

Sample Nonrecourse Loan Carveout and Springing Recourse Provisions with Borrower Comments

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MANY LOAN DOCUMENTS, especially those for loans secured by commercial real estate, provide that the loan is generally nonrecourse to the borrower and guarantor except for:

- Certain “carveouts” for which the borrower and guarantor are liable for resulting losses to the Lender (see Section 4.02(a) below); and
- Certain actions or events that, if they occur, cause the borrower and guarantor to become fully liable for the entire loan on a recourse basis (see Section 4.02(b) below).



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Such provisions vary greatly from lender to lender and are often highly negotiated between the parties. The borrower and its counsel often assert that the lender's form loan documents include vague and overbroad language that, if read literally, can create recourse liability far beyond what the borrower and guarantor expect in a nonrecourse loan.

The sample loan agreement provisions below are intended to be representative of a first draft that might be received from a lender. The redlining is intended to show comments that a borrower might be expected to make on that first draft to make the provisions more acceptable to the borrower and guarantor. The provisions proposed by both parties are intended to be ones that are typical. They are not intended to be highly aggressive; however, the borrower comments are also not intended to be ones that would be uniformly accepted by a lender. Many lenders would object to several of the proposed redlined revisions, would seek to further negotiate others, and tend to be particularly resistant to moving any provisions from the Section 4.02(b) category of springing recourse events into the Section 4.02(a) category of lender-loss carveouts as is proposed in the redlining below.

These sample provisions assume that the borrower is a single purpose limited liability company with no assets other than the commercial property that secures the loan and that a guarantor with substantial assets in addition to its interest in the borrower has executed a guaranty under which it guarantees all of the full recourse obligations of the borrower under the loan documents. These sample provisions are meant for illustrative purposes and are not intended to be comprehensive. Note that, in many cases, loans are structured differently from this example so that they are full recourse to the special purpose entity borrower (which has no assets other than the project securing the loan) and the nonrecourse carveouts and springing full recourse events are provided for in the guaranty.

ARTICLE 4- RECOURSE LIABILITY

Section 4.01 Non-Recourse Loan; Exceptions

Except as otherwise provided in this Article 4 or in ~~any other Loan Document~~, the Guaranty or the Environmental Indemnity Agreement, none of Borrower, Guarantor or any director, officer, manager, member, partner, shareholder, trustee, trust beneficiary, or employee of Borrower or Guarantor, shall have personal liability under this Agreement or any other Loan Document for the repayment of the Indebtedness or for the payment or performance of any other obligations of Borrower under the Loan Documents, and Lender's only recourse for the satisfaction of such Indebtedness and the payment and performance of such obligations shall be Lender's exercise of its rights and remedies with respect to the Property and any other collateral held by Lender as security for the Indebtedness.

Section 4.02 Recourse Liability of Borrower (Exceptions to Non-Recourse Provision)

(a) Recourse Liability Based on Lender's Loss

Borrower shall be personally liable to Lender for the repayment of the portion of the Indebtedness equal to any loss or damage suffered by Lender as a result of:

