

Building a Good Construction Loan Agreement

Presented by **Laura S. Peck** | 608.283.6729 | lpeck@axley.com

There are several loan documents unique to Construction Loan Projects, including a collateral assignment to the Lender of Borrower's rights in and to the construction contracts, permits and plans and specifications. We will focus on the agreements governing the loan disbursement process and the construction loan covenants of the Borrower. Can a Lender simply rely on the Construction Loan Disbursing Agreement provided by most title companies disbursing the funds?

1. Construction Disbursing Agreements – Title Company

- a. Construction Disbursing Agreements are typically stand alone agreements required by the Title Company to detail the logistics and the requirements of construction draw process.
- b. Parties are generally the Borrower, Lender and Title Company
- c. Others providing construction services such as Architect and General Contractor may be required to provide documentation as well
- d. Provisions typically include:
 - i. Lender's approval of title
 - ii. Architect/GC and Owner's list of all construction contracts, contractors and subcontractors, description of services and materials to be provided by each, and construction budget
 - iii. Details of the Process, timeline and requirements for each draw – e.g. the standard American Institute of Architect's (AIA's) draw request form with all attachments; lien releases (prospective or retroactive 30 day delay) for all contractors to be paid from the draw; funds from Lender sufficient to cover the entire draw (providing funds generally considered Lender's "approval" of the draw); hard cost expenditures do not exceed the progress of construction on a percentage of completion basis
 - iv. Inspection of site to verify work done and materials installed
 - v. Timing of funding and limit of # of draws – one per month; # total draws expected
 - vi. Fees or charges for each draw including title bring down and endorsement charges
 - vii. Escrow provisions and Title Company /Disbursing Agent protections

2. Construction Loan Lender Protections that may be missing from or incomplete in the Title Company form:

- a. Typically these provisions can be entered into as a separate Construction Loan Agreement or an addendum to the Construction Disbursing Agreement
- b. May an agreement between the Borrower and the Lender, but Title Company should be provided a copy and aware of its provisions if it is not made a part of or appended to the Construction Disbursing Agreement
- c. Borrower Representations and Warranties:
 - i. Plans and Specifications provided to Lender are a complete and final set of all plans and specifications required;

continued



- ii. Final budget has been approved by Lender, setting forth all line items of categories of costs
- iii. True and correct copies of all construction contract, architect's contract, and engineer's contract, and any subcontracts have been delivered to the lender;
- iv. Architect certification that Plans and Specs and the intended use of the Project comply with all applicable laws, ordinances, and regulations;
- v. All utilities and access necessary for the construction, use, operation, and maintenance of the Project are available through public or private easements
- vi. All permits, certificates, and authorizations required for construction and use of the project have been obtained;
- vii. No labor has begun or materials furnished or contract executed that could give rise to a lien against the Project, for which lien waivers have not been obtained

d. Loan covenants

- i. Use of Loan Proceeds solely to construct the Project; and at the time of each draw request that no default exists under the Loan Documents
 - ii. Construction of the Project shall be made in accordance with the final approved Plans and Specs and shall be complete by a certain Completion Date;
 - iii. Final Disbursement Date set after which Lender shall have no obligation to disburse any Loan Proceeds (usually a few months later to facilitate certificates of Occupancy, punch lists and winding up of Final Lien Waivers.
 - iv. Begin construction by a certain date and diligently pursue to completion; the Project remains on schedule at each draw
 - v. No material alterations of Plans and Specs without prior Lender approval
 - vi. No line item of the Budget shall be exceeded without Lender's prior written consent; loan must remain "in balance" - total advances will not exceed the maximum loan amount
 - vii. Limits on developer's fees; salaries and overhead of developer or affiliate
 - viii. Required surveys (foundation, and final as-built)
 - ix. Required construction-specific insurance and risk mitigation not typically required in mortgages
 - x. Lender (as opposed to Title Company disbursing agent) inspection timeframes
 - xi. Retainage requirements to protect lender and borrower from overruns and ability to get final lien waiver
 - xii. Materials stored on jobsite and security measures
 - xiii. Correction of any construction defects and remedies of Lender
 - xiv. Acceptable Borrower contacts authorized to sign for and request draws
 - xv. Borrower agreement to provide estoppel upon request stating progress of Project
 - xvi. Requirements for final disbursement including c/o, final lien waivers from all contractor and suppliers, final as-built survey, Borrower/architect/inspector certification that Project completed in accordance with final Plans and Specs and in compliance with all laws; approval and acceptance by any major tenant; and permanent property and casualty insurance.
- e. Remedies of Lender; notice, default and cure rights

