

**LENDER'S MODEL
STATE-OF-THE-ART
NONRECOURSE
CLAUSE
(WITH CARVEOUTS)**

Joshua Stein

It really *is* possible to draft
a clear nonrecourse clause.

MANY MORTGAGE LENDERS have dramatically expanded the "nonrecourse" clauses in their loan documents. Although "nonrecourse" remains the market standard for long-term financing of income-producing real estate, lenders have added one "carveout" after another to these

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clauses. See Joshua Stein, *Nonrecourse Carveouts: How Far Is Far Enough?* Real Estate Review, (Summer 1997); *Nonrecourse Clauses Revisited*, Real Estate Review (Summer 1992). This process has made nonrecourse clauses quite complex, long, and tedious. Despite their literary defects, however, many of these clauses still do not clearly say who is personally liable for what, and when.

The Lender's State-of-the-Art Nonrecourse Clause that follows is intended to offer a better and clearer structure for nonrecourse clauses, an example of how the use of a logical structure, headings, and defined terms can help a document communicate better. The use of defined terms in this model, and in legal documents generally, is discussed in depth in the author's article *How To Use Defined Terms to Make Transactional Documents Work Better*, which appears starting at page 15 in this issue.

This model nonrecourse clause also provides a reliable reference point (a "benchmark" or perhaps a "high-water mark") against which Lenders' counsel can compare other nonrecourse clauses. Finally, it collects in one place, and clearly identifies, many of the common Borrower negotiations of these clauses.

This Lender's State-of-the-Art Nonrecourse Clause represents a combination of the most aggressive positions taken by mortgage lenders in nonrecourse clauses today. Although it contains little or no duplica-

tion, it is quite long. It can be shortened. Some of its definitions may already appear elsewhere in the loan documents, or can be buried in the existing "dictionary" of defined terms, leaving a nonrecourse clause whose length is probably within industry expectations. A brief Short-Form Alternative Nonrecourse Clause follows.

Although this model is written from the lender's perspective, the author does not intend to take sides regarding what a nonrecourse clause "should" or "should not" say. Each such clause represents a negotiation whose outcome will depend on the context (primarily the loan-to-value ratio, the Borrower's business reputation, and the positions taken by other lenders in the marketplace). This model is offered only as one possible outcome, albeit an extreme one, of such a negotiation. More likely it would be a starting point for discussions, probably vehement.

POINTS TO CONSIDER • In using this Lender's State-of-the-Art Nonrecourse Clause, you should consider the following points.

Location of Nonrecourse Clause

Some attorneys who negotiate mortgage loan documents like to restate the nonrecourse clause, in full, in every loan document. This approach requires numerous conforming changes every time the clause is negotiated or modified, thus creating unnecessary cost and risk of error. To

save time, trouble, and effort, the Nonrecourse Clause should probably be spelled out in full only once, in whichever Loan Document is the "main" statement of the business deal (the Loan Agreement, if there is one). All other Loan Documents would then incorporate this Nonrecourse Clause by reference. Increasingly, the first document that sets out the Nonrecourse Clause will be the loan application, term sheet, or commitment letter, as a way to prevent subsequent negotiations.

Defined Terms

This Lender's State-of-the-Art Nonrecourse Clause assumes the documents already have fully defined the following terms:

- ADA;
- Affiliate;
- Bankruptcy (including any proceeding for dissolution, liquidation, or termination of Borrower or any constituent entity);
- Borrower;
- Casualty;
- Environmental Obligations (including obligations of Personal Obligors under separate indemnities);
- Event of Default;
- Financial Information;
- Ground Lease;
- Ground Lessor;
- Impositions;

- Lease;
- Legal Requirement;
- Lender;
- Lessee;
- Loan;
- Loan Documents;
- Mortgage (or Deed of Trust with conforming changes);
- Person;
- Property (including all Property Documents, Property Income, Proceeds, and other collateral held by Lender);
- SPE Covenants;
- Transfer (including subordinate liens of any kind, whether or not recourse, including mechanics' liens, and transfers of direct and indirect entity interests);
- U.C.C. Sale; and
- Yield Maintenance Premium.

To the extent that the Loan Documents already define words defined in the model clause, the latter definitions may be unnecessary. Also, it is assumed that somewhere the documents say, once, that notice means *written* notice, and that the word "include" means what any dictionary says it means, and not something else.

Two Important Five-Letter Words

The words "Fraud" and "Waste" are two of the most basic nonrecourse carveouts. Both predate the expan-

sion of carveouts during the last decade. But these terms can mean different things to different people. The Lender's State-of-the-Art Nonrecourse Clause defines these terms only to show "clarifications" and "concessions" that can arise by opening this door.

In the long run, Lender might do better by leaving both of these terms undefined—grains of sand around which Lender's litigators can try to spin elegant pearls of personal liability if necessary. Lender should consider whether, in view of market conditions, Borrower's counsel, timing, and so on, Lender will be able to push through the pro-Lender definitions suggested here, without too much dilution.

If the answer may be no, then perhaps "Fraud" and "Waste" should be left lower case; expanded slightly, such as by adding "intentional misrepresentation" to "fraud"; and their definitions removed. See Joshua Stein, *The Art of Real Estate Negotiations: Practical Psychology at the Table*, Real Estate Review (Winter 1996) (discussing the relative benefits of living with uncertain documents versus seeking certainty and losing). See also Godin, S. and Conley, C., *Business Rules of Thumb* (Warner Books, 1987), p. 7 ("One party generally benefits more than the other from vague . . . language in a contract . . .") (quoting Mark McCormack).

Borrower-Lender Spectrum

Wherever this Lender's State-of-the-Art Nonrecourse Clause provides for any "Personal Liability Amount," the list starts with "basic and standard" carveouts and then grows to include recent, creative, and exotic additions, in increasing order of recency, creativity, or exoticness. Throughout, *common concessions that a borrower might request—but not necessarily advisable for a Lender to make—appear in italics.* [Bracketed language indicates pro-Borrower alternatives to preceding bracketed pro-Lender language.] The italicized concessions sometimes overlap, and are sometimes inconsistent, but they suggest common lines of attack for Borrower.