- (1) failure to pay as directed by Lender upon demand after an Event of Default (to the extent ~~actually the following are~~ received by Borrower): (A) all Rents to which Lender is entitled under the Loan Documents; and (B) the amount of all security deposits ~~then held or thereafter collected by Borrower~~ from tenants ~~under the and not properly applied pursuant to the applicable~~ Leases;
- (2) failure to maintain all insurance policies required by the Loan Documents, to the extent cash flow from the Property received by Borrower is sufficient to pay the premiums and except to the extent Lender has the obligation to pay the premiums pursuant to this Agreement;
- (3) failure to apply all insurance proceeds received by Borrower or any amounts received by Borrower in connection with a Condemnation Action, as required by the Loan Documents;
- (4) failure to pay the amount of any assessments and property taxes (~~accrued due~~ and/or payable) with respect to the Property prior to the completion of foreclosure of the Security Instrument to the extent cash flow from the Property received by Borrower is sufficient to pay the same and except to the extent Lender has the obligation to pay the same pursuant to this Agreement;
- (5) except to the extent directed otherwise by Lender pursuant to Section 4.02(a)(1), failure to apply Rents to the ordinary and necessary expenses of owning and operating the Property and the Indebtedness, as and when each is due and payable, except that Borrower will not be personally liable with respect to Rents that are distributed by Borrower in any calendar year if Borrower has paid all ordinary and necessary expenses of owning and operating the Property and all portions of the Indebtedness, in each such case to the extent the same are due and payable during such calendar year;
- (6) the amount of (a) any termination fee, cancellation fee or any other fee received by, or on behalf of, Borrower in connection with any Lease termination, cancellation, surrender or expiration at any time during the term of Loan, and (b) any judgment, settlement or other recovery received by, or on behalf of, Borrower against or from any tenant under, or any guarantor of, any Lease at any time during the term of Loan if such amount is greater than one month's base rent payable under the applicable Lease and is not paid to Lender (or an escrow agent selected by Lender) to be (i) disbursed for the payment of Lender-approved tenant improvements and/or market leasing commissions, or (ii) otherwise applied in a manner permitted by the Loan Documents;
- (7) Borrower's failure to return, or to reimburse Lender for, all material personal property removed from the Real Property by or on behalf of Borrower and not replaced with personal property of the same or greater utility and value;
- (8) ~~waste or abandonment of the Property;~~ or (i) abandonment of the Property by Borrower prior to completion of foreclosure by Lender of the Security Instrument or the appointment of a receiver for the

Property at the request of Lender, or (ii) intentional physical waste of the Property by Borrower, Guarantor or any officer, director, partner, manager, member, shareholder, or trustee of Borrower or Guarantor;

(9) ~~grossly negligent or reckless unintentional~~ fraud or other material misrepresentation or omission by Borrower, Guarantor, or any officer, director, partner, manager, member, shareholder, or trustee of Borrower or Guarantor in connection with the Loan, on-going financial or other reporting required by the Loan Documents, or any request for action or consent by Lender; or

(10) failure by Borrower to comply with the single-asset entity requirements of Section 5.12 of this Loan Agreement.

Notwithstanding the foregoing, Borrower shall not have personal liability under clauses (1) through (6) above to the extent that Borrower lacks the legal right to direct the disbursement of the applicable funds due to: (a) appointment of a receiver for the Property at the request of Lender or another Person that is not an Affiliate of Borrower or Guarantor; or (b) an involuntary bankruptcy of Borrower that occurs without the consent, encouragement, or active participation of Borrower or Guarantor, or any Affiliate of Borrower or Guarantor. Further, amounts received, or actions taken, by Lender, any servicer of the Loan for Lender, any agent of Lender or any receiver for the Property appointed by or with the consent of Lender will not be deemed to have been received or taken by or on behalf of Borrower.

(b) Full Recourse Liability for Loan

Borrower shall be personally liable to Lender for the repayment of all of the Indebtedness, and the Loan shall be fully recourse to Borrower, upon the occurrence of any of the following:

(1) failure by Borrower to comply with the single-asset entity requirements of Section 4.10 of this Loan Agreement and a court of competent jurisdiction determines in a final, non-appealable order or judgment that such failure is the basis, in whole or in material part, for the substantive consolidation of the assets and liabilities of the Borrower with the assets and liabilities of a debtor under the Bankruptcy Code;

(2) a Prohibited Transfer that consists of (A) a voluntary security instrument being placed against the Property or any material portion thereof and not being released prior to Lender's commencement of remedies for an Event of Default, (B) a Transfer of ownership of all or a material portion of the Property (other than by foreclosure of the Security Instrument or Transfer in lieu thereof or Transfer in connection with a Condemnation Action), or (C) a Transfer of ownership of equity interests that results in a Change of Control;

