

Key Issues In Construction Lending (With Sample Forms)

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Construction loans are one of the most difficult kinds of loan for a lender and borrower to negotiate, document, and carry out to conclusion. There are many reasons for this phenomenon. Construction projects by definition are subject to change, delays, cost overruns, and unanticipated events. The construction loan documentation must be structured so as to anticipate the unforeseen. There are often multiple parties involved. In addition to the borrower, design professionals, and contractors, there may be key tenants, governmental authorities providing incentives or entitlements, and other parties that have a say in the construction process. A mixed use project may involve multiple owners, lenders, and other constituent parties for each of its components. Finally, each construction project is unique in its location, design, construction, and marketing challenges.

Nevertheless, most construction loans involve a common set of issues. They involve, perhaps, more due diligence and planning at the outset and entail a more risky exit strategy. These materials will highlight some of the key issues that parties should consider in negotiating and documenting a construction loan. For the most part, these materials will highlight issues and attempt to provoke thought. The solutions to the problems and the documentation to address them will vary from jurisdiction to jurisdiction and from project to project.

A. Commitment Letters

1. The first step of any construction loan is a commitment letter or term sheet. Unlike a permanent loan commitment, there is often a very short period of time between a construction loan commitment let-

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ter and the initial funding of the loan. That may provoke the question: Why not go straight to documents? There are a few key issues that may drive a lender or borrower to want a construction loan commitment letter.

a. *Market Factors*

i. Market factors may cause either the lender or the borrower to want a construction loan commitment letter.

(1) *Interest Rates*—In a market of rising interest rates and limited credit availability, a borrower will be looking to lock in a rate for its construction loan. In an environment of stable rates and competition among lenders for loan assets, a lender may be looking to bind a borrower to a construction loan.

(2) *Real Estate Values*—Likewise, in a market of declining real estate values or overbuilding, a borrower may be struggling to commit one or more lenders to a project. In a market of stabilized values or increased absorption and demand, a lender may be looking to commit a borrower and to prevent a borrower from “shopping” its loan.

b. *Costs*—Even in the most basic of construction loans, a lender will incur significant time and expense in underwriting the loan terms, performing due diligence on the project, preparing loan documents, and reviewing title, survey, and environmental reports. The lender will want the borrower obligated to pay those costs if the loan does not close.

c. *Binding v. Nonbinding*—It is infrequent to see a commitment letter where the lender is bound to make the loan. Even a commitment letter that appears to be binding will have significant “outs” for the lender if various conditions occur. A lender will do as much as it can to have a commitment letter that is not binding on itself, but that conversely binds the borrower. More often than not, the parties will revert to some type of “term sheet” with significant disclaimers, yet with a binding obligation on the borrower to pay fees and costs if the loan does not fund. The parties do need to be careful in spelling out key terms in any term sheet, even if not binding. Once the term sheet is approved by the lender’s credit or similar committee, it will be hard to deviate from those key terms without going back to the committee. Even with a nonbinding term sheet full of disclaimers, the parties’ conduct can give rise to an obligation on the lender’s part under concepts of promissory estoppel and good faith and fair dealing. Compare *Mitsui Manufacturers Bank v. Superior Court*, 212 Cal. App. 3d 726 (1989), with *Peterson Development Company, Inc. v. Torrey Pines Bank*, 233 Cal. App. 3d 103 (1991).

d. *Key Loan Terms*—Against this background, the parties should try to resolve as many material terms as possible at the commitment letter or term sheet stage. Key issues to consider are as follows.

i. *The Basics*—Typically, the beginning of a loan commitment or term sheet will set forth a basic description of the project, the loan, and the terms, including the following:

- (1) The identity of the borrower and its principals.
- (2) A description of the project.
- (3) The amount of the loan.

- (4) The interest rate.
 - (5) The maturity date, including any extension rights.
 - (6) The required collateral.
 - (7) The equity requirements imposed on the borrower. Even at the commitment or term sheet stage, the lender and borrower may want to specify the kinds of borrower contributions to the project that will qualify as equity.
 - (8) Whether the closing is contingent on approval by the lender's loan or similar committee.
- ii. *The Specifics*—After a general overview of the loan, more detailed loan terms and conditions to closing typically follow. Key items include:
- (1) *Closing Conditions*—The commitment letter or term sheet will set out the conditions to the closing of the loan and the initial advance under the construction loan. Those conditions will likely include:
 - (A) Requirements as to title to the project, including whether the project will involve fee or leasehold interests. Any required reciprocal easement agreements or similar arrangements should likewise be addressed.
 - (B) The required priority of the lien of the lender's security interest.
 - (C) Satisfactory evidence that all permits and governmental entitlements have been received or that the conditions to receiving them can be met within a specified period of time.
 - (D) The lender's approval of the architect and the plans and specifications for the project, including a description of whether the project will be constructed on a "fast track" basis, whether it will be constructed in phases, and whether it is a multi-use project.
 - (E) The lender's approval of the general contractor, "major" subcontractors and suppliers and their contracts, including retainage and bonding requirements and requirements for the waiver or subordination of lien rights by the general contractor and major subcontractors.
 - (F) Pre-leasing requirements.
 - (G) A satisfactory appraisal.
 - (H) Insurance requirements.
 - (I) Requirements for environmental site assessments.
 - (J) Evidence of zoning.
 - (K) Evidence of the availability of utilities.
 - (L) Any requirements for credit enhancements, including any guaranties or letters of credit, and any requirements applicable to a credit tenant.

- (M) Requirements as to the kind of permanent loan commitment that will be needed to close.
 - (N) Borrower's counsel opinions.
 - (O) Consents or estoppels from: key tenants; ground lessors; governmental agencies; the contractor; the design professionals.
 - (P) SNDAs with key tenants.
- (2) *Completion Date*—the commitment should spell out the deadline or deadlines for completing the project or its phases.
- (3) *Financial Covenants*
- (A) Any requirements for the net worth of the borrower; the guarantor; the contractor; and key tenants.
 - (B) Debt service coverage tests.
 - (C) Occupancy requirements.
 - (D) Loan-to-value ratios.
- (4) *Loan Balancing*—The commitment letter or term sheet should include a brief description of any requirement for loan balancing under the construction loan agreement. A more detailed description of loan balancing issues is set forth below.
- (5) *Change Orders*—The commitment letter or term sheet may touch on the process for approving change orders.
- (6) *Lease Approvals*—The commitment letter or term sheet should cover the primary criteria for approving and funding key leases, include provisions for:
- (A) Tenant improvement allowances.
 - (B) Leasing commission allowances.
- (7) *Assignments/Participations*—The loan commitment should cover the lender's right to syndicate or assign the loan. The lender will want an unfettered right to participate or assign the loan. A borrower will have concerns over finding itself with a new lender after closing. A borrower should be concerned not only about any assignee's ability to fund the loan, but also about an assignee's ability to administer the loan.
- (8) *Set Aside Requirements*—If there are to be any set aside requirements for bonding companies or other parties (such as anchor stores), those should be described in the commitment letter or term sheet. A more detailed description of set aside agreements is set forth below.
- (9) *Defaults*—Not every event of default can be described in detail in a commitment letter or term sheet. Nevertheless, it would behoove the parties to list the key events of default that are expected to be included in the loan documents and whether any cure rights will be afforded to the borrower.

