

Covenant-Lite Loans: Overview

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This Note explains the typical features of covenant-lite loans and examines the benefits and drawbacks of covenant-lite loans for borrowers and lenders.

A covenant-lite (or cov-lite) loan is a borrower-friendly type of loan facility found in certain leveraged financings. Cov-lite loans are most likely to be found in syndicated loan transactions.

The core feature of any cov-lite loan is the absence of financial maintenance tests requiring the borrower to meet certain performance criteria monthly or quarterly (see Box, Purpose of Financial Covenants). A cov-lite loan also typically has a covenant package with features similar to high-yield bonds, including incurrence-style negative covenants. However, cov-lite loans can come in many different variations having some or all of the features discussed in this Note (see Cov-Lite Loan Provisions).

Cov-lite loans are a well established feature in the leveraged lending marketplace. Although investors pushed back on the terms of some leveraged loans issued in the third and fourth quarters of 2018, overall the trend toward cov-lite loans continued in 2018. In 2018, cov-lite loan volume in the US reached \$911 billion, an approximate 26% increase over 2017. At year end, cov-lite loans represented approximately 79.81% of the outstanding \$1,147 billion US leveraged loans, according to S&P Global Market Intelligence's Leveraged Commentary & Data. In 2018, the total volume of covenant lite loans reached 85%, the highest ever.

This Note explains the:

- Typical provisions of cov-lite loans.
- Elements of cov-lite loans.
- Pros and cons of cov-lite loans for borrowers and lenders.

For links to cov-lite credit agreements, see Practice Note, What's Market: Covenant-Lite Loans ([8-506-5054](#)).

COV-LITE LOAN PROVISIONS

Although every cov-lite loan transaction is different, there are some common patterns and themes in the structures. Cov-lite features are most commonly found in cash flow financings, but they also appear in certain asset-based lending (ABL) transactions. In 2018, certain borrower-friendly provisions in cov-lite transactions became even more borrower-favorable than those in prior years. In the fourth quarter of 2018, certain cov-lite terms temporarily shifted in favor of lenders as demand for loans slowed; however, in early 2019, terms loosened up again to borrowers' advantage and borrower-friendly terms continue.

CASH FLOW DEALS

A typical cov-lite cash flow loan has the following structure:

- One loan agreement that includes both a funded term loan or series of term loans and, possibly, a relatively smaller revolving credit facility. If there is not a revolving credit facility, a separate ABL may be used in cash flow financings.
- All of the credit facilities share the same covenants (other than, if there is an included revolving facility, financial maintenance covenants or "springing" financial maintenance covenants), mandatory prepayments and events of default.
- All of the credit facilities are secured by the same collateral, which the facilities share ratably.

Generally, these deals either have no financial maintenance covenants or financial maintenance covenants that only apply to any included revolving credit facility (see Box, Purpose of Financial Covenants). In the latter case, remedies upon a breach of the financial maintenance covenants (usually a single covenant, such as a maximum leverage ratio) will be within the control of the revolving credit lenders only. The revolving credit lenders (usually by majority vote of the class), to the exclusion of the term loan lenders, will have the power to:

- Amend or waive the terms of the financial covenants.
- Declare an event of default relating to a breach of the financial covenants.

- Direct the exercise of remedies (including termination of the revolving commitments to lend, acceleration of debt and foreclosure of collateral) resulting from an acceleration based on breach of the financial covenants.

In certain transactions, if the revolving credit lenders do not agree to a waiver of the breach within a specified time period (usually between 45 and 90 days) the term loan lenders may declare a default and begin exercising their remedies for the breach of the financial maintenance covenant.

It is also typical in these cov-lite loan transactions with included revolvers for the financial maintenance covenants to be “springing” in nature. This means they will only apply to the revolving credit facility if certain thresholds are met. For example, the threshold can be that any revolving credit loans are outstanding or the revolving credit outstandings are above a certain dollar amount or percentage of the total revolving commitments. A borrower may also be able to negotiate a basket for issuing a certain amount of letters of credit before the covenant applies. As a result, the borrower can avoid being required to meet any financial maintenance covenant if, at the time the covenant would otherwise be measured, it reduces its revolving credit usage below the threshold trigger. For this reason, among others relating to credit risk, lenders may in some transactions require the financial covenant to be satisfied on a pro forma basis as a condition to making new revolving credit loans or issuing or extending letters of credit.

