Guide to Construction & Lending Terminology

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AIA DOCUMENTATION

AIA is the American Institute of Architects. The AIA has developed form documents to govern many agreements between parties during the construction process, which are widely regarded as standard in the industry. For consistency, lenders may require certain construction documents to have originated from the AIA forms.

AMORTIZATION

The principal portion of the loan payments made to the lender. **Amortization** is typically expressed terms of years in reference to an amortization schedule. For example: if a loan has 25 year amortization, this states the loan will be fully repaid over a 25 year period of time. The **loan term** and the **amortization** do not always match, and in all cases the borrower is responsible for repayment of the loan balance by the maturity date.

CERTIFICATE OF OCCUPANCY

The local jurisdiction's certification that all construction requirements for occupancy have been met.

CHANGE ORDER

Documentation of a variance from the original agreed upon scope of the construction work to be completed. Change orders are common on large construction projects, and can result in amendments to price and timeline. The **change order** defines the new work to be completed, and it becomes a part of the original **construction contract**.

CONDITIONAL USE PERMITS/ SPECIAL USE PERMITS

This is an exemption granted by the local **zoning** authority, which permits a specific use on a particular parcel of land that otherwise would not be allowed under the parcel's current zoning designation.

CONSTRUCTION BOND/ PERFORMANCE BOND

A performance bond is typically issued by an insurance company, which guarantees satisfactory completion of a project by a contractor. Lenders may require that the general contractor provides this bond, which offers additional comfort to the borrower and the lender that the building will be delivered per terms of the **construction contract**, regardless of an unfortunate event such as insolvency of the general contractor.

CONSTRUCTION BUDGET

Includes all budgeted costs necessary to build the project to completion and to lease-up the project to a level at which debt service is fully covered by cash flow from the project. These costs include, but are not limited to, **land cost, hard costs, soft costs, a construction interest reserve, and an operating deficit reserve.**

CONSTRUCTION CONTRACT

A legal document between a borrower and a general contractor, which specifies the details and terms under which a construction project will be performed.

COMMITMENT FEE/ ORIGINATION FEE

A fee charged by a lender for committing to fund the construction loan, which is generally payable at the time of loan closing.

CONSTRUCTION INTEREST RESERVE

A reserve established under the loan commitment, which can be drawn against to make payment of loan interest while the project is under construction.

CONSTRUCTION PERIOD

The estimated timeline to complete construction from commencement through receipt of the **certificate of occupancy.**

CONTINGENCY COSTS

Estimates for unknown factors that can influence the cost to complete the development. **Contingency costs** are a standard component of a **construction budget**.

DEVELOPER FEE

A fee charged by the developer for services rendered to the owner during construction of the project. The amount of the **developer fee**, as well as the payment schedule, is then reviewed and confirmed by the lender.

DEVELOPER SERVICES AGREEMENT

An agreement between the borrower and a party that will be responsible for development of the project, which specifically defines the roles, responsibilities, and compensation between the parties.

ENVIRONMENTAL SITE ASSESSMENT

A report prepared by a licensed professional which identifies potential or existing environmental liabilities of a piece of real estate.

PHASE ONE STUDY

Required study for all construction loans, which includes a site visit by a licensed professional, an examination of site conditions with a focus on potential environmental hazards, evaluation of neighboring property uses, examination of prior uses, and searches of public files and records that would indicate a prior or existing environmental concern.

PHASE TWO STUDY

An in-depth study, which may be ordered to investigate concerns raised through a **phase one study**. This report is derived from physical testing of soil, groundwater, and on-site materials to determine contaminant levels.

PHASE THREE STUDY

A study focused on developing a plan for remediation and post-remediation monitoring of a site based on actions necessary to resolve issues recognized during the **phase two study**.

Considering a Seniors Housing Development?

TIPS FROM A LENDER

PREPARE thorough construction and pre-opening budget
INVOLVE operator in proforma, design and market assessment
ARTICULATE defensible business plan
DEMONSTRATE knowledge of the market
ENSURE alignment between parties
TIME financing solicitation appropriately

DRAW FEE/ FUND CONTROL FEE

An administrative fee that a lender may charge for each submitted **draw request package**.

