

# CONSTRUCTION LENDING: FROM THE GROUND UP

by David A. Weissmann, Esq.  
Weissmann & Zucker, P.C.

## **I. Construction lending differs from permanent lending and requires a broader perspective from other lending.**

**A.** Construction lending is different in many respects from other real estate lending. It requires general knowledge of construction industry practices, engineering matters and financing techniques. The pre-closing requirements are similar to other real estate loans, but additional review is required to insure that construction can commence and proceed without interruption. The interplay between construction, completion, lease-up and take-out requires adherence to construction schedules that permit completion within the time expectations of tenants and/or take-out lenders.

**1. More Detailed Front-End Analysis.** Additional pre-closing requirements enable the lender to uncover problems that might hamper construction. The project budget, plans and specifications, and relationships between the various professionals involved in construction are reviewed. The architect, engineers and contractor will be required to make certain representations directly to the lender to provide comfort about the project's scope, compliance with law and ability to open and operate without hindrance.

**2. Risks of Construction.** Construction lending requires a review of risks which are inherent in the construction process and not included in the permanent lender's checklist. The permanent lender typically requires the production of a certificate of occupancy, and from tenants estoppels that state that the premises has been constructed and accepted by the tenants. The certificate of occupancy is evidence that the project has complied with rules, regulations and ordinances required for construction and occupancy. The construction lender has to make sure that the project, as planned, can pass its building inspections and obtain the occupancy permit, and therefore pays close attention to construction schedules and budgets. The construction process has many different stages. There is grading, which may require its own "development" or "land disturbance" permit separate from a "building" permit.

Following, is installation of footings and slabs, with underground utility lines, and accompanying inspections. Then there is vertical construction, followed by interior finish or tenant improvements. Any break along the way can delay the construction schedule leading to a violation of a lease covenant to complete the shell building on time or causing a delay that affects lease-up and stabilization required for permanent financing. The construction budget shows the lender the details, on an item-by-item basis of costs associated with the various stages of construction, and can reveal the nature of the developer as overly optimistic or conservative. If the budget is short in any area, then additional equity may be required to balance the completion costs with the remaining loan proceeds.

**3. Take-Out Strategy.** Finally, most construction lenders are not permanent lenders. They loan at variable rates for usually a short term, from 2 to 5 years, depending on the type of project. The borrower currently enjoys the relatively low floating prime or libor based rates, with no prepayment penalty or premium. The construction lender must look at a project from start to take-out. Take-out can be in the form of a refinance, a sale, or several sales. Refinancing depends on the business operations of the operating project, and its cash flow, credit analysis and appraised value, which may include such other factors as location and comparable sales. A permanent lender will review the creditworthiness of the project tenants, the quality of construction and likelihood for required capital improvements and maintenance over the years. A project that is not in a desirable location, without credit-tenants, and aging, will be relatively more difficult to refinance without capital infusion.

## **II. Pre-Closing Requirements: A variety of due diligence is required to detect construction issues.**

- . The pre-closing review involves the many professionals involved in construction, and is sometimes duplicative by requiring identical verifications from different parties. The lender's physical inspection often includes zoning oversight, which is also required from the architect and engineer. The construction budget is reviewed by the lender, its inspector and by the attorney. Each person's professional eye has a

different outlook and may reveal underlying difficulties the other professional may not find noteworthy.