(3) if the Security Instrument grants a lien on a leasehold estate, if: (A) Borrower surrenders, terminates, cancels or modifies the ground lease creating such leasehold estate or acquiesces in; or (B) fails to object to any termination, cancellation, rejection or sale of the related fee estate free and clear of such ground lease in connection with or as a result of any bankruptcy, reorganization or insolvency proceeding of any owner of such fee estate when Borrower has a reasonable basis for a good faith objection to the same;

(4) the occurrence of any Insolvency Event; other than an acknowledgment in writing of inability to pay debts as they become due or the appointment of a receiver at the request of Lender or of a Person acting on behalf of Lender); provided, however, in the event of an involuntary Insolvency Event, Borrower shall only be personally liable if such involuntary Insolvency Event occurs with the consent, encouragement, or active participation of Borrower or Guarantor, or any Affiliate of Borrower or Guarantor; or

(5) Borrower, Guarantor or any Affiliate of any thereof shall, in connection with any enforcement action or exercise or assertion of any right or remedy by or on behalf of Lender under or in connection with this Agreement, the Note, the Security Instrument or any of the other Loan Documents, asserts a defense, seeks judicial intervention or injunctive or other equitable relief of any kind or asserts in a pleading filed in connection with a judicial proceeding any defense against Lender or any right in connection with any security for the Loan; that the court in such action or proceeding determines is without merit (in respect of a defense) or unwarranted (in respect of a request for judicial intervention or injunctive or other equitable relief).

~~(6) fraud, written material misrepresentation, or material omission by Borrower or Guarantor, or any officer, director, partner, manager, member, shareholder, or trustee of Borrower or Guarantor in connection with any application for or creation of the Indebtedness; or~~

~~(7) fraud, written intentional material misrepresentation, or intentional material omission by Borrower, Guarantor, or any officer, director, partner, manager, member, shareholder, or trustee of Borrower or Guarantor in connection with on-going financial or other reporting required by the Loan Documents, or any request for action or consent by Lender.~~

[Former paragraphs (6) and (7) moved to Section 4.02(a) "above the line" carveouts.]

Section 4.03 Recourse Liability for Indemnity Obligations

Borrower shall be personally and fully liable to Lender for Borrower's indemnity obligations under Section 12 of this Agreement; and the Environmental Indemnity Agreement; ~~and any other express indemnity obligations provided by Borrower under any Loan Document; provided, however, that such indemnity obligations shall in no event create personal recourse against Borrower for payment of principal, interest or Prepayment Premium on the Indebtedness.~~ Borrower's liability for such indemnity obligations shall not be limited by the amount of the Indebtedness, the repayment of the Indebtedness, or otherwise.

[NOTE THAT SECTION 12 CAN BE READ TO REQUIRE INDEMNIFICATION FOR LOSSES RESULTING FROM FAILURE TO PAY PRINCIPAL, INTEREST AND PREPAYMENT PREMIUM ON THE LOAN. SECTION 4.03 SHOULD NOT CREATE BACK DOOR RECOURSE FOR AMOUNTS THAT ARE SUPPOSED TO BE NONRECOURSE.]

Section 4.04 Lender's Right to Forgo Rights Against Property

To the extent that Borrower has personal liability under this Loan Agreement or any other Loan Document, Lender may exercise its rights against Borrower personally to the fullest extent permitted by applicable law without regard to whether Lender has exercised any rights against the Property or any other security, or pursued any rights against Guarantor, or pursued any other rights available to Lender under this Loan Agreement, any other Loan Document, or applicable law. ~~To the fullest extent permitted by applicable law, in any action to enforce Borrower's personal liability under this Article 4, Borrower waives any right to set off the value of the Property against such personal liability.~~

Section 4.05 No Waiver of Certain Rights

Nothing herein shall be deemed to be a waiver of any right which Lender may have under Section 506(a), 506(b), 1111(b) or any other provision of the Bankruptcy Code to file a claim for the full amount of the indebtedness secured by the Security Instrument or to require that all of the Property shall continue to secure all of the indebtedness owing to Lender under this Agreement, the Note, the Security Instrument and the other Loan Documents: ~~;~~ provided, however, that in no such event will Guarantor have any recourse liability solely as a result of any of the foregoing matters described in this Section 4.05.