In contrast, in deals with full financial maintenance covenants, breach of one of these covenants is normally an immediate event of default regardless of the amounts outstanding at the time. If an event of default occurs, the Agent or all of the lenders (term and revolving lenders voting as a single class) by majority vote can exercise available rights and remedies.

ASSET-BASED LENDING

Cov-lite loans can also be structured using an ABL component for the revolving credit portion. Typically, this involves an ABL revolving credit facility with a separate cash flow term loan (or multiple term loans).

In these transactions, the ABL revolving credit facility is documented separately from the term loan, and will have a different covenant package and prepayment events. The ability of the borrower to use the ABL facility is limited by a borrowing base formula often tied to a percentage of accounts receivable and a percentage of inventory meeting certain eligibility criteria in the ABL documents. The ABL documents generally have a springing financial maintenance covenant for minimum fixed charge coverage. Unlike a cash flow cov-lite loan transaction where springing covenants are tied to the usage of the revolving credit facility, the trigger in an ABL cov-lite transaction is, typically, tied to the amount of remaining availability under the borrowing base formula.

In an ABL cov-lite transaction, the term loan is documented in a separate agreement that would not have any financial maintenance covenants. To prevent the term loan lenders from getting the benefit of the ABL financial maintenance covenant, the term loan agreement usually has a cross acceleration to the ABL facility rather than a cross default. This means the occurrence of an event of default in the ABL facility will not trigger an event of default under the term loan facility unless and until the ABL lenders have accelerated their debt.

For more information on ABL transactions, see Practice Note, Asset-Based Lending: Overview ([1-500-8019](#)).

COMMON COV-LITE FEATURES AND BORROWER FRIENDLY DEVELOPMENTS IN 2018 – EARLY 2019

The absence of a financial maintenance covenant for the benefit of the term loan lenders is the core feature of a cov-lite loan. Cov-lite loans also often have other borrower-favorable terms that make the restrictions on the borrower more like high-yield bonds than traditional loan transactions with full covenant packages. In particular, cov-lite loans have looser negative covenants. Many cov-lite loans allow the borrower to take one or more of the following actions, subject to certain restrictions:

- **Incur additional debt.** Rather than having a hard dollar cap on the amount of additional debt a borrower can incur, many cov-lite loans allow an unlimited amount of debt above an untested cap if the borrower meets an incurrence test after giving effect to the incurrence of the new debt. Often the incurrence test is a maximum leverage or net leverage ratio or a minimum interest coverage ratio. Additionally, in most cov-lite transactions, if a borrower incurs debt under its fixed incremental basket and its ratio basket at the same time, it can exclude the fixed amount from the ratio calculation.
- **Incur additional secured debt.** Even if a borrower can incur additional debt, additional liens on the collateral may not be permitted by the security arrangements entered into with the initial lenders. However, cov-lite loans typically allow the borrower to grant additional liens to secure newly-incurred debt (thereby diluting the security of the initial lenders), if the borrower meets an incurrence test. Often this test is a maximum leverage or net leverage ratio that applies to secured debt or first lien debt.
- **Incremental debt.** Incremental debt provisions continue to be more borrower friendly in 2019.
 - **Amount of debt.** The fixed amount of incremental debt permitted and not subject to any ratio incurrence test has increased. Often the fixed amount now includes a “grower” concept so that the fixed amount is the greater of a dollar amount and a percentage of EBITDA. This provides the borrower with greater flexibility to incur more debt without being in pro forma compliance with the incurrence ratio. The borrower often has the ability to reclassify the incremental debt that was incurred under the fixed amount basket as having been incurred under the ratio basket.
 - **Most favored nation pricing protection.** Rather than maintaining strict protections for existing lenders under incremental debt provisions, many most favored nation provisions (MFN) became more borrower-favorable by (a) completely excluding from the MFN a fixed amount of incremental debt, (b) permitting a basket of incremental loans to mature sooner after the maturity (or have the same weighted average life to maturity) of the then existing term loans than previously allowed, (c) permitting a higher interest rate spread (75 basis points or more) between the incremental loans and the then existing term loans, and (d) excluding the proceeds of incremental loans to be used to finance an acquisition from MFN protection. In some multicurrency facilities, the MFN may only apply to term loans made in the same currency as the new incremental loans.

