

# Non-Recourse Guaranties

By **Albert C. Valencia**

Despite the name, “non-recourse” real estate loans have the potential to

increase personal liability due to the so-called “bad-boy provisions” that are included in non-recourse carveout guaranties, often required by lenders

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to be delivered by the borrower’s principal(s) as a condition to making the loan. Examples of bad-boy acts that would give rise to personal liability of the borrower’s principals could be waste, unpermitted transfers of the property or the interests in the borrower, or the misapplication of funds. These bad-boy provisions serve to make the principal(s) personally liable to the lender in the event of a default by the borrower under the loan and are intended to protect lenders from certain wrongful acts of the borrower that would limit the lender’s ability to be repaid from the borrower’s assets, which assets are often solely the borrower’s ownership interest in the real property securing the loan.

In order to limit a principal’s personal liability, borrowers must review the non-recourse carveout guarantee to make sure that any borrower covenants for making of payments (e.g. payment of taxes, maintaining insurance, and preventing mechanics’ liens) are limited to the extent there is sufficient cash flow from the property to make such payments. The rationale is that failure to make these payments if the property simply isn’t producing enough cash flow is not a “bad-boy act”, but rather an inherent risk of owning real estate. Borrowers must also scrutinise other covenants (e.g. transfer restrictions) to be sure that the loan does not become recourse for acts that do not intentionally prevent a lender from controlling its collateral.

Because non-recourse loans offer the benefit of limiting liability to the property itself, they are prevalent in the marketplace. Accordingly, we recommend borrowers give proper attention to any accompanying non-recourse carveout guaranties to ensure they are getting the benefit of a non-recourse loan.