- 1. Analysis from Lender's Inspector.** The lender's inspector usually is a professional who has been in the construction industry as an engineer or an architect, and has the responsibility for oversight of the construction project from start to finish. The inspector is the lender's eyes and ears on the ground. He will review the initial plans and specifications in conjunction with the construction budget and provide a general opinion as to the ability of the project to be completed within budget on a line item by line item basis. The inspector begins by receiving a complete copy of the plans and specifications, and a copy of the construction contract, which should be accompanied by a budget. The inspector will also make periodic visits to the construction site and converse with the job superintendent and other contractors on the job as part of the draw request process. As each draw is requested, the inspector may be asked to insure that the project is doing well, qualitatively and quantitatively, within budget, and can be completed with remaining loan funds, and that the work which has been claimed to be finished is in fact work in place. If not, an additional equity infusion may be required from the borrower. The inspector receives copies of various field tests and analysis and daily reports and logs, including geotechnical tests. A good inspector will initially review the status of project approval from the several governmental agencies which might be involved. Governmental involvement varies from locality to locality. The inspector insures that the project is being constructed in accordance with all applicable governmental codes, ordinances and regulations, and in accordance with the plans and specifications. The inspector also tries to determine the location of utility lines and drainage which is necessary for the project to operate after completion.
- 2. Appraisals.** It has been said "ask for the appraisal you want and you shall receive," meaning that appraisals have a knack of uncovering the required appraised value to support loan value regardless of the circumstances. While there is some truth to the notion that appraisals often support underlying loan value requirements, it is not true

that they are always on target. Banks need appraisals to comply with their internal and governmental auditing requirements. If an appraisal is delivered with a low value, the borrower will be asked to contribute more equity, either in the form of cash or other collateral, or in the form of deferred fees contained in the loan budget to lower the actual amount of loan which may be disbursed until higher project value is attained.

**a. Appraisers generally employ three methods:** The "cost" approach, the "income" approach and the "market" approach. The appraiser is generally asked to reconcile the differing values obtained using each of these methods to arrive at a truer value. The cost approach uses the anticipated costs of constructing the project as the basis for value. One problem is hidden or soft costs which can inflate the cost and not really add to value. These costs may be development fees, professional fees, or overhead and profit. The income approach uses presumed income following presumed lease-up and stabilization, and derives value based on capitalization rates ("cap rates") which institutional investors might use to estimate returns on investment if the project were purchased for cash. The market approach seeks comparable sales figures for projects in the same general vicinity and similar to the project being constructed. Appraisers have a network of information which allows them to closely derive income figures from those of similar projects. As of the date of this article, cap rate expectations of institutional investors are 7% to 7.9% for apartments, low 6's% for regional malls, 10% or more for unanchored retail centers, around 8% for food anchored retail centers, and 7% or more for Walgreen's, CVS or similar retail centers. A good construction lender may focus on the "income" approach from a good, well-placed appraiser. The lender may then look at comparable sales and change certain assumptions when calculating different financial scenarios, like increase the vacancy to

lower income or change interest rates to increase debt load.

### III. **Construction Process and**

**Professionals:** Architect, Engineer and Contractor.

The triumvirate of leading professionals in the construction process is generally comprised of the architect, engineer and contractor. In some cases, the contractor may have staff architects used in a "design-build" job, or the architect may have in-house engineers, but it is useful to understand the basic tasks generally assigned to each in the construction process. The developer/owner/borrower generally begins with a tract of land and reviews the current zoning to ascertain the allowed density and other externally imposed requirements which dictate the physical footprint of the planned project. The developer may first approach a civil engineer or architect who has knowledge of the zoning requirements and is skilled in fitting the project ideal to these requirements. The developer then has a rough idea of the square footage of improvements which can be constructed, and can extrapolate the income potential. Costs of construction may vary greatly because of site conditions. It is well known that rock or unsuitable soils will greatly increase grading costs, which is why the risk is sometimes shifted to the seller who is required to provide a graded and compacted site. Water and streams may create regulatory hurdles which slow the permit process or require engineering water modifications which can increase cost. But nevertheless, for the average construction project, most developers, or their contractors, can arrive at a fair estimate of cost per square foot of construction, based on the type of project and proposed use. Finished office space costs a great deal more than warehouse space, which is why rent is so much higher, per square foot, in office space. The developer may then take the general project design to an architect, who for a fee, designs the plans and specifications for the building. Working with the civil engineer, which generally

