

11-2015

Construction and Development Financing v1 & v2

Marshall E. Tracht
New York Law School

Alvin L. Arnold

Follow this and additional works at: http://digitalcommons.nyls.edu/fac_books



Part of the [Business Commons](#), and the [Law Commons](#)

Recommended Citation

Tracht, Marshall E. and Arnold, Alvin L., "Construction and Development Financing v1 & v2" (2015). *Books*. 23.
http://digitalcommons.nyls.edu/fac_books/23

This Book is brought to you for free and open access by the Faculty Scholarship at DigitalCommons@NYLS. It has been accepted for inclusion in Books by an authorized administrator of DigitalCommons@NYLS.



3 5207 00330 1322

Construction and Development Financing

Law • Practice • Forms

November 2015 Edition

Alvin L. Arnold
Marshall E. Tracht



**THOMSON
REUTERS**

CONSTRUCTION AND DEVELOPMENT FINANCING

Law • Practice • Forms

THIRD EDITION

ALVIN L. ARNOLD

Member, New York Bar

and

MARSHALL E. TRACHT

Professor of Law and Director of Graduate

Real Estate Programs,

New York Law School

November 2015 Edition
Issued in November 2015

Volume 1

prepared by

ALVIN L. ARNOLD

and

MARSHALL E. TRACHT



THOMSON REUTERS

NEW YORK

NOV 3 0 2015

LAW SCHOOL

For Customer Assistance Call 1-800-328-4880

4
5698
13
H37

© 2015 Thomson Reuters

For authorization to photocopy, please contact the **Copyright Clearance Center** at 222 Rosewood Drive, Danvers, MA 01923, USA (978) 750-8400; fax (978) 646-8600 or **West's Copyright Services** at 610 Opperman Drive, Eagan, MN 55123, fax (651) 687-7551. Please outline the specific material involved, the number of copies you wish to distribute and the purpose or format of the use.

This publication was created to provide you with accurate and authoritative information concerning the subject matter covered; however, this publication was not necessarily prepared by persons licensed to practice law in a particular jurisdiction. The publisher is not engaged in rendering legal or other professional advice and this publication is not a substitute for the advice of an attorney. If you require legal or other expert advice, you should seek the services of a competent attorney or other professional.

Nothing contained herein is intended or written to be used for the purposes of 1) avoiding penalties imposed under the federal Internal Revenue Code, or 2) promoting, marketing or recommending to another party any transaction or matter addressed herein.

ISBN 978-0-314-64396-4

ISSN 2329-4485

2015–2016 Authors' Highlights

New features and recent developments in this November 2015 Edition of *Construction and Development Financing* include:

New § 2:51 Underwriting, administrative, and legal considerations—The pervasive effect of governmental regulations—Public opposition to new projects—Disparate Impact under the Fair Housing Act

New § 4:159 The hotel/motel construction loan—Hotel condominiums

New § 4:160 The hotel/motel construction loan—Hotel condominiums—Luxury markets

New § 4:161 The hotel/motel construction loan—Hotel condominiums—Loan underwriting

New § 4:162 The hotel/motel construction loan—Hotel Condominiums—Pre-sale requirements

New § 4:163 The hotel/motel construction loan—Hotel condominiums—Regulatory issues

New § 4:164 The hotel/motel construction loan—Hotel condominiums—Securities laws

New § 7:10 Real estate development without mortgage financing—Tax benefits from conservation easements—Regulatory approvals as consideration

New § 7:44 Lease transactions involving the improvement of landlord's property—Build-to-suit lease—In general

New § 7:45 Lease transactions involving the improvement of landlord's property—Build-to-suit lease—Lease term

New § 7:46 Lease transactions involving the improvement of landlord's property—Build-to-suit lease—Sample commencement date clause

New § 7:47 Lease transactions involving the improvement of landlord's property—Build-to-suit lease—Sample substantial completion clause

New § 7:48 Lease transactions involving the improvement of landlord's property—Build-to-suit lease—Construction Agreement

New § 7:49 Lease transactions involving the improvement of landlord's property—Build-to-suit lease—Rent provisions

Preface

The process of financing real estate land development—from raw acreage to finished building—presents the borrower/developer and its financier with great risk. The legal and business procedures of land development and construction finance are the most complex aspects of real estate finance, and perhaps of commercial finance in general. This revised edition examines and explains the financing of the entire range of the land development and construction process, from raw land to finished building, with separate treatment of each type of financing loan: the land loan, development loan, construction loan, and permanent loan.

The lawyer for the construction lender and developer is confronted with many legal problems throughout the development process that counsel for a lender making a loan on the security of a finished building is not faced with. Land development is carried on by many diverse participants whose interests and rights vary, and each is compensated separately and in accordance with different guidelines. The seller of raw land, the engineer, the architect, the surveyor, the general and subcontractors, the leasing agents, and the salespeople all have legal rights established by contract and in many instances conferred by law. The attorney for developer and lender must be aware of the rights and duties of each party and see that these are recognized in the legal instruments that form the structure of the development process. Land development and finance is uniquely an area where business and legal problems go hand in hand. The borrower and its counsel must be familiar with the development process and concepts of real estate credit.

As the decade of the 1990 begins, the construction lending process is undergoing some of its most significant changes in many years. Among the causes of these changes are the demise of the savings and loan industry as a result of years of unsound loan practice, the tremendous influx of capital to pension funds and the desire to invest a portion of these funds in real estate, and the rise in importance of commercial banks, which see real estate loans, both construction and permanent, as the way to replace lost markets in corporate lending (as a result of the much greater use by corporations of commercial paper) and in lending

to underdeveloped countries.

An additional factor affecting the construction finance industry is the move toward more conservative underwriting resulting from excessive building in the 1980's that led to extremely high vacancy rates and a large number of loan defaults. For the foreseeable future, developers can anticipate permanent and construction loan commitments that involve (1) lower loan-to-value ratios; (2) imposition of some or all resource (personel) liability; and (3) substantial preleasing requirements.

Perhaps the most significant fact relating to construction finance as this edition goes to press is the sharp increase in the market share of construction loan originations made by commercial banks, now by far the leading source of construction loans in all major lending categories. Commercial banks now account for about 93 percent of all construction financing on commercial projects, about 80 percent on multifamily projects, and 82 percent of all land development loans. About one half of all loans made on commercial projects are now held by the 300 largest banks.

Which institutions gave up the market share now held by commercial banks? The most obvious decline in originations is by thrift institutions which, in all three categories of construction loans, more than doubled their shares between 1980 and 1984 (following the Depository Institutions Act of 1982, which gave thrifts much broader lending powers). In the last few years the market shares of the thrifts declined to a point below the 1980 levels.

Mortgage companies are a second type of lender that lost significant market share in commercial construction financing. Many of these firms were bought by commercial banks, which is one cause of the shift in market share from the mortgage companies to the banks. In the case of multifamily housing, the sharpest decline in market share is by state and local housing finance companies which, from a peak of just under 18 percent in 1986 fell to only 3.5 percent in 1989 as a result of restricts on tax-exempt financing imposed by Congress.

At the present time, virtually no lenders other than commercial banks play a significant role in the construction loan market. Given the banks current exposure in long-term mortgage markets, the ability of commercial banks to continue to provide this level of construction financing becomes more difficult until

PREFACE

nonbank institutional lenders resume their traditional functions of providing permanent takeout commitments.

Acknowledgments

I wish to express my appreciation to Jayne Allen, who acted as a most effective book editor in connection with this revision. Her comments and suggestions about organization of material and completeness of coverage were most helpful.

Jo Ann Drew type and retyped many pages of manuscript with her usual patience and good nature.

ALVIN L. ARNOLD

Manhasset, New York
August 1990

WestlawNext™

THE NEXT GENERATION OF ONLINE RESEARCH

WestlawNext is the world's most advanced legal research system. By leveraging more than a century of information and legal analysis from Westlaw, this easy-to-use system not only helps you find the information you need quickly, but offers time-saving tools to organize and annotate your research online. As with Westlaw.com, WestlawNext includes the editorial enhancements (e.g., case headnotes, topics, key numbers) that make it a perfect complement to West print resources.

- FIND ANYTHING by entering citations, descriptive terms, or Boolean terms and connectors into the WestSearch™ box at the top of every page.
- USE KEYCITE® to determine whether a case, statute, regulation, or administrative decision is good law.
- BROWSE DATABASES right from the home page.
- SAVE DOCUMENTS to folders and add notes and highlighting online.

SIGN ON: next.westlaw.com

LEARN MORE: store.westlaw.com/westlawnext

FOR HELP: 1-800-WESTLAW (1-800-937-8529)

Summary of Contents

Volume 1

- Chapter 1. The Land Loan
- Chapter 2. The Land Development Loan
- Chapter 3. The Construction Loan: Application, Underwriting Approval, and Commitment
- Chapter 4. The Construction Loan

Volume 2

- Chapter 5. The Construction Loan "Takeout" or Permanent Loan
- Chapter 6. Construction Loan Defaults, Enforcement, and Workouts
- Chapter 7. Other Construction-Financing Transactions
- Chapter 8. Environmental Risks in Construction Financing
- Chapter 9. Uniform Laws, Public Policy, and Tax Issues Affecting the Construction Lender

Appendices

- APPENDIX A. Requirements for Plan Confirmation Under Bankruptcy Code
- APPENDIX B. Determination of Plan's Fairness Under Bankruptcy Code
- APPENDIX C. The Americans with Disabilities Act of 1990 Title III—Public Accommodations and Services Operated by Private Entities

Table of Cases

Index

Table of Contents

CHAPTER 1. THE LAND LOAN

- § 1:1 Raw land as the basis of the real estate development process
- § 1:2 Initial considerations when acquiring raw land
- § 1:3 The speculator's role in the real estate development process
- § 1:4 —Land investors seek high returns
- § 1:5 —Predicting growth paths
- § 1:6 —Utilizing vacant urban land
- § 1:7 —Due process: contract breach by state
- § 1:8 Duty to disclose to participant
- § 1:9 The speculator's role in the real estate development process—Capital gain or ordinary income?
- § 1:10 —Capital gain or ordinary income?—Qualifying for capital gain
- § 1:11 —Capital gain on inventoried land
- § 1:12 —Amortizing land costs
- § 1:13 —Opportunity funds look at brownfields
- § 1:14 —The new immigrant gateways
- § 1:15 —Charitable deduction for tainted property
- § 1:16 —Direct grants and liability protection for brownfields
- § 1:17 —Liability of landowner knowing of contamination
- § 1:18 Donated land and the public purpose doctrine

I. ACQUISITION AND WAREHOUSING OF LAND BY DEVELOPERS

- § 1:19 The warehousing process
- § 1:20 Dangers of warehousing
- § 1:21 Current market strategies
- § 1:22 Real options analysis
- § 1:23 Exchanging development rights
- § 1:24 Conventional sources of land financing

