



Examining construction loans: What you need to know

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Prior to selecting a site, it is essential to establish a relationship with an experienced engineering/surveying firm that has knowledge of the area. When selecting a firm, cost and delivery should be requested for the initial vacant land survey, the foundation location survey and the existing building survey. A title search should be done of the proposed site and forwarded to the engineering/surveying firm. The firm will require this search in order to help them ascertain if the site will support the desired improvements. They will also need to locate all easements and right of ways affecting the site in order to produce a survey in accordance with American Land Title Association (ALTA) standards.

If an acquisition mortgage is required for the purchase, this can be done with a vacant land or foundation location survey. Funds from a construction loan cannot be utilized to purchase the land, as the priority of the mortgage over subsequent liens could be jeopardized. The acquisition mortgage is put in place when the site is purchased. Subsequently, the construction loan is closed. Construction loans represent greater risks to lenders than loans against existing building, and therefore the interest rates are higher.

A building and loan agreement is made between the lender and the builder and is recorded prior to the recording of the construction loan. This agreement sets forth the advance schedule of the funds in accordance with the completion of the improvements. A Section 22 affidavit must be filed with the building and loan agreement. This affidavit sets forth all costs paid from the proceeds of the loan for engineering and for the closing of the loan. The purpose of this affidavit is to put all parties on notice as to what amounts have already been expended for the improvement of the site from the loan proceeds to allow a determination as to how much is still available for construction. If the Section 22 Affidavit is not accurately filled out and filed with the building and loan agreement, the priority of the entire mortgage may be challenged. In New York state it is this agreement and affidavit that establishes the priority of the mortgage as future advances are made.

The first advance is generally made upon the completion of the foundation. An existing foundation location survey will be forwarded to the title company to be read into the policy. The title company will review the foundation location survey with the covenants, restrictions and setbacks affecting the site and forward it along with the reading to lender's counsel. An inspection of the site will be made by the lender or one of it's agents and a continuation of title will be ordered. The title will be checked from the date of the last advance to the date of the requested advance to make sure that no judgments or liens were filed against the site during this period. If a judgment or lien is filed against the site during this period and is not satisfied prior to the advance of funds, the entire mortgage will become subordinate to the intervening lien. If the title is clear, the advance can be made and the entire mortgage maintains its position. This is done for subsequent advances until the entire amount of the proceeds of the loan are advanced and the construction has been completed. A modification

agreement between the builder and the lender can then be made, generally lowering the interest rate and extending the terms of the loan.

During the construction process it is essential to work closely with the title company and the engineering firm to avoid any delays in funding. It is important to put together a knowledgeable team to avoid problems that can be devastating to the work schedule and therefore to the bottom line.

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