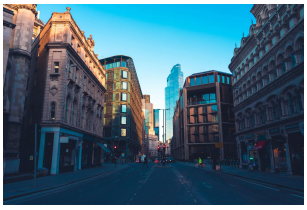

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The Beyond Agency Series: What Should a Borrower Focus on When Negotiating Transfer Provisions in Private Capital and CMBS Loan Documents?

Few provisions in a non-recourse loan, whether originated by a private capital lender or a commercial mortgage-backed securities (CMBS) lender, carry as much latent risk for a borrower as the restriction on transfers. In this third installment of our *Beyond Agency* series, we look at transfer and permitted transfer provisions through the eyes of the borrower, and at how borrower and lender priorities collide when those provisions are negotiated. Private capital and CMBS lenders protect themselves by tying an unconsented "transfer" to a recourse carveout. This means that a borrower who completes a transfer without first securing the lender's approval may lose the benefit of its non-recourse protection.

Because liability hinges on whether an action is a "transfer," the real negotiation tends to happen in the definitions section rather than in the carveout itself. The breadth of that defined term, and the list of exceptions to it, effectively determine which events expose the borrower and its guarantor to personal liability. Those definitions are also the natural place to tailor the private capital or CMBS loan to a particular ownership structure or to transactions the borrower already expects to undertake.

At the highest level, negotiations concerning the "transfer" provisions of a loan are a proverbial tug of war between the lender and the borrower, with the private capital or CMBS lender tending to seek a relatively ***broad*** "transfer" definition and relatively ***narrow*** "permitted transfer" definition; and with the borrower seeking the opposite — a relatively ***narrow*** "transfer" definition and a relatively ***broad*** "permitted transfer" definition. Achieving the optimal landing spot as it relates to those defined terms not only turns on a

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knowledge of the operative legal concepts and recent trends in the industry, but it also requires a keen knowledge and understanding of the interworking of the client and what is intended to be accomplished given their particularized identity, structure, and needs.

Defining the Universe of "Transfers" and Its Exceptions

A private capital or CMBS lender's form will typically sweep in nearly any change affecting the collateral or the ownership behind it: selling, conveying, encumbering, or leasing (outside of permitted leasing) any portion of the property, and any direct or indirect change in the equity of the borrower, with particular emphasis on a change of control. Many forms then layer on an illustrative list of specific events that are deemed transfers. Taken at face value, language this expansive could capture ordinary business activity, such as granting a ministerial easement that improves the property or shifting interests among the borrower's small, non-controlling upstream owners. Private capital and CMBS lenders generally recognize that the property must be run as a going concern, and they are usually receptive to carving out these kinds of routine events.

Those carved-out events, the "permitted transfers," may proceed without lender approval as long as the conditions attached to them in the loan documents are met. Certain narrow categories may require no notice at all; trading in publicly listed shares that sit somewhere above the borrower is the classic example, since tracking those trades would serve no one. Most permitted transfers, however, come with a notice obligation. Common examples include:

- Moving equity in the borrower into vehicles established for estate planning;
- The passing of an ownership or control interest when its holder dies or becomes incapacitated; and
- Transfers of minority, non-controlling stakes in the borrower.

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Why Does the Lender Care So Much About Transfers?

The prohibition on transfers tends to address two overarching themes: (1) restricting transfers of interests in the mortgaged property, and (2) restricting transfers of equity interests in the borrower.

On the first point, absent a carveout being triggered, a non-recourse private capital or CMBS lender can look only to the property for satisfaction of a loan that is no longer performing. The lender is therefore ultra-focused on ensuring that the mortgaged property operates profitably, is maintained in good condition throughout the loan term, does not undergo changes in title that could adversely affect the security of its mortgage, and is not encumbered or burdened by interests that may run counter to those of the lender and/or the borrower. If the secured property is transferred to a new owner, the loan documents will, at a minimum, need to be assumed, and that assumption must be properly documented to ensure the lender's mortgage remains effective and maintains its priority. Even the transfer of more limited interests in the property may have significant impacts on the value of the lender's collateral. As a result, it is typical for the lender to insist on a requirement to consent to any transfer of the property itself.