- **Basket reclassification.** Borrowers are frequently permitted to reclassify indebtedness originally incurred under the initial fixed dollar-based baskets as debt incurred under a ratio-based basket once their financial performance improves enough to satisfy the relevant ratio test. Reclassification permits borrowers that have fully used up their dollar-based baskets to re-load the baskets (that is, provide for additional capacity). Reclassification is often used in both the general indebtedness basket as well as the fixed dollar-based basket in the incremental facility provisions.
 - **Mandatory prepayments.** Some borrowers successfully negotiated leverage-based step-downs for the excess cash flow and asset sales subject to mandatory prepayment requirements with the ability to add the retained amounts to the “available basket” that can be utilized, among other purposes, to make restricted payments, investments and to prepay junior debt. Additionally, “soft call” repricing protections have weakened in some cases by reducing the fee the borrower must pay to lenders in connection with certain repricing transactions undertaken by the borrower or shortening the period of time the protections apply.
 - **Pay dividends.** Rather than prohibit dividends or cap them at a fixed amount annually or over the life of the deal, or both, many cov-lite loans allow dividends (much like a typical high-yield bond deal), subject to either a limit based on a percentage of net income or EBITDA at any given time and, in many transactions, on an unlimited basis subject to satisfaction of a leverage or net leverage test.
 - **Make acquisitions.** Rather than cap acquisitions at a fixed amount, per acquisition, annually or over the life of the deal (or some combination of caps), cov-lite loans typically allow unlimited acquisitions, subject, in some cases but not all, to the borrower showing pro forma compliance with an incurrence test. Often, in transactions with both a revolving credit facility and a cov-lite term loan governed by the same document, this incurrence test is pro forma compliance with the level set out in the financial maintenance covenant applicable to the revolving credit facility at that time, regardless of whether the covenant is required to be complied with at that time. Other tests may be a maximum leverage or senior leverage test at a level set out in the acquisition covenant. The level may be based on the closing leverage or slightly above or below it.
 - **Repay junior debt.** A common negative covenant in leveraged loans is limitations on repaying a defined class of junior debt. Junior debt may include second lien, unsecured or subordinated debt. Likely, the junior debt is more expensive than the borrower’s first lien debt so it is beneficial for the borrower to pay down the junior debt. Many cov-lite loans allow borrowers to repay junior debt subject to compliance with an incurrence test.
 - **EBITDA addbacks.** Borrowers and sponsors continue to obtain friendly EBITDA adjustments. Since most covenant compliance, grower baskets, and potentially pricing are determined by reference to EBITDA, this issue has become heavily negotiated. Current borrower-friendly trends to EBITDA adjustments include: permitting projected cost-savings not connected to acquisitions or reorganizations, increased or removal of caps on pro forma cost-savings synergies, longer look-forward periods, board expenses, severance and relocation costs, synergies “of a type” shown in a sponsor’s QOE report, accrued dividends on preferred stock, expenses due to exercise of employee options, indemnification payments that are reimbursable by third parties, and others.
 - **Collateral leakage and designation of unrestricted subsidiaries.** As cov-lite agreements have become more borrower-friendly, lenders have grown increasingly concerned about collateral leakage out of the restricted group from whom the lenders are primarily looking to be repaid. Several negative covenants, taken together, provide flexibility for loan parties to move assets to entities outside of the credit group. In this regard, the credit agreement covenants are moving to resemble high-yield bond packages. However, some deals now limit the ability of a borrower to transfer key assets to an unrestricted subsidiary as a result of one high profile transaction where a borrower used this flexibility to move material IP to an unrestricted subsidiary.
- In all of these covenants, many times the incurrence-based tests will be additive to the fixed dollar baskets found in traditional credit facilities.
- ### PROS AND CONS FOR BORROWERS
- Cov-lite loans present the following benefits for borrowers:
- **Reduced risk of default.** Freedom from having to meet financial maintenance covenants allows a borrower to keep its credit facility in place even if the business underperforms relative to expectations as long as interest and other obligations are met. This removes the risks to a borrower of having extended and possibly costly workout negotiations with its lenders to waive or avoid a financial maintenance covenant default, which can result in higher interest rates, payment of fees and loss of negative covenant flexibility. It also lowers the risk of other negative consequences of breaching the financial maintenance covenants including a potential cross-default to other agreements (see Box, Purpose of Financial Covenants: Consequences of Non-compliance). The default rate for loans is below the historical average but average recovery rates have fallen since 2010. Over the last twelve months, among defaulted loans, over 65% were cov-lite loans.
 - **Greater flexibility.** The looser incurrence style negative covenants that are often included in cov-lite loans enable the borrower to engage in other transactions (such as acquisitions) without having to worry about seeking lender consent, paying consent fees or being unable to obtain the necessary consent.
 - **Reduced risk of losing ownership or control.** When a borrower defaults, or might default, it may find that there are divergent goals among its lenders. Traditional lenders such as banks, insurance companies and certain institutional investor categories of lenders, such as CLOs and prime rate funds, may have a goal of repayment in full or having a loan with market terms that will trade at par in the secondary loan market. Other lenders, such as hedge funds and distressed investor funds, may view the ownership of the troubled borrower’s debt as a path to owning or taking control of the borrower. The more difficult it is for the borrower to default, the harder it is for the distressed investor to try and obtain control of the borrower.
- For a borrower, there does not appear to be many disadvantages in having a cov-lite loan. A borrower may have to pay a slightly higher interest rate for a cov-lite loan, although this is not universally true. A borrower that pays more for a cov-lite loan may end up overpaying if it performs as expected or better and does not use the additional flexibility of the incurrence style covenants. However, the incremental