II. INSTITUTIONAL LAND FINANCING

- § 1:25 Underwriting considerations
- § 1:26 —Rating commercial land loans
- § 1:27 —New lending standards
- § 1:28 —Excluded transactions

- § 1:29 —Warning to regulated lenders
- § 1:30 Three-party financing of land
- § 1:31 Investments: land purchase-leasebacks
- § 1:32 First-mortgage land loans
- § 1:33 —Drafting partial release provisions
- § 1:34 —Partial release after default
- § 1:35 Land warehousing by third-party ownership
- § 1:36 —Predevelopment land syndicates
- § 1:37 Land banks
- § 1:38 Land lease replacing equity
- § 1:39 Land financing with options
- § 1:40 —Options by speculator or developer
- § 1:41 —Option drafting
- § 1:42 — —Drafting a rolling option
- § 1:43 —Real estate purchase agreement as option
- § 1:44 —Tax advantages and disadvantages
- § 1:45 —New rules for real estate options and contract rights
- § 1:46 Installment land-purchase contracts
- § 1:47 —Types of land-purchase contracts
- § 1:48 —Enforcement
- § 1:49 —Legal problems
- § 1:50 —Tax aspects
- § 1:51 — —Payments received in year of sale
- § 1:52 — —Computation and reporting of gain
- § 1:53 One-payment land-purchase contract with subordination of seller's fee
- § 1:54 Purchase-money mortgage transactions
- § 1:55 —Joint Venture Variations
- § 1:56 Subordination provisions
- § 1:57 —Amount of junior and senior indebtedness
- § 1:58 — —Level of debt service
- § 1:59 — —Need for flexibility of senior debt
- § 1:60 —Junior lender safeguards in connection with subordination arrangements
- § 1:61 —Safeguards for the senior lender
- § 1:62 —Coordinating the terms of junior and senior financing
- § 1:63 —Legal problems of subordination agreements
- § 1:64 — —Effect of subordination provisions on specific enforcement of real estate sale contracts
- § 1:65 — —Specific enforcement of subordination provisions
- § 1:66 — —Obligatory advance rule
- § 1:67 — —Modification of terms of senior debt to detriment of junior lienholder

TABLE OF CONTENTS

§ 1:68	— —Duty of the construction lender to the subordinate lienholder
§ 1:69	— —Cramdown in bankruptcy
§ 1:70	Using escrows in real estate closings
§ 1:71	—Land development and sale
§ 1:72	—Installment sale contracts
§ 1:73	—Land acquisition or assemblage
§ 1:74	—Escrowee indemnity clause
§ 1:75	Escrow agent's duty to disclose fraud
§ 1:76	The institutional lender's role in seller-financed land acquisitions
§ 1:77	—Junior lien on fee title
§ 1:78	—Security in purchaser's interest under installment-purchase contract
§ 1:79	—Security in seller's interest under installment contract
§ 1:80	Land-loan and contract defaults and the effect of bankruptcy
§ 1:81	—Lender's objectives and strategy
§ 1:82	—Junior lender defenses
§ 1:83	—Borrower defenses
§ 1:84	—Retaining the borrower's participation
§ 1:85	—The effect of intervening bankruptcy
§ 1:86	— —Bankruptcy of contract vendee
§ 1:87	— —Bankruptcy of contract vendor
§ 1:88	— —Mortgages as preferences
§ 1:89	Subdivision trust agreements
§ 1:90	Deducting interest on land loans
§ 1:91	Land Financing Subject to Risk of Eminent Domain or Non-Compensable Taking—Risk of Exercise of Eminent Domain
§ 1:92	Land financing subject to risk of eminent domain or non-compensable taking—Risk of non-compensable taking
§ 1:93	21-month moratorium not taking
§ 1:94	Supreme Court expands public use
§ 1:95	New taking limits in nine states
§ 1:96	Aircraft noise not taking
§ 1:97	Taking claim dismissed as not ripe
§ 1:98	When new finding of blight required
§ 1:99	Diminution in land value
§ 1:100	Rezoning after permit was a taking
§ 1:101	Acquisition after use restriction no bar to takings claim
§ 1:102	No taking when use not restricted

- § 1:103 Taking upheld despite benefit to private party
- § 1:104 Taking as result of environmental regulation
- § 1:105 Consequential damages for loss of access
- § 1:106 Severance damages
- § 1:107 Condemnation damages based on unity of land doctrine
- § 1:108 Flood barricade not taking
- § 1:109 Purchase agreement with option to purchase adjoining parcels
- § 1:110 Phased-purchase installment land contract
- § 1:111 Provisions for one-payment land-purchase contract
- § 1:112 Security agreement covering purchaser's interest under an installment land-purchase contract
- § 1:113 Security agreement covering seller's interest under an installment land-sale contract
- § 1:114 Seller's option to finance sale
- § 1:115 Fixed option agreement
- § 1:116 Sale of ranch for real estate development
- § 1:117 Three-cornered deferred exchange agreement with qualified intermediary
- § 1:118 Like-kind exchange with pass-through entities
- § 1:119 Line of credit for site acquisitions
- § 1:120 Development: using real options analysis

CHAPTER 2. THE LAND DEVELOPMENT LOAN

- § 2:1 Land development and its place in the overall development process
- § 2:2 —Land development by the developer who completes construction
- § 2:3 —Land development by the developer who sells prior to construction
- § 2:4 — —Duty to disclose soil conditions
- § 2:5 — —Residential lots
- § 2:6 — —The industrial park developer
- § 2:7 —The Interstate Land Sales Full Disclosure Act
- § 2:8 — —The improved lot exemption
- § 2:9 — —Unconditional obligation
- § 2:10 — —Exceptions to the unconditional obligation
- § 2:11 — —Habitable and usable requirement
- § 2:12 — —Manufactured homes may be considered residential buildings
- § 2:13 — —Parties liable under the act
- § 2:14 — —Reservations
- § 2:15 Using multiple exemptions

TABLE OF CONTENTS

§ 2:16	Land development and its place in the overall development process—The Interstate Land Sales Full Disclosure Act—Penalties
§ 2:17	—State laws
§ 2:18	—Strong performance in single-family homebuilding
§ 2:19	—Elements of the homebuilding process
§ 2:20	—Sources of homebuilding returns
§ 2:21	—Homebuilding risks
§ 2:22	—Asset management and the need for “exit strategies”
§ 2:23	—Determining need
§ 2:24	—Positioning the property
§ 2:25	—Implementing the exit strategy
§ 2:26	Underwriting, administrative, and legal considerations
§ 2:27	—Underwriting considerations
§ 2:28	—Loan balance
§ 2:29	—Mechanic’s-lien protection
§ 2:30	—Criteria for evaluating development loans
§ 2:31	—Legal interests in the work of professionals
§ 2:32	—Lender’s approval of professionals employed
§ 2:33	—Lien rights of professionals and disbursement procedures
§ 2:34	—Securing the lender’s interest in the work product of professionals
§ 2:35	—The pervasive effect of governmental regulations
§ 2:36	—Seeking zoning changes
§ 2:37	—Standing to sue city on rezoning
§ 2:38	—Affordable housing denial upheld
§ 2:39	—Due process and subdivision application
§ 2:40	—Zoning denial not discrimination
§ 2:41	—Zoning ordinances and the Americans With Disabilities Act
§ 2:42	—When developer’s property interest protected by due process
§ 2:43	—Restricting development rate impermissible
§ 2:44	—Taking of non-productive land
§ 2:45	—Equitable estoppel of rezoning resolution
§ 2:46	—Exemption for religious institutions
§ 2:47	—Rights in governmental applications and proceedings
§ 2:48	—Public opposition to new projects
§ 2:49	—Downzoning held not discriminatory
§ 2:50	—Supreme Court permits referendum on site plan
§ 2:51	—Disparate Impact under the Fair Housing Act
§ 2:52	—Township can challenge zoning relief

- § 2:53 ———Strategic lawsuits against public participants
- § 2:54 ———Development agreements
- § 2:55 ———Mediating land use disputes
- § 2:56 ———Mediation in the land use approval process
- § 2:57 ———Advantages and disadvantages of land use mediation
- § 2:58 ———Using mediation to resolve development disputes
- § 2:59 ———Legal issues in land development mediation
- § 2:60 ———Using mediation to supplement the zoning hearing process
- § 2:61 ———Historic preservation
- § 2:62 ———Historic preservation tax credits for hotels
- § 2:63 ———Historic preservation tax incentives
- § 2:64 —Subordination
- § 2:65 —The revolving credit land development loan
- § 2:66 —Effect of wetlands regulation on land development
- § 2:67 —The *federal manual for identifying and delineating jurisdictional wetlands*
- § 2:68 —Obtaining a determination for potential sites
- § 2:69 —MOA requirements for individual permits
- § 2:70 —Avoiding impact on wetlands
- § 2:71 —Minimizing impact on wetlands
- § 2:72 —Compensating for impact on wetlands
- § 2:73 —Impact of the MOA
- § 2:74 —Working with local agencies to develop wetlands
- § 2:75 —Inland wetlands agency
- § 2:76 —Local planning commission
- § 2:77 —State agencies
- § 2:78 —Qualified conservation easements
- § 2:79 Subdivision control ordinances

I. ORIGIN, STATUTORY BASIS, AND FUNCTION OF SUBDIVISION CONTROL ORDINANCES

- § 2:80 Historical origin
- § 2:81 Statutory basis for subdivision control ordinances
- § 2:82 Structure and function of local ordinances
- § 2:83 Impact fees—Legal Framework
- § 2:84 —Types of impact fees
- § 2:85 —Inclusionary Zoning Upheld
- § 2:86 —Tax treatment of impact fees
- § 2:87 In-lieu fee substitutes for affordable housing
- § 2:88 Community benefits agreements
- § 2:89 Financing and financial assurances required to comply with subdivision control legislation

TABLE OF CONTENTS

- § 2:90 —Surety performance bonds
- § 2:91 Lenders checklist for legal contest over bond proceeds
- § 2:92 —Cash deposits or escrows
- § 2:93 —Property escrow
- § 2:94 —Letter of credit
- § 2:95 — —Fraud and the independence principle
- § 2:96 — —Integrating the letter of credit with the land development loan
- § 2:97 — —Letter-of-credit defenses and safeguards for municipality and lender
- § 2:98 —Subdivision improvement agreement
- § 2:99 —Standby letters of credit in the public sector
- § 2:100 Reimbursable subdivision exactions
- § 2:101 Partial release clauses
- § 2:102 Infrastructure financing: the California example
- § 2:103 Subdivision improvement agreement
- § 2:104 Development rights purchase agreement