(10) *Termination Provisions*—There should be conditions allowing the lender not to close the loan based on:

- (A) Material misrepresentation.
- (B) Material adverse change affecting the borrower, a guarantor, the contractor, or a key tenant. The parties may want to include examples of a material adverse change. A borrower will want that precision, and a lender may well resist.
- (C) Condemnation.
- (D) Material litigation against the borrower, a guarantor, the contractor, or a key tenant.
- (E) Insolvency or bankruptcy of the borrower, a guarantor, the contractor, or a key tenant.
- (F) Failure to meet closing conditions by a specified date. From the lender’s perspective, this provision should be self-executing and should not be extended by continued negotiation of the loan documents past the termination date.
- (G) A change in market conditions.
- (H) A failure to comply with all other “reasonable” requirements.

(11) *No Third Party Beneficiary*—Unless third party beneficiaries are eliminated, a defaulting lender may have more than the borrower to contend with. *See Silverdale Hotel Associates v. Lomas & Nettleton Co.*, 677 P.2d 773 (Wash. Ct. App. 1984) (contractor not a third party beneficiary of construction loan); *A.F. Blair Co., Inc. v. Haydel*, 504 So. 2d 1044 (La. Ct. App. 1987) (contractor found to be third party beneficiary based on letter from bank).

(12) *Specific Performance/Consequential Damages*—Even if a term sheet purports to be nonbinding, it should say whether there is a right to specific performance of any binding features and waive consequential damages. *See City Centre One Associates v. Teachers Insurance and Annuity Ass’n*, 656 F. Supp. 658 (D. Utah 1987) (borrower could not be ordered to specifically perform a loan commitment).

(13) *Expenses*—The lender will want to protect itself for fees and expenses that it incurs in connection with the loan. A borrower may want some cap, budget, or understanding of the fees that might be incurred before closing.

(14) *Deposit*—To protect itself against expenses, the lender may want to take a deposit to apply against due diligence, legal, and other fees and expenses incurred in preparing for a loan closing.

iii. A lender will want to reserve as much flexibility as it can in any term sheet or commitment letter. Nevertheless, the more key issues the parties can cover in a term sheet or commitment letter, the more they can minimize disagreements over loan documents.

B. Loan Balancing

1. Once the commitment letter is finalized, then it is time to start preparing and negotiating documents. There are certain key features of a construction loan that will not appear in a permanent or land loan. One of the most critical issues is loan balancing. A loan is in or out of balance depending on whether there are sufficient funds, including equity and available loan proceeds, to fund any acquisition costs of the land, to complete construction, and to carry the loan to the point at which it should be taken out by a permanent loan, plus some reasonable cushion. As the loan progresses, it can become out of balance due to cost overruns, because anticipated revenues do not materialize, or because carrying costs increase when construction takes longer or there is a delay in the permanent loan funding. Certain key issues are as follows.

a. *Equity Component*

i. *Timing*—The lender and the borrower will have different views about whether all of the borrower's equity must be put up first and expended first, before loan proceeds are advanced, or whether the borrower's equity contribution can be staged. Once a business deal is struck between the parties, careful thought must be given to drafting the relevant provisions. Otherwise, a loan could quickly go out of balance because the borrower is not obligated to contribute equity at the time the lender thought the equity would be coming into the project.

ii. *Calculation Of Equity*—The parties need to think about what is equity and how it will be valued. That analysis is not as simple as it might first seem. The parties should ask certain questions.

(1) *Land*—Will contributed land be counted at full appraised value or some lesser fraction (e.g., 80%)? What will happen if the value of the land appreciates during the progress of construction? Will the borrower have the benefit of that increase?

(2) *Soft Costs*—Will the borrower receive a dollar-for-dollar recognition of its payment of soft costs leading up to the construction loan?

(3) *Equity Distributions*—As construction progresses, should the borrowing entity be able to make distributions to its members?

b. *Future Revenues*—Some lenders are willing to consider projected revenues as a “plus” in a loan balancing test, while others are not. If projected revenues are to be included, the parties need to agree on how the revenues will be projected, whether some discount will be applied to the projected revenues, the time period in which the expected revenues should be received, and how to offset them against costs that will be incurred during that same time period.

c. *Subsequent Advances*—Over the course of the loan, the lender will want to make sure that the loan remains in balance. The borrower will want flexibility to reallocate budgeted line items so as to cover unanticipated cost overruns. A construction loan agreement should provide for periodic balancing of the loan (for example, with each construction draw). The lender will also want to have the discretion to rebalance the loan at other times if it suspects a problem. As part of their negotiations, the parties need to look at mechanisms for the following:

i. How are project costs determined on the front end?

- ii. What kinds of budget must the borrower deliver?
 - iii. How will the parties handle amendments to the budget and line items within the budget?
 - iv. How frequently will costs be recalculated to see if the loan remains in balance?
 - v. What level of discretion will the lender have to reassess the project costs, the percentage of completion, the remaining available fund, and anticipated revenues with each draw? A lender will want the maximum flexibility (but see below).
 - vi. How are projected revenues determined over time?
 - vii. How much flexibility will the borrower have to move items from one line item within the overall budget to address cost overruns in another line item?
 - viii. At what point may the contingency line item be used and for what kinds of costs?
 - (1) As a general proposition, a balancing test should apply to the individual line items within the budget and to the overall budget itself.
- d. *Remedies*—If a loan becomes out of balance, the parties need to consider the consequences and provide for them. Depending on the severity of being in or out of balance, a lender may not necessarily want to call a default. The lender will want as much discretion as possible. Conversely, the borrower will want some safety net. Typical alternatives are as follows:
- i. The flexibility of the lender or the borrower to reallocate savings in certain line items, within specific tolerance levels, to cover overruns in another line item.
 - ii. The flexibility to draw on the project contingency, within certain tolerances.
 - iii. A provision for additional collateral or equity if the loan is out of balance. If the borrower is required or permitted to post additional equity or cash collateral, the parties should address whether those funds will be held by the lender or immediately applied to costs of the project.
 - (1) A sample loan balancing provision is attached as an exhibit to these materials. It does not provide for the inclusion of projected revenues as part of the balancing test, which would complicate the formula. It is also fairly favorable to the borrower. As is the case with all forms, it is included to provoke thought. Any loan balancing provision will depend on the transaction in question and applicable law. Finally, see the discussion of set aside agreements below for their effect on a loan balancing provision.

C. Conditions To Advances

1. The initial funding under the construction loan will be subject to all of the conditions to closing that the parties have negotiated. In addition, there will be conditions to each loan advance. Key conditions are as follows.
 - a. *Typical Conditions*—there are certain conditions that should apply before a lender is obligated to make subsequent advances of the construction loan as work progresses. Typical conditions are as follows:

- i. There are no defaults existing and there exists no event that, with the giving of notice or the lapse of time, would constitute a default. Defaults should be defined to include defaults under key agreements, such as the construction contract, the design agreements, leases with key tenants, and any set aside agreements.
 - ii. The loan is in balance.
 - iii. The costs have been incurred and are within line items of the defined project costs set forth in the budget.
 - iv. The requested draw will not cause advances to exceed the anticipated percentage of completion contemplated by the budget. In other words, the borrower is not getting ahead of itself. Otherwise, the loan will go out of balance.
 - v. Lien waivers have been delivered. The type of lien waiver may depend on the jurisdiction. It may be appropriate to have conditional lien waivers signed by the contractor and applicable subcontractors and suppliers for the current draw, to be followed up with final lien waivers in the next draw. In other words, unconditional lien waivers may run one draw behind.
 - vi. The inspecting architect has approved the disbursement.
 - vii. Title insurance endorsements or other forms of date down of title are delivered showing no unpermitted exceptions.
 - viii. Appropriate notices of completion or similar statutorily required filings have been made.
 - ix. The borrower has delivered evidence demonstrating that required leasing benchmarks have been met.
 - x. Any other periodic conditions of the loan agreement have been satisfied (*e.g.*, financial covenant testing).
 - (1) The loan agreement may include limits on how often the lender is obligated to make construction draws (for example, no more than once per month). The loan agreement should also afford the lender the flexibility to fund amounts directly to contractors, subcontractors, and suppliers.
- b. *Stored Materials*—Often in a large construction project, materials are purchased by the borrower or the general contractor and stored off site, pending incorporation into the project. The borrower or contractor will want to be reimbursed for these items from loan proceeds. The lender, on the other hand, will want to make sure that it has protected itself. If a lender is willing to make disbursements for stored materials, the following issues should be addressed in the loan documents:
- i. Requirements for the materials to be covered by satisfactory insurance.
 - ii. A requirement that title either is vested in the borrower or will be vested as soon as the proceeds are paid to the vendor.
 - iii. A requirement that the materials will be free of all other liens.

