

"Bad Boy" Guarantees

One of the advantages of entering into loans with life insurance companies and conduit lenders has been that such loans are frequently written as non-recourse obligations. In general, if a loan is non-recourse, if there is a default, the lender's remedies are limited to pursuing its rights in a foreclosure action. The lender could not pursue the borrower for a deficiency judgment. Typically, loans with banks and savings and loans are written on a full-recourse basis so, in such situations, if the borrower defaulted, the lender could pursue both its right to foreclose as well as its right to pursue a deficiency. Even in non-recourse loan situations, however, conduit lenders and life insurance companies frequently require the borrower's principals to enter into "bad boy" guarantees (sometimes also known as "springing recourse" guarantees).

Pursuant to these guarantees, the principals agree that, if the borrower engages in certain "bad acts," then the guarantors become liable. Generally, these types of provisions are drafted in two separate ways. First, if the bad act at issue can be remedied either by the payment of money or otherwise, the guarantor would be liable for remedying the default. For example, the principals would be liable for damage caused by the borrower causing waste on the mortgaged property. Secondly, certain acts which could not be so remedied, caused the guarantors to become fully liable for the entire amount of the debt. In this later category, for example, if the borrower transferred an interest in the property without the lender's consent, the bad boy guarantee might be triggered.

As conduit lending increased, the number of issues that might cause a guarantor to become liable under a bad boy guarantee began to increase. Many of these guarantees are several pages in length and include numerous "bad boy" acts. Lenders have been reluctant to either negotiate away the bad boy provisions or even limit their applicability. Borrowers and their counsel hoped, however, that because of the severe consequences of turning a non-recourse loan into a full-recourse obligation, courts would be very sensitive to the rights of guarantors and would limit the applicability of the bad boy guarantees.

Unfortunately for borrowers, however, courts in many instances have willingly created full liability against the bad boy guarantors. In one recent case, a court held that the bad boy guarantors were fully liable on a \$20.9 million mortgage loan because the borrower had filed for bankruptcy. In another recent situation, the court enforced full liability against the guarantors in a situation where the

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borrower had placed subordinate financing against the property.

When situations become difficult, borrowers are frequently forced to look at alternatives to keep their project alive. If the borrower is having cash-flow problems, the borrower may attempt to either put some form of secondary financing against the property or may wish to bring in additional equity investors. Sometimes, one of the individual guarantors may be struggling through difficult financial issues and may wish to personally file for bankruptcy. In any of the above situations, the borrower needs to be very careful to review the bad boy guarantee and to make sure that the action being undertaken will not trigger recourse liability for the guarantors.

If you are considering undertaking actions relating to your property that might impact the lender and you are working with a non-recourse loan, you should first carefully review any bad boy guarantees to make sure that you obtain any required consent. Your [Reinhart real estate attorney](#) would be happy to review any such documents on your behalf. This is clearly an area that will need increased attention as we struggle through the current financial difficulties we now face.

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