



# A Better Loan Guaranty

**By George M. Bobo**

One lesson learned in the past recession is that full loan guaranty agreements, where the investors in a commercial real estate project guarantee full repayment of the loan, don't work, and inflict misery on guarantors and lenders alike. It is standard practice for lenders making residential construction loans, development loans, and small to midsize loans secured by income-producing real estate to require that the investors in the projects guarantee full repayment of the loans.

In this writer's experience, full recovery doesn't happen often. I've prepared perhaps two thousand loan guaranties and fully collected cash to repay loans on two. Not a misprint - two. Except on rare occasions, full recovery on an unlimited loan guaranty is an unrealistic dream. Lenders who have learned this lesson underwrite loans differently than those who have not.

The lender's first formal step after a loan default is to send the borrower and guarantors a demand for payment of the entire loan amount plus "reasonable attorneys' fees" which under Georgia law adds an additional fifteen percent to the loan balance.

Faced with liability impossible to pay, the guarantor usually begins hiding cash, transferring his home out of his name, liquidating retirement accounts, and positioning for a long legal battle. After considerable anxiety, the legal contest usually results in either a settlement for pennies on the dollar, or, more likely, bankruptcy by the guarantor. The lender gets little more than the loan collateral, although it may get an uncollectable judgment.

While full guaranties have been the norm, less common are guaranty agreements requiring the guarantor to pay a limited amount of the loan. Those may be secured or unsecured.

A loan guaranty secured by a deposit of cash, securities, or a security interest in real estate, with the guarantor's liability under the guaranty limited to foreclosure by the lender against the security for the guaranty, accomplishes three goals:

1. It limits the guarantor's liability to loss of the collateral securing payment of the guaranty;
2. It guarantees the lender certainty of some recovery on the guaranty, to be added to the lender's recovery of the asset securing payment of the loan; and,
3. Since a lender typically recovers little on the loan guaranty anyway, it forces a realistic evaluation of loan collateral when making the loan, knowing that the collateral and the property securing payment of the guaranty are all that a lender will recover upon default.

Where the lender insists on an unlimited guaranty of the loan, or the guarantor has no property to collateralize the limited guaranty, a guarantor should consider requesting an amendment to the lender's form whereby the guarantor's principal residence and assets held in IRA or 401k retirement plans are exempt from recovery by the lender upon default by the guarantor, and attorneys' fees are limited in amount to actual fees paid by the lender rather than fifteen percent of the loan amount. The lender's unlimited guaranty thereby becomes limited to some extent. The reality is that collecting something on a guarantee is far better than collecting nothing. Those lenders who realize this will do far better than those who do not.