cost, if there is one, is small and the benefits generally seem to greatly outweigh the costs.

Another risk, especially in a transaction with a combined revolving credit and term loan in one document, is the potential for an activist lender to obtain voting power disproportionate to its share of the facility. Because only 50% of the much smaller revolving credit facility (rather than 50% of the entire debt amount (term loan plus revolving facility)) is needed to block an amendment or declare a default, an activist lender can potentially gain greater influence and control over the process with a smaller investment. A borrower may have consent rights over assignments to new lenders, but it may be hard to keep out the activist lender because that right has to be exercised reasonably. To help protect against this risk, many cov-lite loans require borrower consent (at least prior to an event of default or certain defaults such as payment or bankruptcy) for assignments of revolving credit commitments to lenders that only hold term loans. An activist lender is not likely to seek to own the revolving commitment prior to the borrower experiencing distress, so this feature may make it easier for the borrower to keep them out of the revolving credit facility.

Other arguments against a cov-lite loan from the borrower's perspective are theoretical. Some have argued that a borrower and its management benefit from the focus and discipline of having to meet financial maintenance covenants quarterly, and as a result, they may do a better job of maximizing profit. Another argument is that incurrence style negative covenants can allow a borrower to engage in transactions that would otherwise be restricted by a fully-covenanted deal, which may involve taking on too much debt or overpaying for an acquisition.

PROS AND CONS FOR LENDERS

From a lender's perspective, cov-lite loans may dilute many key lender protections, such as:

- **Early warning of payment default.** The early warning provided by the periodic financial maintenance covenant can alert lenders in advance of a possible payment default or bankruptcy.
- **Avoiding unfavorable transactions.** The lack of limits otherwise provided by tighter negative covenants can allow the borrower to enter into transactions that are not beneficial to the lenders.
- **Security interest in collateral.** The ability of the borrower to incur additional secured debt may dilute the lenders' collateral coverage for their loans.
- **Priority over junior creditors.** If the borrower is permitted to repay higher-cost junior debt prior to a default on the lower-cost credit facilities, the senior lenders would then have to work out loans with an underperforming or over-leveraged borrower without the cushion of the junior debt (whose repayment depleted the borrower's available cash).

In a fully-covenanted transaction, if the borrower cannot meet its financial maintenance covenants or wishes to engage in a transaction that the negative covenants prohibit, the borrower and the lenders can negotiate a waiver or amendment. In these negotiations, the lenders, acting as a group, have the option to provide relief in return for concessions by the borrower that either compensate the lenders

for increased risk (such as increased interest and fees) or further protect the lenders through tighter covenants or new events of default. The lenders also have the option to refuse to provide relief and try to exercise remedies or precipitate a bankruptcy. In a cov-lite deal, these options are significantly reduced.

For a Note describing the process of amending a syndicated loan agreement, see Practice Note, Loan Agreement: Amendments ([5-382-7142](#)).

The benefits for lenders in a cov-lite loan seem to be more limited. As discussed, the lenders may (but may not) receive a higher yield than in a fully-covenanted loan. However, other benefits seem to be highly theoretical. One argument is that the lenders may ultimately enjoy a greater recovery if an underperforming borrower is given time to improve its performance without the pressure of financial maintenance covenants and the costs and distractions of a workout.