handles grading, utilities, drainage and land planning issues, the architect and engineer will produce a set of plans and specifications for the project. These plans can then be distributed to a group of contractors who want to "bid" on the job, or to a select few contractors, in either case, for detailed pricing and general contracting proposals. Construction contracts can be in various shapes and sizes, but generally follow are either based on cost of construction plus a fee, cost of construction plus a fee, with a guaranteed maximum cost, or just a fixed price. It is still possible for the contractor to shift some of the risk of construction cost to the developer by excluding certain costs, like costs of rock blasting or other removal, or costs associated with other unknown conditions, or by granting certain allowances for line item costs, which if exceeded, must be paid by the developer as an additional cost. The architect often continues to serve as the owner's representative and contract administrator, approving draw requests of the contractor, monitoring the progress of the work and inspecting the work for defects. The standard AIA contract grants the architect the primary role as decision-maker under the construction contract and the first line of defense for any dispute. As the project nears completion, the architect will generally issue a certificate of substantial completion indicating that the work is nearly complete, except for "punchlist" items, materially in accordance with the plans and specifications. It is at the time that the certificate of occupancy will be issued and the project open to the public for business operations. In retail projects, the space is then turned over to the tenants, which will then begin installation of tenant improvements and fixtures, which are required before a permanent certificate of occupancy can be issued. Be certain to obtain copies of the various contracts from the contractor, architect and engineer because in a default scenario, the lender may require enforcement of these contracts, as discussed below.

· **Pre-closing Lender Requirements from Construction Professionals.**

The construction lender requires three basic items from each professional. First, the lender wants assurance that if it needs to foreclose and remove the developer from the project, that the professionals will provide continued service to the lender so as to complete the project as soon as possible and within budget. Second, the lender seeks confirmation that the project complies with all applicable governmental requirements and can be constructed and operated as planned. Finally, since work has commenced prior to loan closing, the lender seeks lien waivers and subordinations so that it is assured a first-priority security interest or mortgage on the underlying real estate. Each of the professionals is asked, in various formats, to provide these assurances to the lender.

1. **Contractor.** The contractor is asked for assurance that it will continue to perform the work if the lender removes the borrower from the job. The costs of mobilizing and demobilizing a work force can significantly increase construction costs and delay the construction schedule. Unless the contractor is part of the problem with a project, the most sensible approach is to retain the contractor to finish a project despite the borrower default. The contractor's agreement to provide continuous service (a "continuation agreement") may take several forms. It is usually a letter format, or document requiring contractor execution whereby the lender is granted several concessions. Since the contractor wants the lender to make the loan so as to provide financial assurance that there are funds to pay the contractor, it is usually willing to comply. The agreement may ask that:
  - The contractor provide the lender with notice of default under the construction contract by the borrower;
    - a. The contractor not consent to material changes in plans and specifications without lender's consent; and
    - b. The contractor provide continued performance under the construction contract if it is notified by the lender that the lender is taking control of the project.
2. The contractor is happy to provide continued performance, but may negotiate that continued work is conditioned upon being paid all sums due under the construction contract, which could include a delinquent payment from the

borrower. The lender will not want to pay the contractor for work reflected on a draw has already been processed and paid. However, if the contractor succeeds in its negotiations, the lender will have no choice, and some lenders may be sympathetic to the plight of the contractor. A preferred approach from the lender's perspective is to provide that the contractor be paid for all work performed under the contract at the lender's request, and to otherwise allow the contractor to retain rights under the contract it may have vis à vis the borrower. A sample continuation is attached as Appendix "1".

. **Construction Contract.** The construction contract is very important to review. Review should include:

- i. Contract Price compared to the construction budget, itemized, if possible
- ii. Retainage amounts. A typical retainage is 10% of each draw. The retainage keeps the contractor from getting ahead of the construction process, and helps guarantee the contractor will keep its attention focused on the project until completion.
- iii. Proper execution. Make sure the "owner" is the borrower under the loan.
- iv. Subtle terms and conditions, like allowances, excluded work, liquidated damages, and miscellaneous expenses.