DRAW REQUEST PACKAGE

A submission made by a borrower to a lender in connection with a request for loan proceeds. The package provides detailed documentation regarding expenses to be paid with the requested loan proceeds and estimates of total work progress. The specific form of the submission is agreed upon by the borrower and the lender prior to loan closing.

ENTITLEMENTS

A broadly used term to describe any permissions that are required to be received from regulatory bodies prior to proceeding with a planned development, including but not limited to, zoning approvals and all categories of permits.

EVENT OF DEFAULT

An action or event, or lack thereof, that may occur during the loan term. If an **event of default** was to take place, the lender is entitled to certain rights and to certain actions in order to protect its investment.

EXIT FEE

A fee charged by a lender, which is payable at either loan maturity or loan payoff.

FLOOD ZONE DETERMINATION

Designation of the development parcel within a flood zone as determined by the Federal Emergency Management Agency (FEMA). The **flood zone determination** can impact insurance requirements plus site and building designs.

GUARANTEED MAXIMUM PRICE/GMAX CONTRACT

A form of **construction contract, which** includes a ceiling price in which overruns are the responsibility of the general contractor. Typically, any savings during construction are returned to the owner or shared between the owner and the general contractor. The level of access that an owner is given to detailed reporting of construction costs by the general contractor exceeds that of most other forms of **construction contracts**. The transparency in reporting, alignment of interests, and ceiling price make the GMax a preferred form of **construction contract** by many construction lenders. There are many forms of **construction contracts**, including lump sum and cost-plus fixed-price contracts.

INDEMNITY CLAUSE

A commonly negotiated feature of contracts with contractors, (general contractor, architect, designer, etc.), which provides parties to the agreement with relief from any potential liability caused by certain acts. **Indemnity clauses** can benefit either party, but in the case of construction projects, owners commonly negotiate for contractors to indemnify them against losses or claims relating to defects in their work performance.

HARD COSTS

Costs related to the physical development of the project, including labor; materials; infrastructure; furniture, fixtures & equipment (FF&E); site work; landscaping and **contingency costs**. These costs are addressed in a **construction contract** with a general contractor.

INDEPENDENT COST VERIFICATION ANALYSIS

A third-party review performed by an engineering firm for a lender's benefit, which delivers an opinion on the validity of the construction budget relative to the final plans and specifications produced for the project.

INSURANCE COVERAGE

A variety of coverages are required to be maintained while construction is ongoing, including but not limited to, commercial general liability insurance, worker's compensation, automobile insurance, builder's risk insurance, flood insurance, and a performance bond covering the general contractor's obligations. **Insurance coverage** shifts risk from the purchaser to the insurance company, and all parties to a construction project hold common interest in using insurance to mitigate risks. Each lender will have its own insurance requirements and minimum coverage limits.

INTEREST RATE

The rate of return payable to the lender on any outstanding loan proceeds. Construction loans commonly feature variable interest rates, which are expressed as an index rate (such as LIBOR or prime rate) plus a percentage (spread). Interest is calculated daily based on outstanding amounts, typically collected monthly, and most often paid from established reserve accounts until such time that the project's cash flow can cover the monthly payments without the support of reserves.

LAND COST

The cost or value of the land to be developed, which can be the purchase price of the parcel or a current market valuation that must be agreed to by the lender.

LEVERAGE

Expressed as "loan to cost" or "total loan commitment" divided by the total approved **construction budget**.

LIQUIDATED DAMAGES CLAUSE

A common feature of a **construction contract**, which defines amounts payable by the parties to one another in the case that certain events should occur. The clause is most commonly used to protect an owner from delays in delivery of a completed project by the contractor, whereby the contractor must pay the owner a certain amount per day that the owner exceeds the agreed upon timeline for delivery.

LOAN ADVANCES

Construction loan proceeds are advanced periodically upon the lender's approval of a **draw request package** submitted by the borrower.

LOAN TERM

This is the time before which the borrower has to repay the loan balance. The **loan term** begins at loan closing and ends on the maturity date. The borrower is required to repay the entire loan balance by the maturity date.

