The Beyond Agency Series: What Should a Borrower Pay Attention to When Negotiating CMBS or Private Credit Cash Management Terms?

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The previous post in our *Beyond Agency* series examined the three primary cash management structures (the Springing Lockbox with Springing Cash Management, the In-Place ("Soft") Lockbox with Springing Cash Management, and the In-Place ("Hard") Lockbox with Hard Cash Management), together with the Deposit Account, the Cash Management Account, and the DACA and the CMA that govern them. Readers who have not yet reviewed that article or who would like a refresher on these terms may wish to begin with our "Guide to Private Credit and CMBS Lockbox and Cash Management Account Provisions." It addresses how this language is typically drafted and what each structure requires of a borrower at and after closing.

Now, having already covered the basics in cash management, part one, let's talk about the application. What follows are some of the questions borrowers should be asking themselves when signing up a new CMBS or private credit deal, and they can each affect the asset in their own way. They are the practical, and frequently overlooked, questions that arise once cash management provisions are being negotiated and, ultimately, lived with.

What Counts as a Cash Management Trigger Event — and Can You Actually Live with It?

Before agreeing to a Cash Management Trigger Event built around a debt service coverage ratio (DSCR) or debt yield threshold, it is important to understand how that ratio is actually calculated and what the lender is basing it on: which revenue streams are counted, which expenses are deducted, whether the measurement looks backward over a trailing period or forward on a projected basis, and what debt service constant or assumed interest rate the lender

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applies. In most deals, that calculation can run through a stack of defined terms — effective gross income, then net cash flow, then the ratio itself — and each layer applies its own adjustments before the ratio is ever computed. There is often limited room to change the formula itself, but there is considerable value in understanding what drives it, because the same property can test very differently depending on those inputs. Two questions matter more than the definition itself:

- **Will the property actually satisfy the threshold as of closing?** If your deal is underwriting close to the line, you may think that you're safe with a Springing Lockbox or an In-Place ("Soft") Lockbox structure with Springing Cash Management, but a springing structure may not buy you as much runway as it looks like on paper — you could be tested (and fail) at the very first measurement date.
- **Is the threshold something you can sustain for the life of the loan, not just on day one?** Seasonality, upcoming capital expenditures, known lease rollover or planned rent concessions can all move the ratio in the wrong direction well before maturity. Market conditions can also reach the calculation through rental concessions, including abatements, free rent, and other inducements. At the same time, even if your property is the outlier to a difficult market, the income definition will often assume a vacancy factor drawn from the submarket or a stated floor rather than the property's actual occupancy.

If the property isn't fully stabilized at closing — due to new construction, a recent lease-up or renovation, or a repositioning plan still underway — it's worth negotiating a grace period before the trigger is tested at all, giving the property time to reach stabilized occupancy before its performance is measured against a DSCR or debt yield covenant. A finite window, such as a stated number of months after closing, is one way for a lender to get comfortable. And where the property is acknowledged from the outset to be operating at a shortfall and the lender sizes a shortfall reserve, and sometimes a related guaranty, to carry debt service through lease-up, you should confirm that cash management

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cannot spring while that reserve remains funded and the guaranty remains in place. The borrower, having already reserved or provided credit support for the very underperformance the trigger measures, should not also lose control of cash flow during that same period.

Mixed-use properties raise a separate question. If the deal is predominantly multifamily with a commercial or retail component, check whether that commercial tenant is carved out and subject to its own separate cash management trigger, often tied to that tenant's lease expiration, termination or insolvency, independent of the overall property-level DSCR or debt yield test.

If the commercial space is a small piece of the property's overall cash flow, consider whether a standalone trigger tied to that one tenant is proportionate to what the tenant actually contributes. It is also worth thinking through what replacing that tenant would realistically involve. A comparable tenant may exist in the market, but the pool of candidates for ground-floor or ancillary space in a predominantly residential building can be considerably narrower — especially when you take into account any lender requirements to replace the existing tenant with a tenant of similar size on similar terms.

And keep in mind that a trigger is not limited to a failed DSCR, debt yield test, or a tenant-specific event. An event of default, despite having its own category of remedies, can itself be a Cash Management Trigger Event, and an otherwise performing property can be put into cash management on a technical rather than monetary default: late financial statements, rent rolls or operating statements; an insurance lapse; an unpermitted transfer; or liens. Each of these is easily curable in principle, but each can independently send you down the path of cash management.

