**Documentation – term sheet**

This element presents the key elements of a term sheet for a loan transaction and how this will form the basis for drafting the facility agreement.

N.B. clause references throughout this element are to the LMA Agreement.

**What is a term sheet ?**

A term sheet is a document setting out the principal terms of the facility agreement between the parties – it can be referred to as ‘heads of terms'. It will be attached to the mandate letter, which will be signed by both lender (Arranger if the loan is syndicated) and borrower.

Term sheets can be anything between 2 and 80 pages long (and in some very complex transactions, even longer than this). Broadly speaking, the lender’s in-house counsel (for less complex deals) or the lender’s external lawyers (for more complex transactions) will usually draft the term sheet (as well as the mandate letter and fee letter). It is also common for the borrower’s counsel to draft these documents, so the loan documents reflect a more borrower friendly position from the beginning. In general, a straightforward bilateral or syndicated loan (‘plain vanilla’) will have a short-term sheet and structured transactions (such as those involving acquisitions or project finance) will have a longer, more detailed term sheet.

The more non-specific the terms of the term sheet and the simpler the structure, the less important it is that lawyers be involved at this stage. However, borrowers will usually want their external lawyers to review the term sheet before it is agreed.

**What is the legal effect of a term sheet?**

A term sheet is non-binding save for the provisions relating to confidentiality and costs and should therefore contain the wording ‘**subject to contract**’ clearly at the top of it. However, it is normally considered to be morally binding.Where there is a mandate letter, provisions relating to confidentiality and costs are usually included in the mandate letter, which is legally binding.

**Function of the term sheet**

The term sheet provides an overview of the deal before the parties start working on the loan agreement itself. It is unlikely to contain detailed drafting. It serves as the initial summary of the fundamental terms of the loan. It assists the solicitors in estimating their fees for the transaction. The lender's lawyers will use it to draft the loan agreement, and the borrower's lawyers will use it when reviewing the draft to check that it reflects the terms agreed between the parties.

Alternatively, the borrower's lawyers may draft the loan agreement in which case the loan agreement will be considerably more borrower friendly. Note that in some deals, e.g. where the documentation from a previous deal is agreed to be used as a precedent, a formal term sheet may not be prepared. However, on this knowledge stream, you will be encountering a term sheet prepared by the lender.

[Pen Symbol]

**Task:** What do you think a term sheet would contain? Take a brief moment to draw yourself a mind map of possible areas you think the term sheet should cover, remembering that it provides an overview of the fundamental loan terms.

NB: You will see a completed term sheet in Workshop 1.

**Mind map**

[Diagram: shows “Contents of a term sheet” in centre with arrows pointing to

· Boilerplate clauses

· Date and parties

· Type and amount of facility/ies

· Availability Period and termination date of facility

· Dates for repayment / schedule of repayments

· Voluntary/ mandatory prepayments

· Interest payments and other pricing

· Conditions precedent

· Representations and warranties

· Undertakings

· Events of default

· Guarantees and security

· Costs

**Contents of the term sheet**

**The term sheet comprises clauses which are both deal specific and boilerplate, including the following:**

Date, parties (including any guarantor(s)), type, amount, availability period and termination of the facility;

Repayment and prepayment of principal and payment of interest including:

o dates or schedule for repayment as applicable;

o voluntary prepayments (when, notice period and minimum amounts);

o any mandatory prepayment requirements in certain situations, e.g. change of control of the borrower normally gives rise to a prepayment obligation; and

o terms of interest payments; and

· Conditions precedent, representations and warranties, undertakings, events of default.

The term sheet will typically only explicitly state any unusual / deal-specific provisions, referring to all others as those “usually included in this type of facility”.

The main exceptions or carve-outs to undertakings may be stated “to be agreed” or a borrower may try to get these agreed at the term sheet stage, if they feel strongly about a particular exception or carve-out.

It is important that where a list of provisions is not exhaustive, a clear phrase such as “…including but not limited to” is used as a preface.

**Confidentiality issues**

The borrower will be subject to an obligation not to disclose the contents of the term sheet other than to their legal and financial advisers for the purposes of the transaction. If there is no mandate letter, this should be included in the term sheet and be expressed as legally binding.

In addition, the borrower will be keen to ensure the lender treats all information gathered about the borrower during the due diligence process as confidential. Accordingly, a separate confidentiality agreement (also known as a non-disclosure agreement or NDA) will be entered into containing an undertaking given by the lender not to disclose confidential information about the borrower other than in restricted circumstances to aid syndication. Any lender considering participating in the syndicate will be required to sign a 'back-to-back' confidentiality agreement before receiving any information about the borrower.

**Costs**

If the loan does not go ahead, substantial costs may already have been incurred (e.g. legal fees). The term sheet should, therefore, include an obligation on the borrower to pay the lender’s costs whether or not the loan is completed, together with any fees charged by the bank (e.g. a cancellation fee).

Again, this obligation on the part of the borrower should be expressly stated to be legally binding, which is why it is usually set out in the mandate letter instead of the term sheet.

**Boilerplate clauses**

These are clauses that are standard terms and which appear in some form or other in all loan agreements. They are provisions which govern the relationship between the parties and enforcement of the agreement including fees, governing law and jurisdiction etc.

The term sheet will state at the top that it is **subject to contract.**

**Subject to contract- Disclaimer in LMA form of term sheet**

'Please note that the terms set out in this term sheet are indicative only and do not constitute an offer to arrange or finance the Facility/ies. The provision of the Facility/ies is subject to due diligence, credit committee approval, the terms and conditions of the Mandate Letter (if one is used) and satisfactory documentation.'