CHAPTER 3. THE CONSTRUCTION LOAN: APPLICATION, UNDERWRITING APPROVAL, AND COMMITMENT

I. THE CONSTRUCTION LOAN

- § 3:1 Definition and place in the development process
- § 3:2 Comparison to long-term mortgage and other commercial loans
- § 3:3 —Short-term loans
- § 3:4 —Payment of principal and interest
- § 3:5 —High, fluctuating interest rates
- § 3:6 Calculating construction loan yields
- § 3:7 Special know-how required for construction lending
- § 3:8 —Construction loan underwriting
- § 3:9 —Closed-end, Open-end and Gap Loans
- § 3:10 Business and legal risks unique to construction lending
- § 3:11 —Land and buildings under construction are the security
- § 3:12 —Unforeseeable construction risks
- § 3:13 —Construction loans in CDOs

II. INTERVENING LIENS AND RIGHTS OF THIRD PARTIES

- § 3:14 Mechanic's liens

- § 3:15 Non-mechanic's-lien rights
- § 3:16 Zoning and building requirements
- § 3:17 Loss of permanent financing
- § 3:18 Marketing the finished project
- § 3:19 Development over the next 25 years
- § 3:20 Construction loan underwriting
- § 3:21 —Evaluation of the borrower/developer
- § 3:22 — —Factors for evaluating the borrower/developer
- § 3:23 —Reducing risk through borrower screening
- § 3:24 —Lending to limited liability companies
- § 3:25 — —Characteristics of LLCs
- § 3:26 — —Authority
- § 3:27 — —Establishing formation, good standing, and qualification to do business
- § 3:28 — —Determining the LLC's authority to enter into the transaction
- § 3:29 — —Who may act for the LLC?
- § 3:30 — —Legal opinion
- § 3:31 — —Execution of the documents
- § 3:32 — —Structuring the loan
- § 3:33 — —Taking collateral from an LLC
- § 3:34 — —LLCs and personal guaranties of members
- § 3:35 — —Executing on an LLC interest
- § 3:36 — —LLCs and bankruptcy
- § 3:37 — —Summary of authorization documentation for LLCs

III. REVIEW OF THE PROJECT

- § 3:38 Construction plans and costs
- § 3:39 Appraisals
- § 3:40 The Interagency Appraisal Guidelines
- § 3:41 —Appraisal Review
- § 3:42 —Deductions and Discounts
- § 3:43 —Tract Developments
- § 3:44 Underwriting summary
- § 3:45 Evaluation of the contractor
- § 3:46 Source and use of funds
- § 3:47 Financial analysis of the finished project
- § 3:48 The takeout commitment
- § 3:49 —Preferred takeout lenders
- § 3:50 —Evaluation of takeout lender
- § 3:51 The "open ended" construction loan
- § 3:52 Convertible mortgages
- § 3:53 —Advantages to borrower

TABLE OF CONTENTS

§ 3:54	—Disadvantages to borrower
§ 3:55	—Advantages to lender
§ 3:56	—Disadvantages to lender
§ 3:57	—Negotiating guidelines
§ 3:58	—Underwriting guidelines for convertible mortgages
§ 3:59	— —Case study
§ 3:60	Private real estate equity funds
§ 3:61	—“Phantom equity” approach
§ 3:62	—Financing plus joint venture
§ 3:63	—Sale and leaseback
§ 3:64	—Straight joint venture
§ 3:65	—Straight sale
§ 3:66	—Guidelines for Negotiating the Equity Investment
§ 3:67	—How entity financing helps developers
§ 3:68	Overview of commercial real estate loan underwriting
§ 3:69	—Underwriting ratios and measures
§ 3:70	—Required documents
§ 3:71	—Repayment sources
§ 3:72	Covered bonds: two jurisdictions
§ 3:73	Underwriting apartment projects
§ 3:74	Capital Requirements for “High Volatility CRE”
§ 3:75	Sources of construction loans—Commercial banks
§ 3:76	— —Real estate company bank loan ratings
§ 3:77	—Thrift institutions
§ 3:78	—Mortgage bankers
§ 3:79	—Real estate investment trusts
§ 3:80	— —Increased use of REITs
§ 3:81	— —Expanding role of nonbank sources in 2015
§ 3:82	—Using REITs to fund construction loans for single-family housing
§ 3:83	— —Underwriting difficulties
§ 3:84	— —Traditional development cycle
§ 3:85	— —Mismatch of interest and principal duration
§ 3:86	— —The REIT mechanism
§ 3:87	— —Indemnification feature
§ 3:88	— —Pricing
§ 3:89	— —Conservative debt/equity configuration
§ 3:90	—Insurance companies and pension trusts
§ 3:91	EB-5 regional centers
§ 3:92	Sources of construction loans—Federal government assisted financing
§ 3:93	— —Community Reinvestment Act
§ 3:94	— —Investing in low-income housing tax credits
§ 3:95	— — —Update of housing tax credit program
§ 3:96	Federal construction program

- § 3:97 Sources of construction loans—Federal government assisted financing—Investing in low-income housing tax credits—Tax-deferred exit for limited partners
- § 3:98 — — —Construction outlook
- § 3:99 — — —Tax credit transactions as reportable tax shelters
- § 3:100 — — —New Markets Tax Credit program
- § 3:101 — — —Programs under New Markets Tax Credit
- § 3:102 — — —HUD financing of nursing homes
- § 3:103 — — —Financing with HUD 108 loan guarantees
- § 3:104 — — —FNMA affordable housing program
- § 3:105 — — —Negotiating low-income tax-credit partnership agreements

IV. BOND FINANCING BY STATE AND LOCAL FINANCING AGENCIES

- § 3:106 State housing finance agencies
- § 3:107 State and local industrial development bonds
- § 3:108 Taxable housing bonds
- § 3:109 Tax anticipation notes
- § 3:110 Loan presentation by developers
- § 3:111 —Underwriting criteria
- § 3:112 —Packaging a loan
- § 3:113 Nontraditional loan funding
- § 3:114 —New money sources
- § 3:115 —Using participating leases for financing
- § 3:116 Financing real estate with commercial paper
- § 3:117 Financing with letters of credit
- § 3:118 —New loan sources for home builders
- § 3:119 —Pension fund financing
- § 3:120 —Private debt offerings
- § 3:121 —Public offerings
- § 3:122 Structuring joint ventures with pension funds
- § 3:123 —Relationship between plan and manager
- § 3:124 — —Performance fee arrangements
- § 3:125 — —Computing performance fee
- § 3:126 — —Anticipated rates of return
- § 3:127 —Prohibited transactions with parties in interest
- § 3:128 —Developer as ERISA fiduciary
- § 3:129 —Other issues
- § 3:130 Structuring public/private partnerships
- § 3:131 —Benefits—Developers
- § 3:132 — —Local governments
- § 3:133 — —Lenders

TABLE OF CONTENTS

§ 3:134	—Problems unique to public/private partnerships
§ 3:135	—State law issues
§ 3:136	—Tax incentives
§ 3:137	—Financing alternatives
§ 3:138	—Tax-increment financing
§ 3:139	—Job retention
§ 3:140	—TIF triggers prevailing wage requirement
§ 3:141	—Increasing popularity of tax-increment financing
§ 3:142	—Constitutional debt limit not violated by TIF
§ 3:143	—Public purpose defined
§ 3:144	—Securing TIF financing
§ 3:145	—Public agency participation structures
§ 3:146	—A public/private multifamily venture
§ 3:147	—The property
§ 3:148	—The financing
§ 3:149	—The developer's returns
§ 3:150	Wraparound mortgage financing
§ 3:151	—Legal considerations for borrowers and lenders
§ 3:152	—Analysis of economics of wraparound loans
§ 3:153	—How wraparound loans can increase investment yield
§ 3:154	Leasehold mortgage financing
§ 3:155	—Leasehold mortgage lender's considerations
§ 3:156	—Negotiating the leasehold mortgage
§ 3:157	Construction loan application and approval process
§ 3:158	—Standard loan application
§ 3:159	—Non-standard loan presentation
§ 3:160	—Non-standard construction loan application
§ 3:161	—Letter of intent to make loan
§ 3:162	—The lender's internal approval process
§ 3:163	—Levels of loan approval authority
§ 3:164	—The presentation for loan approval
§ 3:165	The construction loan commitment
§ 3:166	Commitment letter: unclear terms
§ 3:167	The construction loan commitment—Negotiating and drafting the construction loan commitment
§ 3:168	—Drafting a mortgage loan commitment from the lender's perspective
§ 3:169	—Construction loan commitment preparation
§ 3:170	—Points often overlooked
§ 3:171	—Interest rate ceiling
§ 3:172	—Deadline dates
§ 3:173	—Limiting lender's attorney fees and other expenses
§ 3:174	—Commitment fees

- § 3:175 — — Consents
- § 3:176 — — Guaranties
- § 3:177 — — Determining whether a loan commitment is a binding agreement
- § 3:178 — Agreed-on procedures
- § 3:179 — — Specific requirements of the new standards
- § 3:180 Enforcement of construction loan commitments: borrower versus lender
- § 3:181 — Contract-Law defenses of lender
- § 3:182 — — Lack of sufficient definiteness
- § 3:183 — — Lack of authority of issuer
- § 3:184 — — Lack of consideration
- § 3:185 — — Lack of legal authority
- § 3:186 — — — Guidelines for pre-loan negotiations
- § 3:187 — — Lack of strict compliance with conditions of loan commitment
- § 3:188 Construction loan commitments
- § 3:189 Liquidated damage subject to reasonable test

V. REMEDIES FOR THE BORROWER

- § 3:190 Money damages generally
- § 3:191 Lost profits
- § 3:192 Specific performance
- § 3:193 Liability under Bank Holding Company Act
- § 3:194 Enforcement of construction loan commitments: lender versus borrower
- § 3:195 — Commitment fees and standby deposits as impermissible penalties
- § 3:196 — Fees paid for lender's readiness to make the loan
- § 3:197 — Commitment fees as usury
- § 3:198 — Lender's lost profits
- § 3:199 — Suggestions for drafting and counseling to retain fees and deposits
- § 3:200 — Specific performance
- § 3:201 Validity and enforceability of the oral construction loan commitment
- § 3:202 — Third-party beneficiary
- § 3:203 — Promissory estoppel
- § 3:204 Tax deductibility of commitment fees
- § 3:205 Bankruptcy of borrower prior to funding
- § 3:206 Accounting for real estate acquisition, development, or construction arrangements
- § 3:207 Accounting for loan origination and acquisition fees
- § 3:208 — Loan origination fees and costs
- § 3:209 — Commitment fees and costs

TABLE OF CONTENTS

- § 3:210 —Construction phase cost sheet
- § 3:211 —Construction and permanent loan application
- § 3:212 —Presentation to loan committee on tract-housing development
- § 3:213 —Recommendation to senior loan officer on office building construction loan
- § 3:214 —Construction loan commitment
- § 3:215 —General terms and conditions for construction commitment letter
- § 3:216 —Construction loan commitment with commentary

