

Presented:

The University of Texas School of Law
47th Annual William W. Gibson, Jr. Mortgage Lending Institute

September 19-20, 2013, AT&T Conference Center, Austin, TX
October 10-11, 2013, Belo Mansion, Dallas, TX

**Risk vs. Reward: Lender Concerns
When Making Loans to
Condominium Developers
and Condominium Associations**

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A natural conflict arises between lenders and borrowers in any real estate transaction. This paper deals specifically with the conflicts between lenders, on the one hand, and developers or condominium associations as borrowers, on the other hand. These are often complex transactions, and an analysis of what lenders must consider, not only for practical purposes but also for compliance under state and federal law, in connection with what developers and associations as borrowers must be prepared to deliver in any loan transaction, is an essential issue for all parties involved, and is the subject of this paper.

I. LOANS TO DEVELOPERS: LENDER CONCERNS

Developers want to move quickly and are more willing to take risks. Lenders are more likely to move slowly, want to hedge risk, and seek the conservative route. The below list is a brief summary of concerns that lenders of mixed-use developments are likely to raise when entering into a loan transaction with a developer as a borrower. This list offers lenders a summary of considerations they should take into account, and also puts developers on notice of issues their lenders are likely to raise, so developers can attempt to address these concerns up front.

A. Financibility

The ability to obtain financing is the primary factor that drives the growth of mixed-use developments. Lenders typically prefer to finance a property that is used for a distinct purpose because the cash flow is easier to underwrite. However, if a property is structured as a condominium that has been subdivided by use, a developer has access to a larger number of permanent lenders. Thus, a mixed-use condominium that is properly structured and clearly presented in its formative legal documents should allow permanent lenders who are familiar with mixed-use structures to become comfortable with the project as whole.

B. Lien Priority

Also concerning for lenders is the fact that the deed of trust lien is customarily subordinated to the condominium declaration, and consequently, the assessment lien in favor of the condominium association (the “Association”) has priority, which preserves the condominium regime in the event the lender's lien is foreclosed. However, the Texas Uniform Condominium Act (the “Act”) protects construction lenders by providing that an Association's assessment lien does not have priority over a first lien deed of trust that is recorded prior to the date on which an assessment the Association seeks to enforce *becomes delinquent*.¹ Therefore, as long as the lender's deed of trust is recorded before the developer has conveyed any units, the lender will be protected because the Association will not yet have levied any assessments.

A lender should also execute and record a written consent to the condominium declaration. Although the lender retains its ability to foreclose its lien on the property, the lender takes the property subject to the rights created in the condominium declaration and other documents governing the condominium and the Association (the “Governing Documents”), including the right of the Association to levy assessments for common expenses against unit owners for operation and maintenance of the condominium. Typically, lenders scrutinize these assessment provisions, particularly those which allow the Association to place a lien on a unit if the unit owner fails to pay assessments. If a lender files its consent after the filing of the condominium declaration, its lien will be subordinate to the Association's lien for delinquent assessments, and therefore, the lender should require an estoppel certificate from the Association certifying that there are no delinquent assessments in relation to the condominium. Critically, if no consent is ever filed, a foreclosing lender runs the risk of inadvertently creating a tenant-in-common ownership structure that is governed only by common law.

C. Right to Notice and Cure

A developer should expect that its lender will want to receive notice in situations such as: (i) damage to or threatened condemnation of units or the common elements; (ii) default by a unit owner in the payment of assessments or the payment of taxes on a unit; (iii) a lapse, cancellation

¹ TEX. PROP. CODE § 82.113(b)(3).

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First appeared as part of the conference materials for the
47th Annual William W. Gibson, Jr. Mortgage Lending Institute session
"Construction Lending to the Condo and Common Interest Community Developer"