**Term sheet terminology**

‘**Facility’ or ‘Facilities’**- This can, depending on the context, mean the overall facility under which monies will be lent and, at the same time, the individual RCF or term loan facility comprised within the overall facility / facilities.

‘**Utilisation’ or ‘Drawdown'**- The borrowing of money under a loan facility.

**‘General corporate purposes’**- Usually seen in the ‘Purpose’ clause of a facility agreement in relation to an RCF.

**‘Availability Period’ or ‘Commitment Period’ -** Usually seen near the beginning of the term sheet.- The period in which the loan may be drawn down by the borrower, e.g. for a term loan, say three months after execution. For an RCF, the availability should be until shortly prior to termination of the facility because the borrower can draw down, repay and later re-draw part or all of the facility throughout the life of the loan. This is the nature of an RCF.

‘**Acceptance’ / ‘Available’** – usually seen near the end of the term sheet. The period for which the terms of the loan contained in the term sheet will be available to the borrower to accept. After this time the term sheet may need to be renegotiated.

‘**Repayments’ As opposed to….** The scheduled repayments set out in the repayment schedule, i.e., principal repaid to the lender.

**‘Prepayments’-** The borrower repaying the loan early:

· Voluntary: sums repaid to the lender voluntarily in order to reduce the loan. Voluntary prepayments are generally subject to a minimum amount. Prepayment fees may also be charged.

· Mandatory: payable on the occurrence of certain events, e.g., change of control of the borrower - to be considered in a later Workshop.

**‘Fees’ -** The lender’s fees, e.g. arrangement fee, commitment fee etc. The exact amounts may appear in a separate fee letter in order to preserve confidentiality.

**‘Costs’ -** The expense of setting up the deal e.g. advisers’ fees. If loan negotiations break down and the deal does not go ahead the borrower will be obliged to pay the costs that the lender has incurred. This term will be expressed to be binding whether it is in the term sheet or the mandate letter or indeed a separate fees letter.

**From term sheet to loan agreement**

Once a term sheet is agreed and signed by both parties, work on drafting the loan agreement will start.

Although no two loan agreements will be the same, as a starting point each one should be able to answer the 6W questions: Who owes What to Whom, When, Where and Why?

· Who? The borrower (and any guarantor);

· What? Loan amount, type of facility, definitions clause;

· Whom? Correct details and capacity of lender(s);

· When? Date of loan, repayment and interest payment dates, CPs to be satisfied;

· Where? Availability of facility; and

· Why? Purpose of the facility.

Naturally, loan agreements contain many more provisions than these, as you will come to see over the next few workshops.

**Drafting of the loan agreement**

**Lender’s perspective on drafting the loan agreement**

Lenders will try to minimise the **risk** of not getting their money back by finding out as much as possible about the borrower and its business before granting the loan – see **due diligence** (Element 1).

Lenders will also use their **internal credit assessment** to determine the level of interest and fees charged, and whether security is required. The rigidity of the undertakings, financial covenants, representations etc. will also be determined by this internal credit assessment of the borrower. The higher the risk for the lenders, the higher the fees and interest charged, the more onerous the provisions in the documentation and the more likely guarantees and security will be required.

Lenders base their credit assessment on the borrower undertaking a certain kind of business with certain assets and will want the borrower to maintain this status quo throughout the life of the loan. In order to protect itself, the lender will ensure the loan agreement expressly states the purpose of the loan (restricting other use of the funds) as well as **restricting any change** in the nature of the borrower and its assets. It is likely to prohibit significant disposal of assets and the creation of security so that no other interested party can take priority or compete with the lender’s claim against the borrower’s assets.

**Drafting of the loan agreement will be explored in Workshops 2 and 3**

**Borrower’s perspective on drafting the loan agreement**

A borrower will want the cheapest available funds from a lender while retaining **flexibility** to run its business as it currently does. A borrower will be concerned about excessively onerous provisions which restrict the day to day running of its business (and indeed the expansion of its business). It would be administratively burdensome on the borrower and will slow-down its day to day operations if it is regularly required to seek waivers from the lenders..

A borrower will want the ability to keep hold of the funds until maturity of the loan and to run its business without the interference of the lender.

**Compromise position**

Both parties to a commercial deal will understand the tension between the borrower’s desire for funds ‘without strings’ and the lender’s desire for control. In order to get the deal done, compromises will have to be made by both sides.

As a debt finance solicitor, you need to be able to advise from both perspectives, so that the loan can be put together constructively and co-operatively. Respective bargaining positions and the state of the market will both play a part.

**Summary**

• The term sheet sets out in overview the principal terms of the loan agreement between the parties. Subject to certain specific exceptions (e.g. confidentiality and costs), it is not intended to be legally binding.

• The term sheet will serve as a basis for drafting the loan agreement. It will also be used for marketing the loan, in conjunction with the information memorandum. Advisers will use the term sheet in order to estimate fees.

• The term sheet will cover areas including parties, facility amount, duration, payments of interest and capital, prepayments, fees, guarantees, security, conditions precedent, representations, undertakings, events of default etc.

• There is a natural tension between the perspectives of the borrower and lender in drafting the loan agreement. The lender will wish to protect itself against risk and therefore impose significant restrictions on the borrower, whereas the borrower will seek flexibility. The compromise position ultimately reached will also be influenced by respective bargaining power and the current state of the lending market.