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EXCLUSIVE

Recourse, Don't Do It

By Jim Conway, Principal and Chief Credit Officer of A10 Capital | Commentary

The non-recourse bridge loan is a borrowers and sponsor's insurance policy to limit risk, says Conway.

BOISE, ID-The owner of a **CRE** property is exposed to multiple risks of both an operational nature and of a market/financial nature. Operational risks include the risk of loss caused by fire and other types of casualty or damage to the property caused by weather and other events, personal injury liability or risks caused by injury or death taking place on the property, or from environmental risk related to past, current, and future uses of the property. Fortunately, most of these risks may be mitigated by purchasing and maintaining appropriate insurance coverage.

Market and financial risks include the potential economic losses that may be incurred when challenges arise that prevent the CRE owner from fully implementing its business plan. This may result from tenant defaults, increased competition in the marketplace, dramatic reductions in tenant demand for space or related to the future availability of CRE mortgage capital and fluctuating interest rates. **Interest rates** are now at un-sustainably low levels, with nowhere left to go but up. When interest rates do inevitably increase, many borrower and sponsors will confront significant refinance risk.

Bridge Loans are often used by a borrower/sponsor to finance a "turnaround" opportunity in which a property is being acquired following foreclosure by a commercial bank or a CMBS special servicer. These loans may either be recourse or non-recourse to the borrower/sponsor.

Non-Recourse versus Recourse Loans:

The lender making a non-recourse loan, perhaps for some economic consideration, contractually agrees to limit the recovery of its investment to the economic value that might be realized through a sale of the CRE property following the lender obtaining title, thereby insuring any loss incurred by the borrower/sponsor is limited to its investment in the CRE property.

In the case of a **non-recourse bridge loan** if the borrower/sponsor is unable to re-finance the loan at maturity, the Lender is likely to foreclose upon the loan and the borrower/sponsor will lose ownership of the CRE property. While the equity investment made by the borrower/sponsor will be completely lost, the loss will be finite and is quantifiable. By obtaining a non-recourse bridge loan, the borrower/sponsor in essence bought an insurance policy limiting its potential loss.

By contrast, in a recourse bridge loan, the lender obtains a security interest in the **commercial real estate** property and obtains a pledge of 100% of the personal assets of the sponsor. Depending upon state law the lender can pursue multiple avenues to collect from the sponsor/guarantor including getting a judgment against the individual sponsor/guarantor with the most assets.

In the case of a recourse loan, it is the lender that obtained the insurance policy and the sponsor/guarantor who insured the lender. The bottom line is: Recourse—Don’t do it.

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