CHAPTER 4. THE CONSTRUCTION LOAN

- § 4:1 The construction loan note
- § 4:2 —Statement of loan amount
- § 4:3 —Principal repayment
- § 4:4 —Incorporating other loan documents by reference
- § 4:5 Nominee agreement to avoid possible usury

I. THE CONSTRUCTION LOAN MORTGAGE

- § 4:6 Comparison to other mortgages
- § 4:7 —Ten frequently neglected mortgage terms
- § 4:8 Fixture priorities and qualification as a construction mortgage under the uniform commercial code
- § 4:9 Interest payment and rate
- § 4:10 —Usury
- § 4:11 ——Interest on undisbursed amounts
- § 4:12 ——Federal preemption for some loans
- § 4:13 ——Savings clause
- § 4:14 —Matched funding
- § 4:15 ——Certificate of deposit rate
- § 4:16 ——Euro-currency loans
- § 4:17 —Multiple interest rate options
- § 4:18 —Maximum, minimum, and average interest rate provisions
- § 4:19 —Hedging construction loan interest rates
- § 4:20 —Deducting construction loan interest
- § 4:21 ——Final regulations on capitalizing interest
- § 4:22 ———The avoided cost method
- § 4:23 ———Unit of property
- § 4:24 ———Production period of a unit of property
- § 4:25 ———De minimis exception
- § 4:26 ———Suspension period
- § 4:27 Interest rate swap agreements
- § 4:28 —Loan documentation for interest rate swaps

- § 4:29 —Provisions for default
- § 4:30 —Quantifying the lender's reimbursement
- § 4:31 —Consequences of prepayment
- § 4:32 — —Liberalized prepayment provisions in swap-linked financing
- § 4:33 —Securing and insuring breakage
- § 4:34 —Interest rate cap agreements
- § 4:35 —Legal obligation of a counterparty
- § 4:36 The "preclosed" loan
- § 4:37 —Business and legal advantages
- § 4:38 —Business and legal disadvantages
- § 4:39 —Integrating the construction and permanent loan documents—Buy-sell agreement needed
- § 4:40 — —Making the note evidence the construction and permanent loans
- § 4:41 — —The mortgage for the preclosed loan
- § 4:42 The comprehensive construction loan agreement
- § 4:43 —Construction loan agreement provisions
- § 4:44 The small construction loan
- § 4:45 Total project finance
- § 4:46 —Advantages
- § 4:47 —Disadvantages
- § 4:48 —Loan documents
- § 4:49 — —Representations and warranties
- § 4:50 — —Division of loan proceeds by development phase
- § 4:51 — —Conditions precedent to disbursement of loan for various phases
- § 4:52 — —Disbursement procedures
- § 4:53 — —Balancing each phase of the loan
- § 4:54 — —Retainages and final disbursement
- § 4:55 — — —Understanding retainage
- § 4:56 — —Inclusion of letter of credit provisions
- § 4:57 —Priority of acquisition and development loans
- § 4:58 The residential subdivision construction loan
- § 4:59 —Unique legal problems and business risks
- § 4:60 — —Speculative nature of home building
- § 4:61 — —Loan repayment from sale of homes
- § 4:62 — —Loan periods and development complexity
- § 4:63 —Defining "home" and "model home"
- § 4:64 —Revolving credit
- § 4:65 —The need to regulate the pace of borrower's development
- § 4:66 —Assignment of purchase contracts
- § 4:67 —Home purchaser financing
- § 4:68 —Sewer and water taps

TABLE OF CONTENTS

- § 4:69 —Partial releases for home sales
- § 4:70 —Lender's monitoring of compliance with development requisites

II. MODEL HOMES

- § 4:71 Financing by the construction lender
- § 4:72 Financing by another lender
- § 4:73 Sale-leaseback of model homes
- § 4:74 Depreciation of model homes
- § 4:75 Priority between the residential construction lender and the home purchaser
- § 4:76 The growth of "New Urbanism"
- § 4:77 The planned community development
- § 4:78 —Development strategy
- § 4:79 —Home building: right to disclaim implied warranties
- § 4:80 Home building: mandatory arbitration
- § 4:81 The planned community development—Community association structure and operation
- § 4:82 —Use restrictions
- § 4:83 —Development rights
- § 4:84 —Regulation
- § 4:85 Financing senior housing developments
- § 4:86 —Types of senior housing
- § 4:87 —Growth and new formats of senior housing
- § 4:88 —Financing senior housing
- § 4:89 Phased projects
- § 4:90 —High front-end costs
- § 4:91 —Different lenders for different phases
- § 4:92 —Mechanic's-lien problems
- § 4:93 —Permanent-loan takeout problems
- § 4:94 The shopping center construction loan
- § 4:95 —Development with multiple owners
- § 4:96 —Financing the mall space
- § 4:97 —Tenant improvement holdbacks
- § 4:98 —Shopping center expansion
- § 4:99 —Component financing and other multiple lender arrangements
- § 4:100 —Financing parking structures
- § 4:101 —Increase in retail construction applications
- § 4:102 —Converting shopping centers into technical and continuing education centers
- § 4:103 —De-malling a shopping center
- § 4:104 The condominium construction loan

- § 4:105 —Underwriting considerations
- § 4:106 —Financing terms
- § 4:107 —Loan terms and provisions
- § 4:108 — —Timing and prerequisites for advances
- § 4:109 — —Timing of lender consent or subordination to condominium declaration
- § 4:110 — —Lender approval requirements
- § 4:111 — —Prohibition of block sales
- § 4:112 — —Assigning the sale contracts to the construction lender
- § 4:113 — —Partial release of units
- § 4:114 —Loans to unit purchasers
- § 4:115 —Government-assisted condominium financing
- § 4:116 —Cooperative apartment financing
- § 4:117 —Rating cooperative mortgage loans
- § 4:118 —Priority between the condominium construction lender and unit purchasers
- § 4:119 — —Foreclosure sale proceeds go first to lender
- § 4:120 — —The condominium construction loan: sell-back agreement
- § 4:121 —The uniform condominium act
- § 4:122 —Minimizing liability and litigation on condominium projects
- § 4:123 — —Drafting homeowners association CC&Rs to minimize liability
- § 4:124 — —Using construction contracts to reduce a developer's liability
- § 4:125 — —Careful use of the plans and specifications
- § 4:126 — —Long-range insurance planning
- § 4:127 — —No liability for defective construction
- § 4:128 —The zero unit condominium
- § 4:129 — —Subdividing the rights, not the land
- § 4:130 — —Raising capital with the zero unit condominium
- § 4:131 — —Conveyances
- § 4:132 — —Objections to the zero unit condominium
- § 4:133 Condominium conversion financing
- § 4:134 —Underwriting considerations
- § 4:135 —Financing needs
- § 4:136 —Rating condominium conversion loans
- § 4:137 Condominium developer purchases
- § 4:138 Condominiums: tighter financing
- § 4:139 Condominiums: new FHA rules
- § 4:140 Rising demand for medical office buildings

III. METHODS OF FINANCING

- § 4:141 Use of existing financing

TABLE OF CONTENTS

§ 4:142	New conversion loan
§ 4:143	—Rating conversion loans
§ 4:144	Multiple loans on individual units
§ 4:145	Conversion financing by the seller
§ 4:146	Loans secured by monthly charges
§ 4:147	Loan disbursement and administration
§ 4:148	Cash flow in a condominium conversion
§ 4:149	Obligation to convert and continue rental
§ 4:150	Statutory compliance
§ 4:151	Tenant litigation
§ 4:152	The hotel/motel construction loan
§ 4:153	—Franchising
§ 4:154	—Equipment financing
§ 4:155	——Complete subordination
§ 4:156	——Lease and option assignment
§ 4:157	——Secondary security interest
§ 4:158	——The importance of advance planning
§ 4:159	—Hotel condominiums
§ 4:160	——Luxury markets
§ 4:161	——Loan underwriting
§ 4:162	—Hotel Condominiums—Pre-sale requirements
§ 4:163	—Hotel condominiums—Regulatory issues
§ 4:164	——Securities laws
§ 4:165	—Handling disaster claims
§ 4:166	The office building construction loan
§ 4:167	—Loan allocation and disbursement
§ 4:168	——The dual allocation approach
§ 4:169	——Dual loans
§ 4:170	—Title insurance problems
§ 4:171	Wind farms
§ 4:172	Student housing growth ahead
§ 4:173	Construction loan guaranties
§ 4:174	—The value and function of construction loan guaranties
§ 4:175	—Types of construction loan guaranties
§ 4:176	——Guaranty of debt repayment
§ 4:177	——Guaranty of construction completion
§ 4:178	———Specific performance of completion guaranty
§ 4:179	———Scope of guaranty and lender remedies
§ 4:180	——Categories of guaranties
§ 4:181	—Enforcement of construction loan guaranties
§ 4:182	—Risk of guarantor's bankruptcy to enforcement of the construction loan
§ 4:183	—Enforcement of construction loan guaranties— Lender's breach of construction loan agreement

- § 4:184 — — Lender's action impairing guarantor's position
- § 4:185 — — — Guarantee not voided by lender's failure to disclose
- § 4:186 — — Guarantor's liability on underlying nonrecourse note
- § 4:187 — — Oral modification of guarantee agreement binding on lender
- § 4:188 — Drafting to avoid guarantor defenses
- § 4:189 — Compliance with the Equal Credit Opportunity Act
- § 4:190 Letters of credit
- § 4:191 — Drawing on a letter of credit
- § 4:192 — — Draw by third-party beneficiary
- § 4:193 — — Construction: contractor as third-party beneficiary
- § 4:194 — Drafting letters of credit
- § 4:195 — Letters of credit for tax-exempt bonds
- § 4:196 Alternatives to construction loan guaranties, letters of credit, and surety bonds
- § 4:197 — Bank guarantee
- § 4:198 — Comfort letter
- § 4:199 — Put agreement
- § 4:200 — Two-party nonbank letters of credit
- § 4:201 Performance and payment bonds
- § 4:202 — Mechanic's-lien bonds
- § 4:203 — Construction bonds

IV. CONSTRUCTION CONTRACTS AND ARCHITECT'S AGREEMENTS

- § 4:204 Loan underwriting
- § 4:205 Lender certification requirements
- § 4:206 Abandonment of construction contract
- § 4:207 Coordination of construction contract and construction loan agreement
- § 4:208 Securing the continued performance of architects and contractors after default
- § 4:209 — Assignment of construction contract
- § 4:210 — Assignment of plans and specifications and architect's agreement
- § 4:211 — Assignment of other rights
- § 4:212 Construction lender's rights against vendors
- § 4:213 — The economic loss doctrine
- § 4:214 — Enforcing an Assignment of Payment
- § 4:215 Agreement among contractor, construction lender, and borrower
- § 4:216 Construction contract damage provisions