CONSTRUCTION LOAN ESCROW AGREEMENT

Escrow No.:

Date:

Refer to:

To: First American Title Insurance Company, Escrowee

At the request of _____ hereinafter referred to as "Owner/Borrower", _____, hereinafter referred to as "Lender", will deposit with you at intervals and in installments to be determined by the Lender and the Borrower, \$ _____ being the proceeds of a first mortgage in the amount of \$ _____, covering land located in _____ County, Insert State and described as:

(See Commitment No. NCS-XXXXXX-MAD)

Commonly known as: Insert Project Legal/address

As Escrowee, you are authorized and directed to disburse the funds hereunder pursuant to statements of amounts due, approved by the Owner/Borrower, after obtaining such releases and satisfactions of mechanic's liens or waivers of mechanic's liens and sworn statements of the general contractor, subcontractors and material suppliers required by First American Title Insurance Company for the purpose of providing the insurance coverage herein specified.

The Inspector/Architect is _____ and the General Contractor is _____.

There will be monthly disbursements, which are to be made in accordance with the terms and conditions of this escrow as hereinafter set forth.

- I. Prior to the first disbursement of funds hereunder, the following are requirements of this escrow, to wit:
 - A. The Escrowee shall be furnished:
 1. An approval by the Lender of the condition of title to the premises described above;
 2. An approval by the Lender for loan disbursement purposes of the owner's statement and the general contractor's statement, which are provided at IA3 and IA4 below;
 3. A signed Owner's statement disclosing the various contracts entered into by the Owner and setting forth the names of the contractors, their addresses, work or materials to be furnished, amounts of the contracts, amounts paid to date, amounts of current payments and balances due;
 4. A signed General Contractor's statement setting forth in detail all contractors and material suppliers with whom he has contracted, their addresses, work or material to be furnished, amounts of the contracts, amounts paid to date, amounts of current payments and balances due.
 - B. The Escrowee shall be prepared to furnish to the Lender an ALTA Loan Policy covering the recording date of the above mortgage and showing the Lender as the insured. Said Policy shall contain no exception for any lien or right to lien for services, labor, or material imposed by law and not shown by the public record.

II. Prior to each disbursement of funds hereunder, it is a requirement of this escrow that the Escrowee be furnished:

- A. An approved Owner's statement disclosing the various contracts entered into by the Owner and setting forth the names of the contractors, their addresses, work and materials to be furnished, amounts of the contracts, amounts paid to date, amounts of current payments and balances due;
- B. A signed General Contractor's statement setting forth all contractors and material suppliers with whom he has contracted, amounts of contracts, amounts paid to date, amounts of current payments and balances due;
- C. A written approval by the Owner/Borrower of the requested disbursement;
- D. A report by the Inspector or a certification by the Architect certifying that work has been completed and materials are in place as indicated by the request for payment of the General Contractor. Said inspection is to be made and submitted by ;
- E. Sufficient funds to cover the requested disbursements and to pay for extras or change orders for which waivers have not been deposited and for which funds have not previously been deposited;
- F. Statements, waivers, affidavits, supporting waivers and releases of lien from such persons and in such form as may be required by First American Title Insurance Company for the purpose of providing the title insurance coverage specified herein;
- G. All required documentation for the final draw request must be submitted to the Escrowee prior to any disbursements of the final draw.

III. All disbursements for construction purposes will be made by the Escrowee **directly to the General Contractor and/or Subcontractors as Escrowee and/or Lender may determine OR directly to the General Contractor, Subcontractors, vendors/suppliers and owner reimbursement.** In the event that the General Contractor and any subcontractor jointly authorize the Escrowee to pay any funds due one to the other, the Escrowee may comply with such authorization. However, it is the intention of the parties named herein and signatories hereto that no person not a party signatory to this escrow shall have the right to look to the Escrowee for any disbursement hereunder, under a third party beneficiary theory or otherwise, and that the Escrowee owes no duty to any such third party to make any disbursement.

IV. As the Escrowee makes a partial disbursement of mortgage proceeds hereunder, it will furnish the Lender the First American Title Insurance Company Endorsements, aforesaid, covering each requested disbursement.