**3. Architect.** The Architect's role during the construction process may be extensive, as the administrator of the construction contract and approving draws, or limited to producing plans and specifications for use by the contractor. The loss of the architect to the project following a default by the borrower is not as harmful as loss of the contractor. However, there is less likelihood of a dispute with the architect over payment following default because the architect's primary role, that of producing plans and specifications, has probably been paid for in large part by such time. Therefore, the architect rarely negotiates its continuation agreement, and delinquent amounts owed to the architect at such time are likely to be small. However, the architect has a larger responsibility to the project and consequently, to the lender, in that the architect must be

familiar with the project site and governmental requirements and prepare the plans and specification in accordance therewith. The architect is the primary professional overseeing this crucial aspect of the project, and will be asked to certify to the lender, that the plans and specifications comply with all governmental laws, ordinances and regulations. Even though the architect should have errors and omissions insurance coverage, it will want to qualify its certification to the best of its knowledge. The lender will usually agree with the qualification, since it has its own inspecting architect providing a second opinion, at least as to major portions of the project. There are certain aspects of the project that may be subcontracted to the engineer, or contracted directly with the engineer, and the lender would be overreaching to require the architect to certify those areas of the plans which it has no oversight or knowledge. This is acceptable as long as the engineer covers such items in its certification. A sample architect's certification is attached as Appendix "2".

- 4. Engineer.** A project may involve one or more engineers. In high-rise or big box construction, you might encounter both a civil engineer and another professional engineer, like a mechanical engineer or structural engineer. The civil engineer usually prepares the site, drainage and utility plans. These plans are usually bundled with the other plans and specifications. Once prepared, the engineer's job is nearly complete, and therefore, a continuation agreement from the engineer is requested, and obtained, but not as essential. An engineer's certification regarding site conditions, availability of utilities, compliance of engineering plans with all applicable governmental requirements, and required permits is required.
- 5. Lien Waivers.** Each state will have its own peculiarities regarding lien law and the availability of liens to the professionals which may begin work prior to the recordation of the mortgage or security instrument. The lender will require some formal lien subordination/waiver from each of these parties prior to funding whereby the professionals lien is waived, as to work completed, and subordinated to the lender's interest, as to work yet to be

performed. The request for a lien subordination/waiver may cause one of these professionals to require payment for sums due as a condition to delivery of the lien waiver. If so, the amount due must be paid as a disbursement under the loan closing statement.

6. **Leases, Estoppels and SNDA's.** If there are existing leases on the project, they must be reviewed for basic information, including rent, commencement, construction requirements, pass-throughs (taxes, insurance and operating or common area maintenance ("cam") costs, default provisions, loan subordination clauses, requirements for restoration on casualty or condemnation and unique features like early termination clauses, rights of first refusal on sale or lease, and purchase options. If the lease has features which are troubling to the lender, it may address them either in the estoppel letter or in a subordination, non-disturbance and attornment agreement ("SNDA"). There is nothing especially unique in the construction context which distinguishes the lender's requirements other than addressing tenant approval of plans and specifications, which can be addressed in the estoppel letter, and the occurrence of borrower default prior to completion of construction, which can be addressed in the SNDA. It is usually in the lender's interest to complete construction, and therefore the lender should agree to do so when honoring the lease pursuant to an SNDA following foreclosure, unless there are serious countervailing issues, such as the bankruptcy of the tenant. Most, but not all leases contain a provision that bankruptcy event is a default.
7. **Payment and Performance Bonds.** Many projects require that the contractor be "bonded," and require as a condition to closing that a bond be issued in favor of the lender, usually pursuant to a so-called "dual obligee" rider to a payment/performance bond.
  - The payment bond guaranties the payment of sums due under the construction contract to potential lien claimants. State lien law should be reviewed with the terms of the payment bond to make sure that the owner is covered (and lender, as "dual obligee") as well as second and third-tier subcontractors who may not have direct privity of contract with the contractor.

