



Transfer Provisions and Emerging Trends in Commercial Real Estate Carveouts

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As mentioned in the inaugural post of [The Carveout](#), non-recourse loans will include a non-recourse carveout providing protection for the lender in the event the transfer provisions in the loan documents are violated. The starting language for the transfer carveout can have different iterations but generally is addressed in the loan documents by including a [full-recourse carveout](#) for the borrower's failure to obtain the lender's prior consent to a "transfer."

The non-recourse carveout for transfers will use the defined term "transfer," so it is important to understand what acts are included, or excluded, from the definition. What constitutes a "transfer" is typically how the parties negotiate the circumstances and events that would trigger full-recourse liability under the loan documents. Changes to the definition of "transfer" may also be made to accommodate various borrower structures or anticipated transfers on a deal-specific basis.

Transfers in Carveout Transactions

Transfers are generally defined broadly to include events such as a sale, conveyance, encumbrance, or unpermitted lease of all or part of the mortgaged property, as well as any transfer of a direct or indirect interest in the borrower or a change of control of the borrower. The loan documents will provide a list of more specific examples and circumstances that constitute transfers in carveout transactions. The definition of "transfer" is often broad and seemingly includes acts that may be unavoidable in the practice of operating the mortgaged property, such as granting easements that are beneficial to the mortgaged property or ownership changes in the borrower's structure. But non-recourse lenders are not seeking to prevent the practical operation of the mortgaged property and will enumerate certain exclusions from the "transfer" definition.

The loan documents will list certain transfers that are permitted without the lender's consent, commonly referred to as "permitted transfers," and will include certain requirements that must be satisfied for such transfers to be deemed permitted. Some transfers, such as transfers of publicly traded shares constituting an indirect interest in the borrower, are permitted without the obligation to provide notice since giving notice can be burdensome for all parties in those specific circumstances. More commonly, non-recourse lenders will require the borrower to deliver notice of transfers that are otherwise permitted under the loan documents, such as transfers of the ownership interests in the borrower for estate planning purposes, transfers occurring upon the death or incapacity of an individual holding an ownership or control interest, or transfers of non-controlling interests in the borrower—all of which are subject to certain conditions set forth in the loan documents. Non-recourse lenders are generally not going to permit transfers of the mortgaged property without consent except for certain minor easements, such as utility easements.

Lender's Perspective

The prohibition on transfers tends to address two main themes: (1) restricting transfers of interests in the mortgaged property and (2) restricting transfers of interests in the borrower. On a non-recourse loan, absent a non-recourse carveout being triggered, the lender is only able to look to the property for satisfaction of the loan if the loan is no longer performing. As a result, non-recourse lenders are focused on ensuring the mortgaged property operates profitably, is maintained in good condition throughout the loan term, and there are no changes in title to the mortgaged property that could affect the security of the lender's mortgage. It comes as no surprise, then, that a non-recourse lender is interested in consenting to any transfers of the mortgaged property itself because, if the mortgaged property is transferred to a new owner, the loan documents will, at a minimum, need to be assumed and such assumption would need to be properly documented to ensure the lender's mortgage remains effective.

Non-recourse lenders are also concerned with ensuring the mortgaged property is owned and operated by borrowers with reputable and experienced sponsors. When approving a loan, the non-recourse lender has determined the specific borrower and sponsor are able to maintain and operate the mortgaged property profitably, so a lender needs to ensure that the approved borrower and sponsor remain in control of the mortgaged property. Moreover, lenders are subject to Office of Foreign Assets Control (OFAC) regulations, as well as their own anti-money laundering and “know your customer” policies. Transfers of ownership interests over a certain threshold, typically 10% or 20% of the ownership interests in the borrower, will trigger a requirement for the lender to gather background information on the individuals and entities involved to satisfy their legal obligations and internal guidelines.

Borrower’s Perspective

Borrowers’ concerns about the ability to complete transfers vary depending on their plans with respect to operating the mortgaged property and their ownership structures. Typically, in the [non-recourse lending space](#), the most common concern for borrowers is the ability for their direct and indirect owners to transfer their ownership interests—especially if the borrowers are capitalized with large funds or publicly traded shares. Borrowers capitalized with preferred equity are often concerned with the ability to effectuate transfers of ownership and control; these borrower structures are generally subject to heightened scrutiny in the non-recourse lending space, and the requirements surrounding transfers will be specially tailored to the specific circumstances, potentially including a full underwriting of a joint venture (JV) partner who has rights to exercise a change in control under certain circumstances.

