

Broker vs. Banker – Guarantor vs. Obligor

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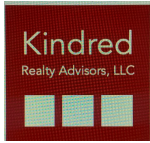
Bankers and Brokers often approach the same asset using different language which, if not translated, can lead to a misunderstanding of structure and risk. Perhaps the most common difference lies in the use of the term “guarantor”.

Brokers often loosely use the term “guarantor” or “guarantee” to indicate the strength of the entity which will be obligated to pay rent on a lease. For example, a Broker might say “the lease is guaranteed by a ten-unit operator” meaning the Tenant entity on the lease operates ten units and the implied certainty of lease payment is that of ten units.

A banker would typically say, the Tenant is a ten-unit operator. The banker differentiates between the tenant who is the “obligor” and the guarantor who is another party. The Oxford Dictionary gives the legal definition of a Guarantee as “a formal pledge to pay **another** person’s debt or to perform **another** person’s obligation in the case of default. The banker draws a significant distinction between the primary obligor, which is the Tenant and a secondary obligor, which is the Guarantor. Both uses of the term acknowledge that the obligation to pay the rent lies with the obligor and not necessarily the specific operational unit operating from a given property.

Every lease has a Tenant (a/k/a an “obligor”). Guarantors of leases are also common but not all leases have guarantors. Often a Tenant entity is an operating business where the real property rights are held for investor or tax reasons in another entity. In these cases, landlords often require a guarantee of a sister or affiliated company. Similarly, if an operating location is held in a single asset entity for ownership or operational reasons, a parent or larger operating company may be required to guarantee.

Using the term “guarantee” as a proxy for obligor, can also create uncertainty as the obligation to pay under a guaranty rises from the form of the guarantee. If one accepts a guaranty as an assurance that rent will be paid, one must understand if the guarantee is limited or joint and several, joint and several meaning a landlord can pursue payment under the guarantee to the exclusion of any other guarantor or even the actual obligor. Further, some guarantees are limited in that they have dollar caps or thresholds as to how large a default must be or long a default must be uncured before a guarantor can be called on to make payment. It is also common to see guarantees “burn off” meaning the guarantor’s contingent obligation to pay ceases after some amount of time or after some event such as completion of construction or stabilization of a property. Finally, guaranty documents and local law often provide defenses which a guarantor may exercise to avoid payment under a guaranty obligation. Often, these defenses are more significant than those offered to a direct obligor.



The important distinction between a tenant and a guarantor is that a guarantor is only contingently liable for a lease payment. The level of uncertainty introduced by relying on a guarantor vs a direct obligor such as a tenant varies greatly.