SPE PROVISIONS

Section 5.12 Borrower Single Asset Status

Borrower covenants and agrees that it has not and shall not (and that its organizational documents shall provide that it has not, and shall not):

- (1) acquire or lease any real property, personal property, or assets other than the Property and personal property incidental to the leasing, ownership, management, operation, and maintenance of the Property
- (2) acquire, own, operate, or participate in any business other than the leasing, ownership, management, operation, and maintenance of the Property;
- (3) commingle its assets or funds with those of any other Person, unless such assets or funds can easily be segregated and identified in the ordinary course of business from those of any other Person;
- (4) fail to maintain its financial statements, accounting records, and other partnership, limited liability company, or corporate documents, as the case may be, separate from those of any other Person (unless Borrower's assets are included in a consolidated financial statement prepared in accordance with generally accepted accounting principles) or fail to use its own separate ~~stationery, telephone number,~~ invoices and checks;

(5) have any material financial obligation under any indenture, mortgage, deed of trust, deed to secure debt, loan agreement, or other agreement or instrument to which Borrower is a party or by which Borrower is otherwise bound, or to which the Property is subject or by which it is otherwise encumbered, other than:

(a) unsecured trade payables incurred in the ordinary course of the operation of the Property (exclusive of amounts ~~(i) to be paid out of the Replacement Reserve Account or Repairs Escrow Account, or (ii) for rehabilitation, restoration, repairs, or replacements of the Property or otherwise approved by Lender described in the immediately following paragraph (5)(b)~~) so long as such trade payables (A) are not evidenced by a promissory note, (B) are payable within ~~sixty ninety~~ (60 90) days of the date incurred, and (C) as of any date, do not exceed, in the aggregate, ~~two three~~ percent (2 3%) of the ~~outstanding original~~ principal balance of the Loan;

(b) unsecured trade payables (i) to be paid out of the Replacement Reserve Account or Repairs Escrow Account, or (ii) for rehabilitation, restoration, repairs, or replacements of the Property or otherwise approved by Lender;

(c) if the Security Instrument grants a lien on a leasehold estate, Borrower's obligations as lessee under the Ground Lease; and

(d) obligations under the Loan Documents and obligations secured by the Property to the extent permitted by the Loan Documents;

(6) make any distribution or payment that is not permitted by this Agreement and that causes the Borrower to become insolvent ~~and as of the date of such distribution or payment and to fail to~~ pay its debts and liabilities (including, as applicable, shared personnel and overhead expenses) from its assets as the same become due;

(7) make any distribution to owners of equity interests in Borrower that causes the Borrower to fail to maintain adequate capital for the normal obligations reasonably foreseeable in a business of its size and character and in light of its contemplated business operations as of the date of such distribution;

(8) fail to maintain a sufficient number of employees in light of its contemplated business operations (currently zero and anticipated to continue to be zero);

(9) fail at any time to have at least two Independent Directors except during a reasonable period of time (not to exceed 30 days) following the date the Borrower first learns that an Independent Director has ceased to serve as an Independent Director due to death, incapacity or resignation;

(10) fail to provide in its operating agreement, partnership agreement, or articles of incorporation, as applicable, that for so long as the Loan is outstanding, it shall not file or consent to the filing of any petition, either voluntary or involuntary, to take advantage of any applicable insolvency, bankruptcy, liquidation or reorganization statute, or make an assignment for the benefit of creditors without the affirmative vote of

each Independent Director and of all other general partners, limited liability company managers, or directors, as applicable;

