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| Construction Lenders Risk Management Roundtable |
| Construction Disbursements |
| Draft White Paper |
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| **CLRM Roundtable** |
| **October 19, 2018** |

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| A summary of construction loan disbursement practices. It is recognized that disbursement requirements will vary depending on a wide array of considerations. This document is not intended to imply requirements for any particular approach. |



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# Stakeholders

Disbursement monitoring and controls can provide significant value to all stakeholders, but are conducted by the lender for their sole use and benefit. Loan agreements should clearly prohibit third-party reliance on monitoring and controls conducted by the lender.

Stakeholders within the lending organization include:

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| * Stockholders and Investors * Senior management * Credit Admin | * Business Line * Originator * Loan Servicing |

Third-parties may wish to undertake independent monitoring and control in order to protect their interests. A partial list of third-parties is provided below.

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| * Owners and Developers * Investors * Participating lenders * Other lenders * Agencies * Housing authority * Bridge and take-out lenders * Borrowers and their investors * Sellers * Contractors * Subs and suppliers * Project architect/designers | * Buyers * Tenants * Regulators (OCC, FDIC, FED...) * Municipalities and Communities * Title companies * Insurers * Funds control providers * Construction Managers * Designers * Assessment Districts * Surety companies |

# Objectives of Construction and Disbursement Monitoring

The interests of stakeholders can vary. Each stakeholder is responsible to perform an independent evaluation to protect their interests. Evaluation, disbursement monitoring and controls conducted by the lender are intended to:

## Protect assets of the bank

* + Get a completed, lien-free piece of collateral that matches the as-complete description from appraisal
  + Identify deviations from agreed improvements, cost and schedule early in the process
  + Evaluate conformance with the agreed schedule
  + Assure remaining funds are adequate for completion of the work.
  + Identify and evaluate change orders (design, cost, schedule)
  + Monitor and evaluate soft costs disbursements

## Assure conformance with

* + Regulations
  + Loan docs
  + Policies and procedures

# Disbursements

Disbursements may be made by the lender or funds control company to the borrower or direct to the general contractor, or subs and suppliers at the discretion of the lender.

## Borrower Responsibilities

Borrowers are fully responsible for the management of construction, approval of improvements, changes and disbursements. Lenders typically reserve the right to control disbursements may impose additional requirements; however, all controls imposed and oversight performed by or on behalf of the lender is for the lender’s sole benefit and may not be relied upon by the borrower, investors, tenants or others.

When submitting disbursement requests, borrowers are frequently asked to

* Provide supporting documentation
* Notify the lender of and request changes to improvements, budgets and schedules
* Request and authorize specific disbursement amounts from specific loan budgets
* Release the lender from liabilities
* Reaffirm reps and warrants
* Provide information concerning sales and leasing activity
* Provide disbursement instruction

## Disbursement Requests

Construction disbursement can be managed in many ways. The required documents and degree of monitoring and control can vary significantly depending upon the project complexity, experience of the development and construction teams, loan structure, and lender policies, risk tolerance, experience and resources. Related activities range from processing and submittal through representations, authorizations and approvals.

It can be useful to review project-specific disbursement processes and requirements with the borrower prior to submission of the first draw.

### Typical Disbursement Processes

* Line of Credit – Construction is funded from a line of credit established for the borrower. The LOC may be supported by the subject property, or by alternative collateral.
* Reimbursement of Invoices – Lenders sometimes reimburse construction costs based on the submission of invoices. This approach is typically limited to reimbursements for soft costs, or for construction hard costs when the total disbursement budget represents only a small portion of the property value such as disbursement of insurance proceeds, minor renovations and tenant improvements.
* Stage Draws – Construction costs are funded based on completion of construction thresholds; e.g. completion of the foundation, framing, roofing, etc.
* Construction Draws – Contractor pay requests and supporting documents are submitted individually evaluated.
  + Subcontractors and suppliers submit required information to the GC
  + General contractor assembles invoices and other required documentation
  + Draw request is reviewed with architect, borrower and lender
  + Contractor submits finalized and executed draw request to the borrower
  + Borrower collects invoices and documentation required to support other soft costs
  + Borrower submits finalized draw request and an executed disbursement request form to lender
  + Lender reviews and evaluates requested disbursements, coordinates additional information needed for processing, and disburses funds.

### Supporting Documentation

* Tax reporting information is typically required for all entities to be paid directly by the lender.
* Requirements for the submission of additional supporting documentation can vary depending on the risk tolerance of the lender. For example, additional documentation may include:

#### Borrower’s Request

Borrowers are typically required to request and authorize requests for disbursement; however, requests direct from the General Contractor are sometimes accepted. Borrower requests commonly include:

* A completed and executed disbursement request form
* Identification of the amount authorized from each loan budget line item
* Authorization of requested disbursements
* Funding instructions
* Recertification of conformance with loan requirements, reps and warranties
* Disclosure of revisions, problems, new issues, additional contracts, sales and lease information and other matters governed by the loan agreement
* Copies of owner-approved change orders and change orders requested for approval (Sometimes included in the contractor’s request.)

#### Soft Costs

* Copies of invoices and cancelled checks for services to be funded or reimbursed.

#### Construction Hard Costs

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| * G702 (or equivalent) completed and executed by GC, Architect and owner (Notarization is not always required.) * G703 (or equivalent) * Supporting invoices * Lien releases (Conditional for current draw, unconditional for previous) * Sworn Contractor Statement | * Updated budget * Updated schedule * Change orders and supporting docs * Change log, RFIs * Buyout log * Subcontracts * Tax reporting information * Insurance certificates * Special inspections/testing |

ADDITIONAL TOPICS TO BE ADDED TO SUBSEQUENT DRAFTS