

Construction Lending Menu: A Smorgasbord of Recent Issues and Trends

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Most Commercial Construction is Financed with OPM

(Other People's Money)



Overview

- ✓ Completion Guaranties
- ✓ New HVCRE Law
- ✓ Mezzanine Financing
- ✓ Title Endorsements



Completion Guaranties

Dearth of Case Law: Only 6 published state and federal cases directly interpreting completion guaranties in construction loan transactions.

1) *Glendale Federal Savings & Loan Ass'n. v. Marina View Heights Development Co., Inc.*



2) *Black v. O'Haver*



3) *1633 Associates v. Uris Buildings Corporation*



4) Chase Manhattan Bank, N.A. v. American National Bank and Trust Company of Chicago

5) Turnberry Residential Ltd. Partner, L.P. v. Wilmington Tr. FSB

6) Western-Southern Life Assurance Co. v. Kaleh

Guiding Legal Principles

1. Lender cannot recover a windfall profit – its sole remedy is to be made whole.



2. Lender may be able to recover:
 - a) attorneys' fees,
 - b) the cost to settle outstanding mechanic's liens and
 - c) actual costs incurred or likely to be incurred by lender to pay for completion so long as lender incurs costs in strict compliance with the completion guaranty.

What role does the completion guaranty play in modern construction financing transactions?

Drafting Considerations

- 1) Limited, fact-specific judicial guidance
- 2) The 2 Great Recession legal opinions (*Turnberry* and *Western-Southern*) = modern courts more inclined to analyze completion guaranties like any other contract.

Do your clients rely on liquidated damages provisions to increase certainty in how damages will be calculated?

New HVACRE Legislation

May 2018 – Congress
passes:

*Economic Growth,
Regulatory Relief, and
Consumer Protection
Act*



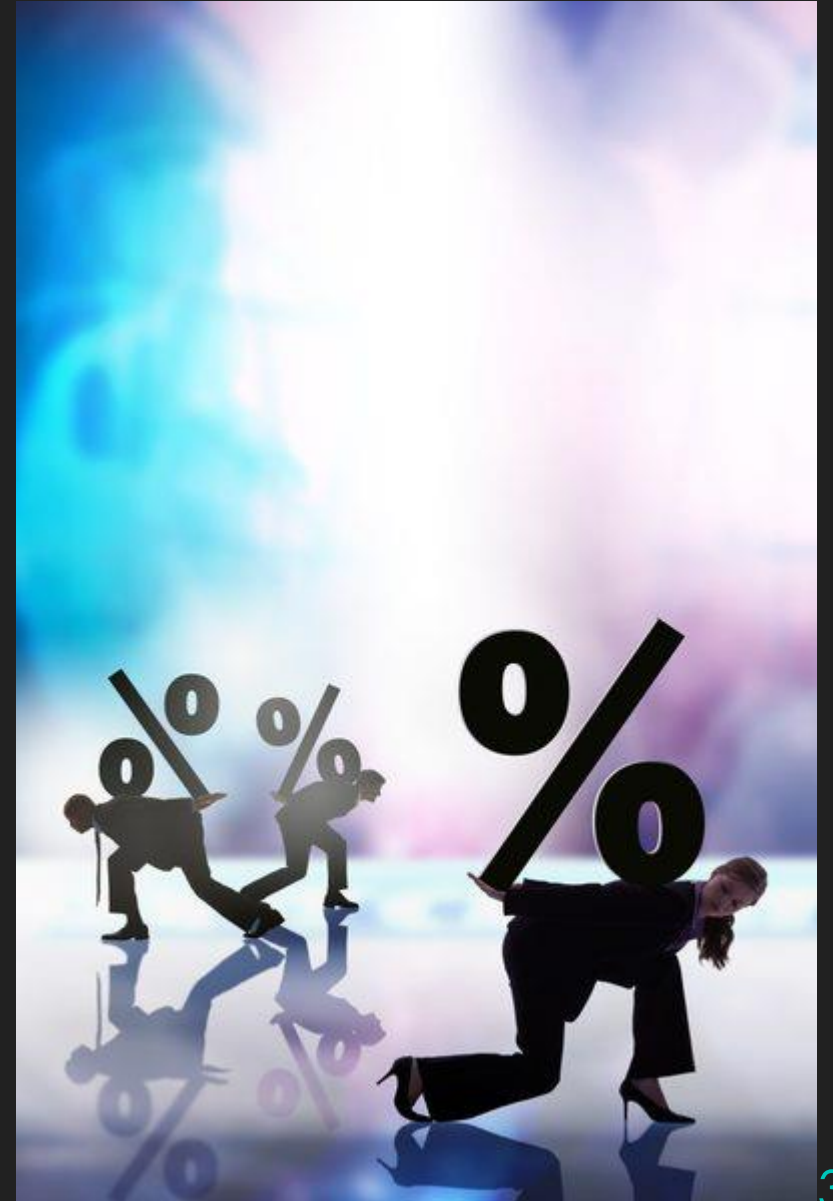
What loans are designated HVCRE?

A credit facility secured by real property that:

- a) **primarily** finances, has financed, or refines the acquisition, development, or construction of real property;
- b) has the **purpose** of providing financing to acquire, develop, or improve real property into income-producing real property; and
- c) **depends** on future income, sales refinancing of real property for repayment.

What is the consequence of HVCRE ADC designation?

Acquisition, Development or Construction loans made by banking institutions classified as HVCRE have a higher reserve requirement, which raises the cost of borrowing.



Did the EGRRCPA provide any relief for bank construction loans?

Yes. Benefits to borrowers and lenders include:

1. HVCRE rules only applies to loans
 - SECURED BY real property
 - PRIMARILY to finance ADC activities
2. The appraised value of the property (rather than cost basis) can be used to determine the borrower's required 15% equity contribution
3. Borrowers can withdraw capital in excess of the required 15%

Did the EGRRCPA provide any relief for bank construction loans?

4. Loans can convert to non-HVCRE status on project completion and income generation sufficient to service debt without having to refinance
5. Added two exceptions for loans on income producing property with sufficient cash flow to service debt

Mezzanine Financing in Construction Loans



Timing Considerations on the Funding of Mortgage and Mezzanine Loan Components



**Should mezz loan be advanced
upfront at closing or *pari-passu*
with senior as construction
progresses?**

Sample Mortgage/Mezzanine Intercreditor Issues



- 1) Should mezz lender be required to deliver a completion guaranty upon a Realization Event?
- 2) What should the completion guaranty delivered by the mezz lender cover?

3) Should mezz lender have to deliver:

Title Insurance for Construction Loans

- Title insurance industry experienced large losses on construction loans during the Great Recession
- As a result, the availability of full coverage at the time of policy issuance has been restricted



**When full coverage
not available, what
does incremental
coverage look like?**

- ❑ **ALTA 32/33**
 - 3 types of ALTA 32 – before
 - ALTA 33 – moves date of coverage with each advance – mechanic's liens only
- ❑ **“Pending Endorsements” alternative**
- ❑ **CLTA 122**



Please Join Us at the Roundtable