(11) fail to allocate fairly and reasonably any overhead expenses that are shared with a Borrower Affiliate, including paying for office space and services performed by any employee of a Borrower Affiliate;

(12) fail to file its own tax returns or be included on the tax returns of any other Person except as permitted by applicable law;

(13) assume, guarantee, or pledge its assets to secure the liabilities or obligations of any other Person (except in connection with the Loan or by indorsement of checks or other negotiable instruments in the ordinary course of business) or hold out its credit as being available to satisfy the obligations of any other Person;

(14) make loans or advances of credit (advance payment of the purchase price of goods or services in the ordinary course of business are not deemed to constitute a loan or advance of credit) to any other Person; or

(15) enter into, or become a party to, any transaction with any Borrower Affiliate, except in the ordinary course of business and on terms that are no more favorable to any such Borrower Affiliate than would be obtained in a comparable arm's-length transaction with an unrelated third party.

Notwithstanding anything to the contrary, nothing in this Agreement or the other Loan Documents will require Guarantor or any other owner of an equity interest in Borrower to make capital contributions to Borrower or to repay to Borrower any distribution to equity owners or other payment that is or has been paid by Borrower in compliance with the terms of this Agreement and applicable law.

INDEMNIFICATION PROVISIONS

Section 5.12 Indemnification

Borrower shall indemnify, defend and hold harmless Lender from and against any and all other liabilities, obligations, losses, damages, penalties, actions, judgments, suits, claims, costs, expenses and disbursements of any kind or nature whatsoever (including, without limitation, the reasonable fees and disbursements of counsel for Lender in connection with any investigative, administrative or judicial proceeding commenced or threatened, whether or not Lender shall be designated a party thereto), that may be imposed on, incurred by, or asserted against Lender in any manner relating to or arising out of (i) any breach by Borrower of its obligations under, or any material misrepresentation by Borrower contained in, this Agreement or the other Loan Documents, or (ii) the use or intended use of the proceeds of the Loan (collectively, the "Indemnified Liabilities"); provided, however, that Borrower shall not have any obligation to Lender hereunder to the extent that such Liabilities arise from gross negligence, illegal acts, fraud, willful misconduct, or breach of contract by Lender. To the extent that the undertaking to indemnify, defend and hold harmless set forth in the preceding sentence may be unenforceable because it violates any law or public policy, Borrower shall

pay the maximum portion that it is permitted to pay and satisfy under Applicable Law to the payment and satisfaction of all Indemnified Liabilities incurred by Lender.

TRANSFER PROVISIONS

“Permitted Encumbrances” means only ~~the:~~ (a) easements, restrictions and other matters listed in a schedule of exceptions to coverage in the Title Policy and taxes for the current tax year that are not yet due and payable; (b) statutory Liens securing non-delinquent amounts (including but not limited to tax Liens, assessment Liens, mechanics’ Liens and material suppliers’ Liens); (c) statutory or judgment Liens that are bonded off, released of record, or otherwise remedied to Lender’s reasonable satisfaction within 60 days after the date Borrower has actual notice of the existence of such Lien or that are being contested by Borrower in accordance with the provisions of this Agreement; (d) Leases entered into in compliance with this Agreement and the other Loan Documents; (e) Liens created by the Loan Documents; and (f) Liens, easements, restrictions and other matters to which Lender has granted its written consent.

“Lien” means any claim or charge against property for payment of a debt or an amount owed for services rendered (whether voluntary, involuntary, or by operation of law), including any mortgage, deed of trust, deed to secure debt, security interest, tax lien, any material supplier’s or mechanic’s lien, or any lien of a Governmental Authority, including any lien in connection with the payment of utilities, or any other encumbrance.

