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# Tricky Loan Clauses Can Create Disaster For A Property Owner That Waives Or Defers Rent

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Tenants can't pay their rent because of the pandemic. They ask for abatements, deferrals or other accommodations. Property owners sometimes go along, signing formal abatement or deferral agreements with tenants. Owners may feel they have no choice. They look ahead into a dark future and would rather have tenants in occupancy than vacant space. Or they may just want to be nice because it's a round world.

When tenants are forced to shutter businesses, they often ask for rent concessions. Owners beware! RANJAN SAMARAKONE

If property owners accommodate many of these tenant requests, then they may soon find they have trouble paying their own obligations, particularly their mortgage loans. Before long, owners may decide to approach their lenders for accommodations like the ones they gave their tenants.

This all sounds entirely logical, reasonable, and businesslike. If an owner takes a wrong step in the process, though, it may find itself in default under its mortgage loan, at risk of losing its property through foreclosure.

Loan documents often require the borrower to obtain the lender's approval before waiving or deferring any rent payment or modifying any lease in any way. Those restrictions will vary among loans and with the size, duration, importance and type of leases. When the restrictions do apply, if an owner accommodates its tenant without getting the lender's approval, the lender might very well have the right to call a default and ultimately foreclose.

A court might throw the lender out of court, but that is by no means a certainty. So the borrower ought to have a conversation with its lender, and get approval for any rent abatement or deferral, if the loan documents require it. If the lender refuses to go along, the borrower might structure the accommodation in a way that avoids the lender approval requirement, but that could raise its own issues.

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Any rent waiver made without lender approval may produce bad consequences that go far beyond just allowing the lender to call a default.

In most commercial mortgage loans, the borrower's principals sign a "nonrecourse carveout guaranty," in which they agree to guaranty the loan – but only if the borrower does certain bad things, such as selling the property or voluntarily filing bankruptcy. As long as the borrower doesn't do any of those bad things, the lender might foreclose but it won't have any recourse against the borrower or its principals if the collateral doesn't have enough value to repay the loan.

The list of bad things activating a nonrecourse carveout guaranty sometimes includes amending a lease, or waiving a tenant's obligations, without the lender's consent. So an ordinary accommodation to a tenant in trouble, if done without the lender's consent, might make the owner's principals responsible for payment of the entire loan, an exposure they otherwise would have avoided. That would be a disaster.

A borrower should consider similar issues before approaching its lender for any loan relief. Almost all loan documents say it's a default if the borrower admits in writing its inability to pay its debts. This default usually appears in a long dense paragraph on insolvency-related defaults. If a borrower admits it can't pay its debts, this might help support an involuntary bankruptcy filing against the borrower. So the lender doesn't want that to happen – not that the borrower's written admission will affect the outcome very much if the borrower in fact can't pay its debts.

At any rate, if the borrower makes such a written admission to anyone, even the lender, the loan documents will typically allow the lender to call a default and foreclose. Such an admission will also often allow the lender to claim that the borrower's principals are now liable for the

entire loan under a nonrecourse carveout guaranty. This is of course an absurd result, but no more absurd than some other recent results in litigation over similar guaranties.

Therefore, any real estate borrower must proceed with extreme care both in accommodating its tenants and in seeking any accommodations from its lender. The borrower should read its loan documents. It should do nothing to give the lender a hook on which to hang a default – or, even worse, a claim under a nonrecourse carveout guaranty.

**Joshua Stein**

I help buyers, sellers, borrowers, lenders, tenants, property owners, and other commercial real estate market participants identify and achieve their business goals. To do that, I need to understand risk, security, numbers, value, financeability, flexibility, and exit strategy. Some legal issues matter a lot and many don't. It's important to know the difference. I write extensively on commercial real estate law and practice – over 300 articles and five books on leasing, lending, and other areas, with some emphasis on ground leases. I occasionally serve as an arbitrator or expert witness in complex real estate disputes. That lets me see how transactions go wrong. Often, the problems could have been avoided by keeping it simple and following the money, but everyone got sidetracked. As a Forbes contributor, I try to tell stories that teach worthwhile lessons for real estate deals. **Read Less**


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