- iv. A requirement that the lender's security interest will attach to the items purchased. Protecting the lender's security interest may involve separately identifying the materials, getting consents from warehouse owners, or receiving lessors' waivers.
 - v. Requirements to store the materials in a bonded warehouse or at an appropriate location, secure from theft or damage.
- c. *Retainage*—Retainage is the amount that is withheld from the general contractor under the general contract. There will be corresponding retainage withheld by the construction lender in accordance with the construction loan agreement. The parties will need to analyze whether there are any applicable state law requirements for the retainage. If not, the credit worthiness of the borrower and the general contractor will dictate the amount of retainage and whether that amount will decrease over time as the project progresses to certain benchmarks. The conditions to making the final loan advance and disbursing the retained amount under the loan agreement will be the same as those for any other draw. Other requirements will also be imposed, such as:
- i. An AIA form of certificate of substantial completion.
 - ii. Final lien waivers.
 - iii. Delivery of final plans and specifications.
 - iv. Delivery of a final as-built survey.
 - v. Proof that all insurance is in place.
 - vi. Final title date downs.
 - vii. Other evidence that any statutory lien periods have elapsed or that statutory lien rights have otherwise been satisfied.
 - (1) Depending on the nature of the project, the final retainage may not be disbursed until some or all of the project is occupied by certain tenants that have evidenced acceptance of their premises.
- d. *Lender Discretion*—In many respects, a lender will want to retain the maximum amount of flexibility to make or not make construction draws. A lender should be careful in a jurisdiction that distinguishes between discretionary and obligatory advances, in terms of lien priority. *See National Bank of Washington v. Equity Investors*, 81 Wash. 2d 886, 506 P.2d 20 (1973) & 83 Wash. 2d 435, 518 P.2d 1072 (1974) (all advances were optional because conditions had to be met to lender's satisfaction); *Dempsey v. McGowan*, 291 Ark. 147, 722 S.W.2d 848 (1987) (reasonable conditions do not render advances optional); *J.I. Kislak Mortgage Corp. v. William Matthews Builder, Inc.*, 287 A.2d 686 (Del. Super. Ct. 1972), *aff'd* 303 A.2d 648 (Del. 1973); *Irwin Concrete Inc. v. Sun Coast Properties, Inc.*, 33 Wash. App. 190, 653 P.2d 1331 (1982).
- i. In addition, if a lender becomes too involved in project decisions, it may find itself liable to the borrower or third parties if things go wrong. A complete discussion of those lender liability issues is beyond the scope of these materials. For a discussion of those issues, see Paul A. Sandars III, *Theories of Lender Liability on Construction Projects*, 25 Construction Lawyer 44 (Fall 2005).

D. Construction Documents And Bonds

1. In connection with any construction loan, the lender and its counsel should carefully review the underlying construction contract documents. Key areas of concern for a lender are default provisions, the provisions allowing an assignment to a lender, change orders, and how progress payments are made. Assurances should be obtained from the contractor and design professionals that changes will not be made to their respective contracts without lender consent and allowing for performance directly to the lender in the event of a borrower default. Depending on borrower and contractor creditworthiness and applicable state law, payment and performance bonds may be required. The lender also should make sure that, if payment and performance bonds are required, they are obtained in the appropriate amounts, in appropriate forms, and from duly qualified sureties. The details of construction and design documents are beyond the scope of these materials. A good source of background materials is found in Stanley P. Sklar, *The Construction Loan: Who Really Pays for the Project? What Happens When the Loan is in Trouble?*, 531 PLI/Real 317 (2006).

E. Guaranties

1. A payment guaranty is fairly standard in any number of loan transactions. Often, a construction loan will involve a completion guaranty from one or more of the borrower's principals, or another solvent party. In short, the completion guaranty obligates the guarantor to complete construction of the project in accordance with the approved plans and specifications free of all liens on or before a specified date. Completion guaranties pose some unique challenges.
 - a. *Enforcement*—Although it may seem simple at first, what does it mean to require a party, other than the borrower, to complete the project on time, in accordance with the plans and lien free? Issues to address in a completion guaranty include:
 - i. A description of the project, including whether it does or does not include tenant improvements and, if so, for which tenants. If the construction loan agreement includes an adequate description of the project, cross-references may work.
 - ii. What happens if the project, or its plans and specifications, are modified? The completion guaranty should address those kinds of changes.
 - iii. Does the completion obligation include obtaining any governmental entitlements, paying governmental surcharges, or paying soft costs?
 - iv. What if, after a foreclosure, the lender changes general contractors or major subcontractors?
 - v. Does the completion obligation include keeping the loan in balance? If so, must the lender accelerate the loan to force a balancing call?
 - b. *Damages On A Guarantor Failure To Perform*—If the guarantor fails to complete the project in accordance with the completion guaranty, then what? What are the lender's damages? In *Black v. O'Haver*, 567 F.2d 361 (10th Cir. 1977), *cert denied*, 435 U.S. 969 (1978), applying Oklahoma law, the court ruled that the damages were an amount equal to the amount needed to complete the project. The court in *Glendale Federal Savings & Loan Association v. Marina View Heights Development*, 66 Cal. App. 3d

101(1977), rejected that view. In *Glendale*, the California court held that the measure of damages is the value that the improvements, if completed, would have added to the security. In other words, to what extent did the noncompletion of the improvements impair the lender's security interest? The *Glendale* court found that the lender had suffered no damages. In light of these cases, it behooves a lender to describe the damages to which it would be entitled if the guarantor fails to perform under its completion guaranty.

- c. *Specific Performance*—In light of these concerns, a lender might simply think it will force the guarantor to complete the project by specific performance. Not so simple. A court may be reluctant to enforce specific performance. Moreover, there are some practical issues to consider when negotiating a completion guaranty, including:
- i. What kind of access will the guarantor have to the site?
 - ii. Does the guarantor have privity with the general contractor and the design consultants? How can it enforce those contracts?
 - iii. Should the lender be obligated to fund any remaining loan balance to the guarantor to permit completion?
 - iv. Does the guarantor have the right to approve change orders if it is obligated to complete the project in accordance with a specified set of plans?
 - v. What if there is a casualty? What happens to the insurance proceeds?
 - (1) For these reasons, both the lender and the guarantor should be very careful in negotiating and documenting a completion guaranty. A guarantor will want to be sure that it can perform the obligation it has undertaken if called on to complete the project. The guarantor's counsel should think in practical terms of guaranty provisions that allow the guarantor the requisite access, rights, and funds. Of course, a lender will be wary of how much it will be committing to the guarantor in the event of a default. The lender also needs to understand the practical limits that may be placed on its enforcement rights if the borrower defaults.
 - (2) A simple form of payment and completion guaranty is attached to these materials as an exhibit. Again, it is a form only. Each completion guaranty will depend heavily on local law, the nature of the project, and the underwriting of the loan.