- a. The performance bond guarantees performance of the work. If issued separately from the payment bond, for the full contract sum, it should provide coverage for full performance regardless of cost (if both are written on the same document as a "payment and performance" bond, effective coverage may be limited to the amount of the payment bond). The performance bond does not guaranty the completion date or payment of delay damages, or penalties or claims by third parties. Therefore, it should specify how much time the surety has in which to respond to a default by the owner.
  - b. Be careful of circumstances that might cause an inadvertent waiver of the surety's obligations. Under some states' law, a change in circumstances that increases a surety's risk can release the surety. The bond should contain an express waiver of notice of these changes, which include:
    - Changes in material terms of the contract;
      - i. Changes in payment terms;
      - ii. Extensions of time; and
      - iii. Changes in developer's ownership entity.
8. **Permits.** Many construction lenders require the building permit be issued prior to loan funding. Fannie Mae has imposed this requirement on some of its "DUS" programs for new construction. This may present a practical difficulty when the cost of the permit is high and is to be funded out of loan proceeds. One compromise is for the professionals to issue letters indicating that all requirements for the issuance of the permit have been fulfilled, except payment of the fee. A lender will usually agree to advance funds for closing, as long as the permit is obtained expeditiously thereafter. As with any other closing requirement which is delayed, additional funding may be withheld until delivery. There are several different types of permits, depending on the county or municipality involved. Each development department has its own requirement. These may include sewer permits, grading or land disturbance permits, tree permits, wetlands permits from

the Army Corp of Engineers, building permits and curb-cut permits.

- If the property contains wetlands, or certain streams which might be entitled to Federal protection, the borrower may have to engage in a lengthy process of evaluation by an engineer and application with the appropriate governmental agency for permission for its development.

- a. Curb-cut permits entitle the owner to actually "cut" the curb along the adjacent right-of-way for the driveway or roadway to the development. Certain state or county road authorities will grant this right at the time of the review process and no actual "permit" is required. The concern is that the driveway must be within the parameters established by the government for safety and traffic flow, such as the requirement that the driveway not be too close to an intersection. Some roads are condemned with "limited access rights" such as on some State highways to allow faster traffic. The governmental authority might require acceleration and deceleration lanes as part of the process, which takes acreage and may impact the size of the improvements which can be construction, thereby affecting cash-flow projections.

9. **Utility Availability Letters.** Letters are usually issued by the various utility companies on new projects stating that capacity is available sufficient for the planned project at or near the project site. In some states, utility company providers bring the utilities to the project site upon payment of the required fees, and in others, the construction is by the developer. Letters should be obtained regarding telephone, electrical, natural gas (if planned) and sewer/water facilities. The lender can waive the requirement if it has adequate assurance that the utilities are available from its review of other due diligence.

- It is most important that all utilities be on the boundary of the property, or be available through perpetual easement appurtenant to title to the property.

10. **Project Budget.** The project budget is the key component to the evaluation of the loan budget. It should detail construction on a line-item basis, and should separately delineate all major components of construction, such as

concrete, steel, masonry, interest reserves, marketing, lease-up, development or other fees.

- The budget should also have a realistic contingency line-item. If there is a cost saving in an line item, then the lender will usually agree to move the savings to the contingency line-item, to be used for other items at the lender's reasonable discretion.
  - a. If there is a shortfall in any line-item, the lender may either use the contingency, or require additional equity from the borrower. The construction loan agreement should provide for an event of default if the borrower does not provide the additional equity infusion.
  - b. In condominium or townhome development, there is a lag time between construction, completion and sales. 3% - 5% of the budget should be for marketing costs. In apartments or other speculative projects, funds will need to be allocated for lease-up costs.

