



When Should a Guarantor's Liability Terminate under a Carry Guaranty?



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In construction lending, a Carry Guaranty is a standard and typical requirement whereby a Guarantor will guaranty the payment by Borrower of all costs incurred in connection with the operation, maintenance and management of the Property (or some subset of the same) for the term of the Loan (or, if the Property is operating but not at capacity, until the Property is generating sufficient revenue as determined pursuant to the satisfaction of one or more financial tests). In addition, a Carry Guaranty may also be required in financing transactions where the mortgaged Property is not generating sufficient revenue to pay all of the operating expenses with respect to the Property.

The greatest point of contention for a Lender and Guarantor in negotiating a Carry Guaranty is when, pursuant to the Guaranty, will the Guarantor be released from its obligations thereunder in connection with a foreclosure, the acceptance by Lender of a deed-in-lieu of foreclosure or the tender by Borrower of the Property to Lender. Guarantors take the position that their liability under the Carry Guaranty should terminate in connection with the transfer of the Property to the Lender. Lenders contend that, although the Lender or a designee thereof now has title to the Property, since the Lender never made a loan to own the Property and the Property still cannot support itself, the Guarantor should be responsible for the expense of maintaining the Property (post transfer) for a period of time to enable the Lender to sell the Property or for the Property to sustain itself. This period of time is referred to in the market as "tail." Many Lenders seek to have a period from thirty (30) days up to one (1) year of "tail." Guarantors obviously seek to have little to no "tail" on their obligations.

In addition, most Lenders will not release the Guarantor from its obligations under a Carry Guaranty (with or without "tail") upon a tender of the Property by Borrower to Guarantor (*i.e.*, the delivery of a deed to the property by Borrower to Lender even if the Lender does not accept such deed), unless the Guarantor

satisfies certain conditions in connection with such tender. Some Guarantors argue that there should be no conditions to the tender of a deed-in-lieu of foreclosure since that is what a Lender would obtain pursuant to an actual foreclosure. However, since the Guarantor is obtaining relief from its obligations under the Carry Guaranty, most Lenders will require that certain pre-conditions are satisfied. The following is a list of customary conditions to a release from a Carry Guaranty upon a tender of the Property:

- delivery of a clean environmental report with respect to the Property;
- delivery of a deed executed by Borrower, together with any necessary transfer tax forms;
- payment of all transfer taxes that are payable in connection therewith;
- delivery of a title commitment which demonstrates that the Lender would receive good and marketable title, subject to only permitted encumbrances;
- payment of all title insurance premiums with respect to such Owner's Policy of Title Insurance;
- delivery of a FIRPTA affidavit and all other affidavits, certificates and registration forms required in the applicable jurisdiction;
- delivery of a bill of sale with respect to the personal property, if any;
- delivery of an assignment of all contracts, licenses and permits necessary for the operation of the Property;
- delivery of an assignment of leases and rents executed by Borrower;
- delivery of the books and records with respect to the Property;
- delivery of an assignment of any warranties and guaranties with respect to the Property;
- delivery of a legal opinion issued by Borrower's counsel as to such tender;
- delivery of all organizational documents, consents and certificates of good standing as reasonably requested by Lender;
- delivery of all tenant security deposits or deposits under sales contracts, as applicable;
- delivery of a release from the Guarantor and Borrower in favor of the Lender and its affiliates, employees, agents, officers, directors, shareholders and members;
- delivery to Lender of all real property taxes with respect to the Property for the term of Borrower's ownership thereof;
- evidence that Guarantor has paid all amounts then payable by Guarantor under any other Guaranty (or, with respect to the applicable Completion Guaranty, Completion of the Improvements shall have occurred) or Environmental Indemnity executed by Guarantor with respect to the Loan transaction;

- confirmation that neither the Borrower nor the Guarantor is the subject of a bankruptcy action; and
- confirmation that there exists no action, suit, proceeding or investigation with respect to Borrower or the Property that may result in the forfeiture of the Property.

Again, the Lender and Guarantor will negotiate the foregoing list of conditions to a tender. From the Lender's perspective, Guarantor should not be relieved of its obligations under the Carry Guaranty by tendering the deed if the property is not in the condition in which Lender would accept such tender and Guarantor is responsible for all costs which would be incurred by Lender in accepting such tender. From Guarantor's perspective, the tender conditions should not put the Lender in a better position than the Lender would otherwise be in the case of foreclosure and therefore many Guarantors will take the position that they should not be responsible for the payment of title premiums or transfer taxes, among other things.

There are many considerations involved in negotiating a Guarantor's potential release from a Carry Guaranty. At the end of the day, the Guarantor and Lender may also be negotiating a completion guaranty, a carveout guaranty and, perhaps, a payment guaranty, and the Lender will negotiate based on the package of guaranties it is receiving.