a transactional guaranty whereby the guarantor only guarantees a specific loan.

The guarantor can also attempt to limit his or her exposure by use of a limited guaranty. Even with limited guaranties you have the question of exactly what are you being asked to guaranty. Assume your commitment letter states the guarantor must guarantee 50% of the loan. Does that mean 50% of the original loan amount or 50% of the outstanding principal balance of the loan at the time of the default by the borrower? Does the limitation relate to the principal balance or does it also include accrued interest, fees and costs?

Once the guaranty is in place the guarantor may assume that his or her liability is dependent upon a default by the borrower and the failure of the lender to be able to collect sums it is due from the borrower. However, that is generally not how commercial guaranties are structured. Most commercial guaranties are called "payment" guarantees not "collection" guarantees. This means, if the borrower misses a payment recourse can immediately be had against the guarantor. You may have limited ability to negotiate these provisions. However, without the knowledge and counsel of his or her lawyer a guarantor may miss the opportunity to limit their exposure.

Maybe your company is financially strong enough that it can borrow money on a non-recourse basis. Even in such instances a typical lender will require the personal guaranty of non-recourse carve-outs. These carve-outs are usually limited to fraudulent actions or environmental matters. Although, it is not uncommon for such guaranties to be broadly written so as to essentially emasculate the non-recourse nature of the debt. Knowledge of the intricacies of such provisions can avoid severe consequences in an event of default by the borrower.

With any commercial loan there are also numerous due diligence requirements of the lender. It is important to know and anticipate these requirements. First, failure to anticipate the lender's due diligence requirements may lead to delays in your financing. Second, you must realize that you will generally be required to pay the lender's lawyer's fees. Proper presentation and timing of the delivery of the due diligence to the lender's counsel can minimize such costs. What about the cost of the actual due diligence items? Your lawyer should be familiar with and able to minimize such costs. While you may not be familiar with UCC searches, Phase I Environmental Reports, surveys or title insurance your lawyer will have extensive knowledge in each of these areas and have experience in providing the lender only the level of due diligence which the particular transaction requires. Also, with items like title insurance your lawyer should be familiar with all the credits to which you are entitled to reduce the ultimate cost.

Commercial loans cross a number of legal disciplines. While the issues enumerated above can be anticipated, there are a significant number of related issues upon which we do not have time to elaborate in the limited space of this article. It will cost money to engage your lawyer in any commercial financing. However, if you choose a lawyer with knowledge and experience, the decision to engage him or her will result in overall cost savings and a loan facility that will provide you the risk avoidance and flexible that you will need in the future.

Carlile Patchen & Murphy LLP has a number of lawyers skilled in the review and negotiation of commercial loan transactions. Give your contact attorney at the firm a call and receive the value and benefit of our years of experience in your commercial or commercial real estate financing transaction.