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# Guarantor Liability—New Development

**POSTED:**

Aug 4, 2010

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Real estate financings, whether commercial or residential, involve borrowers borrowing money and securing those obligations with real estate mortgages. Typically, the loan transaction involves at least two separate instruments. The first instrument is the promissory note pursuant to which the borrower agrees to pay the lender the amount owing. The promissory note is secured by a mortgage on real estate, with that mortgage being the second instrument.

Often, if the lender wants additional assurance that its loan will be repaid, it will insist on the borrower providing a guarantee executed by a third party guarantor.

If the borrower defaults, the lender will ultimately accelerate the amount owing under the promissory note and then sue to foreclose on the mortgage. The lender may also make a claim for a deficiency judgment if the foreclosure sale fails to generate sufficient proceeds to satisfy the loan.

In Wisconsin, there are generally two categories of foreclosures. The first involves the foreclosure of a one to four family residential property, a farm, a church or the property of a tax-exempt charitable organization, while the second involves the foreclosure of multifamily properties containing more than four units and other commercial properties. Section 846.101 of the Wisconsin Statutes provides that in all foreclosures the lender must first go to court and obtain a judgment of foreclosure. Then, after waiting a 12-month redemption period for properties in the first category or six months for properties in the second category, the lender may have the property sold at a foreclosure sale and then pursue a deficiency judgment against the borrower if the sale proceeds are not sufficient to satisfy the loan.

In both foreclosure situations, however, the Wisconsin statutes provide that the redemption periods may be cut in half if the lender elects not to pursue a deficiency judgment and allows the borrower to remain in possession of the property during the redemption period. In other words, the 12-month redemption period is cut to six months for residential/church/ nonprofit property and three months for multifamily and other commercial properties. This benefits the lender by allowing a shorter redemption period and it benefits the borrowers by allowing them to avoid a deficiency judgment if the property does not sell for the outstanding loan amount.

In situations where lenders have required guarantees, a significant issue concerns


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whether, if the lender waives its rights to claim a deficiency and elects the shortened redemption period, it can separately pursue a guarantor of the loan. This has become an even more important issue in the current lending environment where lenders rarely allow entities such as corporations and limited liability companies to avoid having their loans guaranteed. The Wisconsin Supreme Court recently addressed this issue in the case of *Bank Mutual v. S. J. Boyer Construction, Inc*.

In *Boyer*, the Boyers' entity, Boyer Construction, Inc., (Boyer) entered into five business notes, totaling nearly $1.4 million, with Bank Mutual. The loans were secured by seven mortgages on five properties owned by Boyer. In addition, Boyer's owners, Marcy and Steven Boyer, executed a continuing unlimited guarantee pursuant to which they jointly and severally guaranteed payment of Boyer's notes.

When Boyer defaulted, Bank Mutual foreclosed on the mortgages, electing the shortened redemption period and waiving a deficiency judgment.

Because the bank waived the deficiency judgment, it decided to pursue the Boyers individually on their guarantee. The question presented to the Court was whether, when a lender elects the shortened redemption period and waives the deficiency judgment, it can nonetheless pursue guarantors on their guarantee. The Court held that the Boyers' individual guarantee constituted a separate contract from the loan to Boyer and, therefore, the Boyers remained liable even though the lender had chosen the shortened redemption and waived the deficiency judgment against the borrower.

The Court's decision has major implications for both borrowers and lenders. For borrowers, the decision means that if their entity borrows money and they, as the owners, personally guarantee the loan, the bank can both elect a shortened redemption period and personally sue the principals on the guarantee. It also will make negotiating a forbearance or workout agreement with the lender more difficult since the Boyer decision gives the lender increased leverage.

From a lender's standpoint, the decision makes obtaining separate individual guarantees even more important. Banks will know that, as long as they obtain personal guarantees, they can assure themselves of being able to pursue individuals even if they choose a shortened redemption period.

When borrowers are presented with commitment letters setting forth the bank's proposed loan terms, they should have [their Reinhart attorney] carefully review


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that commitment letter. If the commitment letter provides for a loan to an entity, it will likely require personal guarantees. Your Reinhart attorney can advise you as to your rights and risks in entering into such a guarantee and may also be able to limit your obligation under the guarantee. The best time to try to negotiate such limitation is at the commitment letter stage.

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