V. If at any time during the course of construction the total of the unpaid disclosed cost of construction as indicated by the column totals on the General Contractor's signed statement exceeds the amount of the undisbursed mortgage proceeds as calculated by subtracting the total amount of liability taken on the endorsements from the face amount of the mortgage, the Escrowee need not make further disbursements under the terms of this escrow until the Owner/Borrower has deposited in this escrow the sum necessary to make the available funds equal to the unpaid disclosed cost of construction, unless specifically directed to do so by the Lender. Also, if Escrowee discovers a misstatement in an affidavit furnished by General Contractor or Owner/Borrower, it may stop disbursement until the misstatement has been corrected. First American Title Insurance Company has no liability hereunder to the Owner/Borrower relating to protection against mechanic's lien claims.

VI. The functions and duties assumed by First American Title Insurance Company include only those described in this agreement, and the Escrowee is not obligated to act except in accordance with the terms and conditions of this escrow. First American Title Insurance Company does not insure that the building will be completed nor does it insure that the building, when completed, will be in accordance with plans and specifications, nor that sufficient funds will be available for completion, nor does it make the certifications of the Inspector/Architect its own, nor does it assume any liability for same other than procurement as one of the conditions precedent to each disbursement.

VII. Bill all title and escrow charges to the owner. Escrow fees are payable when billed. If escrow fees are not paid within fourteen (14) days of billing, Escrowee may cease making any further disbursements until escrow fees have been paid.

VIII. General Conditions: At any time prior to its commencement of disbursement of funds hereunder, the Escrowee reserves the right to decline commencement of disbursement of funds, if First American Title Insurance Company declines any risk offered for insurance hereunder, whereupon Escrowee shall return to Lender any documents in its possession relating to such loan and the funds received by it. Commencement of disbursement makes this agreement effective as to all funds received and disbursed on the construction in question.

Where, after the first disbursement, a further title search reveals a subsequently arising exception over which First American Title Insurance Company is unwilling to insure, Escrowee will notify the Lender and may discontinue disbursement until the exception has been disposed of to the satisfaction of the Lender.

A mechanic's lien claim over which First American Title Insurance Company is required to insure hereunder does not warrant a discontinuance of disbursement.

Escrowee has no liability for loss caused by an error in the certification furnished it hereunder as to work in place.

Escrowee shall not be responsible for any loss of documents or funds while such documents or funds are not in its custody. Documents or funds deposited in the United States mail shall not be construed as being in custody of the Escrowee.

In the event of default as declared by the Lender and/or foreclosure by the Lender, Escrowee shall have the right to discontinue further disbursements under this agreement.

Interest, income or other benefits, if any, earned or derived from the funds deposited shall belong to First American Title Insurance Company, First American Title Insurance Company may deposit all funds received hereunder to one or more of its general accounts. First American Title Insurance Company shall be under no duty to invest or reinvest any funds, at any time, held by it pursuant to the terms of this agreement.

IX. The undersigned agree that this Construction Loan Escrow Agreement is not intended by any of the undersigned to give any benefits, rights, privileges, actions or remedies to any person, partnership, firm or corporation other than First American Title Insurance Company, _____ (Lender), and _____ (Owner/Borrower), as a third party beneficiary or otherwise under any theory of law.

Lender:	Owner/Buyer:
By: _____	By: _____
Its: _____	By: _____

Accepted: First American Title Insurance Company
National Commercial Services, Escrowee

By: _____

Name: _____ Office: _____

General Contractor:

The undersigned acknowledges that he/she is neither a party to the Construction Loan Escrow Agreement, nor does that agreement confer any benefits, rights, privileges, actions or remedies to any person, partnership, firm or corporation other than First American Title Insurance Company, _____ (Lender), and _____ (Owner/Borrower), under a third party beneficiary theory or otherwise under any theory of law.

The undersigned agrees that the improvements referred to in the escrow agreement will be constructed and completed in strict accordance with the plans and specifications and the building contract. The undersigned also concurs in the above escrow instructions signed by the Owner/Borrower and the Lender or their representatives.

For the General Contractor

**ENDORSEMENT
ISSUED BY**

First American Title Insurance Company

Attached to Policy No. NCS-533454-MAD

CONSTRUCTION LOAN DISBURSEMENT ENDORSEMENT

The Date of Policy is amended to .

Previous Amount of Insurance \$.

Increase in Amount of Insurance \$.

The Amount of Insurance is amended to \$.

Schedule B is amended as follows:

This Endorsement is made a part of the Policy and is subject to all of the terms and provisions thereof and of any prior Endorsements thereto. Except to the extent expressly stated, it neither modifies any of the terms and provisions of the Policy and any prior Endorsements, nor does it extend the effective date of the Policy and any other prior Endorsements, nor does it increase the face amount thereof.

First American Title Insurance Company

By: _____
Authorized Signature

Dated: