

Practice Update

Tools for a Construction Lender's Toolbox in the COVID-19 Era

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The coronavirus (COVID-19) pandemic has shut down non-essential construction projects in numerous states, and has severely delayed or otherwise impacted construction in almost every other state. These delays and impacts may deal a fatal blow to some project owners. While lenders are rightfully reluctant to take over a distressed project, they would still be wise to remain prepared in the event they are left with no other choice. Lenders should consider the following tips in order to remain ready to take over a failing project.

1. Monitor the project closely.

As noted above, taking over a construction project is typically a last resort. Therefore, lenders should be closely monitoring owners' and contractors' work in order to keep apprised of project status and to ensure that owners are complying with all loan agreement obligations. This observation may keep the owner in check and ultimately decrease the likelihood that the lender will have to take over the project. Of course, the lender must ensure that it is not overstepping its rights pursuant to the loan agreement and potentially incurring lender liability.

2. Obtain all relevant project records.

In order to keep apprised of the project status and

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best be prepared in the event a takeover is warranted, a lender must possess all of the most relevant and up-to-date project records. The loan agreement will likely contain a provision entitling the lender to obtain copies of project records. Consider conditioning any discussions of requests for relief under the loan documents on the lender's receipt of the requested project records. Be sure to request copies of the following:

- Recorded Notice of Commencement (and check to make sure it is not expired or due to expire. The lender can also run its own search of public records)
- Payment and performance bonds from the prime contractor and all subcontractors
- Insurance policies and certificates of insurance for the prime contractor and all subcontractors
- All project agreements, including any construction contracts, subcontracts, purchase orders, architect/engineer agreements, consultant agreements, rental agreements, development agreements, and operating agreements. Ensure that these are the complete and signed agreements.
- Building permits and any other governmental approvals (and check to make sure these are not expired or due to expire)
- All Notices to Owner (if required by statute) served upon the owner to date, and a notice log, if available
- All lien releases received to date from the prime contractor and all subcontractors and suppliers
- All change orders, construction change directives, proposed change orders, and pending change orders
- Project drawings, specifications, and plans
- Construction schedule and all updates and revisions to the schedule

- Daily reports/logs, and any other similar reports/logs prepared by the prime contractor and all subcontractors
- Inspection reports/logs
- Claims of lien against the project or property (and run your own search to determine if there are any additional liens or encumbrances of record)
- Correspondence log
- Progress photos of the construction work to date

The project records listed above relate mainly to construction, but also be sure to obtain all financial records from borrowers and guarantors to which the lender is entitled.

3. Review the prime contract agreement and any subcontracts for major trades.

A lender must review and understand the prime contract in order to fully understand the rights, remedies, and obligations it will have if it steps into the shoes of the project owner. It is also important to review all subcontracts, especially those for the major trade subcontractors. While the lender likely reviewed all of these prior to loan closing, it should again review the entirety of these contracts, while specifically focusing on sections pertaining to the following issues (and the parties rights and remedies pertaining to each):

- Assignment
- Force majeure
- Emergencies
- Governmental orders/directives
- Delays
- Demobilization and remobilization costs
- Extended general conditions or overhead costs for delays
- Change orders

- Material or labor impacts
- Indemnification
- Insurance
- Default and remedies
- Termination provisions
- Suspension provisions
- Bonds in place (and rights and remedies against the surety)
- Dispute resolution

Also confirm that there are existing signed collateral assignments of the project agreements, preferably with subordinations.

4. Review the owner's and prime contractor's plan of action in the event of a shut down.

A lender should also review the owner's and the prime contractor's contingency plan in the event of a shutdown caused by governmental order or any other cause. To the extent such a plan does not yet exist, encourage the owner and prime contractor to develop a coherent and manageable project shutdown plan, and if allowed under the loan documents, require lender approval of the plan. This plan should address, among other things, who is responsible for closing down and securing the project during the shutdown, the actions taken to comply with all applicable laws and governmental orders during the shutdown, the parties rights, responsibilities, and obligations during the shutdown, and what must occur before the project may be resumed. Ensure that this plan includes providing notices of potential claims under any applicable policies of insurance. Also ensure that to the extent the project may continue in whole or in part, that the plan takes into account all emergency orders issued by governmental entities relating to social distancing, face masks, and signage. Failure to have a straightforward and practical plan could subject the owner or prime contractor to additional

demobilization and remobilization costs, and could also contribute to further project delays. As the lender is stepping into the shoes of the owner, the owner's additional costs and delays could pass through to the lender.

5. Determine the status of the project budget and schedule, and other loan agreement obligations.

It is always vitally important that a lender understand the project budget and schedule, and this is true to an even greater extent now that so many projects face such great uncertainty. Knowing the budget and schedule could be crucial in deciding whether to permit the prime contractor to continue work, to take over the project, or to abandon the project altogether. Also evaluate whether the borrower is complying with all other loan agreement covenants and obligations, including keeping insurance in place and maintaining reserve funds. Stay apprised of this information in order to be able to make the most sound and economical decision.

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