F. Set Aside Agreements

1. A set aside agreement is an agreement by a lender to "set aside" certain amounts within the construction loan budget for the benefit of a bonding company or for the benefit of another party depending on those loan proceeds (for example, an anchor department store for which the borrower is performing site work). A set aside agreement may take the form of a simple letter agreement from the lender to the benefited party. Alternatively, it may be a three-way agreement among the lender, the borrower and the benefited party. In either event, there are certain risks in set aside agreements. A lender may forget about the set aside requirements as the loan is administered or when it is in trouble. When the benefited party comes calling, the loan proceeds may be exhausted. Nevertheless, the lender has a

commitment to that benefited party. To minimize these risks, a lender should consider the following provisions in any set aside agreement.

- a. *Parties*—It is best for the agreement to be among the lender, the borrower, and the benefited party, and should exclude third-party beneficiaries.
- b. *Amount*—The maximum amount of the lender’s commitment should be set forth in the set aside agreement. General references to “costs of construction” or similar language could leave a lender with an open-ended exposure.
- c. *Loan Balancing*—The set aside amount should be taken into account in the loan balancing provisions of the construction loan agreement. That amount should be inviolate and should not be subject to reallocation for other construction costs.
- d. *Use Of Funds*—The agreement should describe the use to which the funds will be put, including any improvements that they are to cover. The benefited party should not have the ability to use those funds for any other purpose.
- e. *Disbursement Conditions*—A lender may want the disbursement of any set aside funds to be subject to the same conditions as are set forth in the loan agreement. A benefited party may resist those conditions, arguing that it is not a party to the loan agreement. Absent an incorporation of the loan agreement conditions, the parties should arrive at some specified set of conditions for those disbursements, including evidence of their use and that the project is lien-free. The loan documents should allow the lender to make those disbursements directly to the benefited party and should provide that those disbursements will be treated as if they were disbursed directly to the borrower for purposes of determining the indebtedness due and the amounts secured by the mortgage lien.
- f. *Bankruptcy*—A lender should not be in a position of having to make unsecured advances to a benefited party once the borrower has filed bankruptcy. The letter should provide that the lender need not make advances under the set aside agreement after bankruptcy unless there is a bankruptcy order authorizing the advances and preserving the lien and priority of the lender’s mortgage as to those advances.
- g. *Change Orders*—The set aside agreement should make it clear that the benefited party need not consent to change orders approved by the borrower and the lender. Nevertheless, a lender may want the benefited party’s approval to change orders that affect the benefited party. The construction loan agreement should make the benefited party’s consent a condition to advances.

G. Mixed Use Projects

1. If the construction loan is being made for one or more components of a mixed use project, then the complications multiply geometrically. Clearly, there will need to be an intercreditor agreement between lenders funding construction loans for separate components of a mixed use project. In a large project, there may also be mezzanine financing. The completion of the different phases of the mixed use project will be interdependent. For example, will a hotel component of a mixed use project survive if the garage is not built? What if the condominium component of a mixed use project depends on a hotel component for support and services? In these instances, the lenders, the borrowers, and their

counsel need to think through the various turns that the project could take until construction is complete and permanent financing sources are in place. For example:

- a. What happens if the conditions to funding under one loan are met, but not the other? Can one lender force the other to fund?
- b. What happens if there is a casualty? May one lender opt not to rebuild, while the other opts to rebuild? Can one lender force all of the insurance proceeds to be applied to the debt? Alternatively, can one lender force all lenders to proceed with rebuilding?
- c. What if there is a default under one loan, but not the other? For example, what if one loan is out of balance, but the other is not? Can a default under one loan stop the entire mixed use project?
- d. What if one borrower files for Chapter 11 but the other does not?
- e. In answering any of these questions, does it matter how far construction has progressed? Should the parties establish different benchmarks in time or percentage of completion and have different results apply accordingly?
 - (1) Before the parties ever finalize commitment letters or term sheets for the construction loans, significant thought should be given to these concerns.

H. Tri-Party Agreements

1. A tri-party agreement is an agreement among the borrower, the construction lender, and the permanent lender that will outline the conditions on which the permanent financing will be funded. Another form of agreement is a buy-sell agreement, by which the permanent lender agrees to buy the construction loan and related documents, subject to the conditions set out in the documents. Both documents serve the same function and will be treated the same in these materials. In short, the construction lender wants to know when it will be taken out and what risk it has of exposure if the permanent lender does not fund. Likewise, the permanent lender wants to know the circumstances under which it will be committed to finance the project.
2. To address these competing concerns, it is important to document the conditions to the permanent loan. Even more important is for the construction lender to monitor and comply with those conditions as the construction loan progresses. Otherwise, it may end up with a defaulted construction loan on its hands, with no permanent solution. Key conditions are as follows:
 - a. *Approvals*—Up front, both parties should approve the title, the plans and specifications, the lease form, the environmental assessments, the engineering and soil reports, the budget, the procedure for any changes to the budget, the key construction and design professionals and their contracts, the procedure for change orders, tenant improvement allowances, leasing commission allowances, and borrower’s counsel opinions.
 - b. *Changes*—The permanent lender will want expansive approval rights over any changes to the plans and specifications, the project, the budget, the leases, and similar items. The construction lender will want to limit those approval rights to material items.

- c. *Inspections*—The permanent lender may well want inspection rights as construction progresses. The parties may want to engage the same inspecting architect.
- d. *Priority*—The permanent lender will want to ensure that it has the same lien priority as the construction lender for its permanent loan.
- e. *Borrower Default*—The permanent lender will want the right to cure a borrower default during the construction loan period. The construction lender will be concerned about how long a cure period the permanent lender will be granted. There may be instances in which the construction lender will need to act quickly.
- f. *Enforcement*—Both parties will be keenly interested in what rights of enforcement there will be if the conditions to the permanent loan are satisfied, or if there is a disagreement over those conditions.

I. Conversion

1. Some construction loans include a feature by which the construction loan will convert to a permanent loan on the occurrence of various enumerated conditions. As with a permanent lender under a tri-party agreement, the construction lender will want to craft very carefully the listing of conditions to conversion. Otherwise, it might find itself with a troubled, permanent loan. Similarly, the borrower will want to be sure that those conditions can be satisfied and will want to consider whether conversion should be at the borrower's option. Key contingencies would include items such as:
 - a. That the conditions to the final draw under the construction loan have all been satisfied.
 - b. That certain occupancy levels have been obtained.
 - c. That a requisite percentage of leases have been signed for tenants that have not yet occupied the premises.
 - d. That a final appraisal of the project has been delivered meeting certain criteria, including a prescribed loan-to-value ratio.
 - e. That other financial covenants, such as debt service coverage tests, are being met.

J. Conclusion

1. Construction loans present a challenge to lenders, borrowers, and their counsel. Risks to the parties can be minimized if they, together with their counsel, spend time anticipating what could happen over the course of the loan and providing for those contingencies in the loan documents. If something can go wrong in a construction project, it will go wrong. Planning for the unexpected will minimize the risk to all concerned.

