



KEEPING YOUR NON-RECOURSE LOANS NON-RECOURSE

The good news is that even in today's tough credit markets, non-recourse loans are generally available. The bad news is that lenders have been expanding the "carve-outs" to non-recourse protection - eroding the benefit of the bargain that Borrowers and Guarantors thought they made. Unfortunately, it is very easy for these changes to go unnoticed, but a closer look is necessary to ensure Guarantors aren't met with an unhappy surprise, simply because a property failed to perform as projected and the non-recourse loan they thought they had, was not non-recourse.

Non-recourse Guarantees or "Bad Boy" Guarantees are exactly that - Guarantees where the Guarantor will only incur liability if the Borrower or Guarantor has taken certain specific acts, usually prohibit under the law or loan documents. Carveouts to this non-course protection should generally be limited to (i) fraud, (ii) voluntary bankruptcy, and (iii) theft of rents, each of which, to one degree or another, could have been avoided by the Guarantor, generally without outside factors coming into play. Not surprisingly, borrowers will want their non-recourse carveouts drafted very narrowly, as precise wording is essential to know whether the loan is truly non-recourse. More and more, however, there are loans being "sold" as non-recourse, which contain broad and even ambiguous carveouts that could either intentionally or unintentionally subject a Guarantor to personal liability even without doing anything "wrong."

The following are some troubling terms, which have made their way into some lenders' non-recourse guarantees, which may subject to a borrower to unknowing liability:

- ***"Any failure to pay real estate taxes, insurance premiums, or charges for labor or materials or any and all other charges which may create liens on the Property."*** A borrower can only pay such amounts to the extent there is income generated by the property to do so. Creating obligations to pay such amounts absent such rental income is antithetical to a non-recourse loan. Even "waste", typically viewed as a terrible sin among real estate owners, can only be avoid if there is money to pay for maintenance and repairs.
- ***"The borrower must not commit a default under any lease of all or any portion of the Property."*** While lenders do have a fair concern if their borrowers are breaching their commercial leases, this is not the kind of loan default that should trigger personal liability. After all, there could be a number of reasons why a lease is breached (or alleged to be breached) by a borrower/landlord which could arise in the borrower's reasonable business judgment.
- ***"The borrower must remain solvent."*** Including a solvency requirement negates the entire benefit of a non-recourse loan, which would otherwise allow a borrower to walk away from the property if the property is no longer profitable.
- ***"Any attempt by Borrower to delay or enjoin of any remedies provided to Lender under the Loan Documents, raise defenses or counterclaims in connection with any such enforcement action, or otherwise object to any actions taken by Lender to exercise any remedies under the Loan Documents"***. It is unfair for a borrower to open itself up for personal liability simply by challenging a lender that it believes is acting without just cause.

Lastly, Borrowers should be wary of word games. Lenders may substitute one appropriate carveout, with another similar sounding, but very different one. For example, a Borrower or Guarantor may not deserve protection in the case of "misappropriation" of rents or funds. Misappropriate is defined as "the intentional, illegal use of the property or funds of another person for one's own use or other unauthorized purpose." However, Lenders frequently replace this sinister act with "misapplication". A benign act, where because of a shortage of funds a Borrower may have to choose between paying the electric bill and the insurance bill. Even if the loan documents suggest a priority among payments, liability under a non-recourse guaranty should not be triggered if funds are used for a legitimate property related purpose.

Commercial real estate borrowers have the most leverage in negotiating their non-recourse terms early on in the loan process, at the time when the commitment is being prepared and approved and should use that time wisely to have their terms reviewed and negotiated to ensure that the terms are fair and understood. After all, a loan is not truly non-recourse, if the borrower has potential liability even when it has not been behaving badly.

For more information please call (480) 889-8948, send an email to info@steinlawplc.com or visit www.SteinLawPLC.com.

Upcoming Speaking Engagements

[Scott J. Stein](#) will serve as a faculty member for the [National Business Institute \(NBI\)](#) and present a seminar on *Handling Real Estate Transactions With Confidence* on **Thursday, December 1, 2011** (time and location to be confirmed).



Mr. Stein's presentation is entitled "Step-by-Step Through the Purchase Contract" and will offer proactive strategies to confidently navigate through commercial property transactions and prevent future disputes.

More information is available at www.nbi-sems.com.

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