TABLE OF CONTENTS

- § 4:217 Hazard and liability insurance
- § 4:218 —Hazard insurance
- § 4:219 —Flood hazard insurance
- § 4:220 — —Identifying flood hazard areas and maintaining insurance records
- § 4:221 —Liability insurance
- § 4:222 — —Landowner's potential liability for contractor's employees
- § 4:223 — —Additional-insured indemnification for lessors
- § 4:224 — —Stiffer underwriting standards

V. ENSURING THE PRIORITY OF THE CONSTRUCTION MORTGAGE LIEN

- § 4:225 Priority vis-à-vis mechanic's lien claims
- § 4:226 —Choice of Law Provisions
- § 4:227 —Equitable Subrogation
- § 4:228 —Lender's inadvertent waiver of priority
- § 4:229 Construction loan title insurance
- § 4:230 —The American Land Title Association loan policy—1970 (amended October 17, 1970)
- § 4:231 —The American Land Title Association construction loan policy—1975
- § 4:232 —1987 ALTA loan policy
- § 4:233 Priority vis-à-vis mechanic's lien claims—Circular Priority Problems
- § 4:234 Construction loan participations

VI. BUSINESS REASONS

- § 4:235 Commercial banks
- § 4:236 Mortgage bankers
- § 4:237 Participations with permanent lenders

VII. STRUCTURING THE PARTICIPATION

- § 4:238 Pari passu
- § 4:239 Phased contributions
- § 4:240 Subordination
- § 4:241 Loan default
- § 4:242 Put and call provisions
- § 4:243 Compensating the lead lender

VIII. LEAD-LENDER AUTHORITY AND RESPONSIBILITY

- § 4:244 Lead-lender authority

- § 4:245 Lead-lender standard of care
- § 4:246 Lead-lender liability to participant

IX. CONSTRUCTION LOAN ADMINISTRATION

- § 4:247 Definition and objectives of construction loan administration
- § 4:248 Monitoring of construction loans
- § 4:249 —Contractor selection
- § 4:250 —Project shop drawings
- § 4:251 —Project change orders
- § 4:252 —Project schedule
- § 4:253 —Coordination and communication
- § 4:254 —Dispute resolution

X. RESPONSIBILITY FOR CONSTRUCTION LOAN ADMINISTRATION

- § 4:255 Lender's attorney
- § 4:256 Loan administrator
- § 4:257 Construction loan disbursement administration
- § 4:258 —Application for disbursement
- § 4:259 —Architect's certificate
- § 4:260 —General contractor's certificate
- § 4:261 —Monitoring contract changes
- § 4:262 —Monitoring the interest reserve
- § 4:263 —Title continuation
- § 4:264 —Final disbursement
- § 4:265 Methods of loan disbursement
- § 4:266 —Voucher method
- § 4:267 —Direct payment method
- § 4:268 —Joint checks
- § 4:269 —Construction escrow
- § 4:270 Project inspections
- § 4:271 —Responsibility for inspections
- § 4:272 — —Bank's duty to oversee construction
- § 4:273 —Functions of the inspection
- § 4:274 — —Inspection of project site
- § 4:275 Bankruptcy of construction loan borrower
- § 4:276 Attempts by third parties to reach construction loan funds or construction lender's security
- § 4:277 —Garnishment
- § 4:278 —Escrow
- § 4:279 —Third-party beneficiary
- § 4:280 —Equitable lien

TABLE OF CONTENTS

- § 4:281 — —Equitable lien based on establishment of loan fund
- § 4:282 — —Equitable lien based on affirmative conduct of lender or others
- § 4:283 — —Equitable lien based on unjust enrichment of lender
- § 4:284 — —The FHA cases and the “*Trans-Bay* doctrine”
- § 4:285 — —Right to prejudgment interest when equitable lien awarded on undisbursed construction loan proceeds
- § 4:286 — —Constructive trust, unjust enrichment, and the degree of project completion
- § 4:287 — —Advance for claimant’s work already made by construction lender
- § 4:288 — —Full project completion as determining unjust enrichment
- § 4:289 — —Construction loan proceeds as trust fund
- § 4:290 — —Express trust
- § 4:291 — —Statutory construction trusts
- § 4:292 — —Estoppel
- § 4:293 — —Guaranty
- § 4:294 — —Promissory estoppel
- § 4:295 — —Surety claim
- § 4:296 — —“Stop notice” statutes requiring construction lender to make direct disbursement to contractors
- § 4:297 — —“Stop notice” statute declared unconstitutional
- § 4:298 — —Prompt pay acts

XI. LIABILITY OF CONSTRUCTION LENDER TO THIRD PARTIES

- § 4:299 Construction defects
- § 4:300 Other grounds
- § 4:301 — —Construction lender’s duty to subordinate purchase-money lienholders
- § 4:302 — —Construction lender’s duty to contract vendees
- § 4:303 — —Construction lender’s negligence or breach of duty in loan disbursement
- § 4:304 — —Bank’s duty to oversee construction
- § 4:305 — —Construction lender and borrower as joint venturers
- § 4:306 — —Construction lender’s assumption of project control
- § 4:307 — —Construction lender’s duty to disclose certain information to third parties
- § 4:308 — —Construction lender’s duty to disclose adverse information to buyer of real estate loan

- § 4:309 —Construction lender's duty to disclose facts to real estate buyer
- § 4:310 Construction lender's duty and liability to construction borrower
- § 4:311 —Breach of fair dealing
- § 4:312 —Willful diversion or suspension of loan disbursements
- § 4:313 — —Implied obligation of good faith when disbursing funds
- § 4:314 — —Lender liability for fraud and non-disclosure
- § 4:315 — —Course of conduct modifies loan agreement
- § 4:316 —Careful loan administration
- § 4:317 —Tortious conduct
- § 4:318 —Negligent misrepresentation as jury issue
- § 4:319 —Misrepresentation claim survives foreclosure
- § 4:320 —Misappropriation of confidential information from borrower
- § 4:321 —Lender liable to developer for defamation
- § 4:322 —Fraudulent inducement
- § 4:323 —Lender action for its own protection only
- § 4:324 —Funding project overruns
- § 4:325 —RICO liability
- § 4:326 —Lender's counterclaims: developer liability
- § 4:327 — —Misallocation of funds and false statements
- § 4:328 — —Lender liability for improper disclosure
- § 4:329 Construction fraud: How to mitigate
- § 4:330 Construction lender's duty and liability to construction borrower—Lender's counterclaims: developer liability—Bank officer bribery
- § 4:331 — —The nominee loan and false entries
- § 4:332 — —Disclosure during workout negotiations
- § 4:333 — —The examination process and lender's obligation to report suspected crimes
- § 4:334 — —Punitive Damages for Failure to Pay Property Taxes
- § 4:335 Construction lender's right to apply loan disbursements to construction
- § 4:336 —Assignment by borrower of construction loan funds
- § 4:337 —Setoff of borrower's debt against construction loan funds
- § 4:338 Oral modification of loan agreements
- § 4:339 —Written agreement overrides alleged oral promise
- § 4:340 Mortgage note for construction loan
- § 4:341 Mortgage note with multiple interest rate options
- § 4:342 Construction loan agreement provisions for euro-dollar interest rate alternatives

TABLE OF CONTENTS

- § 4:343 Interest rate swap agreement between party and intermediary bank
- § 4:344 Construction loan agreement
- § 4:345 Single-family-home construction loan agreement
- § 4:346 Guaranty of repayment of construction debt
- § 4:347 Unconditional, continuing guaranty of loan documents
- § 4:348 Construction completion guaranty
- § 4:349 Assignment of construction contract with contractor's agreement to continue
- § 4:350 Assurance letter for tri-party agreement among borrower, lender, and contractor
- § 4:351 ALTA loan policy requirements
- § 4:352 Construction loan participation agreement
- § 4:353 Lead lender's subordination of its receipt of principal and interest to participant's receipt
- § 4:354 Subordination of interest of participant declining to contribute its share of loan advances or expenses
- § 4:355 Participants' rights and responsibilities in management and sale of collateral after its acquisition
- § 4:356 Participant's right to "Put" its interest to lead lender
- § 4:357 Lead lender's right to "Call" participant's interest
- § 4:358 Application for construction loan disbursement
- § 4:359 Construction escrow agreement
- § 4:360 Construction status report
- § 4:361 Borrower's request for inspection services of architect
- § 4:362 Construction inspection—Outside consultant's report to lender—Sample letter
- § 4:363 Construction/permanent note rider to be used with standard Fannie Mae/Freddie Mac promissory notes
- § 4:364 Combination construction/permanent loan agreement to be used with standard Fannie Mae/Freddie Mac promissory notes
- § 4:365 Selected provisions in condominium declaration for a zero unit condominium
- § 4:366 Additional covenants in condominium construction mortgage
- § 4:367 Commitment letter for construction loan—Fee project
- § 4:368 Cooperative apartment loan commitment
- § 4:369 Cooperative apartment loan note
- § 4:370 Cooperative apartment loan security agreement
- § 4:371 Assignment of proprietary lease
- § 4:372 Recognition agreement
- § 4:373 Participation agreement
- § 4:374 Project account agreement

CONSTRUCTION AND DEVELOPMENT FINANCING

- § 4:375 —Labor and Material Payment Bond
- § 4:376 —Performance Bond
- § 4:377 —Construction and completion guaranty: guarantor's representations, warranties, and waiver of certain defenses
- § 4:378 Covenant that property will not be declared a condominium
- § 4:379 Financing: three specialties

CONSTRUCTION AND DEVELOPMENT FINANCING

Law • Practice • Forms

THIRD EDITION

ALVIN L. ARNOLD

Member, New York Bar

and

MARSHALL E. TRACHT

Professor of Law and Director of Graduate

Real Estate Programs,

New York Law School

**November 2015 Edition
Issued in November 2015**

Volume 2

prepared by

ALVIN L. ARNOLD

and

MARSHALL E. TRACHT



THOMSON REUTERS™

NEW YORK

NOV 30 2015

LAW SCHOOL

For Customer Assistance Call 1-800-328-4880

Table of Contents

CHAPTER 5. THE CONSTRUCTION LOAN "TAKEOUT" OR PERMANENT LOAN

§ 5:1 Definition and function of the takeout

I. TYPES OF TAKEOUTS

- § 5:2 Construction lender converting to intermediate- or long-term lender
- § 5:3 Long-term amortizing loan by a "permanent lender"
- § 5:4 —Accrual loans
- § 5:5 —Case study
- § 5:6 —Debt service coverage ratios and rising interest rates
- § 5:7 Intermediate-term loan
- § 5:8 —Mini-perm rollovers
- § 5:9 Standby commitments
- § 5:10 —Underwriting guidelines
- § 5:11 —Case study
- § 5:12 —Mortgage commitment issues for borrower
- § 5:13 Gap loans
- § 5:14 —The mezzanine loan
- § 5:15 —The growth of mezzanine
- § 5:16 —Rating mezzanine loans
- § 5:17 —Mezzanine financing exit strategies
- § 5:18 —Preferred equity
- § 5:19 —How subordinate debt impacts senior debt rating
- § 5:20 —Intercreditor agreement
- § 5:21 Sale of the completed project as the takeout
- § 5:22 Sale-leasebacks
- § 5:23 —Tax problems in sale-leasebacks
- § 5:24 —Recharacterization in state court or bankruptcy
- § 5:25 Joint ventures
- § 5:26 —Interim joint ventures
- § 5:27 —Tenant-developer joint ventures (equity leases)
- § 5:28 —Landowner-developer joint ventures
- § 5:29 —Example of a residential subdivision joint venture
- § 5:30 —The joint venture agreement
- § 5:31 —Breaking joint venture deadlocks
- § 5:32 —Joint ventures between developers
- § 5:33 Outright sale