EXHIBIT 1**Sample Loan Balancing Provision****Section ___—Loan Balancing**

___1 **Loan in Balance.** (a) At all times, the loan must be “in balance”. The Loan will be “in balance” only if the Lender determines, in its reasonable discretion based on Lender’s Construction Cost Estimate, that: (1) the undisbursed portion of Loan proceeds allocated to each line item in the Budget is sufficient to complete that line item; and (2) the undisbursed portion of the Loan, less the Contingency, equals or exceeds the amount necessary to pay for (A) all work done and not theretofore paid for; (B) all work remaining to be done in connection with the completion of the Improvements substantially in accordance with the Plans, including without limitation the installation of all fixtures and equipment required for operation of the Improvements; (C) all other costs incurred and not theretofore paid for, or to be incurred, in connection with the Development including the Soft Costs defined in Section ___; and (D) all payments of interest that will be due on the Loan through the Maturity Date.

(b) If the Lender gives its prior written consent, based in part on recommendations made by the Consulting Engineer, and provided no Event of Default has occurred and there exists no event which, with the giving of notice, the passage of time, or both, would constitute an Event of Default (other than an Event of Default or other event that will be cured on application of the requested allocation of the Contingency as set forth below), and so long as the Loan is in balance (or will be after allocation), the Borrower may (1) apply cost savings for one line item or cost category in the Budget to the Contingency and (2) apply the Contingency to bring the Loan in balance. The costs and expenses incurred and estimated by the Lender to be incurred will include all items set forth in the Budget, all other costs and expenses actually incurred and all other costs and expenses reasonably estimated by the Lender and customarily incurred in projects in the greater _____ metropolitan area similar to the Development to be incurred at any time with respect to all or any part of the Development. Without limiting the generality of the foregoing, the Loan will be out of balance if at any time the Lender in good faith reasonably estimates that the Retainage is not sufficient for the purposes intended, or the amount of the Contingency will not be sufficient to correct an imbalance in the Loan, whether due to delay in or increase in the cost of construction or increase in the interest rate payable on the Loan. All estimates of costs, expenses, and income described in this Section will be determined in good faith by the Lender.

(c) If at any time the Loan is out of balance, then, in addition to any other rights or remedies contained in this Agreement:

(i) The Lender will be entitled, without notice, to withhold Advances until the Loan imbalance is corrected; and

(ii) An Event of Default will automatically occur if the Loan imbalance is not corrected within 10 business days from the date the Lender notifies the Borrower of the imbalance, by the Borrower’s depositing with the Lender the full amount of the deficiency in cash. The Borrower’s deposit will be first applied to all costs and expenses of the Development.

___2 **Lender’s Construction Cost Estimate.** Before the Loan Opening Date, the Lender will have the right to make (and thereafter from time to time the Lender will have the right to revise), in its reason-

able discretion, an estimate of the cost of construction of the Improvements (the “Lender’s Construction Cost Estimate”). In the first instance, the Lender’s Construction Cost Estimate will be made on the basis of the executed Contracts and Subcontracts, and purchase orders which have not yet been let, or the Lender’s estimate of those costs, and will take into account such allowances for reserves as the Lender shall deem appropriate. Thereafter, the Lender’s Construction Cost Estimate will take into account, in addition to the Contracts, subcontracts and purchase orders, other considerations that the Lender, in its reasonable discretion, deems relevant or likely to have an impact on the cost of the Improvements, including current costs for and availability of materials, supplies and labor, the provisions of the Contracts, Subcontracts and purchase orders, the ability of the Contractors to perform under the Contracts, and the ability of parties to perform under and in accordance with the terms of Subcontracts and purchase orders. If any Contractor or Subcontractor is an Affiliate of the Borrower, any contract with that Affiliate will be regarded solely as an estimate for the purpose of this Section _____. The “Budget” is the Budget approved pursuant to Section _____ as it may be amended from time to time in accordance with the provisions of Section _____.

EXHIBIT 2

Sample Repayment And Completion Guaranty

This Repayment and Completion Guaranty (this “Guaranty”) is made as of _____, 200__, by Big Shot Developer, an individual residing in the State of Denial (the “Guarantor”), in favor of Friendly Bank, National Association (the “Lender”).

R E C I T A L S

A. Pursuant to the terms of the Construction Loan Agreement between Big Shot Development, L.L.C., a Delaware limited liability company (the “Borrower”), and the Lender dated as of _____, 200__ (the “Loan Agreement”), the Lender has agreed to loan to the Borrower the principal sum of \$100,000,000 (the “Loan”). The Loan is for the development and construction of a shopping center on the real property described in the Loan Agreement (the “Property”).

B. The Loan is evidenced by a promissory note (the “Note”) made by the Borrower and payable to the order of the Lender in the principal amount of the Loan and is secured by a Mortgage, Assignment of Leases and Rents and Security Agreement dated _____, 200__, by the Borrower, as mortgagor, to the Lender, as mortgagee, and filed under _____ in the records of Continued County, Denial (the “Mortgage”), and by the other security instruments described in the Loan Agreement. For purposes of this Guaranty, the “Loan Documents” are the Loan Agreement, the Mortgage, the Note, and the other documents described in the Loan Agreement as Loan Documents, as well as any other documents evidencing, securing, or relating to the Note, the indebtedness represented by the Loan, or any other obligations of the Borrower to the Lender whether now existing or hereafter arising (the “Indebtedness”). Capitalized terms used in this Guaranty and not defined have the same meanings given them in the Loan Agreement.

THEREFORE, to induce the Lender to enter into the Loan Agreement and to make the Loan, and in consideration thereof, the Guarantor unconditionally guarantees and agrees as follows.

1. Guaranty

(a) **Repayment.** The Guarantor hereby guarantees and promises to pay to the Lender or to order, on demand, in lawful money of the United States of America, in immediately available funds, the Indebt-

edness, including the entire principal sum that is now or hereafter due and owing under the Note or any of the other Loan Documents, together with interest and any other sums payable on the Indebtedness, under the Note or under any of the other Loan Documents. The Guarantor hereby irrevocably and unconditionally agrees that the Guarantor is liable for the payment of the Indebtedness as a primary obligor. The liability and obligation of the Guarantor to the Lender under this Guaranty will not be reduced, discharged, or released by reason of any existing or future offset, claim, or defense of the Borrower or any other party against the Lender or against payment of the Indebtedness, whether the offset, claim, or defense arises in connection with the Loan or otherwise. Notwithstanding anything to the contrary contained in this Guaranty, the direct liability of the Guarantor for the Indebtedness or under the Note and other Loan Documents will not be limited or restricted in any way by any provision of this Guaranty.

(b) Completion. The Guarantor hereby guarantees and agrees to be surety for the performance by the Borrower of all the terms and provisions of the Loan Agreement pertaining to the Borrower's obligations with respect to the construction and completion of the Improvements. Without limiting the generality of the foregoing, the Guarantor guarantees and provides assurances that:

(A) construction of the Improvements will commence and be completed within the time limits set forth in the Loan Agreement;

(B) the Improvements will be constructed and completed in accordance with the Plans and Specifications and the other provisions of the Loan Documents, without substantial deviation therefrom unless approved by the Lender in writing;

(C) the Improvements will be constructed and completed free and clear of any mechanic's liens, materialman's liens, and other liens (other than the lien of the Mortgage);

(D) all costs of constructing the Improvements (including, without limitation, all permitting fees, licensing fees, amounts payable under construction contracts, subcontracts and supply contracts, and all amounts payable to architects, engineers, and other design consultants) will be paid when due;

(E) all costs of completing any tenant improvements under all Leases will be paid when due;

(F) all amounts required to maintain the loan "in balance" as required under Section ___ of the Loan Agreement will be paid when due; and

(G) the Loan proceeds will remain available for disbursement free and clear of any mechanic's, materialman's, or other liens or claims.