Mere deletions that a Borrower might request are not specifically marked, as most of the Lender's State-of-the-Art Nonrecourse Clause would fall in that category. A realistic Borrower will want to prune back each list of carveouts as much as possible, probably starting at the bottom, and preserve all italicized language and pro-Borrower options.

A Lender using this sample clause might delete all italics and nothing else. If a Lender were to give up the entire second half of each collection of carveouts, that Lender would still be left in a tolerable position ("middle-of-the-road" but not "state-of-the-art") with regard to nonrecourse. Of course, every carveout de-

leted means that Lender gives up personal liability for one risk or another.

For each carveout, there is a reason a Lender would want personal liability. Although a "good" Borrower might in theory be willing to live with almost all of the carveouts—because "I would never do these bad things"—any Borrower knows that when a loan turns nasty every carveout may create some form of incremental leverage for the Lender. The less leverage Lender has, the better for Borrower.

Guaranty by Principals

In a typical single-asset real estate transaction, nonrecourse and its carveouts are a waste of paper and legal fees unless someone other than the single-asset borrower delivers a meaningful personal guaranty, covering all personal liability of the borrower under the nonrecourse carveouts. The core of such a guaranty might read as follows:

"Guarantor unconditionally guarantees Borrower's prompt and complete payment of each and every Personal Liability Amount, when and as payable from time to time pursuant to the Loan Documents. This Guaranty extends to payment of all Loan Obligations if, when, and as, pursuant to the Loan Documents, all Loan Obligations become a Personal Liability Amount. Guarantor shall be jointly and directly liable, with Borrower, as to the payment of all Personal Liabil-

ity Amounts. If at any time Borrower or Guarantor is obligated to pay any Personal Liability Amount, then Guarantor shall upon demand pay such Personal Liability Amount to Lender, whether or not (i) an Event of Default Date has occurred or (ii) Lender exercises any other rights or remedies under the Loan Documents."

Lenders need to consider the interaction between a guarantor's liability under language like this and the operation of any antideficiency or one-form-of-action rules in the particular state where the Property is located.

Borrower's Issues

A Borrower may wish to raise the issues discussed below in responding to a Nonrecourse Clause and its carveouts, in addition to the more specific points suggested through italicized language in the model.

Exit Strategy

Borrower and its principals will want to assure that the carveout structure leaves open a clear exit strategy, so that if the transaction goes bad Borrower and its principals can still walk away—the original premise of nonrecourse financing. Today's nonrecourse clauses, in their effort to create personal liability for nearly every possible risk, can go so far that they forget to leave open an unambiguous escape hatch for the "good" Borrower who merely wants to abandon a project. The Short-Form Alternative

Nonrecourse Clause suggested below offers one possible way to address this concern.

*"It's Not My Fault; I'm a Victim,
Not a Perpetrator"
(The Blame Game)*

A Personal Obligor will try to disclaim any personal liability resulting from acts or omissions of anyone other than such Personal Obligor—including, for example, the acts or omissions of any other Personal Obligor, a bad employee of Borrower, and so on. The Personal Obligor might grudgingly agree to be responsible for third parties' acts or omissions that were directed by such Personal Obligor or from which Personal Obligor benefited. Although any such qualifications are logically appealing, they also expose Lender to a complex factual inquiry, and problems of proof, if Lender ever wants to actually enforce personal liability. To a Personal Obligor, of course, this is part of the reason for suggesting the qualifications.

Failure To Pay

Wherever Lender seeks personal liability for failure to pay any costs related to the Property, Personal Obligors will try to limit such liability to apply only to the extent that Property Income was available to pay such costs but Borrower did not pay them and as a result something bad happened. With this qualification, any personal liability for "failure to pay"

effectively becomes personal liability for "misapplication of income." Such a limitation is probably consistent with the theory of "nonrecourse"—the theory that each real estate project is a separate investment and Borrower's principals have no obligation to put more money into the asset (they can walk away). On the other hand, Lender might argue that even in a nonrecourse loan, Borrower must either put money into the asset or abandon the asset to Lender, but cannot keep the asset without doing whatever is necessary to carry it ("having your cake and eating it too").

If a lockbox is in place, Borrower might reasonably disclaim all liability for failure to pay Property expenses, so long as Borrower does not violate the lockbox.

Timing of Payment

Regardless of the premise or scope of personal liability, Borrower and its principals should try to defer any personal liability until such time as Lender has actually suffered a Loss as a result of Borrower's bad acts. After all, the foreclosure sale might theoretically produce enough proceeds to make everyone whole. Particularly in the absence of language accelerating payment of any Personal Liability Amount, the foreclosure and deficiency judgment procedures in some states may automatically give Personal Obligors the benefit of this delay in actual exposure to liability.

Transaction-Specific Issues

If the loan is not "plain vanilla," consider tailoring the carveouts to the particular circumstances. Some examples:

- This Lender's Model State-of-the-Art Nonrecourse Clause already includes a few ground lease provisions, which can be deleted for fee mortgage transactions;
- If the transaction involves a condominium project, Lender might create carveouts for Borrower's misapplication of purchase deposits, for entering into sales contracts in violation of the Loan Documents, and for Borrower's indemnity against any liability arising from violation of the laws governing condominium sales;
- For a construction loan, or junior or mezzanine financing subordinate to a construction loan, Lender may want personal liability for misapplication of loan disbursements as well as the usual range of personal liability relating to the construction process itself;
- To the extent that a particular transaction creates low-likelihood risks that require a disproportionate volume of documentation (hence legal fees) to resolve as part of the initial transaction structure (for example, extra documents to mitigate "fraudulent conveyance" risks on a multiborrower portfolio mortgage loan), appropriate carveouts may give the parties an easier way to solve the problem; and

- For any subordinate loan, Lender might want personal liability if Borrower modifies the senior loan documents or, perhaps, fails to cure defaults under the senior loan documents. Borrower will want to know that if the senior lender forecloses (or takes a deed in lieu, including the equivalent through a pre-packaged bankruptcy), this will not trigger personal liability for the subordinate loan.

In each case, Lender should ask whether it wants to be able to look beyond the collateral for protection from a particular risk or loss. Many of the most interesting issues in structuring any real estate loan will ultimately drive the structure and negotiation of the nonrecourse clause.

Short-Form Alternative Nonrecourse Clause

Borrowers and Lenders and their counsel struggle endlessly to devise ever-more complex and complete nonrecourse clauses and carveouts. The popularity of this sport seems to have eclipsed the popularity of negotiating opinions of counsel. At the end of the day, however, it may make more sense to boil down the issue to a much simpler proposition: Borrower and its principals must either pay the loan or give up the collateral, in good condition, peacefully, and quickly. Nothing else matters.

An example of a Short-Form Alternative Nonrecourse Clause along these lines appears after the Lender's

State-of-the-Art Nonrecourse Clause. It uses the same defined terms.

To more fully implement this approach, Lender's counsel would also delete all nonrecourse and carveout language in the loan documents; and obtain personal guaranty(ies) of the entire Loan, subject to the same escape clause.

Lender would need to consider whether, in view of the other terms of the Loan Documents, this structure would leave Lender in a satisfactory position regarding some of the more exotic or recent carveouts, such as ADA problems, asset forfeiture risks, ERISA noncompliance, and uninsured casualty. Borrower would need to think about similar issues and decide whether this structure imposes on Borrower's principals any meaningful risks and obligations beyond those arising under today's nonrecourse clauses. Borrower would also need to examine whether the Loan would still qualify as nonrecourse indebtedness for income tax purposes.

Consent To Copy

Readers of *The Practical Lawyer* may copy, re-use, and adapt this Lender's State-of-the-Art Nonrecourse Clause, in whole or in part, for use: in any lender's standard documents; in any transaction-specific documents; and provided appropriate credit is given and copyright notice included, in any published materials relating to this topic. For any of these purposes, the Lender's State-of-the-Art Nonrecourse Clause, as updated from time to time, may be down-

loaded from the author's Web site: www.real-estate-law.com. Versions are available there in several formats, with or without concessions to Borrower.

Future Updating, Revision, and Availability

The author believes this Lender's State-of-the-Art Nonrecourse Clause includes all "carveouts" and pro-Lender ideas that are commonly, or even occasionally, used today in nonrecourse clauses. A reward of five dollars will be paid to anyone who reports to the author anything inconsistent with the belief expressed in the preceding sentence and not previously reported.

Although no reward is offered, readers are also invited to suggest other improvements to the Lender's State-of-the-Art Nonrecourse Clause, particularly additional concessions that a Borrower might request. This Lender's State-of-the-Art Nonrecourse Clause will be revised based on suggestions received, then reposted on the author's Web site.

Too Tough?

This Lender's State-of-the-Art Nonrecourse Clause represents an extremely "tough" and pro-lender position, including a few provisions that are not yet in common use but perhaps should be. On the other hand, Borrower may intend (or at least at time of closing may believe it intends) either to pay the Loan or to hand over the collateral peacefully and in good condition. In that case, the Lender's

State-of-the-Art Nonrecourse Clause imposes little incremental burden on Borrower and its principals—particularly if it is trimmed back a bit, such as with respect to uninsured casualty. The Short-Form Alternative Nonrecourse Clause leads to about the same place in a fraction of the space.

The Bigger Picture: A Few Questions

As Borrowers and Lenders structure, restructure, negotiate, and fine-tune their nonrecourse clauses and nonrecourse carveouts, they might want to pause to consider the following questions:

- *Loan pricing.* If a Borrower accepts an extremely pro-Lender nonrecourse clause (such as this one), will that Borrower be able to negotiate higher proceeds or a lower rate?
- *History.* The explosion of nonrecourse carveouts is driven primarily by the Real Estate Depression earlier this decade. In fact, just how badly did borrowers behave, overall, in that Real Estate Depression? Overall, how many problems actually occurred that would have been prevented by carveouts like these?
- *Competition.* Does competition force Lenders to trim back their

“carveouts”? If so, is this another race to the bottom, just like what happened just before the Real Estate Depression earlier this decade?

- *Better luck next time?* If (when?) the next Real Estate Depression hits, will “modern” nonrecourse clauses make borrowers behave differently than they did in the last Real Estate Depression? Will borrowers roll over and play dead to preserve their personal assets? Should foreclosure and real estate bankruptcy attorneys find a new line of work?

- *Strategic planning by borrowers.* Is there anything that Borrowers and their principals can do (or have already done) to improve their leverage in the next Real Estate Depression, in the face of general adoption of broad carveouts like those proposed here?

- *New deal structures.* Does the growth of securitization and portfolio financing change the parties’ treatment of these issues? If there is no identifiable deep-pocket individual to act as Personal Obligor, and if the collateral pool is large enough and deep enough that the transaction is in substance a corporate financing, and if Lender is relying on quality of management at least as much as the assets themselves, does “nonrecourse” matter?

Lender's State-of-the-Art Nonrecourse Clause

Notwithstanding anything to the contrary in the Loan Documents, Borrower and Lender agree as follows (collectively, the "Nonrecourse Clause").