“Transfer” means: (a) a sale, assignment, transfer or other disposition (whether voluntary, involuntary, or by operation of law); (b) a granting, pledging, creating or attachment of any Lien; (c) an issuance or other creation of a direct or indirect ownership interest; (d) a lease of all or substantially all of the Property other than for purposes of occupancy of the leased premises by the tenant; or (e) a merger, consolidation, dissolution or liquidation of a legal entity.

“Permitted Transfer” means: (a) a Transfer to which Lender has consented in writing; ~~and~~ (including but not limited to Leases entered into in compliance with this Agreement and the other Loan Documents); (b) Permitted Encumbrances; (c) a Transfer of obsolete or worn out personal property or fixtures that are of de minimis value or that are promptly replaced by items of equal or better function and quality and that are free of Liens (other than Permitted Encumbrances); and (d) [see Note below].

“Prohibited Transfer” means a Transfer that is not a Permitted Transfer.

Section 5.13 Liens; Transfers

(a) Liens. Borrower shall not permit the grant, creation, or existence of any Lien on all or any portion of the Property other than Permitted Encumbrances.

1. (b) Transfers. Other than Permitted Transfers, Borrower shall not Transfer, or cause or permit a Transfer of (i) all or any part of the Property or any interest in the Property or (ii) any direct or indirect ownership interest in Borrower or Guarantor.

[NOTE: DISCUSS ADDING PROVISIONS ALLOWING THE FOLLOWING PERMITTED TRANSFERS AND APPROPRIATE LIMITATIONS AND REQUIREMENTS FOR THE PROTECTION OF LENDER:]

- (1) Transfers of public securities in entities that directly or indirectly own or Control Borrower or Guarantor;
- (2) Transfers among current owners of direct or indirect equity interests in Borrower or Guarantor that do not result in a Change of Control or in transfer of more than a specified percentage of such equity interests over the term of the Loan;
- (3) Transfers of direct or indirect interests in Borrower or Guarantor that occur by devise, descent, operation of law, creation of a trust, termination of a trust, or change of the trustee of a trust upon the death or disability of a natural person;
- (4) Changes of Control that occur due to the death or disability of a natural person;
- (5) Transfers of direct or indirect interests in Borrower or Guarantor that are made for bona fide estate planning purposes, do not result in a Change of Control, and are made to immediate family members of the transferor, lineal descendants of such immediate family members, or trusts for any of the foregoing;
- (6) Transfers pursuant to specified existing contractual obligations;
- (7) Equipment leases and purchase money security interests in equipment (in each case subject to appropriate dollar limitations); and
- (8) Others?]

DEFINITION OF “INSOLVENCY EVENT”

“Insolvency Event” means any one or more of the following:

- (a) the commencement, filing or continuation of a voluntary case or proceeding by Borrower under the United States Bankruptcy Code, 11 U.S.C. Section 101, *et seq.*, or under any other federal or state law affecting debtor and creditor rights or relating to the bankruptcy, insolvency, reorganization, arrangement, moratorium, readjustment of debt, dissolution, liquidation or similar laws, proceedings, or equitable principles affecting the enforcement of creditors’ rights, as amended from time to time (collectively, the “Insolvency Laws”);
- (b) the acknowledgment in writing by Borrower that it is unable to pay its debts generally as they mature;
- (c) the making of a general assignment for the benefit of creditors by Borrower;
- (d) the commencement, filing or continuation of an involuntary case or proceeding against Borrower under of the Insolvency Laws; or
- (e) the appointment of a receiver, liquidator, custodian, sequestrator, trustee or other similar officer who exercises control over Borrower or any substantial part of the assets of Borrower; provided, however, that any proceeding or case under (d) or (e) above shall not be an Insolvency Event until the sixtieth (60th) day after filing (if not earlier dismissed) so long as such proceeding or case occurred without the consent, encouragement or active participation of (1) Borrower or Guarantor, (2) any Person Controlling Borrower or Guarantor, or (3) any Person Controlled by or under common Control with Borrower or Guarantor (in which event such case or proceeding shall be a Insolvency Event immediately).