On the second point, both private capital and CMBS lenders underwrite the sponsor as much as the real estate, and their credit decision rests on the conclusion that this particular borrower and sponsor can run the asset successfully. A change in who controls the borrower can undercut that conclusion. Compliance obligations also play a role: lenders must satisfy Office of Foreign Assets Control (OFAC) requirements and their own anti-money laundering and "know your customer" (KYC) procedures. So, a transfer that pushes a new party above an ownership threshold, often 10% or 20%, will typically require the lender to run background checks and searches on the incoming investor.

What Should a Borrower Think About in Reviewing a "Transfer" Provision of a Loan Agreement?

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A borrower's concerns about completing transfers will vary depending on its plans for operating the mortgaged property and its ownership structure. Typically, in the private capital and CMBS non-recourse lending world, the most common concern is the ability of the borrower's direct and indirect owners to transfer their ownership interests — especially, for example, where the borrower is capitalized with publicly traded shares or through a multi-member investment fund, joint venture, or other sophisticated structure.

Borrowers with less complicated ownership structures, such as those with only one or two individuals involved, tend to be primarily concerned with the ability to restructure ownership to accommodate trusts for the benefit of family members, or to have other individuals step in if the sponsor is no longer able to hold its interests, as in the event of death or incapacity. Private capital and CMBS lenders are typically willing to accommodate these structure and deal-specific concerns, but they will generally do so by changing how a "transfer" is defined rather than by changing the carveout for violating the transfer provisions. Even with those accommodations, borrowers are frequently wary of accidentally triggering a full-recourse carveout while acting in good faith.

For borrowers whose principals are individuals or families, it is often critical that the loan documents expressly treat transfers to estate planning vehicles as permitted transfers. Over the life of a typical non-recourse loan, principals may reasonably be expected to move their direct or indirect interests in the borrower into revocable or irrevocable trusts, family limited partnerships, or similar entities for the benefit of a spouse, children, or other family members. They may also transfer interests to those vehicles or to heirs upon death or incapacity. Without a clear carveout, routine and well-intentioned estate planning could fall within a broadly drafted "transfer" definition. In that case, the borrower would need to obtain the lender's prior consent, and a misstep could trigger full-recourse liability under the transfer carveout.

Generally speaking, borrowers negotiating the permitted transfer provisions of a loan agreement with a private capital or CMBS lender should also resist language that ties every ownership change to the

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lender's discretion. They should push instead for objective control tests that clearly define when a transfer is allowed whenever possible. Lender forms in the private capital and CMBS spheres often require consent for any direct or indirect change in ownership, and they may let the lender withhold that consent in its "sole discretion." In addition to permitting the lender to exercise its discretion for material changes in ownership that may have a real impact on the property, these forms may also give the lender (or a future servicer) leverage it can use to extract fees, reprice the loan, or block routine estate planning and investor turnover for less impactful changes.

A better approach is to define permitted transfers by clear benchmarks. For example, the identified sponsor, any guarantors, and/or key principal must keep "control," meaning the power to direct the borrower's management and policies, and must keep at least a specified minimum percentage of indirect ownership, in addition to certain other clear tests that may be appropriate for a given transaction. When those tests are met, the transfer needs no consent, only notice and customary KYC deliverables. This framing still protects what the private capital or CMBS lender actually cares about: continuity of experienced management, satisfaction with internal and external regulatory requirements, and a creditworthy party standing behind the loan. It also gives the borrower certainty and flexibility for the life of the loan, so it can plan ownership changes in advance without having to negotiate each one.

