

COVID-19: REAL ESTATE FINANCE AND COVID-19 - WILL COVID-19 TRIGGER A MATERIAL ADVERSE CHANGE (MAC) CLAUSE?

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UK Real Estate Finance Alert

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K&L Gates has established a [global task force](#) to guide our clients and contacts through a full spectrum of practical issues to address their issues around COVID-19. In this Alert our real estate and finance lawyers will look at whether COVID-19 can trigger Material Adverse Change Clauses (MAC) in facility and loan agreements.

MATERIAL ADVERSE CHANGE CLAUSES - BACKGROUND

These clauses exist to protect lenders by capturing circumstances which are not predictable and can't be foreseen, so circumstances which would not usually be catered for by other clauses in a commercial loan document or facility agreement. In this Alert we are only focusing on the laws of England and Wales.

WHAT IS A MAC CLAUSE?

MAC clauses are not standardised and their exact drafting will differ document by document, the final wording resulting from negotiation between the parties. The related definition in the Loan Market's Association form of real estate facility agreement references, amongst others, events that have "a material adverse effect on: (i) the business, operations, property, condition (financial or otherwise) or the prospects of an Obligor or (ii) the ability of an Obligor to perform its obligations under the Finance Documents".

A representation that there has been no MAC is generally included as a repeating representation in a loan or facility agreement (normally repeated as a condition to each drawdown) and a MAC generally also amounts to an event of default.

Where there has been an MAC a lender may have sound reasons for wanting to walk away from a loan transaction (ie call a default), or to put a stop to further lending (to avoid increasing its exposure to the borrower), maybe particularly currently where the exposure is to a business hard hit by the current crisis (for example the hospitality sector or retail). However, those reasons need to be balanced against the serious risk to the lender of wrongfully calling a MAC (both in terms of risks to its reputation and the risk of claims against it for wrongfully making such a call) and so the particular wording and the particular facts will require careful consideration. Trading difficulties directly caused by the COVID-19 crisis (or the associated Government directives) may also cause other defaults, for example, failure to meet payment obligations (interest or principal) or breach of financial covenants and these might be less susceptible to challenge. Events of default relating to cessation of business and expropriation should also be considered.

WILL COVID-19 TRIGGER MAC CLAUSES IN LOAN/FACILITY AGREEMENTS?

The real estate industry is already feeling the significant financial impact of COVID-19. Lenders and borrowers will be considering the impact on their own arrangements especially where they operate in an industry or sector particularly affected by COVID-19 and MAC provisions may provide a means for lenders to protect their lending positions. As with the review of clauses in any legal agreement, it is predominantly about the drafting, and it is important for advice to be taken on an individual basis, mindful of individual circumstances and impact on both lenders and borrowers. There has been surprisingly little case law on MAC clauses. However, the 2013 case of *Grupo Hotelero Urvasco S.A. V Carey Value Added S.L.* provided some useful guidance:

- *Interpretation:* The actual interpretation of a "material adverse change" clause depends on the particular terms of the clause construed.
- *Materiality:* A change will only generally be material if it significantly affects a borrower being able to repay its loan and perform its obligations under the relevant agreement. An assessment of the financial condition of the borrower should normally begin with its financial information at the relevant times, and a lender seeking to demonstrate a MAC should show an adverse change over the period in question by reference to that information. However the enquiry is not necessarily limited to the financial information if there is other compelling evidence. In the current situation, other factors such as government relief packages, currently being implemented on an almost daily basis, should also be taken into account.
- *How long will the impact last for, is it temporary or likely to be more permanent?:* In order for a change to be "material" it should not be temporary. So if the event itself is temporary, it must have a longer lasting impact on the borrower in order to constitute a MAC.
- *There needs to be a change in circumstances:* A lender cannot trigger such a clause on the basis of circumstances of which it was aware at the time of the agreement. For new documents entered into now, parties will know about the pandemic and therefore the current circumstances alone will not constitute a MAC (unless there is a subsequent further material adverse change).
- *Burden of proof:* It is up to the lender to prove the breach.

Dependent upon the particular circumstances, the outcome that a lender may seek to achieve from a MAC will be different. In some cases the event will be used by the lender to force a renegotiation of its lending terms or perhaps to require additional security. However, where the event giving rise to the MAC has caused a serious deterioration in the borrower's position and there seems to be no prospect of recovery, the outcome will likely be more extreme and may result in its calling a default and acceleration.

The Courts have historically reviewed MAC clauses very narrowly and case law is very much based on individual drafting of the clauses in light of whether the borrower can manage its capital reserves. If a clauses are more "lender friendly", so wording allowing a "lenders opinion" for example to be taken account of, there may be more leeway for a lender to invoke the clause. That would need to be weighed against the bigger picture of what other lenders might be doing on an industry level.

Ultimately dialogue between lenders and borrowers in the months ahead will be critical, and we would advise dialogue at an early stage. Our real estate and finance team are on hand and please contact [Richard Hardwick](#)

with any queries either specific to MAC clauses or other questions around loan/finance agreements impacted by COVID-19.

BELOW ARE SOME PRACTICAL RESOURCES

The government has produced a package of measures to support businesses affected by the disruption caused by COVID-19. The link to the webpage is below. This may assist borrowers in complying with financial obligations in their loan agreements.

TCCFF is also known as the joint HM Treasury and Bank of England Lending Facility – see link to Bank of England website. –

- [Bank of England](#)
- [Coronavirus Action Plan](#)
- [COVID-19 Task Force](#)
- [COVID-19 Guidance to Employers & Businesses: Support for Businesses](#)

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