A. *Definitions.* For purposes of this Nonrecourse Clause, the following terms shall be defined as follows:

1. *Borrower Payment.* A "Borrower Payment" means any money or other consideration distributed (or paid as a dividend or similar payment or as a payment on account of indebtedness or paid as return of capital or as a redemption of any equity interest in Borrower) by Borrower to (or to any Affiliate of) any partner, member, shareholder, principal, or other equity owner of Borrower, or paid as *above-market* management, asset management, development, or other fees to any of the foregoing *excluding reimbursement of actual expenses incurred (provided that the Loan Documents would have permitted Borrower to pay such expenses directly after taking into account priorities of application of Property Income as set forth in the Loan Documents)*;

2. *Event of Default Date.* An "Event of Default Date" means any date when *Lender has validly given Borrower notice that an Event of Default has occurred, which notice has not been withdrawn or invalidated and which Event of Default has not been cured, and Lender has validly accelerated Borrower's obligation to repay the Loan;*

3. *Exculpated Persons.* "Exculpated Person" includes: (i) Borrower; (ii) any Person that owns, directly or indirectly, any legal or beneficial interest in Borrower or the Property; (iii) any other Affiliate, agent, attorney, beneficiary, controlling person, director, employee, investor, manager, member, officer, owner, parent company, partner (general or limited, or a subpartner at any level), principal, real estate investment advisor or other similar fiduciary, shareholder, or trustee of any Person described in clauses (i) or (ii) above; or (iv) any successor or assign of any Person described in clauses (i) through (iii) above;¹

¹ Even in the most pro-Lender nonrecourse clauses, the basic scope of "Exculpated Persons" is nearly always quite broad, so there is no need for any Borrower negotiations.

4. *Fraud.* "Fraud" means any *actual, material, intentional, and proven* fraud or misrepresentation (as opposed to constructive or negligent fraud or misrepresentation), upon which Lender actually and reasonably relied in making the Loan, which fraud or misrepresentation is not cured within _____ days (or such reasonable additional period as Borrower shall reasonably require, provided that Borrower is endeavoring, with reasonable diligence and continuity, to cure such fraud or misrepresentation) after notice from Lender;

5. *Ground Lease Impairment.* A "Ground Lease Impairment" means any *material* amendment, modification, cancellation, termination, or waiver of any Ground Lease, or the obligations of any Ground Lessor, caused or agreed to by Borrower, or any *intentional and substantial* default by Borrower under any Ground Lease that *materially impairs Lender's security*;

6. *Lease Impairment.* A "Lease Impairment" means: (i) any *material* amendment, modification, cancellation, termination, or waiver of any Lease, or the obligations of any Lessee, caused or agreed to by Borrower, that *materially impairs Lender's security*; (ii) any *intentional and substantial* default by Borrower under any Lease; or (iii) Borrower's delivery of any notice to any Lessee that is inconsistent with the Property Income collection procedures set forth in the _____ Agreement, which notice is not withdrawn in writing within _____ days after notice from Lender;

7. *Lessee Deposits.* The "Lessee Deposits" means all security deposits, prepaid Property Income (including any Property Income collected more than _____ days before the date first required to be paid under the applicable Lease) not yet properly applied in compliance with the Loan Documents, letters of credit, escrow deposits, and similar sums delivered to Borrower by any Lessee in connection with any Lease;

8. *Lien Enforcement Action.* A "Lien Enforcement Action" means any action in which Lender exercises any rights and remedies *against Borrower (and/or Personal Obligor(s))* pursuant to the Loan Documents or under applicable law or at equity against or with respect to the Property, including: appointment and maintenance of a receiver; any action to prevent Waste or otherwise to protect the Property from *material physical* damage or

material physical deterioration; Lender's exercise in full compliance with applicable law of a power of sale contained in any Loan Document; commencement and prosecution of a foreclosure, trustee's sale, or similar proceeding or other judicial process (including such an action in which Lender seeks a deficiency judgment against Borrower or any Personal Obligor but only as to any Personal Liability Amount or as to a deficiency judgment enforceable only against the judgment debtor's direct or indirect interest in the Property); prosecution of any and all rights available to Lender relating to Borrower and the Property in any Bankruptcy (including Lender's rights under the United States Bankruptcy Code to file a claim for the full amount of all Loan Obligations, to require that all collateral held by Lender continue to secure all Loan Obligations, and to elect treatment under 11 U.S.C. § 1111(b)(2)); consummation of a U.C.C. Sale; and any other action or proceeding relating to the Property (including an action for specific performance as to Borrower's express nonmonetary obligations under the Loan Documents), or relating to any other collateral held by Lender for the Loan, which action or proceeding does not seek a personal judgment against the assets of any Exculpated Person (beyond the direct or indirect interest of such Exculpated Person in the Property);²

9. *Loan Obligations.* The "Loan Obligations" means all obligations of Borrower with respect to: (1) payment of principal, interest, and any other sums payable under the Loan Documents; (2) performance of all nonmonetary obligations of Borrower under the Loan Documents; (3) payment of damages for breach of any representation, warranty, or covenant in any Loan Document; (4) any obligation to indemnify any party under any Loan Document; and (5) payment of any judgment obtained by Lender under the Loan Documents requiring payment of money;

10. *Loss Proceeds.* The "Loss Proceeds" means any insurance proceeds or condemnation awards (including payments arising from change in grade of streets), or payments in lieu of the foregoing, arising from the Property, and any other sums payable by any Person to or for the account of

² Many nonrecourse clauses actually do permit Lenders to seek deficiency judgments, even without the qualifications suggested here. Borrowers and their principals are presumably comfortable relying on other provisions of the nonrecourse clause for protection.