(c) Multiple Guarantors. If one or more additional guaranty agreements (the "Other Guaranties") are executed by one or more additional guarantors (the "Other Guarantors") that guarantee, in whole or in part, any of the Indebtedness or obligations evidenced by the Loan Documents, the Lender may enforce the provisions of this Guaranty or of the Other Guaranties with respect to the Guarantor or one or more of the Other Guarantors under the Other Guaranties without seeking to enforce the provisions of this Guaranty or the Other Guaranties as to all or any of the parties constituting the Guarantor and the Other Guarantors. The Guarantor hereby waives any requirement of joinder of all or any other of the Other Guarantors in any suit or proceeding to enforce the provisions of this Guaranty or of the Other Guaranties. The liability under this Guaranty of all parties constituting the Guarantor will be joint and several.

2. Lien-Free Completion. “Completion” of the Improvements free and clear of liens will be deemed to have occurred on: (a) (i) the Lender’s receipt of a written statement or certificate executed by the Architect certifying, without qualification or exception, that the Improvements are completed in accordance with the Plans and Specifications; (ii) the Lender’s receipt of all required occupancy permits for all of the Improvements issued by the local government agency having jurisdiction and authority to issue them; (iii) either (x) the expiration of the statutory periods within which valid mechanic’s liens, materialman’s liens, and similar affidavits or notices may be recorded or served by reason of the construction of the Improvements, or (y) the Lender’s receipt of valid, unconditional lien releases from all persons entitled to record liens or serve affidavits or notices; and (iv) the delivery by the City of all Entitlements due to the Borrower pursuant to the Entitlement Agreement, and the Borrower’s deposit, and the Lender’s acknowledgment of receipt of, all Entitlements into the Entitlement Account; or (b) the Lender’s receipt of such other evidence of lien-free completion as the Lender deems satisfactory in its reasonable discretion.

3. Obligations of the Guarantor on Borrower Default. If the Improvements are not commenced and Completed in the manner and within the time required by the Loan Agreement, or if, before the expiration of the time limits for Completion set forth in the Loan Agreement, construction of the Improvements ceases or is stopped before Completion and the cessation or stoppage constitutes a Default, the Guarantor will, promptly on demand of the Lender: (a) diligently proceed to Complete construction of the Improvements at the Guarantor’s sole cost and expense; (b) fully pay and discharge all claims for labor performed and services and materials furnished in connection with the construction of the Improvements; (c) release and discharge all mechanic’s liens, materialman’s liens, and other liens or related affidavits or notices that may arise in connection with the construction of the Improvements; and (d) pay to the Lender the amount of any loss or damage incurred by the Lender as a result of any delay in the Completion of construction of the Improvements beyond the time specified in the Loan Agreement for Completion, which amount will include, but not be limited to (i) interest on the principal amount outstanding under the Loan for any period of delay that precedes the transfer of title to the Property to the Lender; and (ii) the reasonable rental value of the completed Improvements during any period of the delay in Completion that the Lender is the owner of the Property. Without in any way limiting the obligations of the Guarantor described above, the Lender will make the undisbursed Loan funds available to the Guarantor, pursuant to the terms and conditions of the Loan Documents, for the purposes of Completing the Improvements and fulfilling the Guarantor’s other obligations under this Guaranty; provided, however, that the obligation of the Lender to make undisbursed Loan funds available to the Guarantor is expressly conditioned on: (x) there being no continuing default by the Guarantor under this Guaranty; and (y) the Borrower or the Guarantor having provided to the Lender all of the Borrower’s Equity Funds required by the Loan Agreement.

4. Remedies. If the Guarantor fails promptly to perform its obligations under this Guaranty, the Lender will have the following remedies:

(a) The Lender may from time to time, and without first requiring performance by the Borrower or exhausting any or all security for the Loan, bring any action at law or in equity or both to compel the Guarantor to perform its obligations hereunder and to collect in any action compensation for all loss, cost, damage, injury, and expense sustained or incurred by the Lender as a direct or indirect consequence of

the Guarantor's failure to perform its obligations, together with interest thereon at the rate of interest applicable to the principal balance of the Note; and

(b) At the Lender's option, and without any obligation to do so, to proceed to perform on behalf of the Guarantor any or all of the Guarantor's obligations under this Guaranty. In that event, the Guarantor, on demand and whether or not construction is actually Completed by the Lender, will pay to the Lender all sums expended by the Lender in performing the Guarantor's obligations under this Guaranty, together with interest thereon at the Default Rate specified in the Note.

5. Rights of Lender. Without giving notice to the Guarantor or obtaining the Guarantor's consent and without affecting the liability of the Guarantor, from time to time the Lender may:

(a) renew or extend all or any portion of the Borrower's obligations under the Note, the Mortgage, or any of the other Loan Documents;

(b) declare all sums owing to the Lender under the Note and the other Loan Documents due and payable on the occurrence of a Default under the Loan Documents;

(c) make changes in the dates specified for payments of any sums payable in periodic installments under the Note or any of the other Loan Documents;

(d) otherwise modify the terms of any of the Loan Documents, including, without limitation, making changes in the terms of repayment of the Loan or modifying, extending, or renewing payment dates, releasing or subordinating security in whole or in part, changing the interest rate, or advancing additional funds in its discretion for purposes related to the purposes specified in the Loan Agreement, except for (i) increases in the principal amount of the Note or changes in the manner by which interest rates, fees, or charges are calculated under the Note and the other Loan Documents (the Guarantor acknowledges that if the Note or other Loan Documents so provide, interest rates, fees and charges may vary from time to time) or (ii) advancement of the Maturity Date of the Note where no Default has occurred under the Loan Documents;

(e) take and hold security for the performance of the Borrower's obligations under the Note or the other Loan Documents and exchange, enforce, waive, and release any security;

(f) apply security and direct the order or manner of sale thereof as the Lender in its discretion may determine;

(g) release, substitute, or add any one or more endorsers of the Note or guarantors of the Borrower's obligations under the Note or the other Loan Documents;

(h) apply payments received by the Lender from the Borrower to any obligations of the Borrower to the Lender, in such order as the Lender determines in its sole discretion, whether or not any of the obligations are covered by this Guaranty;

(i) assign this Guaranty in whole or in part;

(j) assign, transfer, or negotiate all or any part of the Indebtedness guaranteed by this Guaranty;

(k) approve modifications to the Plans and Specifications so long as the modifications do not materially increase the cost of constructing the Improvements or materially increase the time necessary to Complete the Improvements; or

(l) change the terms or conditions of disbursement of the Loan so long as the changes do not materially interfere with the Borrower's ability to construct the Improvements as and when required under the Loan Agreement.