**11. Project Schedule.** The project schedule is a timeline of activity anticipated to occur during the construction process. It typically takes the form of a bar-graph, showing the various stages of construction at the time they are anticipated to commence and conclude. This allows the lender to monitor the course of construction.

- If the developer does not adhere to the construction schedule, it may reveal early in the construction process problems which are occurring that could impact the completion date, cost of completion, and the commencement date of underlying leases. Failure to adhere to the schedule should be a default under the construction loan agreement.
  - a. Sometimes on smaller transactions, there is not a printed construction schedule and construction is tied to a completion date. In such cases, the construction loan agreement should provide an event of default occurs if the lender in its reasonable discretion determines that the project will not be completed prior to the completion date.

**IV. Construction Loan Documentation.** Construction loans require specialized documentation in addition to traditional real estate loan documentation, which includes mortgages, assignments of leases and rents, hazardous materials indemnities, and various other

affidavits. These additional documents and provisions are described below

- **Construction Loan Agreement.** First and foremost among the additional requirements is the construction loan agreement. Attached as Appendix "3" is a construction loan agreement. The construction loan agreement provides lender protection for the various issues discussed above. Each loan is different, and the document must be tailored to each transaction, but basically it is comprised of a few key sections.
  1. **Representations and Warranties.** In addition to the various representations and warranties contained in most commercial real property loan agreements, a construction loan agreement should contain representations about the following matters:
    - That the plans and specifications delivered to the lender constitute a complete and final set of all plans and specifications required for the construction of the project, and no architects or engineers have been retained except as previously disclosed.
      - a. That true and correct copies of the construction contract, architect's contract and engineer's contract have been delivered to lender.
      - b. That the plans and specifications and the use of the project contemplated thereby comply with all applicable governmental laws, ordinances and regulations.
      - c. That all utilities and rights-of-way necessary for the construction, use, operation and maintenance of the project are available through public rights-of-way or through private easements appurtenant to the property; and that adequate quantities and capacities of water and of sanitary sewerage and waste disposal are present and available on the project.
      - d. That all building permits, foundation permits, water tap permits, sewer permits, drainage permits, curb cut and access permits, environmental approvals and all other permits, certificates and authorizations required for the construction of the project have been obtained.
      - e. Borrower has not caused any labor (including grading or demolition work) to be furnished in connection with the construction of the project, or entered into any contract, which could give rise to a

lien against the project, except for parties who have been paid in full or have delivered lien subordinations.

2. The construction loan agreement will also contain certain covenants important to allow the lender control over the construction process. The borrower must agree:
  - . To commence construction on a timely basis and to diligently pursue it to completion, in accordance with the construction schedule, prior to the completion date.
    - . The completion date may be extended for force majeure, not to exceed a limited period (60 or 90 days).
      - a. Construction shall be completed in accordance with all applicable governmental laws, ordinances, rules and regulations, using sound construction practices and new materials.
      - b. Not to alter the plans and specifications without lender consent. The lender may provide blanket consent to certain alterations, such as those that do not alter the structural integrity of the project and do not exceed a specified dollar limit.
      - c. To give the lender access to the project for inspections, and to cause the contractor and other professionals to cooperate with the lender.
      - d. **To perform such tests as may be required by the lender, such as soil tests, concrete tests, and mechanical system tests.**
      - e. To correct defects in construction.
      - f. To provide builder's risk insurance during the period of construction, on a "non-reporting" basis, for the full range of casualties.
      - g. To give copies of all subcontracts upon request and to give notice of any claims or lawsuits concerning the project, including claims of subcontractors or materialmen.
      - h. To use loan proceeds solely for purposes allowed under the project budget.
      - i. To allow the lender to erect a publicity sign at the project.