Borrower or any Exculpated Person on account of any loss, condemnation, or taking of, or damage to, the Property, *but only to the extent actually paid to Borrower or any Affiliate of Borrower, and subject to the rights of Lessees and other third parties;*

11. *Loss(es)*. Any "Loss(es)" incurred by a Person shall mean any and all *actual, out-of-pocket, reasonably documented, and reasonable* losses, damages, costs, and expenses (including *reasonable* attorneys' fees and expenses), *directly and reasonably* incurred, paid, or suffered by such Person: (i) as a *direct* result of a specified matter; (ii) to cure or remedy any *material* default with respect to such matter *after having provided reasonable notice and opportunity to cure such matter;* and (iii) in enforcing such Person's claims *after an Event of Default Date* against [any Person] [*any Personal Obligor*] with respect to such matter. Any reference to Losses incurred by Lender as a result of any matter shall also include: (x) an amount equal to the diminution in value of the Property resulting from the matter in question *but only to the extent that Lender has actually held a foreclosure sale of the Property and, as a result of such diminution in value, Lender has failed to recover the full amount of the Loan Obligations from the sale of the Property, all as determined by a court of law of competent jurisdiction beyond right of further appeal;* and (y) any Losses incurred by Successor with respect to such matter;

12. *Personal Liability Amount*. The "Personal Liability Amount" means, upon occurrence of any circumstance or event that causes Borrower or any Personal Obligor to become personally liable to Lender pursuant to this Nonrecourse Clause, the amount of such personal liability as provided for (and more specifically defined) in this Nonrecourse Clause, including the entire amount of the Loan *only* where expressly stated, *provided, however, that no Personal Obligor shall be personally liable with respect to any Personal Liability Amount arising from any cause or circumstance other than such Personal Obligor's intentionally wrongful acts or omissions (including acts or omissions of others at the direction or for the direct and substantial monetary benefit of such Personal Obligor);*

13. *Personal Liability Document*. A "Personal Liability Document" means any guaranty (whether partial or full) of any Loan Obligation, affidavit, certificate, certification, master lease, or indemnity issued or delivered in

writing to or for the benefit of Lender with respect to Borrower, the Loan, or the Property at any time (including any certification accompanying, or deemed by the Loan Documents to accompany, any Financial Information required to be delivered to Lender), *subject in each case to all the terms and conditions of any such document*;

14. *Personal Obligor(s)*. The "Personal Obligor(s)" means any Person(s) who shall have executed and delivered, in its or their individual or personal capacity, any Personal Liability Document, *but only to the extent of any personal liability of such Person(s) arising under the express terms of any such Personal Liability Document*;

15. *Proceeds*. The "Proceeds" of the Property means all Loss Proceeds, *directly traceable* proceeds from any Transfer, Property Income *after an Event of Default Date*, and other proceeds and products of the Property *first arising after an Event of Default Date*;

16. *Property Documents*. The "Property Documents" means all books, records, and files relating to the Property maintained *in its actual possession* by Borrower, any Affiliate of Borrower, or any managing agent or property manager engaged by any of them, including original counterparts of all Leases;

17. *Property Income*. The "Property Income" means, *to the extent actually paid by Lessees and received by Borrower after an Event of Default Date*, any and all *material*: (i) sums payable to or on behalf of Borrower under any Lease, including rent, additional rent, escalations, and any and all other payments and charges of any kind; (ii) other issues, profits, royalties, revenues, income, and other benefits of the Property; (iii) damages or claims of Borrower against Lessees or others on account of or with respect to the foregoing; and (iv) sums paid in settlement of any of the foregoing;

18. *Successor*. A "Successor" means any Person (including Lender; Lender's subsidiary, nominee, or designee; a receiver; and the purchaser at any foreclosure or similar sale, including an auction in Bankruptcy) that obtains title to, or the right to possess or control, the Property or any portion thereof, or collect any Property Income, as the result of or pursuant to a Lien Enforcement Action or a conveyance, transfer, or assignment in lieu of a Lien Enforcement Action; and

19. *Waste.* [“Waste” means any “waste” of the Property, whether intentional or negligent. “Waste” includes allowing the Property to deteriorate in any manner or to any degree, failure to pay Impositions, and any other act or omission that reduces the value of the Property, including its value as collateral for the Loan.] [“Waste” means actual intentional physical damage resulting in harm of a substantial nature to the Property, directly caused by Borrower or a Personal Obligor, that materially reduces the value of the Property. “Waste” does not include failure to pay Impositions or deferral of ordinary maintenance or repairs.]

B. *Nonrecourse, Generally.* Except as otherwise stated in this Nonrecourse Clause, and except for the obligations of any Personal Obligor under any Personal Liability Document (subject to the terms of such Personal Liability Document) or with respect to any other Personal Liability Amount: (i) no Exculpated Person shall be personally liable, and Lender shall not commence or prosecute any action against any Exculpated Person, for payment or performance of any Loan Obligation; (ii) Lender shall not seek or obtain a deficiency judgment against any Exculpated Person; and (iii) Lender's recourse for the Loan Obligations shall be limited to the Property.

C. *Liability Arising from Certain Matters.* Borrower and (subject to the terms of the applicable Personal Liability Documents) each Personal Obligor (but only as to any matters directly caused by the acts, or directions to others to act, of such Personal Obligor, or as a result of which such Personal Obligor obtained a direct and substantial monetary benefit) shall be personally liable to Lender, and nothing in this Nonrecourse Clause shall limit the personal liability of any Personal Obligor, for an amount (a “Personal Liability Amount”) equal to the sum of the following, as proven in a court of law of competent jurisdiction beyond right of further appeal, as to the payment of which an Event of Default shall have occurred:

1. *Environmental Provisions.* All liability of Borrower or any Personal Obligor with respect to any Environmental Obligations;

2. *Loss Proceeds.* An amount equal to _____ times the amount of all Loss Proceeds not applied by Borrower in compliance with the Loan Documents after the occurrence of an Event of Default;

3. *Lessee Deposits.* An amount equal to all material Lessee Deposits previously received by Borrower or any Exculpated Person, except to the

extent that Borrower properly applies such Lessee Deposits as Property Income in *substantial* compliance with the Leases and the Loan Documents, as refunds to Lessees as required by Leases, or by delivering such Lessee Deposits to Successor within _____ days after notice by Successor;

4. *Property Income*. An amount equal to _____ times the amount of any *material* Property Income collected by or on behalf of Borrower or any Exculpated Person *after an Event of Default Date* and *intentionally* applied other than to comply with Borrower's obligations under the Loan Documents *and to make capital improvements to the Property*, in full compliance with the Loan Documents (including any provisions of the Loan Documents relating to the priority of application of any Property Income), *but only to the extent that as a direct result of such misapplication Borrower failed to comply with any Loan Obligations*;