PURPOSE OF FINANCIAL COVENANTS

Financial covenants are one of the key protections for lenders in a leveraged loan transaction. Syndicated loan transactions generally are either investment grade or leveraged. Leveraged loans are perceived to have greater credit risk than investment grade loans.

Most often the distinction is determined by the rating on the loan from a rating agency. A loan with a rating in one of the four highest rating categories is typically considered an investment grade loan. A loan with a rating below the four highest categories is a leveraged loan. A loan without any rating can also be categorized as investment grade or leveraged based on how the borrower's credit profile, including its leverage ratio or interest or fixed charge coverage ratio, compares to rated loans for similar borrowers.

Because of their perceived greater credit risk, leveraged loans typically have greater protections for the lenders. These protections include, but are not limited to:

- Guaranties and security interests from the loan parties.
- Negative covenants limiting voluntary activities by the loan parties such as incurring indebtedness, selling assets, making investments or acquisitions, paying dividends or prepaying or repaying other indebtedness.
- Mandatory prepayments from the borrower from asset sales, excess cash flow and certain other events.
- Financial maintenance covenants to be satisfied by the borrower.

COMMON FINANCIAL MAINTENANCE COVENANTS

Financial maintenance covenants require a borrower to meet certain financial performance criteria periodically, usually quarterly but sometimes monthly. Failure by the borrower to meet the financial performance criteria can result in a default under the loan documents which potentially can have several adverse consequences (see Consequences of Non-compliance).

There are many types of financial maintenance covenants, but the most common are tied to an agreed definition of the borrower's cash flow available for debt service. Often this is defined as EBITDA (earnings before the deduction of interest, taxes, depreciation and amortization). Common financial maintenance covenants are:

- **Maximum leverage ratio.** The borrower must not exceed a specified ratio of debt to EBITDA (or some other cash flow measure). Depending on a borrower's capital structure and market conditions at the time of the loan, leverage tests can apply to total debt, secured debt, senior debt or first lien debt, and the loan agreement may include a combination of leverage tests. Many times a net leverage ratio is used, which gives the borrower credit for unrestricted cash on its balance sheet, sometimes up to a cap and other times unlimited.
- **Minimum interest coverage ratio.** The borrower must, at a minimum, meet a specified ratio of EBITDA (or some other cash flow measure) to interest expense. As with leverage tests, depending on a borrower's capital structure and market conditions at the time of the loan, interest coverage tests can apply to total interest or only cash interest that is payable on total debt, secured debt, senior debt or first lien debt, and the loan agreement may include a combination of interest coverage tests.
- **Minimum fixed charge coverage ratio.** The borrower must, at a minimum, meet a specified ratio of EBITDA (or some other cash flow measure) to an agreed definition of fixed charges. Some of the items that can be included in fixed charges are interest expense, capital expenditures, dividends and other distributions and scheduled payments of principal. In some deals, several of these items may be subtracted from EBITDA in the numerator of the ratio rather than included in the fixed charge denominator.

For more information on financial covenants, see Practice Note, Loan Agreement: Financial Covenants ([3-384-0955](#)). For Standard Clauses for financial covenants, with explanations and drafting and negotiating tips, see Standard Clauses: Loan Agreement: Financial Covenants ([2-383-3168](#)).

A leveraged loan that has financial maintenance covenants may have one, some or all of the covenants described above. The definitions and required ratio levels are set when the loan is negotiated. Normally, the required ratios are based on financial projections prepared by the borrower for the lenders plus a cushion on top of the projected performance. The purpose of financial maintenance covenants is to provide the lenders with an early warning that the borrower is not performing as expected and that action to improve performance or adjust the loan terms may be needed.

Financial maintenance covenants apply periodically at the times they are required to be tested, usually at the end of a quarter or, sometimes, at the end of a month. The borrower is required to comply with the financial maintenance covenants regardless of whether it is looking to engage in a transaction restricted by

its negative covenants or is currently able to pay its debt service and other obligations when due.

In contrast, an incurrence-based negative covenant only applies when a borrower wants to voluntarily engage in a transaction or activity restricted by that covenant. An incurrence-based negative covenant prohibits a borrower from those actions only if it does not comply with the specified incurrence test. Therefore, a borrower that is underperforming relative to its projections can avoid violating its incurrence-based negative covenants by not engaging in the activities restricted by those covenants.

