Negotiating Carry Guarantees in Modern Real Estate Financings: Strategies and Trends

Insights • January 17, 2025

Lenders are increasingly requiring carry guarantees—sometimes framed as completion guarantees, operating shortfall guarantees, or carry cost guarantees—to ensure support for debt service and operating costs during distress. Unlike traditional non-recourse carve-outs or "bad boy" guarantees, carry guarantees can impose ongoing obligations on sponsors, effectively serving as a "catch-all" for deal-specific risks.

This article outlines the key features of carry guarantees, negotiation strategies, tender conditions, and distinctions between negotiating with mortgage versus mezzanine lenders.

What Is a Carry Guarantee?

A carry guarantee obligates a guarantor—often the sponsor or a creditworthy affiliate—to fund shortfalls in debt service, taxes, insurance, and sometimes operating expenses when project cash flow is insufficient. Unlike a bad-boy guaranty, the carry obligation is forward-looking and operational, requiring the guarantor to "carry" the project until resolution (sale, refinancing, lease-up, or other milestone).

Borrowers should carefully consider these obligations in tandem with other financing provisions such as joint ventures & structured investments and real estate acquisitions & sales.

Key Negotiation Points

Scope of Obligations

- **Borrower Position:** Limit to debt service, taxes, and insurance only. Exclude discretionary operating costs, capital expenditures, or tenant improvement/leasing commission reserves.
- **Lender Trend:** Expanding scope to cover operating expenses, transfer costs, and reserves.
- **Negotiation Tip:** Define "Carry Costs" narrowly. Exclude capital expenditures, environmental costs, and litigation expenses.

Triggering Events

- **Borrower Position:** Carry obligations triggered only after defined shortfalls or defaults (e.g., failure to pay debt service).
- **Lender Trend:** Expanding to cover covenant breaches, construction delays, or adverse leasing performance.
- **Negotiation Tip:** Tie obligations to objective events (missed payments, uncured defaults) rather than subjective lender determinations.

Duration and Burn-Off

- **Borrower Position:** Terminate obligations upon achieving stabilization, construction completion, or a fixed period after loan closing.
- **Lender Trend:** Indefinite obligations until repayment in full or foreclosure.
- **Negotiation Tip:** Negotiate “sunset provisions” tied to debt yield, occupancy, or NOI benchmarks.

Funding Mechanics

- **Borrower Position:** Require written demand, cure periods, and right to contest amounts.
- **Lender Trend:** Immediate demand obligations, often requiring advance reserve funding.
- **Negotiation Tip:** Insist on detailed backup, notice, and the ability to offset incorrect calculations.

Cap on Liability

- **Borrower Position:** Request a hard cap (e.g., 6–12 months of debt service).
- **Lender Trend:** Resistance to hard caps, though some accept limited multiples tied to stabilization.
- **Negotiation Tip:** Frame caps around the lender’s foreclosure/stabilization horizon.

Tender Conditions and Current Trends

Tender conditions allow guarantors to extinguish carry guarantee obligations by tendering the property or collateral (e.g., deed-in-lieu of foreclosure).

- **Historic Approach:** Lenders resisted, requiring obligations to survive until foreclosure.
- **Current Trends:** Transitional/construction lenders more open to tender options, provided environmental indemnities are satisfied and property is lien-free.
- **Transfer Taxes:** Borrowers should negotiate caps, cost-sharing, or lender responsibility—particularly in high-tax jurisdictions like New York City’s Real Property Transfer Tax (RPTT) and the New York State Real Estate Transfer Tax.

Borrowers should integrate these strategies with broader financing negotiations, including commercial lending & leveraged finance structures.

Mortgage Lenders vs. Mezzanine Lenders

Nature of Collateral

- **Mortgage Lenders:** Secured by property; remedies involve foreclosure.
- **Mezzanine Lenders:** Secured by equity; remedies involve UCC foreclosure—faster and less expensive.

Carry Guarantee Expectations

- **Mortgage Lenders:** Focus on debt service, taxes, insurance.
- **Mezzanine Lenders:** Broader demands including operating expenses, TI/LC reserves.

Tender Conditions

- **Mortgage Lenders:** Deed-in-lieu with title/lien focus.
- **Mezzanine Lenders:** Delivery of pledged equity, often requiring borrower to cover deficits through sale.

Caps and Sunsets

- **Mortgage Lenders:** More open to time/dollar caps.
- **Mezzanine Lenders:** Less willing; borrowers should push for partial caps tied to NOI or leasing.

Best Practices

- Involve guarantors early—carry liability impacts sponsor credit capacity.
- Model exposure under both mortgage and mezzanine scenarios.
- Negotiate caps, sunsets, and objective benchmarks.
- Address tender and transfer tax allocation explicitly.
- Recognize mezzanine lenders' more aggressive stance; push for proportionality.

Practical Takeaways

- Narrowly define "Carry Costs" and exclude discretionary/extraordinary items.
- Tie obligations to clear, objective triggers.

- Negotiate sunset provisions tied to stabilization or NOI metrics.
- Secure hard or partial caps on liability.
- Address tender conditions and transfer tax allocations upfront.
- Differentiate negotiation approach for mortgage vs. mezzanine lenders.

RELATED ATTORNEYS

Managing Partner

Michael K. Federman

VIEW BIO

Partner

Jeffrey D. Friedman

VIEW BIO

Partner

Peter J. Mannarino

VIEW BIO

RELATED PRACTICES

1031 Exchanges and Net Lease Investment Acquisitions

Commercial Lending and Leveraged Finance

Joint Ventures and Structured Investments

Real Estate Finance and Structured Finance