



# Construction Loan Disbursements

August 22, 2018



# Logistics



- Phones
  - Mute if you're in a noisy location
  - Don't put us on hold – even if you have great music!
- Join the discussion!

# OIG - Analysis of Failed Banks

## Common Elements

- Aggressive objectives
- Rapid portfolio growth
- CRE and CLD concentrations
- Insufficient capital reserves



## Focus areas

- **Aggressive growth**
- **CLD Concentrations**
- Specific Funding Sources
- **Ineffective Controls**
- **Poor Risk Management**
- Compensation Incentives

# Objectives

- Protect assets of the bank and investors
  - Get a completed, lien-free piece of collateral that matches our as-complete description from appraisal
  - Early detection of problem projects (schedule and cost)
  - Timely completion
  - Funding in line with completion
  - Identify and evaluate change orders (design, cost, schedule)
  - Monitor and evaluate soft costs disbursements
- Conform to
  - Regulations
  - Loan docs
  - Policies and procedures
- Manage reputational risks
- Provide service consistent with Bank objectives
- It's tempting to list "Help borrowers succeed", but that may imply participation in management.

# Stakeholders

- Bank and **their** investors
  - Credit Admin
  - Business Line
  - **Originator**
  - Loan Admin
  - Participating lenders
  - **Bridge and take-out lenders**
  - **Agencies**
  - **Housing authority**
  
  - **Communities**
  - **Regulatory**
    - **OCC, FDIC, FED, etc...**
    - **Municipality**
      - Planning, building, approvals, CO
- Borrower and **their** investors
  - Seller
  - Contractor
  - Subs and suppliers
  - Project architect/designers
  - Buyers
  - Tenants
  
  - **Consultants**
    - Title companies
    - Insurance
    - Funds control
    - CPM
    - **Surety**

# Actions

- Process
  - Contact
  - Receive
  - Send
  - Compare
  - Verify/validate
  - Record (on title)
  - Order
  - Observe
  - Document
  - Prepare
  - Report
  - Summarize
  - Notify
  - Submit
  - Fund
- Request
- Rep/Warrant
- Disclose/notify
- Release
- Evaluate
  - Review
  - Consider
  - Analyze
  - Decide
- Advise
  - Estimate
  - Anticipate
  - Challenge, question, test
  - Recommend
  - Opine
- Manage
  - Monitor
  - Resolve
  - Enforce
- Approve
  - Decide
  - Reject
  - Concur
  - Authorize
  - Instruct
  - Approve
    - Disbursements
    - Exceptions
  - Negotiate

Reorganized all  
Added...

# Disbursement Requests - Borrower

## Documentation

- Request form?
  - Authorize disbursements
  - Identify loan budget for each request (spreadsheet based on loan budget provided to borrower, followed by call)
  - Renew reps and warrants
  - Affirm conformance with loan requirements?
  - Disclose revisions, problems, new issues?
  - Additional agreements for project services?
  - Additional requirements under permit?
  - Certification
- Moved...
- Contractor's request
    - Architect signature?
      - Where engaged for CPM
      - May not be a design team, e.g. for rehab
    - Notary
      - Not always provided
  - Conditional and unconditional lien waivers
    - Even if they only filed a prelim
  - Supporting invoices for out of contract items
  - Deposits, off-site storage, insurance
  - Tax reporting information for subs and suppliers funded directly

# Disbursement Requests - Borrower

## Documentation

- Borrower payment application form
  - Authorize disbursements
  - Identify loan budget for each request (spreadsheet based on loan budget provided to borrower, followed by call)
  - Renew reps and warrants
  - Affirm conformance with loan requirements?
  - Disclose revisions, problems, new issues?
  - Additional agreements for project services?
  - Additional requirements under permit?
  - Certification
  - Entire budget, incl soft costs



