SAMPLE ANCILLARY CONSTRUCTION LOAN DOCUMENTS:
OVERVIEW OF KEY ISSUES AND DISCUSSION OF DOCUMENTS

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MORTGAGE LENDING INSTITUTE
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Luke E. Kraus
745 E. Mulberry Avenue, Suite #550
San Antonio, Texas 78212
www.BartonBensonJones.com
Telephone: 210.610.5335
Email: lkraus@bartonbensonjones.com

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I. Introduction

This paper accompanies a PowerPoint presentation as well as sample marked-up pages from construction loan documents. Specifically, two common ancillary loan documents are discussed – a collateral assignment of construction contract and a collateral assignment of property management agreement. Also discussed are certified borrowing resolutions. This presentation focuses on the considerations a borrower's counsel should keep in mind upon the initial receipt and markup of draft collateral assignments from the lender. As the lender typically prepares the initial draft of the collateral assignment, borrower's counsel will have the initial pass at revising it. This presentation also provides context for where these ancillary loan documents fit in with primary construction loan agreement. Further, common suggested revisions are highlighted, taken from example collateral assignments. At the end of this paper, excerpts from those redlined collateral assignments are included.

II. The Parties

In the interest of providing context to the sample excerpts, this the focus will primarily be on a representative deal with certain characteristics. Here, the borrower is the real estate developer in the process of building a multifamily building on an empty parcel of land. Legally, the borrower may be special purpose entity created for the sole purpose of purchasing and developing a piece of raw land. This special purpose entity may consist of the primary developer and any investor members.

On the other side of the of the deal is the lender who will be providing a significant piece of the funding. The lender requires ancillary loan documents to protect its interests in case the deal goes south and it is compelled to exercise its rights to step into the borrower's shoes.

Lastly, there are third parties. These third parties (vendors) have contracts with the borrower to assist in a certain aspect of the development. This presentation focuses on two specific third parties: the contractor and the property manager. In addition to those third parties, any similar ground-up development may include an architect and engineer – each of whom will be consent to similar collateral assignments. The provisions of those collateral assignments will have many similarities as those for the contractor and property manager discussed in this presentation.

As a primary document to fund the borrower's payment to these third parties to develop the vacant land, the borrower is in negotiations to obtain funding from the lender. Typically, this funding is obtained through a construction loan agreement. The terms of the construction loan agreement are beyond the scope of this presentation. The collateral assignments are typically negotiated at the same time. For that reason, in addition to the specific considerations a borrower's counsel should take for each collateral assignment, a borrower's counsel must keep the primary contract – the construction loan agreement – in mind when reviewing and marking up collateral assignments.

Defined terms should be consistent. When possible, reference to the construction loan agreement may be made in collateral assignments to simplify documents and reduce the chance for error.

III. Who is the Client?

There are two typical types of borrower clients. In what is becoming the more common situation in Texas, there is the vertically integrated borrower-developer. The vertically integrated developer has separate legal entities that it directly controls, i.e. the developer has its own property-manager business unit, contractor business unit, etc. In this situation, borrower's counsel is representing the developer as well as those vertically integrated third parties. This can simplify matters, but it may also put those third parties (and the controlling borrower) in an awkward situation if the lender exercises its rights under the construction loan agreement and collateral assignments.

In other cases, the third parties will be true independent companies that are not affiliated with the borrower. It is very likely at least the engineer and architect will be independent. With independent third parties, they will likely be represented by their own counsel. More time may be required to negotiate the collateral assignments, and borrower's counsel may take a slightly different perspective with respect to certain contract terms.

IV. The Collateral Assignment?

A collateral assignment is a *conditional* assignment. Most assignments assign rights and obligations on a date certain on or after they are fully executed. Collateral assignments do not. While many terms of a standard contract are contingency plans for when unlikely events occur, collateral assignments are completely contingency related, primarily for the future benefit of the lender but also for that of the third parties.

In the event of a default by the borrower, the lender may exercise its rights under the construction loan agreement (and related documents excluding the collateral assignments). Further, the lender may exercise its rights under the collateral assignments to step into the shoes of the borrower. This is the essence of the purpose of the collateral assignment – to provide protection to the lender in the event it takes over the development. After a borrower default, the lender desires to as quickly as possible begin to manage (and pay) the third parties that are helping develop the land in order to ensure continued development.

From the borrower's perspective, the collateral assignment is necessary largely because the lender requires it. The borrower certainly wishes the lender never exercises its rights under the collateral assignments. Therefore, borrower's counsel, when negotiating collateral assignments, should consider doing what it can to limit the lender's power to exercise its rights in the collateral assignments (as well as limiting lender's rights to declare events of default in the construction loan agreement). Borrower's counsel should closely analyze cure periods and the specific timing of when actions turn into an event of default that can lead to adverse action by the lender.

From the vertically integrated borrower's perspective, the collateral assignments also serve the purpose of clarifying the potential future relationship between the third parties and the lender (and potential future new owners of the property, as the lender is unlikely to be in a position to manage

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