6. Guarantor's Waivers. The Guarantor waives:

(a) any defense based on any legal disability or other defense of the Borrower, any Other Guarantor or other person, or by reason of the cessation or limitation of the liability of the Borrower from any cause other than full payment of all sums payable under the Note or any of the other Loan Documents;

(b) any defense based on any lack of authority of the officers, directors, partners, or agents acting or purporting to act on behalf of the Borrower or any principal of the Borrower or any defect in the formation of the Borrower or any principal of the Borrower;

(c) any defense based on the application by the Borrower of the proceeds of the Loan for purposes other than the purposes represented by the Borrower to the Lender or intended or understood by the Lender or the Guarantor;

(d) any and all rights and defenses arising out of an election of remedies by the Lender, even though that election of remedies may adversely affect the Guarantor's rights of subrogation and reimbursement against the principal;

(e) any defense based on the Lender's failure to disclose to the Guarantor any information concerning the Borrower's financial condition or any other circumstances bearing on the Borrower's ability to pay all sums payable, and perform all of its obligations, under the Note or any of the other Loan Documents;

(f) any defense based on any statute or rule of law which provides that the obligation of a surety must be neither larger in amount nor in any other respects more burdensome than that of a principal;

(g) any defense based on the Lender's election, in any proceeding instituted under the Federal Bankruptcy Code, of the application of Section 1111(b)(2) of the Federal Bankruptcy Code, or any successor statute;

(h) any defense based on any borrowing or any grant of a security interest under Section 364 of the Federal Bankruptcy Code;

(i) any right of subrogation, any right to enforce any remedy that the Lender may have against the Borrower and any right to participate in, or benefit from, any security for the Note or the other Loan Documents now or hereafter held by the Lender;

(j) presentment, demand, protest and notice of any kind;

(k) the benefit of any statute of limitations or prescriptive period affecting the liability of the Guarantor under this Guaranty or the enforcement of this Guaranty;

(l) any right to require the Lender to institute suit or exhaust remedies against the Borrower or others liable for any of the Indebtedness, to enforce the Lender's rights against any collateral given to secure the

Loan, to enforce the Lender's rights against any Other Guarantors, to join the Borrower or any others liable on any of the Indebtedness in any action seeking to enforce this Guaranty or to resort to any other means of obtaining payment of the Indebtedness;

(m) notices of disbursement of Loan proceeds, acceptance of this Guaranty, proof of non-payment, default under any Loan Document and notices and demands of any kind; and (n) the invalidity, illegality, or unenforceability of all or any portion of the Indebtedness or any of the Loan Documents for any reason whatsoever, including that interest on any of the Indebtedness violates applicable usury laws, that the Borrower or others liable for all or a portion thereof have valid defenses, claims, or offsets to all or a portion of the Indebtedness or that the Note or other Loan Documents have been forged or otherwise are irregular or not genuine or authentic (it being agreed that the Guarantor will remain liable under this Guaranty regardless of whether the Borrower or any other person is found not liable for repayment of all or any part of the Indebtedness). The Guarantor further waives any and all rights and defenses that the Guarantor may have because the Borrower's debt is secured by real property. This means, among other things, that: (x) the Lender may collect from the Guarantor without first foreclosing on any real or personal property collateral pledged by the Borrower; and (y) if the Lender forecloses on any real property collateral pledged by the Borrower, then (i) the amount of the Indebtedness may be reduced only by the price for which that collateral is sold at the foreclosure sale, even if the collateral is worth more than the sale price, and (ii) the Lender may collect from the Guarantor even if the Lender, by foreclosing on the real property collateral, has destroyed any right the Guarantor may have to collect from the Borrower. The foregoing provision is an unconditional and irrevocable waiver of any rights and defenses that the Guarantor may have because the Borrower's debt is secured by real property. Without limiting the generality of the foregoing or any other provision of this Guaranty, the Guarantor further expressly waives, to the extent permitted by law, any and all rights and defenses, including without limitation any rights of subrogation, reimbursement, indemnification, and contribution, which might otherwise be available to the Guarantor. Finally, the Guarantor agrees that the performance of any act or any payment that tolls any statute of limitations applicable to the Note or any of the other Loan Documents will similarly operate to toll the statute of limitations applicable to the Guarantor's liability under this Guaranty.

7. Guarantor's Warranties. The Guarantor warrants and acknowledges that:

(a) the Lender would not make the Loan but for this Guaranty;

(b) there are no conditions precedent to the effectiveness of this Guaranty;

(c) the Guarantor has established adequate means of obtaining from sources other than the Lender, on a continuing basis, financial and other information pertaining to the Borrower's financial condition, the Property, the Borrower's activities relating thereto, the progress of the construction of the Improvements and the status of the Borrower's performance of obligations under the Loan Documents;

(d) the Guarantor will keep adequately informed from such means of any facts, events, or circumstances that might in any way affect the Guarantor's risks hereunder;

(e) the Lender has made no representation to the Guarantor as to any such matters;

(f) the Guarantor has reviewed all of the terms and provisions of the Loan Agreement, the Plans and Specifications, and the other Loan Documents;

(g) the most recent financial statements of the Guarantor previously delivered to the Lender are true and correct in all respects, have been prepared in accordance with generally accepted accounting principles consistently applied, and fairly present the financial condition of the Guarantor as of the respective dates thereof;

(h) no material adverse change has occurred in the financial condition of the Guarantor since the respective dates of the financial statements; and

(i) the Guarantor has not and will not, without the Lender's prior written consent, sell, lease, assign, encumber, hypothecate, transfer, or otherwise dispose of all or substantially all of the Guarantor's assets, or any interest therein, other than in the ordinary course of the Guarantor's business.

8. Guarantor's Covenants

(a) Reporting Requirements. The Guarantor will deliver to the Lender, as soon as available, but in no event later than 120 days after the Guarantor's fiscal year end, a current financial statement (including, without limitation, an income and expense statement and balance sheet) signed by the Guarantor, together with any other financial information including, without limitation, annual financial statements, cash flow projections and quarterly operating statements, requested by the Lender. On the Lender's request, the Guarantor will also deliver to the Lender any other financial information the Lender may specify. If audited financial information is prepared, the Guarantor will deliver to the Lender copies of that information within 15 days of its final preparation. Except as otherwise agreed to by the Lender, all financial information will be prepared in accordance with generally accepted accounting principles consistently applied.

(b) Financial Covenants. As used in this Section 8(b), "Debt" means, as of any applicable date of determination, all items of indebtedness, obligation, or liability, whether matured or unmatured, liquidated or unliquidated, direct or indirect, absolute or contingent, joint or several, that should be classified as liabilities in accordance with generally accepted accounting principles. The term "Debt" specifically includes, without limitation, the Guarantor's obligations under this Guaranty and the Other Guarantors' obligations under the Other Guaranties. The Guarantor agrees that aggregate sum of all Debt of the Guarantor and the Other Guarantors (including without limitation, Skye High and Bigg Deal) may not exceed \$200,000,000 at any time.

9. Subordination. The Guarantor subordinates all present and future indebtedness owing by the Borrower to the Guarantor at any time and from time to time (for ease of reference, "Subordinated Debt") to the Indebtedness and the other obligations at any time owing by the Borrower to the Lender under the Note and the other Loan Documents. The Guarantor assigns all Subordinated Debt to the Lender as security for this Guaranty, the Note, and the other Loan Documents. The Guarantor agrees to make no claim for any Subordinated Debt until all obligations of the Borrower under the Note and the other Loan Documents have been fully discharged. The Guarantor further agrees not to assign all or any part of the Subordinated Debt unless the Lender is given prior notice and the assignment is expressly made subject to the terms of this Guaranty. If the Lender so requests: (a) all instruments evidencing any Subordinated Debt will be duly endorsed and delivered to the Lender; (b) all security for any Subordinated Debt will be duly assigned and delivered to the Lender; (c) any Subordinated Debt will be enforced, collected, and held by the Guarantor as trustee for the Lender and will be paid over to the Lender on account of the Loan,

but without reducing or affecting in any manner the liability of the Guarantor under the other provisions of this Guaranty; and (d) the Guarantor will execute, file, and record such documents and instruments and take such other actions as the Lender deems necessary or appropriate to perfect, preserve and enforce the Lender's rights in and to any Subordinated Debt and any security therefor. If the Guarantor fails to take any such action, the Lender, as attorney-in-fact for the Guarantor, is hereby authorized to do so in the name of the Guarantor. The foregoing power of attorney is coupled with an interest and is irrevocable.