What Happens When Cash Management Actually Triggers?

The mechanics of the trigger itself differ depending on which structure applies, and the difference is worth understanding before a trigger occurs. Under the In-Place ("Soft") Lockbox with Springing Cash Management, the Deposit Account is already open and

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already operating under an executed DACA. When a trigger occurs, the lender instructs the bank to redirect the sweep from the borrower's operating account to the Cash Management Account, and the borrower is typically notified after the fact. Because the switch rests with the lender and the bank, there is comparatively little for the borrower to do at that point. This can be good from a timing perspective, as there is little risk of triggering events of default or recourse by missing any deadlines to open accounts with third-party banks, which can often be a lengthy process, even when there is little conversation before the switch to cash management.

A Springing Lockbox paired with Springing Cash Management works differently. At the moment of trigger, neither account exists yet, and the borrower is establishing a new banking relationship at a point when the lender and servicer expect cash management to be operating promptly. Account opening, including know your customer (KYC) review, internal approvals and DACA execution, takes time, and some of that time is outside the borrower's control. This is where realistic timeframes and protective language are worth negotiating up front. And so long as the borrower is diligently pursuing account opening in good faith, a delay attributable to the bank's own processes should not itself constitute a default, even if it extends beyond the number of days specified in the loan documents.

The balancing act of recourse sits on the other side of the structure. As a general principle, the softer the cash management structure, the harder the recourse carve-outs: a lender giving up day-one control of cash flow under a springing structure will typically look for protection through carve-outs reaching misapplication or misappropriation of rents, failure to deposit rents once a trigger occurs, or failure to establish the accounts and deliver the DACA on time. By contrast, a hard lockbox with hard cash management leaves less pressure to expand these provisions. Where those carve-outs are concerned, push for a losses-based carve-out, under which the guarantor is liable only for the lender's actual losses, costs and damages, rather than full recourse that converts the entire loan into a personal obligation over an administrative failure — and then pair it with notice and a short cure period, so that

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a mistake caught and corrected promptly does not become a recourse event at all.

What Happens to Excess Cash Flow — and Does It Come Back?

Start with what falls inside "Operating Expenses" and the related defined terms in the waterfall, because that is the definition that determines how much cash ever reaches the bottom of it. Read it closely enough to know which costs can actually be paid from collected rents: whether only expenses set out in an approved annual budget qualify, how variances from that budget are treated, whether unbudgeted or extraordinary costs can be funded at all and on what approval, whether capital expenditures, tenant improvements and leasing commissions are included or relegated to separate reserves, and whether property management fees and payments to affiliates are covered. A narrow definition can shrink what counts as "excess" cash flow well before you ever reach the question of where that excess goes.

From there, follow the waterfall to its actual end point. In some cases, whatever remains after debt service, reserves and approved operating expenses is the borrower's profit or distribution amount. Some lenders, however, require that excess cash instead be swept into a cash collateral or reserve account and held as additional collateral for the loan. The detail worth confirming specifically is whether curing the underlying trigger gets that money back. Many loan documents treat a cure as stopping cash management on a going-forward basis, so that excess cash flow resumes from that point on, without necessarily releasing what was already captured and held during the trigger period.

How much is actually at stake in that answer depends on which trigger put the loan into cash management, and the two scenarios are quite different. A DSCR or debt yield trigger reflects, by definition, a property that is not performing to the underwritten level, so in many cases there is little or no excess cash flow left at the bottom of the waterfall to sweep or to release. An event of default or a tenant-specific trigger, by contrast, can occur at a

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property that is performing well. There, the borrower is in cash management, and potentially losing access to meaningful distributions, notwithstanding that the property is generating substantial cash flow. That second scenario is what makes the treatment of excess cash worth negotiating before it becomes relevant.

Can a Cash Management Trigger Be Cured?

A cure right on paper is only as good as whether it can actually be satisfied. Before accepting cure language, make sure you understand precisely what the cure requires: the performance level that must be reached, how long it must be sustained, how and when compliance is tested, and who determines that the cure has been achieved. A cure that requires two consecutive quarters of performance at a stated DSCR is a materially different right from one that can be satisfied by a partial prepayment, a deposit of cash collateral, or a letter of credit. That distinction is worth identifying while the structure is still being negotiated.