For more information on negative covenants, see Practice Note, Loan Agreement: Negative Covenants ([5-383-3077](#)). For Standard Clauses for typical negative covenants, with explanations and drafting and negotiating tips, see Standard Clauses, Loan Agreement: Negative Covenants ([7-383-5792](#)).

CONSEQUENCES OF NON-COMPLIANCE

Failure to comply with financial maintenance covenants can have serious and adverse consequences for a borrower. In almost all loan agreements with financial maintenance covenants, failure to comply with any one of them will result in an immediate event of default under the loan documents.

One exception to this rule is if the loan agreement has an equity cure right. This right gives the borrower's parent company a right to contribute equity to the borrower in an amount that, when added to EBITDA, would cause the borrower to be in compliance with the failed financial maintenance covenant.

Equity cure rights, while not uncommon, are not a panacea for a borrower that is failing a financial maintenance covenant. The equity owners might be unable or unwilling to exercise the right, especially if the amount needed to cure is large or the borrower is expected to fail the financial maintenance covenant again on future test dates. In addition, the use of equity cure rights may be limited by the terms of the loan agreement. Although these rights are highly negotiated and vary from deal to deal, there are often limits on the number of times and the number of consecutive times they can be used. There may also be limits on the size of the equity cure amount, either individually or in the aggregate.

Generally, loan agreements treat all events of default more or less equally. Upon an event of default, lenders have the right, among others, to demand immediate repayment by accelerating the debt and to exercise collateral remedies. In practice, however, market participants do not treat all defaults with the same level of gravity. The most serious are payment and bankruptcy defaults. The next most serious are financial maintenance covenant defaults because they are a warning that a payment default or bankruptcy might be impending for the borrower.

The consequences for a borrower of a financial maintenance covenant default are numerous and varied and will depend on several factors, including the specific terms of the borrower's loan agreement and the composition of the lender group.

The consequences of a financial maintenance covenant default can include:

- **Loss of liquidity.** In a loan agreement with a revolving credit facility, it is usually a condition precedent that no default or event of default exists at the time a new loan is made. Even if the revolving credit facility is governed by a separate loan agreement that does not contain the failed financial maintenance covenant, the revolving credit agreement is likely to contain a cross-default provision to the loan agreement with the failed financial maintenance covenant, thereby preventing the borrower from satisfying the condition precedent and accessing the facility.
- **Reputational damage.** If the borrower is a public company or has public debt outstanding, it may have an obligation to disclose any breach of a financial maintenance covenant. Depending on the nature of the borrower's business, this disclosure can cause customers to leave and go to competitors who are perceived to be more financially sound. It can also cause suppliers to tighten credit terms, potentially further straining the borrower's liquidity.
- **Increased interest costs.** Many leveraged loan agreements require (or may allow lenders to require) the borrower to pay a default interest rate on its overdue loans. This rate is often a 2% per annum increase over the non-default rate. The borrower may also have to start using a higher index for determining its interest rate (such as base rate instead of LIBOR). Both of these consequences can potentially further strain the borrower's liquidity.
- **Cross default.** A financial maintenance covenant default in one loan agreement may result in a cross default in some or all of a borrower's other indebtedness. This can lead to greater pressure for protective bankruptcy filings to fend off aggressive creditors.

- **Distraction to management.** Management may need to spend significant time negotiating an amendment, restructuring or workout of the loan terms in order to waive a financial maintenance covenant default. This can distract management from running the business or fixing the problems responsible for the underperformance.
- **Acceleration.** The lenders may choose to accelerate their debt and demand repayment, which is very likely to lead to a bankruptcy filing.

In addition, if a borrower cannot meet its financial maintenance covenants or, possibly, if prior to a default a borrower cannot show its auditors projected compliance, the auditors may issue a "going concern" qualification in its annual audit because of all the consequences that can result from an event of default. In most leveraged loan agreements, this alone may cause an event of default because of a requirement for the borrower to deliver an unqualified audit. As a result, depending on the timing of when a borrower is no longer able to show projected compliance with its financial maintenance covenants, a borrower may have a default tied to its financial maintenance covenants long before it actually fails a test. Accordingly, since term lenders do not get the benefit of a springing covenant, the loan agreement in some cov-lite transactions may provide that it is not a default if the annual audit includes a qualification based only on the borrower's projected non-compliance with the financial maintenance covenants.

For a Note explaining events of default in loan agreements, including the rights and remedies of lenders, see Practice Note, *Loan Agreement: Events of Default* ([0-382-8276](#)).

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