MARKET FEASIBILITY STUDY

A non-biased, independent report performed for a lender's benefit that presents the strengths and weaknesses of the proposed development. Topics covered include an analysis of demographics and geographic factors, the competitive environment, and the marketability of the proposed project given these factors.

MINIMUM DRAW AMOUNT

A minimum funding amount permitted by a lender to be requested by a borrower in a single **draw request package**.

NET CASH FLOW DISTRIBUTION

The borrower's ability to take distributions of positive cash flow generated from the project. This may be restricted by a lender until certain minimum performance hurdles or other conditions are met.

OPERATING DEFICIT RESERVE

A reserve established under the loan commitment, which can be drawn against to make payment of any operating deficits while the project is leasing up.

PLANS AND SPECIFICATIONS

Commonly referred to as "Plans and Specs." These include all construction drawings related to the project, which cover building, mechanical, and electrical plans, as well as materials selections and specific installation instructions for the subcontractors.

RECOURSE

An obligation that extends to an individual or entity other than the borrowing entity. Commonly used forms of recourse include:

FULL RECOURSE

Allows the lender to seek full repayment of the loan in an **event of default** from the individual or entity providing the guaranty.

PARTIAL RECOURSE

A reduced version of **full recourse** in which a lender may seek repayment of a defined portion of the loan in an **event of default.**

"BURN-OFF" RECOURSE

A hybrid version of **full recourse** and **partial recourse in which** the level of obligation can adjust or reduce during the loan term, based on performance of the property and the loan.

ENVIRONMENTAL INDEMNITY

A requirement that any costs or expenses associated with an environmental condition at the property are the responsibility of the guarantor.

COMPLETION GUARANTY

Lender has the right to require the guarantor to invest additional capital to reach completion, usually defined as the receipt of a **certificate of occupancy**.

NON-RECOURSE CARVEOUTS

Also commonly referred to as the slang term "Bad Boy Guaranty." This obligates the guarantor for the full amount of the loan in the event of specific actions. Examples include: committing fraud, misrepresenting financial performance, conducting illegal acts, making a voluntary bankruptcy filing of the borrower, or violating certain legal covenants as defined by the lender.

PLANS AND SPECIFICATIONS REVIEW

A third party review performed by an engineering firm for a lender's benefit, which confirms the validity of all construction drawings, material selections, and installation instructions produced for the project.

SOFT COSTS

Costs of development, which do not relate to the physical construction of the building but are necessary to complete the project. These may include architectural and engineering costs, pre-opening marketing expenses, **third party reports,** permit/licensing/regulatory fees, **developer** fees, finance fees, **construction interest reserves** and **operating deficit reserves**.

SUBSTANTIAL COMPLETION

An often highly negotiated definition between the borrower and the general contractor, which is contained in the **construction contract**. The liability of the general contractor for delays or incompletion is significantly reduced or eliminated on the date that substantial completion occurs. The responsibilities for utilities, security, and other property management services transfer from the general contractor to the borrower on this date. This date also triggers the beginning of any warranty period provided by the general contractor, release of any retainage, determination of any damages caused by delays, and commencement of the statute of limitations.

THIRD PARTY REPORTS

Any of the following may be required: appraisal, **environmental assessment**, **flood zone determination**, **market feasibility study**, **plans and specifications review**, and **independent cost verification analysis**.

TITLE INSURANCE

A form of insurance, which protects a land owner or a mortgage lender from losses resulting from defective title to real property, liens, or other matters. Lenders will require a title insurance policy that protects them against these losses. Construction loan title policies exist in certain states wherein the amount of insurance coverage will increase in alignment with funding of the construction loan.

WILL SERVE LETTER

A letter issued by various utilities indicating their intent to serve the proposed development, including but not limited to, water, sewer and electric. These letters are typically required by a lender as a condition to close the loan along with final building permits.

ZONING

A designation made by a local zoning authority that governs land use, which must align with the proposed development plans in order for the project to proceed.

Seniors Housing & Health Care

THE FACE OF LENDING

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