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What is a Negative Pledge in Financing Transactions?

A negative pledge is simply an agreement between the owner of a charged asset and a lender stating that the owner will not create further security without the agreement of that lender. In commercial property investment and development loans, that agreement is often, but not exclusively, contained in a loan agreement or charge deed. Irrespective of in which finance document this agreement is found, it is common that such a pledge applies not only to a limited number of assets but often to all assets of the borrower, including assets acquired in the future. It is this latter point that is extremely important for all commercial borrowers to appreciate.

What are the practical implications?

When it comes to commercial real estate (including residential development sites being financed or refinanced), it is usual for a negative pledge restricting further security over any asset it owns to be given by a commercial borrower, even when a commercial borrower believes that a first lender is only really concerned with being granted security over just one property and no other asset. The effect is that if a commercial borrower subsequently decides to grant future security over another property or any other asset in which an unpaid first lender isn't really interested, including a property or other asset acquired later, consent of that first lender will often be required prior to the creation of this additional, standalone security.

In addition, new lenders will then typically require that commercial and development borrowers and their other secured lenders enter into a contract called a deed of priority, which sets out which of those lenders should be paid first on the sale of an asset and which lender will have the right to take enforcement action against a commercial borrower should the need arise.

All of this can lead to additional costs and delays that perhaps are not foreseen at the outset.

What if new security requires consent but that consent is not obtained?

Notwithstanding the presence of a negative pledge, a commercial borrower sometimes grants security to a new lender without consent in respect of an asset in which that commercial borrower believes an unpaid original lender has no concern. However, by virtue of an earlier negative pledge, that unpaid first lender is often entitled

to be consulted prior to the new security being put in place. The commercial borrower's actions are often innocent, but nonetheless, they constitute a breach if the commercial borrower agreed with the unpaid lender that it would do something (i.e. obtain consent to a new charge of something) that it subsequently does not. Therefore, what can be the ramifications for a commercial borrower in this instance? The actions of the commercial borrower are likely to be an "event of default" under the terms of the loan.

The precise sanctions that the unpaid lender can impose following such an occurrence will depend upon the terms of the unpaid lender's loan. Still, it is usual that in such circumstances, the unpaid lender could enforce its security or seek immediate and full repayment of the outstanding loan balance (including unpaid interest together with any other sum for which the borrower is liable). An aggrieved unpaid lender may also be able to cancel undrawn amounts, including ceasing to provide a "rolling credit facility" and/or apply a default interest rate to existing borrowings which will inevitably be higher than the interest rate previously attributable to the loan.

Events of default under commercial loan agreements can trigger events of default or termination rights under other agreements, for example, other loan agreements or key supplier contracts entered into by the borrower. Further, if the event of default results in an unpaid lender demanding full and immediate repayment of the outstanding loan balance, this could mean that the commercial borrower has no choice but to enter some kind of insolvency process.

Conclusion

The process of obtaining consent to security in which an unpaid first lender is not interested is usually straightforward, although it is not always swift. It is, however, advisable to make an early approach to a lender with the benefit of a negative pledge if delays are not to become troublesome. A well-advised commercial borrower will, of course, be aware of the consequences of breaching its banking agreements and ensure that it does not break them. Ignoring the covenants isn't an option.

Need advice?

Our [Real Estate](#) team has extensive expertise in [commercial property finance transactions](#), often advising on refinancings as well as acquisitions and redevelopment matters. If you would like advice on negative pledges or any other real estate finance matter, please contact our team at online.enquires@LA-law.com or contact [David](#) on the details above.