Also, look at what happens on the back end. Is there a cap on how many times a cure can be exercised over the life of the loan? Does a second trigger, shortly after a cure, use up a second bite at the apple, reset the clock, or convert what was a curable event into cash management for the balance of the term, regardless of how the property performs afterward? You want to know, going in, whether you could end up trapped in cash management indefinitely with no realistic path back out, and negotiate around that possibility specifically.

Which Banks Qualify as an Eligible Institution — and Does It Matter Which One You Pick?

One question many borrowers ask is whether they can use their own bank for cash management structures to keep some familiarity and control over fees. Yet the answer is very different when it comes to the Deposit Account and the Cash Management Account.

The Cash Management Account bank is largely the lender's call. Sometimes that bank is the lender itself, and sometimes it is a

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correspondent bank used programmatically across the lender's portfolio or across the industry as a whole. Negotiating which bank holds the Cash Management Account is, for most lenders, a nonstarter, and not a productive use of negotiating capital.

However, the Deposit Account bank is where you have more room to maneuver. Term sheets typically provide that this bank is chosen by the borrower, subject to lender acceptance. That flexibility, however, is subject to the bank meeting the "Eligible Institution" ratings definition and offering lockbox services (and an agreement) in a form compatible with a securitized loan. Plenty of banks, including some large and well-known ones, do not offer such services. Likewise, the regional bank you may use across several of your properties might not meet the ratings criteria for the loan.

Even if your bank appears to meet all of the criteria, it is important for you to flag your preferred bank as early in the process as possible. Account-opening procedures tend to run in the background for most of the closing timeline, and if your first-choice bank doesn't work out, you need enough runway to pivot to whatever alternative — often the bank the lender was planning to use all along — without your own bank selection becoming the reason closing gets delayed.

Have You Talked with Your Property Manager?

Since cash management procedures require coordination of rents, your property manager needs to understand the program to make sure that incorrect allocation of funds does not trigger cash management. Have the conversation with your management company early about how cash flows will actually work once the loan closes.

Under an In-Place ("Soft") or In-Place ("Hard") Lockbox structure, rent has to go directly and immediately into the Deposit Account, in full, before the manager is paid anything, rather than being collected, netted against property-level expenses and the management fee, and remitted the way the manager may be used to doing under an agency loan. The manager is generally the party responsible for making that work in practice: directing residential

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rents directly to the new Deposit Account, preparing and following up on payment direction letters for commercial tenants, reconciling what arrives in the account against what was billed, and submitting property-level expenses for payment through the waterfall.

Management fees warrant a separate conversation. Most CMBS and private credit loan agreements cap management fees payable during an active cash management period. In some cases, fees are not payable at all while a default or cash management is in effect. In other cases, they are limited to the "market rate" the lender's underwriting will support rather than the contractual fee the manager actually charges. It is worth discussing with both the lender and the manager what rate is being charged, what the cap will be during cash management, and whether unpaid or reduced fees can accrue during the cash management period and be paid out once it ends, rather than simply being forfeited.

Bottom Line

Although cash management structures are not at the forefront of every negotiation, their effects will be felt on a near-daily basis during the life of your loan. So, it is important to make sure that the structure you close with is going to be workable for the rest of the loan term rather than a source of ongoing friction. Having an intuitive understanding of the fundamentals of cash management structures and provisions can save you precious time and leave you better positioned to push for meaningful changes at the earliest stages of the closing process. Start the conversation at the term sheet stage. By the time the loan is signed up and the documents are drafted, most of this is settled, and renegotiating it later, even before you close, is a considerably harder conversation.

If you have questions regarding multifamily financing, including CMBS and private credit options, or need help evaluating the cash management provisions of a term sheet, please contact the authors or any member of the firm's Commercial Real Estate Finance and Multifamily teams. And stay tuned for the next installment in our *Beyond Agency* series.

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Beyond Agency Series

- Part 1 – Multifamily Loans in a Higher for Longer World
- Part 2 – A Guide to Private Credit and CMBS Lockbox and Cash Management Account Provisions
- Part 3 – What Should a Borrower Pay Attention to When Negotiating CMBS or Private Credit Cash Management Terms?
- Part 4 – What Should a Borrower Focus on When Negotiating Transfer Provisions in Private Capital and CMBS Loan Documents?

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