

GUEST COLUMN

Nonrecourse Carveout Guaranties and Mezzanine LoansBy **Zev Gewurz, Victoria Ippolito** and **Phillip Levy****Nonrecourse Carveout Guaranties and Mezzanine Loans**

The recent litigation between the lenders at Peter Cooper Village and Stuyvesant Town in New York and other cases like it are raising concerns among borrowers and their related guarantors that they may find themselves liable for debt even after they have been foreclosed out of their property. Senior lenders also are concerned because they are not sure whether the original guaranty they received will be enforceable after the original borrower has been foreclosed upon.

With an estimated \$100 billion of mezzanine loans outstanding across the country today, mezzanine lenders are wielding tremendous power by being able to step into the shoes of borrowers and file for bankruptcy. This is often done without consequences to the mezzanine lender but with the potential to create significant liability for the original loan guarantor and wreak legal havoc for the senior lender. While interests often shift in a bankruptcy situation, sometimes the threat to foreclose and file can be as powerful as the act itself.

The Stuyvesant case addressed important intercreditor questions relating to the rights of mezzanine lenders, first to acquire ownership of the borrower and then to cause the borrower to file for bankruptcy. What the case does not address but which is becoming an increasingly important question for all parties is the status of the original non-recourse carveout guaranty and the original non-recourse carveout guarantor in the event the mezzanine lender *is* able to acquire ownership of the borrower and *is* able to then file for bankruptcy.

During the last commercial real estate financing boom, most permanent real estate loans were entirely non-recourse to the borrower, except for certain non-recourse carveouts which, if triggered, would create liability for the non-recourse carveout guarantor (usually the parent or principal owner of the borrower). Depending on the bargaining power of the parties at the time, liability under the non-recourse carveout guaranty might be limited only to costs and expenses actually incurred by the lender as a result of the occurrence of one of the non-recourse carveout events or it might extend to full repayment of the entire loan. The concept is simple – the loan is non-recourse to the borrower and guarantor, except if certain very bad acts are performed by the borrower, such as fraud, intentional misrepresentation, absconding with funds without paying taxes

or insurance or filing for bankruptcy.

During this time, mezzanine loans became a popular form of additional financing. As part of every mezzanine loan transaction, the lenders enter into an intercreditor agreement, describing, in part, the conditions that must be satisfied before the mezzanine lender is permitted to foreclose upon the equity interests of the borrower. In the past, one of those conditions included the delivery of a replacement non-recourse guaranty from the foreclosing lender.

The increase in the demand for mezzanine debt and the difficulty involved in negotiating complex intercreditor agreements led to the development of a standard form of intercreditor agreement to simplify the process. As early as 2002, *CMBS World*, the publication of the **Commercial Mortgage Securities Association** (now the **CRE Finance Council**) published a suggested standard form intercreditor agreement. Although it was never approved by the rating agencies, in short order it became the credit-neutral platform against which all rating agencies evaluated loans and the standard for almost all mezzanine loan intercreditor agreements. The CMSA form intercreditor does not require mezzanine lenders to deliver a replacement guaranty unless the foreclosure “results in the removal of any guarantor, indemnitor, pledgor, or other obligor under the Senior Loan Documents,” which is almost never the case in a mezzanine loan foreclosure.

Today, borrowers and senior lenders across the country are asking themselves whether a court really would enforce a non-recourse carveout guaranty against the original guarantor when that guarantor no longer has any ownership interest or control over the property and when the action that triggers the liability is taken by an entirely independent and, likely, adversarial third party.

While this question has not been addressed directly by the courts, the law in other contexts would lead one to conclude that that the answer is yes. In a recent New Jersey case, the borrower breached a non-recourse carveout by entering into a second mortgage loan without the senior lender’s consent. Although the loan was paid off in full, the court held that a non-recourse carveout provision, once triggered, fixes liability rather than damages and is fully enforceable against the borrower and guarantor. See *Csfb 2001-CP-4 Princeton Park Corp. Ctr. v. SB Rental I, LLC*, 980 A.2d 1 (N.J. Sup. App. Ct. 2009). In other contexts, courts have held that, so long as the guaranty is absolute and continuing, the guaranty would be enforceable even

if the borrower has changed or even if the risk to the guarantors has been increased. See *Chicago Exhibitors Corporation v. Jeepers! of Illinois, Inc.*, 876 N.E.2d 129 (Ill. App. Ct. 2007). Finally, courts also have held that a guarantor's consent to a change or modification to the loan may be presumed if the guarantor is the parent of the subsidiary that consented. See *Thermo Electron Corp. v. Waste Management Holdings, Inc.*, 825 N.E.2d 545 (App. Ct. of Mass. 2005).

The next question is what intercreditor provisions will look like going forward. Mezzanine lenders still will not want to be required to deliver replacement guaranties, restricting their ability to foreclose upon their borrower and file for bankruptcy. At the same time, now that this issue has been highlighted by the current downturn, borrowers will not want to risk having recourse liability for an action taken by the mezzanine lender or another third party purchaser after they have been foreclosed upon and have no further interest in the property. Senior lenders also will not want to permit any mezzanine loan if it is not clear that the mezzanine lender will have recourse liability if it forecloses upon the equity collateral and then causes the borrower to file for bankruptcy or to otherwise break the non-recourse carveouts while the senior

loan still is outstanding.