5. *Impositions*. An amount equal to any Impositions, or escrow deposits on account of Impositions, not paid by Borrower when required under the Loan Documents, *but only to the extent that Property Income was available to make such payments (it being understood that any Property Income must be applied first to the payment of Impositions before being applied for any other purpose)*;

6. *Removals*. All Losses incurred by Lender as a *direct* result of the *intentional and wrongful* removal or disposal, by Borrower or its Affiliates, in violation of the Loan Documents, of any fixtures, personal property, or improvements on, at, or affixed to the Property;

7. *Collection Costs*. All Losses incurred by Lender in collecting any [Loan Obligations] [Personal Liability Amount] from Borrower or any Personal Obligor;

8. *Certain Cash*. An amount equal to all cash and cash equivalents held by Borrower on an Event of Default Date plus all Borrower Payments made by Borrower after an Event of Default Date or during the _____-month period preceding an Event of Default Date, *but only to the extent that at the time of any such Borrower Payment any ordinary, necessary, and reasonable operating expenses or Impositions relating to the Property, or regularly scheduled payments then required on account of the Loan, were unpaid*;

9. *Prohibited Borrower Payments*. An amount equal to _____ times the amount of all Borrower Payments made by Borrower in violation of the Loan

Documents or the making of which caused a violation of the Loan Documents;

10. *Fraudulent Transfers.* An amount equal to any payment, distribution, or transfer made by Borrower that is recoverable by or for the benefit of a creditor in any Bankruptcy, *but only to the extent that Lender suffers any Loss as a result thereof*;

11. *Lease Impairments.* If any Lease Impairment occurs in violation of the Loan Documents, then an amount equal to *[any Loss actually suffered by Lender as a result of such Lease Impairment]* [the product of _____ times the sum of: (i) any payments that the Lessee would have been required to make but for such Lease Impairment; and (ii) any other Losses suffered by Lender as a *direct* result of such Lease Impairment];³

12. *Prohibited Leases.* If Borrower enters into any Lease in violation of Section ____ of the _____, then an amount equal to ____ times the amount of any Loss *actually* suffered by Lender as a result thereof;⁴

13. *Transaction Costs of Lien Enforcement Action.* An amount equal to all transfer taxes and recording charges required to be paid in order to record any deed or other instrument of conveyance issued or delivered pursuant to any Lien Enforcement Action, or otherwise arising from a transfer of title pursuant to a Lien Enforcement Action;

14. *ERISA Violations.* All Losses incurred by Lender as a *direct* result of any violation of Section ____ of the _____;

15. *Violations of Law.* All Losses incurred by Lender as a *direct* result of any violation of ADA or of any other Legal Requirement *as to which violation Borrower received notice while Borrower owned the Property*;

16. *Operating Costs.* An amount equal to any utility costs and charges, insurance premiums, and other operating costs payable by Borrower

³ If a Personal Obligor with a strong balance sheet is willing to stand behind a Borrower's personal liability for Lease Impairments, this would substantially reduce Lender's concerns in any nondisturbance agreement. It would also simplify nondisturbance negotiations and demonstrate again that many significant issues and problems in the closing process and loan documentation ultimately find their way back to the nonrecourse clause.

⁴ It is hard to measure this Loss. Lender may wish to establish a formula or procedure, or to simplify matters by converting the whole loan into full recourse as punishment and behavior control.

with respect to the Property, to the extent that Property Income was available to pay such costs and charges and any Person validly asserts a lien against the Property, senior to the lien of the Mortgage, as a result of the nonpayment of such amounts;

17. *Uninsured Casualty.* All Losses suffered by Lender as a result of any Casualty that was not covered by insurance (including by operation of any "deductible" amount in any insurance policy), to the extent that the Loan Documents required Borrower to provide and pay for insurance as to such Casualty and such obligation to insure was not assumed by any Lessee pursuant to a Lease;

18. *Letter of Credit Amount.* An amount equal to the required face amount of any letter of credit that the Loan Documents required Borrower, but Borrower failed, to deliver and maintain as security for the Loan;

19. *Indemnity Obligations.* All obligations of Borrower with respect to any indemnification contained in the Loan Documents, and all Losses suffered by Lender as a direct result of the gross negligence or intentional and willful misconduct of Borrower or any Exculpated Person;

20. *Criminal Acts.* Any liability of Borrower or any Personal Obligor resulting from a criminal act committed by the Person against whom liability is being asserted, as to which act such Person was convicted by a court of law of competent jurisdiction beyond right of further appeal;

21. *Closing Costs.* An amount equal to any commitment fee, loan fee, attorneys' fees, mortgage recording tax, brokerage commissions, title insurance premiums, or other closing costs that Borrower was required, but failed, to pay with respect to the Loan;

22. *Yield Maintenance Premiums.* An amount equal to any Yield Maintenance Premium payable by Borrower at any time;

23. *Protective Advances.* An amount equal to all sums advanced by Lender to cure Borrower's defaults under the Loan Documents other than defaults in payment of principal, interest, or other sums payable to Lender; and

24. *Certain Acts or Omissions.* All Losses suffered by Lender as a direct result of any intentionally wrongful act or wrongful omission (including any failure to maintain, preserve, protect, or repair the Property) by any Exculpated Person that substantially impaired the value of the Property, including the value of the Property as collateral for the Loan.