- § 5:34 Sale to partnerships
- § 5:35 Standby commitments
- § 5:36 —Types of standbys
- § 5:37 —Bankable standby commitments
- § 5:38 Forward commitment with two-tier participation
- § 5:39 Life company mortgage loans
- § 5:40 Breach of a mortgage commitment
- § 5:41 Equity standby commitments
- § 5:42 —Use of an equity standby commitment
- § 5:43 —Terms of the equity standby
- § 5:44 —Lender's perspective
- § 5:45 —Developer's perspective
- § 5:46 —Equity standby investor's perspective
- § 5:47 Case study of equity/debt financing
- § 5:48 —"Phantom equity" approach
- § 5:49 —Financing plus joint venture
- § 5:50 —Sale and leaseback
- § 5:51 —Straight joint venture
- § 5:52 —Straight sale
- § 5:53 Negotiating with a securitizing lender
- § 5:54 —The rating process for mortgage securities
- § 5:55 —Rating construction loans for securitization
- § 5:56 —Disadvantages of securitization
- § 5:57 —Special provisions required by securitizing lenders
- § 5:58 — —Credit tenant lease loans
- § 5:59 Yield maintenance premiums
- § 5:60 —Enforceability under state law
- § 5:61 Yield maintenance premium—Enforceability in
Bankruptcy
- § 5:62 Sample yield maintenance premium provision
- § 5:63 Refinancing conduit loans
- § 5:64 The construction lender's business and legal
relationship to the takeout lender
- § 5:65 —Review and administration of the takeout
commitment
- § 5:66 —Takeout provisions to be avoided
- § 5:67 —Administration of the takeout as construction
progresses
- § 5:68 — —Construction lender duty to reveal financial data
- § 5:69 —Legally linking the takeout lender to the
construction lender
- § 5:70 — —The tri-party or buy-sell agreement
- § 5:71 — —Assignment of permanent loan commitment to
construction lender

TABLE OF CONTENTS

- § 5:72 — —Permanent loan commitment issued directly to construction lender
- § 5:73 — —Construction lender's relationship to a takeout investor committing to make an equity investment
- § 5:74 — —Construction lender's relationship to a takeout lender that is also an equity owner of the property
- § 5:75 — —Quadripartite agreements
- § 5:76 — —Construction lender's enforcement of the permanent loan commitment
- § 5:77 — —Borrower's enforcement of the permanent loan commitment—Defenses of lender
- § 5:78 — —Resolving disputes between borrower and lender
- § 5:79 — —Borrower's claim of economic distress
- § 5:80 Transferring the loan to the takeout lender
- § 5:81 Delivery of a loan to a permanent lender (assuming that the same set of mortgage documents will be used)
- § 5:82 Tri-party agreement
- § 5:83 Equity funding conditions letter
- § 5:84 Quadripartite agreement—With convertible loan documents
- § 5:85 — —Without convertible loan documents
- § 5:86 Escrow agreement for construction loan delivery to permanent lender
- § 5:87 Representation and estoppel certificate of construction lender and borrower to permanent lender
- § 5:88 Construction lender's attorney's legal opinion to permanent lender
- § 5:89 Letter of intent to make a permanent loan

CHAPTER 6. CONSTRUCTION LOAN DEFAULTS, ENFORCEMENT, AND WORKOUTS

- § 6:1 The unique problems of construction loan defaults
- § 6:2 — —Changing perceptions and approaches toward workouts
- § 6:3 — —Default myths
- § 6:4 — —Current realities concerning defaults
- § 6:5 Default danger signals
- § 6:6 — —Defaults other than the failure to make payments
- § 6:7 — —Loan out of balance; probable cost overruns
- § 6:8 — —Construction delay
- § 6:9 — —Diversion of loan proceeds
- § 6:10 — —Poor marketing results
- § 6:11 — —Borrower bankruptcy

- § 6:12 — —Borrower difficulty on other projects
- § 6:13 — —Contractor bankruptcy or default
- § 6:14 — — —Property owner not liable to subcontractor
- § 6:15 —Equivocal defaults and equitable defenses
- § 6:16 Objectives after a default—The lender's objective:
completion of construction
- § 6:17 Construction lender remedies
- § 6:18 Objectives after a default—The borrower's objectives
- § 6:19 — —The continuation of the project
- § 6:20 — —The termination of the project
- § 6:21 — —Both strategies
- § 6:22 — —The ability to borrow again
- § 6:23 Foreclosure of the mortgage
- § 6:24 —Borrower's foreclosure defenses
- § 6:25 — —Negligence or breach of contract in the course of
loan administration
- § 6:26 — —Breach of agreement to lend additional funds
- § 6:27 — —Usury
- § 6:28 — —Lender waiver or acquiescence in borrower default
- § 6:29 — —Payment
- § 6:30 — —Lender's obligations during foreclosure
- § 6:31 —Foreclosure defenses of parties having junior
interests in the collateral
- § 6:32 — —Classes of claimants
- § 6:33 — —Common defenses

I. METHODS OF FORECLOSURE

- § 6:34 Equity action
- § 6:35 Nonjudicial foreclosure
- § 6:36 Receivership
- § 6:37 Sale by receiver "free and clear"
- § 6:38 Mortgagee-in-possession status
- § 6:39 Agreements between lenders
- § 6:40 Tax consequences of foreclosure—Nonrecourse
foreclosure gain
- § 6:41 —Tax results to borrower
- § 6:42 Deed in lieu of foreclosure

II. ADVANTAGES FOR THE LENDER

- § 6:43 Continuation of construction and sales
- § 6:44 Inexpensive and nonpublic

III. DISADVANTAGES FOR THE LENDER

- § 6:45 Concessions to the borrower

TABLE OF CONTENTS

- § 6:46 May be construed as an equitable mortgage
- § 6:47 Merger and promotion of the interests of junior lienholders
- § 6:48 Preference or fraudulent transfer in bankruptcy

IV. THE TRANSACTION

- § 6:49 Borrower's and lender's conflicting interests
- § 6:50 Preventing merger and preserving lien priority
- § 6:51 Avoiding equitable mortgage construction
- § 6:52 Avoiding bankruptcy problems
- § 6:53 —Special purpose bankruptcy remote entities
- § 6:54 Broker's commissions
- § 6:55 Title insurance
- § 6:56 —Due Diligence When Taking Deed in Lieu
- § 6:57 Lease assumption in lieu of foreclosure
- § 6:58 Workouts with the existing borrower
- § 6:59 —The preworkout agreement
- § 6:60 —Legal audit of a loan default
- § 6:61 —Adjustments to aid the distressed borrower
- § 6:62 ———Loan-term extensions
- § 6:63 ———Interest adjustments
- § 6:64 ———Continued and additional funding
- § 6:65 ———Sources of additional funds
- § 6:66 —Adjustments improving the lender's position
- § 6:67 ———Lender control
- § 6:68 ———Additional collateral and cross-collateralization
- § 6:69 ———Cross-default provisions
- § 6:70 ———Subordination of borrower's profits
- § 6:71 ———Guaranties
- § 6:72 ———Limitations on project scope
- § 6:73 ———Automatic transfer of property to lender without further borrower consent
- § 6:74 ————Cases holding that executory deed transactions are really security transactions requiring foreclosure
- § 6:75 ————Cases holding that executory deed transactions are not equitable mortgages and do not clog the borrower's equity of redemption
- § 6:76 ————Suggestions to improve the likelihood of enforcement of the executory deed transaction
- § 6:77 ———Bankruptcy waivers
- § 6:78 ————Restraints on filing
- § 6:79 ————"Bad faith" stipulations
- § 6:80 ———Automatic stay waivers
- § 6:81 ————Springing Guaranties

- § 6:82 —Springing Guaranties (Nonrecourse Carveouts)
- § 6:83 —The multiple lender workout

V. LEGAL PROBLEMS OF LOAN MODIFICATIONS AND WORKOUTS WITH THE EXISTING BORROWER

- § 6:84 Promoting the priority of subordinate liens and other interests
- § 6:85 Dealing with the circuity of liens problem
- § 6:86 Mortgage has priority over liens
- § 6:87 Lender liability for undue control of borrower's affairs
- § 6:88 Problems of the obligatory advance rule
- § 6:89 Bankruptcy
- § 6:90 Validity and enforceability of an oral workout agreement
- § 6:91 Business problems of loan modifications and workouts with the existing borrower
- § 6:92 The borrower's approach to construction loan workouts
- § 6:93 Tax consequences of workouts
- § 6:94 —Excusing a portion of the mortgage debt
- § 6:95 —Reducing the interest rate
- § 6:96 —Debt-equity swaps and other loan modifications
- § 6:97 When to "board up" distressed real estate
- § 6:98 —Conventional methods of dealing with distressed real estate
- § 6:99 —The measurement criterion for the decision to board up
- § 6:100 Workout strategies for troubled real estate properties
- § 6:101 —Elements of a workout
- § 6:102 —Preparing the workout proposal
- § 6:103 —Presenting the workout plan
- § 6:104 —When workouts fail
- § 6:105 Workouts with a "new borrower"
- § 6:106 —Completion by a "new borrower"
- § 6:107 —Structuring the new-borrower transaction
- § 6:108 —Contract
- § 6:109 —Conveyance to the new borrower with a purchase-money mortgage
- § 6:110 —Performance standards and control for project completion and sale
- § 6:111 Other sources of construction lender recovery after default
- § 6:112 —Election of remedies and single-recovery rules