# Disbursement Requests - Contractor

## Documentation

- G702 & 703 (or equivalent)
- Architect approval
- Invoices for GC trades, subs, stored materials, deposits
- Change orders and supporting docs?
- Special inspections/testing
- Deposits
  - Subcontract supporting deposit
- Off-site stored materials, photos, insurance, etc.
  - In place
  - Stored securely,
  - Labelled
  - UCC-1
  - Third-party verification
  - Not on foreign soil
  - Bonded warehouse
  - Required by contracts (for deposits)
  - Insurance,
  - Detailed bill of sale
  - Waiver and consent for third-party warehouse
  - Invoices
  - Inventory
- Contractor's request
  - Ex owner/builder if adequate detail
  - Architect signature?
    - Where engaged for CPM
    - May not be a design team, e.g. for rehab
  - Notary
    - Not always provided
- Conditional and unconditional lien waivers
  - Even if they only filed a prelim
- Supporting invoices for out of contract items
- Deposits, off-site storage, insurance
- Tax reporting information for subs and suppliers funded directly
- Change log, RFIs
- Buyout log?
- Subcontracts
- Current schedule?
- Updated budget?
- Tax reporting information
- **Insurance certificates**

# Construction Loan Disbursements

## Disbursement type

- Invoice
  - From general/owner builder
    - Backup required selectively
    - Possible (especially larger) subcontract docs
  - As agreed I draw meeting
- Stage draws
  - Clearly lays out what's required
- Letters of credit/revolving lines
- Based on
  - Percent complete
  - Cost to complete
  - Work in place

## Paid to

- Developer
- Contractor or Subs only on smooth-working transactions
- Funds control/title company
  - Prefer title co to fund directly to subs.

# Participation loans

## Open Questions

- Fixing the scope
  - If the lead's scope of work doesn't satisfy your needs - How do you fill in missing info if you require more?
  - What's required by the syndication agreement?
  - Is the lead meeting their obligations?

# Construction Loan Disbursements

## **Disbursement type**

- Line of credit
- Stage draw
- Vouchers
- Loan Line Items
- Construction Line Items
  - Cost of work
  - Cost to complete
  - Percent complete

## **Paid to**

- Borrower
- Contractor
- Subs and suppliers
- Funds control company

# Borrower Actions

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# Borrower Actions - Reps

- Tie loan budget to current draw request
- Explain deviations
- Every draw funding is like a mini closing
  - Any rep or warrant that applies to changes in the loan
- Changes over agreed threshold
- No knowledge of litigation
- Change orders in dispute

# Borrower Disbursement Request Form

- **Reps?**

- Documentation and information provided are true and accurate
  - Not in default
  - Equity contribution and other conditions precedent satisfied
  - No additional costs and contracts
  - Work is expected to be completed as per loan schedule
  - Previous disbursements to borrower used as per prior requests
  - Requested disbursements will be used...
- Request is
    - for work at the subject
    - Conforms to agreed plans
  - No COs, additional contracts, unapproved changes, etc. except as disclosed herein
  - Permit status
  - Adverse change in financial condition of the borrower
  - Borrower has independently evaluated and approved the amounts requested for disbursement along with all related and supporting activities.
  - Loan remains in balance
    - Borrower may need to inject equity when the expense is realized.



# Borrower Actions - Notify

- Changes to
  - Improvements
  - Cost
  - Schedule
  - Contractor or major subs
- Governmental, permitting or inspection issues
- Utilities/service providers
- Liens
- Legal or regulatory actions
- Sales/leasing status
- Changed conditions
- Upcoming large (over agreed threshold) change orders
- Material changes in ownership, investors, leadership group
- Material changes to design or contracting team
- Additional debt or investment

# Authorize

- Disbursement
  - Of requested amounts
  - From specific loan budgets
  - Disbursement instructions (Who, wire transfer instructions, etc.)
- Reallocation of funds

# Request

- Loan budget disbursements
  - Hard costs
  - Soft costs
  - Interest reserve?
    - Automatically funded from acct?
- Line item revisions
- Use of contingency
- Line item breakdown for loan budgets
  - Threshold for related invoice

# Etc

- Release
- Acknowledge
- Instruct
- Acknowledge lender will rely on information contained herein
- Release of lender?
  - Acknowledge Lender may evaluate information provided, work in place, requested disbursement amounts and other details, but has no obligation to perform such tasks except for the sole benefit of the lender.

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