D. *Full Liability for All Obligations.* Borrower and each Personal Obligor shall become personally liable to Lender for (and the "Personal Liability Amount" shall therefore include) all Loan Obligations if any of the following events shall have occurred, provided that (i) such event shall have constituted, caused, or arisen from an Event of Default; and (ii) each Personal Obligor shall be personally liable only to the extent of any Loss actually incurred by Lender as a result of any such event directly caused by (or at the direction of or for the direct and substantial monetary benefit of) such Personal Obligor, as proven in a court of law of competent jurisdiction beyond right of further appeal:

1. *Interference with Lien Enforcement Action.* If Borrower or any Exculpated Person shall in any way materially contest, delay, oppose, impede, or otherwise interfere with any Lien Enforcement Action, including by filing any pleadings, motions, or other court papers of any kind not approved by Lender or asserting any claims, defenses, or counterclaims whatsoever, except to the extent that any claims, defenses, or counterclaims asserted, or positions otherwise taken, by Borrower or any Exculpated Person either or both: (i) relate solely to whether the acts or omissions of Borrower constituted an Event of Default; or (ii) substantially prevail;

2. *Bankruptcy.* If any voluntary Bankruptcy shall occur with respect to Borrower or (only if the Bankruptcy of a constituent entity of Borrower would in any way impair Lender's ability to commence and prosecute any Lien Enforcement Action affecting Borrower or otherwise materially adversely affect Lender) any constituent entity of Borrower and any such Bankruptcy, if involuntary, either shall have been commenced in whole or in part by or with consent or collusion by any Exculpated Person or shall not have been dismissed within ___ days after the commencement thereof;

3. *Prohibited Transfer.* If any intentional and voluntary Transfer occurs in violation of the Loan Documents and such Transfer is not rescinded within ___ days after notice from Lender;

4. *Fraud; Lease Impairments.* If any Exculpated Person at any time (i) commits or has committed any Fraud in connection with the Loan, the Property, any Financial Information delivered to Lender, or the closing of the Loan or (ii) causes or permits any Lease Impairment;⁵

5. *Ground Lease Impairment.* If Borrower causes or permits any Ground Lease Impairment;⁶

6. *Information.* If Borrower fails to provide any *material* Financial Information that any Loan Document requires Borrower to provide, or fails to permit Lender to inspect and copy any *material* Property Documents or to inspect the Property when and as required by the Loan Documents, and any such failure continues for ___ days after notice;

7. *Further Assurances; Correction of Lender's Security Documents.* If Borrower fails to deliver any financing statement, security instrument, corrective filing, or other document required by Section _____ of the _____, and such failure continues for _____ days after notice from Lender;⁷

8. *Certain Claims.* If any Exculpated Person asserts in writing, whether or not in any judicial proceeding, that Borrower is a partner or joint venturer with Lender or any relationship exists between Borrower and Lender other than that of debtor and creditor *and fails to retract such claim in writing within ___ days after notice from Lender;*

9. *Additional Financing.* If, in violation of the Loan Documents, Borrower obtains any additional financing or incurs any other financial obligations (whether secured or unsecured, direct or contingent, and including the issuance of any guaranty), other than the Loan, *routine trade payables for operation of the Property paid when due or being diligently contested by*

⁵ More typically, Personal Obligors would face personal liability only for the damages arising as a result of the Fraud or Lease Impairment. This paragraph goes further, and makes the entire Loan full-recourse.

⁶ If a Ground Lease Impairment destroys Lender's collateral, full personal liability for the entire Loan is appropriate.

⁷ This paragraph is not a "standard" carveout. It does not appear in any of the dozens of nonrecourse clauses that the author reviewed for this project. In the author's opinion, it is one of the most important and justifiable carveouts that every Lender should request.

Borrower, and unsecured loans to pay for improvements, replacements, or repairs to the Property, which unsecured loans are made by Borrower's Affiliates and are subordinate to the Loan, pursuant to subordination agreements reasonably satisfactory to Lender.

10. *Asset Forfeitures (RICO, Drug Law Violations, Etc.).* If the Property or any portion thereof is subject to any forfeiture as the result of any facts or events constituting a breach of Borrower's covenants, representations, or warranties set forth in Sections _____ of the _____,⁸

11. *SPE Covenants.* If Borrower or Borrower's general partner or manager *intentionally* fails to comply with the SPE Covenants *and fails to cure such default within _____ days after notice from Lender, and such failure materially impairs Lender's security;* and

12. *Nondelivery.* If, after _____ days notice, Borrower fails to surrender to Successor any Property Documents, Property Income, or other property as to which Successor has taken title or is entitled to possession;

13. *Invalidity.* If, *as a direct result of the intentionally wrongful acts or omissions of Borrower, any material real property lien or material real property security interest of Lender as expressly provided for or contemplated by any of the Loan Documents is determined by a court of law of competent jurisdiction beyond right of further appeal to be invalid or unenforceable, in whole or in part, except to the extent that such invalidity or unenforceability (i) does not materially impair Lender's real property security considered in the aggregate; (ii) is cured with _____ days after notice to Borrower; (iii) entitles Lender to make a claim under Lender's policy of title insurance; or (iv) could reasonably have been prevented through the exercise of reasonable care by Lender or Lender's counsel.*

E. Certain Rights and Remedies Unaffected. Notwithstanding anything to the contrary in this Nonrecourse Clause, Lender shall retain the rights to take any of the following actions, and none of the following actions shall be limited, restricted, or impaired by this Nonrecourse Clause:

1. *Lien Enforcement Actions.* Lender may commence and prosecute any Lien Enforcement Action, may exercise any rights or remedies available

⁸ Borrower might try to limit liability under this paragraph to the amount of any Losses actually suffered.

to Lender in any Lien Enforcement Action, and may name [any Exculpated Person(s)] [*Borrower and any Personal Obligor(s)*] as defendant(s) in any Lien Enforcement Action, *provided that Lender does not seek to obtain a monetary judgment enforceable against the assets of such Person(s) other than such Person's interest in the Property, or as contemplated by the Personal Liability Documents;*

2. *Damages for Personal Liability Amount.* Lender may enforce the individual personal liability of any Personal Obligor under any Personal Liability Document, or any right of Lender to name Borrower or any Personal Obligor in any action or proceeding of any kind seeking to enforce personal liability as to any Personal Liability Amount, *subject to the terms of the Personal Liability Documents*, or to obtain a monetary judgment against Borrower or any Personal Obligor for damages in an amount equal to any Personal Liability Amount *as to which such Person is personally liable pursuant to the Personal Liability Documents;* and

3. *Certain Other Liability.* Nothing in this Nonrecourse Clause shall exculpate any Person (including any Exculpated Person) from any liability (and the Personal Liability Amount shall therefore include any liability of any Personal Obligor) for or arising from, under, or with respect to *any of the following caused by the intentionally wrongful acts of such Person:* (i) Waste or Borrower's failure to prevent Waste; (ii) Fraud; (iii) conversion of the Property or any portion thereof; (iv) breach of trust; or (v) any personal liability that would arise under generally applicable tort law (including the common law of negligence, indemnification, and contribution) without regard to the Loan Documents.