TABLE OF CONTENTS

§ 6:113	—Actions by participant against lead lender
§ 6:114	— —Participant strategy
§ 6:115	— —Remedies for the participant
§ 6:116	— —Lead-lender strategy
§ 6:117	— —Participations after recovery of collateral
§ 6:118	—Lead lender's pledge of its interest in loan: law governing priority
§ 6:119	—Lender's rights against title insurer
§ 6:120	—Lender's rights against defaulting tenant
§ 6:121	The effect of co-op sponsor default in New York
§ 6:122	—New York's rental market
§ 6:123	—Cooperative conversions
§ 6:124	—Increase in demand
§ 6:125	—Sponsor defaults
§ 6:126	—Effect of default on corporation
§ 6:127	—Solutions for lenders
§ 6:128	— —Offer shares to tenants
§ 6:129	— —Other alternatives
§ 6:130	—Shareholder control
§ 6:131	—Effect on building mortgagee
§ 6:132	Bankruptcy of the construction borrower
§ 6:133	—Involuntary petition filed by lender
§ 6:134	Single asset real estate provisions
§ 6:135	Bankruptcy of the construction borrower—Debtor's threat of cramdown
§ 6:136	— —Classification and voting of claims
§ 6:137	— —Artificial impairment
§ 6:138	— —Fair and equitable
§ 6:139	— — —Value of secured claim
§ 6:140	— — —Interest on secured claim
§ 6:141	—Purchasing claims to block confirmation of a plan
§ 6:142	—The new value exception
§ 6:143	—The insider preference problem
§ 6:144	—Avoidance of foreclosure sale in bankruptcy
§ 6:145	— —Preference law
§ 6:146	—Financing in bankruptcy
§ 6:147	—Construction lender as DIP lender
§ 6:148	— —Further protections for the construction lender
§ 6:149	—Third party DIP financing
§ 6:150	— —Construction lender's right to adequate protection
§ 6:151	—Nondischargeability for fraud
§ 6:152	Release of guarantor's liability in borrower's bankruptcy
§ 6:153	Construction loan fraud and criminal activity

- § 6:154 Lender participation in workouts
- § 6:155 —Structuring the venture
- § 6:156 —Status of the lender's lien
- § 6:157 —Guarding against partnership bankruptcy
- § 6:158 —Other considerations in the workout relationship
- § 6:159 —Governance issues
- § 6:160 —Forbearance agreements
- § 6:161 —Scope of forbearance
- § 6:162 —Limitations
- § 6:163 —Lien priority
- § 6:164 —Borrower concessions
- § 6:165 —Foreclosure agreement between lenders
- § 6:166 —Deed in lieu of foreclosure agreement
- § 6:167 —Escrow agreement for deed in lieu of foreclosure on happening of specified events
- § 6:168 —Loan modification agreement with guarantors' consent
- § 6:169 —Workout agreement—Change in condominium developer
- § 6:170 —Multiple lender workout agreement
- § 6:171 Checklist for a pre-workout agreement
- § 6:172 Construction loan workouts
- § 6:173 Distressed Property: workout agreements
- § 6:174 Development workouts with lenders
- § 6:175 Construction lender remedies

CHAPTER 7. OTHER CONSTRUCTION-FINANCING TRANSACTIONS

- § 7:1 Real estate development without mortgage financing
- § 7:2 —Owner's own funds or nonmortgage borrowing
- § 7:3 —The at-risk limitation for loss deductions
- § 7:4 —Contributions to real estate entities
- § 7:5 —Disbursement of funds
- § 7:6 —Title insurance
- § 7:7 —Disbursement of insurance proceeds
- § 7:8 —Tax benefits from conservation easements—Generally
- § 7:9 —Benefits from conservation easements
- § 7:10 —Regulatory approvals as consideration
- § 7:11 —Scenic easements
- § 7:12 —IRS caution on conservation easements
- § 7:13 —Façade easements under review
- § 7:14 —Third-party equity for developers
- § 7:15 —Pre-construction sales

TABLE OF CONTENTS

§ 7:16	—Taxation of contributions to real estate entities
§ 7:17	—Opportunity funds
§ 7:18	—Private equity funds
§ 7:19	—Understanding investment terminology
§ 7:20	—Mezzanine lending on the rise
§ 7:21	—Historic tax credits provide developer equity
§ 7:22	—More flexible guidelines for historic tax credits
§ 7:23	—Low-income housing credits
§ 7:24	—Introduction
§ 7:25	—New Markets Tax Credit program
§ 7:26	—New Markets Tax Credit and historic preservation
§ 7:27	Tax credits: new program
§ 7:28	Real estate development without mortgage financing—Black box transactions for pre-opening losses
§ 7:29	Lease transactions involving the improvement of landlord's property—Ground leases
§ 7:30	—Reducing equity with leasehold mortgage
§ 7:31	—Negotiating rentals under ground leases
§ 7:32	—Ground rent escalators
§ 7:33	—Effect of rent escalators in unsubordinated ground leases
§ 7:34	—Reducing the risk of rent escalators
§ 7:35	Lease transactions involving the improvement of landlord's—Sample rent escalation clause based on fair market rental
§ 7:36	—Sample rent escalation clause based on fair market value
§ 7:37	Lease transactions involving the improvement of landlord's property—How subordinated land sales help developers
§ 7:38	—Using ground leases to increase return
§ 7:39	—When not to ground lease
§ 7:40	—Leasehold condominiums
§ 7:41	—Commercial leasehold condominiums—Protection from cross-defaults
§ 7:42	—Arrearages caused by direct defaults
§ 7:43	—Commercial leases
§ 7:44	—Build-to-suit lease—In general
§ 7:45	—Lease term
§ 7:46	—Sample commencement date clause
§ 7:47	—Sample substantial completion clause
§ 7:48	—Construction Agreement
§ 7:49	—Rent provisions
§ 7:50	—Synthetic leases

- § 7:51 — —Benefits of synthetic leases
- § 7:52 — —Tax and accounting issues
- § 7:53 — —New rules limit synthetic leases
- § 7:54 —Equity leases
- § 7:55 Manufactured housing sites
- § 7:56 —Land-lease or fee ownership
- § 7:57 —Site selection
- § 7:58 Joint projects with transit agencies
- § 7:59 Nontaxable contributions to capital
- § 7:60 Owner's construction escrow
- § 7:61 Ground-lease provisions for lessee's construction of improvements
- § 7:62 Agreement between developer corporation and corporate property owner to organize real estate corporation
- § 7:63 Covenant by lessee to make prescribed improvements
- § 7:64 Covenant by lessee to make improvements in accordance with approved plans and specifications
- § 7:65 Covenant by lessee to make improvements with cost to be credited against rent
- § 7:66 Covenant by lessee to make improvements to be financed from business profits
- § 7:67 Duty of lessor or lessee to make improvements or alterations required by law
- § 7:68 Compliance with Americans with Disabilities Act
- § 7:69 Mortgage of fee to finance tenant's construction
- § 7:70 Unsubordinated Ground Lease Option
- § 7:71 Letter of intent for joint venture from developer to institutional investor
- § 7:72 Credit tenant leases (CTLs)
- § 7:73 Exchanging real estate: the improvement exchange
- § 7:74 Developer and tenant joint ventures
- § 7:75 Covered bonds

CHAPTER 8. ENVIRONMENTAL RISKS IN CONSTRUCTION FINANCING

- § 8:1 The impact of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980

I. LENDER LIABILITY UNDER CERCLA

- § 8:2 Definition of "owner or operator"
- § 8:3 —The EPA's 1992 lender liability rule
- § 8:4 —The Asset Conservation, Lender Liability and Deposit Insurance Protection Act of 1996

TABLE OF CONTENTS

§ 8:5	Limitations on third-party defense
§ 8:6	Practical effects of CERCLA on loan transactions
§ 8:7	Protective steps for lenders seeking to limit CERCLA liability
§ 8:8	New due diligence standards
§ 8:9	Lending practices to reduce environmental liability— Underwriting and commitment stage
§ 8:10	—Key issues in lender environmental policies
§ 8:11	—Lender's rights when hazard is discovered during the loan term
§ 8:12	—Liens and superliens
§ 8:13	—Joint ventures and equity participation loans
§ 8:14	—Foreclosure deeds or deeds in lieu
§ 8:15	—Public policy
§ 8:16	— —Lender's rights against borrower for hazard discovered during loan
§ 8:17	Existing environmental hazards—Underground storage tanks
§ 8:18	—Uncovering the risk of underground storage tanks
§ 8:19	—Ways to find hidden sources of contamination
§ 8:20	—Asbestos
§ 8:21	—PCB contamination
§ 8:22	—Electromagnetic fields
§ 8:23	Reducing lender risks
§ 8:24	—On-site investigation
§ 8:25	—Allocation of risk to borrower and seller
§ 8:26	—Environmental liability insurance
§ 8:27	— —Comprehensive general liability insurance
§ 8:28	— —First-party property insurance
§ 8:29	— —Environmental coverage by traditional policies
§ 8:30	— —Pollution exclusion
§ 8:31	— —Pollution exclusion changes
§ 8:32	— —Environmental impairment liability policies
§ 8:33	— —Liability insurance for contractors and architects
§ 8:34	— —New insurance products
§ 8:35	— —Key Issues in Lender Policies
§ 8:36	—Periodic review of the borrower's operations
§ 8:37	—Title insurance
§ 8:38	—Foreclosure
§ 8:39	Conducting an environmental assessment
§ 8:40	—Environmental assessments for commercial loan portfolios
§ 8:41	— —Revised ASTM standard
§ 8:42	—Selection and effective use of environmental consultants

- § 8:43 — —How to select a consultant
- § 8:44 — —Preparing a request for proposals
- § 8:45 — —Reviewing responses to requests for qualifications/proposals
- § 8:46 — —Negotiating the agreement
- § 8:47 — —Managing the consultant
- § 8:48 —Environmental audits by lenders
- § 8:49 —ASTM standard for environmental assessments in commercial real estate
- § 8:50 — —The transaction screen process
- § 8:51 — —Phase I environmental site assessment process
- § 8:52 — —ASTM Standard Report Format
- § 8:53 — —Impact of the new ASTM standards
- § 8:54 — —Bona fide purchaser defense
- § 8:55 —Liability of borrower's negligent assessor to lender
- § 8:56 Environmental hazards in appraisal reports
- § 8:57 Duty of developer to disclose off-site environmental conditions
- § 8:58 Lender concerns in brownfields redevelopment—The brownfields problem and opportunity
- § 8:59 —Encouraging brownfield development
- § 8:60 —State brownfields programs
- § 8:61 — —State cleanup programs
- § 8:62 — —Statutes that eliminate all or most lender liability under a state's environmental laws
- § 8:63 — —Lender liability protections specific to state brownfields cleanup statutes
- § 8:64 — —Lender liability for contaminated real estate
- § 8:65 —Federal initiatives that limit lender liability: EPA initiatives
- § 8:66 —Insuring against liability
- § 8:67 —Brownfield Redevelopment Associations
- § 8:68 —Direct grants and liability protection for developers
- § 8:69 —Financing cleanups with federal programs
- § 8:70 Preliminary environmental risk review questionnaire and disclosure statement
- § 8:71 —Environmental inspection easement
- § 8:72 —Environmental indemnity agreement
- § 8:73 —Environmental services agreement