Beyond the business issues, there also are a few practical considerations with which lenders and borrowers will need to contend. Many mezzanine lenders are private equity or hedge funds that, by the terms of their fund documents, are prohibited from delivering any guaranties. Even if they could deliver a guaranty, how credit worthy will senior lenders require a mezzanine lender guarantor to be? Some of these problems may be able to be solved by having the mezzanine lenders establish a credit-worthy guarantor entity, with a net worth and liquidity, at least as good as the original guarantor's credit worthiness at the time of the loan for purposes of delivering a replacement guaranty upon exercise of remedies.

It seems clear that the mezzanine loan will survive the current downturn and will remain a viable financing mechanism into the next commercial real estate cycle. It also seems clear that the lawyers, lenders and real estate owners and developers will be negotiating the terms of intercreditor agreements a lot more closely this time around.

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Recent Loan Transfers To Special Servicing

The following is a list of loans included in commercial mortgage-backed securities deals that were recently transferred into special servicing.

Property Type	Loan Name	Deal ID	City	State	Zip	UPB	Maturity date	Date xferd to S/S
Hotel	Windsor Hospitality Portfolio	GMAC05C1	Various	Various	Various	\$83,834,711.17	11/1/10	9/24/10
Hotel	Norfolk Marriott	BSC07P18	NORFOLK	VA	23510	\$62,000,000.00	8/1/12	9/17/10
Hotel	Great Wolf Resorts Portfolio	CTG06C04	Various	Various	Various	\$61,871,319.83	3/1/13	9/17/10
Hotel	Great Wolf Resorts Pool	WBC05C17	Various	Various	Various	\$44,212,399.26	1/11/15	10/7/10
Hotel	Salishan Spa & Golf Resort	CTG07C06	LINCOLN CITY	OR	97367	\$19,257,796.36	4/6/17	9/16/10
Industrial	Twin Cities Industrial Portfolio - Pool 4	JPC04LN2	Various	MN	Various	\$10,624,356.44	5/11/14	10/1/10
Industrial	A&P Warehouse	MSC06H10	DETROIT	MI	48228	\$7,587,199.71	7/1/15	9/16/10
Industrial	Drew Court	JPC03C17	KING OF PRUSSIA	PA	19406	\$5,792,877.46	10/1/10	9/24/10
Industrial	Insight Air Center #7	GMAC01C1	LAS VEGAS	NV	89119	\$4,280,020.35	11/1/10	9/24/10
Industrial	9701 Bell Ranch Drive	MSC07H16	SANTA FE SPRINGS	CA	90670	\$3,569,039.09	10/1/17	9/9/10
Multi-family	Lightstone Michigan Multifamily Portfolio	JPC06C16	Various	MI	Various	\$77,917,625.88	7/1/16	9/10/10
Multi-family	Victoria Place Apartments	CD07CD4	Orlando	FL	32828	\$46,000,000.00	3/1/17	9/23/10
Multi-family	Pinnacle Heights	JPC07L10	TUCSON	AZ	85750	\$32,937,000.00	3/11/17	9/16/10
Multi-family	Empirian Waterford Landing	CD06CD3	MCDONOUGH	GA	30253	\$25,800,000.00	11/1/16	9/30/10
Multi-family	Ashby Crossing Apartments	BACM0301	Harrisonburg	VA	22801	\$23,036,835.11	2/1/13	9/14/10
Office	USX Tower	BALL05M1	PITTSBURGH	PA	15219	\$145,000,000.00	9/9/10	9/14/10
Office	123 NORTH WACKER	GECC05C4	CHICAGO	IL	60606	\$122,000,000.00	10/1/15	9/13/10
Office	City Tower	CSM07C04	ORANGE	CA	92868	\$115,000,000.00	5/11/17	10/8/10
Office	Prum Office Portfolio II	MLT05MC1	Various	WA	Various	\$37,096,492.97	10/1/14	9/9/10
Office	River Park Plaza	GCC05GG5	SAINT PAUL	MN	55107	\$32,594,652.60	10/6/10	10/5/10
Other	JC Studios	WBC05C20	BROOKLYN	NY	11230	\$17,391,272.56	8/11/15	9/22/10
Other	Columbus Office Warehouse Portfolio	LBUB08C1	WORTHINGTON	OH	43085	\$9,508,758.37	11/11/17	9/23/10
Other	The Steelyard	GCC07GG9	CHARLOTTE	NC	28203	\$9,409,955.35	11/6/16	9/23/10
Other	Boardwalk Shopping Center	COM07C09	SAN ANTONIO	TX	78257	\$8,479,716.71	7/1/17	10/5/10
Other	8070-8080 Melrose Avenue	WBC06C27	Los Angeles	CA	90046	\$7,707,005.21	8/1/16	9/23/10
Retail	Everett Mall Steadfast	MSC07H14	EVERETT	WA	98208	\$98,000,000.00	5/1/17	10/1/10
Retail	GRAND TRAVERSE MALL	GECC05C4	TRAVERSE CITY	MI	49684	\$83,021,500.63	1/4/11	10/4/10
Retail	Happy Valley Towne Center	WBC05C18	PHOENIX	AZ	85027	\$54,322,756.94	5/11/15	9/23/10
Retail	Gilbert Gateway Towne Center	GSM205G4	HIGLEY	AZ	85236	\$48,727,121.47	5/1/15	9/24/10
Retail	Ashtabula Mall	MSC07H16	ASHTABULA	OH	44004	\$40,262,854.45	9/1/17	9/20/10

Source: Realpoint, LLC

For more information, go to www.realpoint.com or call (800) 299-1665