3. The construction loan agreement will provide for specific instructions for drawing funds and include a list of conditions to be satisfied for each draw. The application for payment must be in a format approved by the lender, and will generally contain information about:
  - The value at cost of that portion of the Improvements completed at that time;
    - a. Those claims for work which have been paid since the last draw request and those claims which will be paid with the current draw request; and
    - b. Where the draw request includes amounts to be paid to the general contractor, it should include a "Schedule of Values" showing the breakdown of the requisition among the line items.
    - c. The lender may require a title checkdown at the time of request to verify no liens have been filed.
  - 4. There will typically be a number of conditions to each advance, thereby granting the lender great leverage during the course of construction to hold up funding without needing to call a default. These conditions include:
    - That the total advances will not exceed the maximum loan amount;
      - a. Evidence that hard costs expenditures do not exceed the progress of construction, on a percentage of completion basis;
      - b. That no potential or "unmatured" default or Event of Default exists;
      - c. That the inspecting architect and lender believe that the construction is on schedule and can be completed on time;
      - d. That the inspecting architect and lender believe that (i) construction has progressed in accordance with approved plans and (ii) can be completed on budget;
      - e. The absence of any casualty; and
      - f. Receipt of lien waivers from all subcontractors through the immediately preceding draw request (advance lien waivers are difficult to obtain and probably not enforceable in most states).
    - 5. In addition, final disbursement at the time of completion may be subject to additional conditions:
      - Lender's receipt of a final, as-built survey which will help verify the project as in compliance with applicable laws;



the savings to be moved to the contingency line item, to be disbursed upon its reasonable consent.

- d. The lender should be allowed to fund itself interest from interest reserve funds without further authorization. The borrower will want to know in advance if the lender is not funding itself, so as to avoid late fees and penalties.
- e. Generally, lenders do not disburse for materials which have not yet been incorporated into the project. These items may be costly and negatively impact the cash flow. To alleviate this problem, in some cases, a lender permits disbursement for materials if stored properly, protected against theft, and are insured, and if the lender has a first priority security interest in the materials.
- f. **Required Additional Funds.** If the lender determines that the project cannot be completed with remaining loan funds, continued funding increases the lender's risk without benefit. Therefore, the construction loan agreement should provide that in those circumstances, the borrower is required to deposit with the lender the required additional funding, failing which, the lender can deny draw requests or declare a default.
- g. **Minimum Equity.** Unlike permanent financing where the equity is determined from the value of the improvements based primarily on an appraisal, construction financing will require evidence of real equity, usually in the form of cash invested in land or construction costs. Soft costs are also considered "equity" but only somewhat so. If there are disguised fees paid to the borrower or its principals, the lender should be careful when evaluating the real dollars invested by the borrower. This can be source of concern and is one of the primary reasons closings may be delayed at the last minute as borrowers scramble for equity dollars.
- h. **Remedy on Default.** In addition to other remedies, the lender is granted wide ability to complete construction of the project on behalf of the borrower, and funds advanced for that purpose will be charged

to the borrower's account. The lender may direct the contractor to complete construction, using the architect's plans, and will use loan funds for that purpose.

**i. No Third-Party Beneficiaries or**

**Liability.** Because the lender is the primary source of capital for the project, the construction loan agreement should specifically provide that those benefiting from such funding (the contractor, subcontractors and materialmen, and other professionals), do not constitute third-party beneficiaries. The document should also avoid liability for defects in construction or in the plans and specifications, which are being reviewed and approved by the lender.

**A. Additional mortgage provisions enhance the security instrument.** These include a grant of a security interest in construction materials, and a requirement that the borrower not acquire any materials pursuant to any conditional sales contract, lease arrangement, or other title retention method which would take priority over the mortgage.

**B. Assignment of Intangibles.** The loan documentation should include in some format an assignment of contract documents and intangibles, granting a security interest in various construction documents and permits, including the construction contract, architect's contract, payment and performance bonds, and plans and specifications.