Borrowers with a joint venture partner should be particularly mindful of transfer concerns, especially where that partner is a real estate fund. Fund investors in the private capital and CMBS lending spaces often need flexibility to transfer interests among affiliated funds and vehicles, admit or replace limited partners, syndicate or sell down their position, or pledge interests in connection with fund-level financing, and any of these could fall within a broadly drafted "transfer" definition. Early in the process, borrower's counsel should ask the joint venture partner to specifically advise what it may need for fund purposes so that those requirements can be built into the permitted transfer provisions from the outset, rather than raised after the private capital or CMBS lender's form has been largely negotiated.

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Borrowers will also want to consider what other items may be implicated by a broad definition of "transfer," which by default may be overinclusive with respect to granting leases, easements, or other minor interests in the real property. It is often possible to negotiate pre-approvals for certain of these considerations — for example, leases otherwise entered into in accordance with the loan documents and customary utility easements that provide benefit to the property. The exact nature of such considerations will be governed by both the form language used by the lender and by the location and nature of the property.

Can the Carveout Itself Be Negotiated?

Borrowers have traditionally had more success revising the definitions than revising the carveout. That is beginning to change. Borrowers increasingly request a carveout exception for any transfer that would have qualified as a permitted transfer had notice been given, provided every other condition was satisfied. If accepted, a missed notice on an otherwise compliant transfer would expose neither the borrower nor the guarantor to recourse.

Many private capital and CMBS lenders are reluctant to give up recourse entirely, even for transfers that would be permitted but for the missed notice, because it is important for the lender to maintain consistent awareness of who owns and operates the mortgaged property. Two alternative approaches are worth noting:

- **Bifurcating by notice:** Transfers that would otherwise be permitted, but for the borrower's failure to provide notice, become "above-the-line" losses recourse carveouts, while all other transfers in violation of the private capital or CMBS loan documents, as applicable, remain "below-the-line" full-recourse carveouts.
- **Bifurcating by type of transfer:** The "below-the-line" full-recourse carveout is limited to (1) voluntary transfers of the mortgaged property, including the borrower granting a security interest in it (i.e., a mortgage or deed of trust secured by the mortgaged property); and (2) transfers of an interest in the borrower that cause the guarantor to own less than the required ownership percentage in the borrower or to no

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longer control the borrower — in each case without the lender's consent. All other transfers in violation of the loan documents would trigger a "losses only" recourse carveout.

Each bifurcation approach allows the lender to retain the ability to pursue some form of recourse for every transfer that violates the loan documents, while keeping the borrower incentivized to fully comply with the transfer requirements.

Bottom Line

How far a private capital or CMBS lender will move off its form depends on the particular transaction and on each side's leverage. A borrower should assume the lender's standard transfer and carveout provisions will stay largely intact unless there is a concrete, persuasive reason to change them. Requests are far more likely to succeed when counsel knows what is market and can tie each request to a real business need.

To that end, it is of the utmost importance to intimately know and understand the client's needs, structure and goals in negotiating transfer provisions. For example, is the principal of the borrower or guarantor an older individual? If so, there should be a hypersensitivity to classifying various estate planning vehicles or transfers resulting from the death of an individual in a manner that does not trigger a violation of the transfer provisions of the loan documents. Is your client planning on a major corporate restructuring in the coming years? If so, the permitted transfer thresholds should be heavily negotiated so as to enable as much flexibility as possible to accommodate the corporate restructuring, with as minimal interference as possible from the lender. When representing a borrower, the approach to negotiating the transfer provisions of the private capital or CMBS loan documents should thus not be as elementary as blindly broadening the permitted transfers definition; but alternatively, they should be narrowly tailored to the client's particularized composition and mandate.

If you have questions regarding the topics addressed above, please contact the authors or any attorney with FBT Gibbons' Commercial Real Estate Finance Team. In case you missed or want to revisit

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prior posts in this series, you can find links to those articles below. And stay tuned for the next installment of the *Beyond Agency* series.

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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