CHAPTER 9. UNIFORM LAWS, PUBLIC POLICY, AND TAX ISSUES AFFECTING THE CONSTRUCTION LENDER

- § 9:1 The Uniform Acts

TABLE OF CONTENTS

§ 9:2	—The Uniform Land Transactions Act
§ 9:3	—The Uniform Simplification of Land Transfers Act
§ 9:4	State legislation
§ 9:5	Public policy and the role and responsibility of the construction lender
§ 9:6	Tax issues affecting the construction lender
§ 9:7	—Deduction for sales taxes
§ 9:8	—Rehabilitation tax credit
§ 9:9	——Active and passive rehabilitation credits
§ 9:10	——Combining rehabilitation credit with depreciation write-offs
§ 9:11	——Tenant rehabilitation expenditures
§ 9:12	——External and internal wall requirements
§ 9:13	——Requirement of substantial rehabilitation
§ 9:14	——Rehabilitation of historic structures
§ 9:15	——Effective date and transition rule
§ 9:16	——Example of rehabilitation credit
§ 9:17	——Audit technique guide
§ 9:18	———Substantial rehabilitation
§ 9:19	———Basis and depreciation
§ 9:20	———Eligible expenditures
§ 9:21	———Historic structure rehabilitations
§ 9:22	———Increasing popularity of rehab tax credit
§ 9:23	———Rehab credit and passive loss rules
§ 9:24	——Rehabbing the suburbs
§ 9:25	—Modified percentage-of-completion method of accounting
§ 9:26	—Tax implications of participating mortgages
§ 9:27	—Taxation of real estate syndicates
§ 9:28	—Federal income tax consequences of foreclosure
§ 9:29	—Tax benefits of dedicating open space
§ 9:30	—Façade easements
§ 9:31	—Passive-loss limitations eased for real estate developers
§ 9:32	—Tax-efficient design and construction
§ 9:33	—Charitable deduction for gifts of land
§ 9:34	—Depreciating land preparation costs
§ 9:35	—Improvements qualifying for 50 percent depreciation
§ 9:36	—Depreciation allowed for building variance costs
§ 9:37	—Capital contribution not taxable income
§ 9:38	—Capitalizing property taxes during construction
§ 9:39	—Capitalizing interest payments during construction
§ 9:40	——Maximizing interest deductions
§ 9:41	—Contribution to water or sewage utility
§ 9:42	—Tax Credits and Bond Ceilings Rise

- § 9:43 —Housing tax credit study shows successes
- § 9:44 —Taxation: deferral of COD income
- § 9:45 Tax consequences of common improvements affecting the developer
- § 9:46 —General method
- § 9:47 —Alternative cost method
- § 9:48 Americans with disabilities act: Effect on real estate
- § 9:49 Compliance with the Americans With Disabilities Act
- § 9:50 —Disability discrimination
- § 9:51 —Removal of barriers
- § 9:52 —New building accessibility
- § 9:53 Compliance with the Americans with Disabilities Act—
New building accessibility—Inaccessible apartments
- § 9:54 —Meeting apartment accessibility requirements
- § 9:55 Compliance with the Americans With Disabilities
Act—Structural impracticability
- § 9:56 Compliance with the Americans with Disabilities Act—
Existing facilities
- § 9:57 Compliance with the Americans With Disabilities
Act—Tax deductibility
- § 9:58 —Cost of the Americans With Disabilities Act to com-
mercial realty
- § 9:59 ——Compliance requirements
- § 9:60 ——Allocation of responsibility
- § 9:61 —Foreclosure planning under the Americans With
Disabilities Act
- § 9:62 ——Barrier removal
- § 9:63 ——Alterations
- § 9:64 ——New construction
- § 9:65 ——Tenant compliance responsibility
- § 9:66 Final guidelines under the Fair Housing Amendments
Act
- § 9:67 —Effect on condominium developers
- § 9:68 —The effect of the Fair Housing Amendments Act on
condominium developers
- § 9:69 Special tax districts for financing infrastructure
construction
- § 9:70 —Creating a special tax district
- § 9:71 —Disadvantages of special tax districts
- § 9:72 —Comparing special tax districts with other financing
devices
- § 9:73 Dispute resolution in the construction industry
- § 9:74 —Advantages of arbitration
- § 9:75 —Techniques to avoid disputes
- § 9:76 ——Dispute resolution board

TABLE OF CONTENTS

- § 9:77 — —Partnering
- § 9:78 —Substantial completion in arbitration award
- § 9:79 —Construing Arbitration Clauses
- § 9:80 Securities law issues in real estate finance
- § 9:81 —Real estate interests as securities
- § 9:82 —Controlling person liability
- § 9:83 —Liability for aiding and abetting
- § 9:84 —Qualifying for the Intrastate Offering Exemption
- § 9:85 Affordable housing—Altering permit requires evidence of impact on proposed development
- § 9:86 “Green building”
- § 9:87 Fair Housing Act—design and construction claims
- § 9:88 Condominium subject to Land Sales Disclosure Act
- § 9:89 American Recovery and Reinvestment Act of 2009
- § 9:90 Vested rights doctrine
- § 9:91 Build America Bonds

APPENDICES

- APPENDIX A. Requirements for Plan Confirmation Under Bankruptcy Code
- APPENDIX B. Determination of Plan’s Fairness Under Bankruptcy Code
- APPENDIX C. The Americans with Disabilities Act of 1990 Title III—Public Accommodations and Services Operated by Private Entities

Table of Cases

Index

Chapter 5

The Construction Loan “Takeout” or Permanent Loan

§ 5:1 Definition and function of the takeout

I. TYPES OF TAKEOUTS

- § 5:2 Construction lender converting to intermediate- or
* long-term lender
- § 5:3 Long-term amortizing loan by a “permanent lender”
- § 5:4 —Accrual loans
- § 5:5 — —Case study
- § 5:6 —Debt service coverage ratios and rising interest rates
- § 5:7 Intermediate-term loan
- § 5:8 —Mini-perm rollovers
- § 5:9 Standby commitments
- § 5:10 —Underwriting guidelines
- § 5:11 — —Case study
- § 5:12 —Mortgage commitment issues for borrower
- § 5:13 Gap loans
- § 5:14 —The mezzanine loan
- § 5:15 — —The growth of mezzanine
- § 5:16 — —Rating mezzanine loans
- § 5:17 — —Mezzanine financing exit strategies
- § 5:18 —Preferred equity
- § 5:19 —How subordinate debt impacts senior debt rating
- § 5:20 — —Intercreditor agreement
- § 5:21 Sale of the completed project as the takeout
- § 5:22 Sale-leasebacks
- § 5:23 —Tax problems in sale-leasebacks
- § 5:24 —Recharacterization in state court or bankruptcy
- § 5:25 Joint ventures
- § 5:26 —Interim joint ventures
- § 5:27 —Tenant-developer joint ventures (equity leases)
- § 5:28 —Landowner-developer joint ventures
- § 5:29 — —Example of a residential subdivision joint venture
- § 5:30 — —The joint venture agreement
- § 5:31 —Breaking joint venture deadlocks
- § 5:32 —Joint ventures between developers

- § 5:33 Outright sale
- § 5:34 Sale to partnerships
- § 5:35 Standby commitments
- § 5:36 —Types of standbys
- § 5:37 —Bankable standby commitments
- § 5:38 Forward commitment with two-tier participation
- § 5:39 Life company mortgage loans
- § 5:40 Breach of a mortgage commitment
- § 5:41 Equity standby commitments
- § 5:42 —Use of an equity standby commitment
- § 5:43 —Terms of the equity standby
- § 5:44 —Lender's perspective
- § 5:45 —Developer's perspective
- § 5:46 —Equity standby investor's perspective
- § 5:47 Case study of equity/debt financing
- § 5:48 —"Phantom equity" approach
- § 5:49 —Financing plus joint venture
- § 5:50 —Sale and leaseback
- § 5:51 —Straight joint venture
- § 5:52 —Straight sale
- § 5:53 Negotiating with a securitizing lender
- § 5:54 —The rating process for mortgage securities
- § 5:55 —Rating construction loans for securitization
- § 5:56 —Disadvantages of securitization
- § 5:57 —Special provisions required by securitizing lenders
- § 5:58 — —Credit tenant lease loans
- § 5:59 Yield maintenance premiums
- § 5:60 —Enforceability under state law
- § 5:61 Yield maintenance premium—Enforceability in
Bankruptcy
- § 5:62 Sample yield maintenance premium provision
- § 5:63 Refinancing conduit loans
- § 5:64 The construction lender's business and legal
relationship to the takeout lender
- § 5:65 —Review and administration of the takeout
commitment
- § 5:66 —Takeout provisions to be avoided
- § 5:67 —Administration of the takeout as construction
progresses
- § 5:68 — —Construction lender duty to reveal financial data
- § 5:69 —Legally linking the takeout lender to the
construction lender
- § 5:70 — —The tri-party or buy-sell agreement
- § 5:71 — —Assignment of permanent loan commitment to
construction lender

- § 5:72 — —Permanent loan commitment issued directly to construction lender
- § 5:73 — —Construction lender's relationship to a takeout investor committing to make an equity investment
- § 5:74 — —Construction lender's relationship to a takeout lender that is also an equity owner of the property
- § 5:75 — —Quadripartite agreements
- § 5:76 — —Construction lender's enforcement of the permanent loan commitment
- § 5:77 — —Borrower's enforcement of the permanent loan commitment—Defenses of lender
- § 5:78 — —Resolving disputes between borrower and lender
- § 5:79 — —Borrower's claim of economic distress
- § 5:80 Transferring the loan to the takeout lender
- § 5:81 Delivery of a loan to a permanent lender (assuming that the same set of mortgage documents will be used)
- § 5:82 Tri-party agreement
- § 5:83 Equity funding conditions letter
- § 5:84 Quadripartite agreement—With convertible loan documents
- § 5:85 — —Without convertible loan documents
- § 5:86 Escrow agreement for construction loan delivery to permanent lender
- § 5:87 Representation and estoppel certificate of construction lender and borrower to permanent lender
- § 5:88 Construction lender's attorney's legal opinion to permanent lender
- § 5:89 Letter of intent to make a permanent loan

Research References

Treatises and Practice Aids

Bruner and O'Connor on Construction Law, Ch 8

Law Reviews and Other Periodicals

"Financing: Construction Lender Need Not Reveal Financial Data to Takeout Lender," 30 Real Estate Law Report 5 (Nov. 2000)

KeyCite®: Cases and other legal materials listed in KeyCite Scope can be researched through the KeyCite service on Westlaw®. Use KeyCite to check citations for form, parallel references, prior and later history, and comprehensive citator information, including citations to other decisions and secondary materials.

§ 5:1 Definition and function of the takeout

The "takeout" is the loan or other financial arrangement for