F. *Notices to Borrower.* Wherever any liability of a Personal Obligor is directly or indirectly conditioned upon Lender's having given Borrower notice of any matter (including notice of acceleration of the Loan), Lender may at Lender's option instead satisfy such condition by giving such notice to any one or more Personal Obligor(s) *if Lender is legally prohibited from giving such notice to Borrower (for example, because of the pendency of a Bankruptcy affecting Borrower).*

G. *No Impairment.* Nothing in this Nonrecourse Clause shall in any way limit, impair, qualify, modify, or otherwise adversely affect the validity or enforceability of the Loan, any Personal Liability Document, any Personal

Obligor's liability under any Personal Liability Document or as to any Personal Liability Amount, the Loan Documents, or the lien of the Mortgage or of any other security interest or collateral held by Lender or the enforcement thereof by Lender.

Short-Form Alternative Nonrecourse Clause

A. *Personal Liability for Loan.* Borrower and all Personal Obligors shall be directly and unconditionally personally liable for all Loan Obligations (and all assets of Borrower and all Personal Obligors shall be subject to full recourse on account of any and all Loan Obligations) ("Personal Liability") at all times until either (x) all Loan Obligations have been paid in cash and performed in full or (y) such Personal Liability shall have terminated (except as to Environmental Obligations) as follows. Except as to Environmental Obligations, Personal Liability shall terminate, *and Lender shall execute and deliver to Borrower and the Personal Obligors a written confirmation thereof (in form reasonably satisfactory to Borrower)*, if and when, pursuant to documentation *reasonably* satisfactory to Lender, all the following conditions shall have been satisfied within _____ days (or such longer period as Lender shall have *reasonably* agreed to in writing) after an Event of Default Date:

1. *Monetary Obligations.* Borrower shall be in full compliance with all monetary Loan Obligations other than (i) *any amounts that are in arrears by no more than _____ days* and (ii) the obligation to pay principal of the Loan (for which purpose, principal shall not be deemed to include any sum that did not originally constitute principal but was added to principal by operation of the Loan Documents because Borrower failed to pay it);

2. *Nonmonetary Obligations.* Borrower shall be in [full] [*substantial*] compliance with all nonmonetary Loan Obligations *relating to the Ground Lease, the Leases, and the physical condition of the Property to the extent that Lender shall have given Borrower notice of noncompliance on or*

*before the Event of Default Date or Lender shall have first discovered such noncompliance after the Event of Default Date and given Borrower prompt notice thereof;*⁹

3. *Tender.* Borrower shall have tendered to Lender a deed (*without covenant or warranty*), valid and effective to convey title to the entire Property to Lender (or Lender's designee) and not subject to rescission or invalidation pursuant to Bankruptcy or otherwise, a certified check to Lender for all payments required to be paid *to any governmental authority* in order to record such deed, all *material* Property Documents *to the extent in the possession of, or reasonably available (without unreasonable expense) to, Borrower or Borrower's Affiliates*, and a general release of Lender executed by Borrower and by _____;

4. *Cooperation.* Borrower shall have otherwise [fully] [*reasonably*] cooperated with Lender, at [Borrower's] [*Lender's*] expense, as *reasonably* requested by *notice from* Lender to achieve an orderly transition of ownership and management of the Property *in accordance with customary industry standards for the transfer of real property pursuant to a deed in lieu of foreclosure.*

⁹ Borrower should not be required to be in compliance with nonmonetary Loan Obligations that would be considered "personal" to Borrower, such as covenants not to dissolve or liquidate; covenants not to transfer entity interests or to maintain a particular affiliation; or covenants to maintain a particular management company. This concept could require fine-tuning based on the circumstances of a particular Loan.

**PRACTICE CHECKLIST FOR
Lender's Model State-of-the-Art Nonrecourse
Clause (with Carveouts)**

Nonrecourse clauses are a fact of life in mortgage loan documents. Another fact of life is that the continual addition of various carveouts has made these clauses quite long, complex, and difficult to read. Because your goal as a transactional lawyer is to create clear transactional documents, why not clean up the nonrecourse clause, too?

• Here are some points to consider:

- Nonrecourse carveouts should clearly delineate the measure of personal liability (partial or full liability), and when it arises;
- Modern carveouts cover a wide range of risks and issues — about two dozen circumstances where borrower and its principals are personally liable for specific amounts or losses, and about half as many circumstances where borrower and its principals might face full liability for the entire loan;
- Two of the most basic carveouts cover fraud and waste. To a lender, it may be better to leave these terms undefined;
- The nonrecourse clause and its carveouts are a waste of paper in single-asset real estate transactions unless someone other than the borrower delivers a personal guarantee of the carveouts;
- If the net effect of nonrecourse carveouts is to impose personal liability for nearly everything except payment of the loan, perhaps the whole issue can be boiled down into giving borrower and its principals two simple choices — either pay the loan or give the lender the keys; and
- Consider the need for transaction-specific carveouts, if a loan is not “plain vanilla.”

• A borrower may want to address at least the following issues:

- Try to defer, complicate, and establish conditions and limitations to personal liability (materiality, intentionally wrongful acts, and so on);
 - Preserve an exit strategy, so the borrower can walk away unscathed if the transaction goes bad;
 - Disclaim personal liability resulting from the acts of others; and
 - Try to limit personal liability for nonpayment of property expenses so it arises only to the extent that funds were available from the property but misapplied.
-