Additionally, borrowers with less complex ownership structures, such as borrowers that may only have one or two individuals involved, are commonly concerned with the ability to change ownership structures to accommodate trusts for the benefit of family members or the ability to have other individuals step in if the sponsor is no longer able to hold their interests, as in the event of death or incapacity. Non-recourse lenders are typically willing to

accommodate the structure- and deal-specific concerns of borrowers but will make efforts to change how a “transfer” is defined rather than changing the carveout for violating transfer provisions. Notwithstanding the fact that lenders may change certain transfer provisions to accommodate borrowers, borrowers are frequently wary of accidentally triggering a full-recourse carveout even when they are acting in good faith.

Potential Changes to the Carveout

As discussed above, it is less common to change the non-recourse carveout language related to transfers than it is to change what constitutes a “transfer” falling under the scope of the carveout. However, we are seeing a growing trend of borrowers asking to change the language of the carveout to specifically exclude transfers that would otherwise be permitted without the lender’s consent if the borrower had provided notice to the lender of the transfer, so long as all other requirements relating to the transfer are satisfied. The result of this change is that, if a transfer that would ordinarily be permitted with notice to the lender occurs, but the borrower fails to provide notice, then the lender is not able to enforce any recourse against the borrower and/or guarantor.

Many non-recourse lenders are uncomfortable giving up the ability to trigger any recourse, even for transfers that would be permitted but for the failure to provide notice, since it is important for lenders to have a consistent awareness of who owns and operates the mortgaged property. An alternative we sometimes see is non-recourse lenders bifurcating the non-recourse carveout so that transfers that would otherwise be permitted, if not for the borrower’s failure to provide notice, are “above-the-line” loss recourse carveouts, while all other transfers in violation of the loan documents remain “below-the-line” full-recourse carveouts.

Another approach to negotiating the carveout itself occurs when non-recourse lenders bifurcate the carveout so the “below-the-line” full-recourse carveout is limited to voluntary transfers of the mortgaged property, including in connection with the borrower granting a security interest in the mortgaged property (i.e., granting a mortgage or deed of trust secured by the mortgaged property),

as well as transfers of a controlling interest in the borrower that cause the loan guarantor to own less than the required ownership percentage in the borrower or that cause the guarantor to no longer control the borrower—in each case without the lender’s consent. When the “below-the-line” full-recourse carveout is limited to voluntary transfers of the mortgaged property and transfers of a controlling interest in the borrower without the lender’s consent, the loan documents will provide that all other transfers made in violation of the loan documents will trigger a losses recourse carveout.

Each approach to bifurcating the carveout for transfers in violation of the loan documents allow the non-recourse lender to retain the ability to potentially pursue some form of recourse for all transfers that occur in violation of the loan documents, and borrowers are incentivized to fully comply with the transfer requirements.

Key Takeaways

As with all negotiations surrounding the loan structure and loan documents, the potential for changes to the non-recourse lender’s standard language pertaining to transfers and non-recourse carveouts is highly dependent on the deal structure and the parties’ negotiating position. Any changes will be determined on a deal-specific basis. Borrowers should expect the standard transfer language and carveout language to remain in its original form unless there is a specific and acceptable reason for the non-recourse lender to accommodate requests for changes. This may be aided by the borrower’s counsel having an understanding of what changes are customary and an ability to articulate the specific business concern.

If you have questions as it relates to the topics addressed above, please reach out to the authors or any attorney with Frost Brown Todd’s [Commercial Real Estate Finance \(CREF\) Team](#). And be sure to check out other posts on [The Carveout](#), aimed at fostering productive dialogue around common pain points and how to resolve them in your next CREF deal.

The Carveout

A legal blog geared toward sophisticated capital market participants, The Carveout provides insight into current trends and developments in commercial real estate finance (CREF)—with a particular focus on non-recourse carveouts and CREF loan platforms including CMBS, debt funds, private capital, REITs, life insurance companies, and other complex sources of capital.

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