10. Bankruptcy of Borrower. In any bankruptcy or other proceeding in which the filing of claims is required by law, the Guarantor will file all claims that the Guarantor may have against the Borrower relating to any Subordinated Debt and will assign to the Lender all rights of the Guarantor thereunder. If the Guarantor does not file any such claim, the Lender, as attorney-in-fact for the Guarantor, is hereby authorized to do so in the name of the Guarantor or, in the Lender's discretion, to assign the claim to a nominee and to cause proof of the claim to be filed in the name of the Lender's nominee. The foregoing power of attorney is coupled with an interest and is irrevocable. The Lender or its nominee will have the right, in its reasonable discretion, to accept or reject any plan proposed in the proceeding and to take any other action that a party filing a claim is entitled to do. In all such cases, whether in administration, bankruptcy, or otherwise, the person or persons authorized to pay the claim will pay to the Lender the amount payable on the claim and, to the full extent necessary for that purpose, the Guarantor hereby assigns to the Lender all of the Guarantor's rights to any such payments or distributions; provided, however, that the Guarantor's obligations under this Guaranty will not be satisfied except to the extent that the Lender receives cash by reason of any the payment or distribution. If the Lender receives anything under this provision other than cash, it will be held as collateral for amounts due under this Guaranty. If all or any portion of the obligations guaranteed under this Guaranty are paid or performed, the obligations of the Guarantor under this Guaranty will continue and remain in full force and effect if all or any part of such payment or performance is avoided or recovered directly or indirectly from the Lender as a preference, fraudulent transfer, or otherwise under the Bankruptcy Code or other similar laws, irrespective of (a) any notice of revocation given by the Guarantor before the avoidance or recovery, or (b) full payment and performance of all of the Indebtedness and obligations evidenced and secured by the Loan Documents.

11. Loan Sales and Participations; Disclosure of Information. The Guarantor agrees that the Lender may elect, at any time, to sell, assign, or grant participations in all or any portion of its rights and obligations under the Loan Documents and this Guaranty, and that any sale, assignment, or participation may be to one or more financial institutions, private investors, or other entities, at the Lender's sole discretion. The Guarantor further agrees that the Lender may disseminate to any actual or potential purchasers, assignees, or participants all documents and information (including, without limitation, all financial information) that has been or is hereafter provided to or known to the Lender with respect to: (a) the Property, the Improvements, and their operation; (b) any party connected with the Loan (including, without limitation, the Guarantor, the Borrower, any partner, joint venturer, or member of the Borrower, any constituent partner, joint venturer or member of the Borrower, any other guarantor, any indemnitor and any non-borrower grantor); or (c) any lending relationship other than the Loan that the Lender may have with any party connected with the Loan. In the event of any sale, assignment, or participation, the Lender and the parties to the transaction will share in the rights and obligations of the Lender as set forth in the Loan Documents only as and to the extent they agree among themselves. In connection with any sale,

assignment, or participation, the Guarantor further agrees that this Guaranty will be sufficient evidence of the obligations of the Guarantor to each purchaser, assignee, or participant. On written request by the Lender, the Guarantor will consent to amendments or modifications to the Loan Documents as may be reasonably required to evidence any sale, assignment, or participation. Anything in this Guaranty to the contrary notwithstanding, and without the need to comply with any of the formal or procedural requirements of this Guaranty, including this Section, any lender may at any time and from time to time pledge and assign all or any portion of its rights under all or any of the Loan Documents to a Federal Reserve Bank; provided that no such pledge or assignment will release that lender from its obligations thereunder.

12. Additional, Independent and Unsecured Obligations. This Guaranty is a continuing guaranty of payment and performance, and not of collection; cannot be revoked by the Guarantor; and will continue to be effective with respect to any Indebtedness arising or created after any attempted revocation of this Guaranty or after the death of the Guarantor (if the Guarantor is a natural person, in which event this Guaranty will be binding on the Guarantor's estate and the Guarantor's legal representatives and heirs). The obligations of the Guarantor under this Guaranty are in addition to and will not limit or in any way affect the obligations of the Guarantor under any other existing or future guaranties unless the other guaranties are expressly modified or revoked in writing. This Guaranty is independent of the obligations of the Borrower under the Note, the Mortgage, and the other Loan Documents. The Lender may bring a separate action to enforce the provisions hereof against the Guarantor without taking action against the Borrower or any other party or joining the Borrower or any other party as a party to any action. Except as otherwise provided in this Guaranty, this Guaranty is not secured and will not be deemed to be secured by any security instrument unless the security instrument expressly states that it secures this Guaranty.

13. Attorneys' Fees; Enforcement. If any attorney is engaged by the Lender to enforce or defend any provision of this Guaranty, or any of the other Loan Documents, or as a consequence of any Default, breach, or failure of condition under the Loan Documents, with or without the filing of any legal action or proceeding, the Guarantor will pay to the Lender, immediately on demand, all attorneys' fees and costs incurred by the Lender in connection therewith, together with interest thereon from the date of demand until paid at the rate of interest applicable to the principal balance of the Note.

14. Rules of Construction. The word "Borrower" includes both the named Borrower and any other person at any time assuming or otherwise becoming primarily liable for all or any part of the obligations of the named the Borrower under the Note and the other Loan Documents. The term "person" includes any individual, company, limited liability company, partnership, trust, or other legal entity of any kind whatsoever. If this Guaranty is executed by more than one person, the term "Guarantor" will include all of those persons. When the context and construction so require, all words used in the singular will be deemed to have been used in the plural and vice versa. All headings appearing in this Guaranty are for convenience only and will be disregarded in construing this Guaranty.

15. Credit Reports. Each person obligated on this Guaranty authorizes the Lender to order and obtain, from a credit reporting agency of the Lender's choice, a third party credit report on that person.

16. Governing Law. This Guaranty will be governed by, and construed in accordance with, the laws of the State of Denial, except to the extent preempted by federal laws. The Guarantor and all persons and entities in any manner obligated to the Lender under this Guaranty consent to the jurisdiction of any

federal or state court within the State of Denial having proper venue and also consent to service of process by any means authorized by Denial or federal law.

17. Parties Liable. The provisions of this Guaranty will bind and benefit the heirs, executors, administrators, legal representatives, nominees, successors, and assigns of the Guarantor and the Lender. The liability of all persons who are in any manner obligated under this Guaranty will be joint and several.

18. Severability. If any provision of this Guaranty is determined by a court of competent jurisdiction to be invalid, illegal, or unenforceable, that portion will be deemed severed from this Guaranty and the remaining parts shall remain in full force as though the invalid, illegal, or unenforceable portion had never been part of this Guaranty.

19. Enforceability. The Guarantor hereby acknowledges that:

(a) the obligations undertaken by the Guarantor in this Guaranty are complex in nature;

(b) numerous possible defenses to the enforceability of these obligations may presently exist or may arise hereafter;

(c) as part of the Lender's consideration for entering into this transaction, the Lender has specifically bargained for the waiver and relinquishment by the Guarantor of all such defenses; and

(d) the Guarantor has had the opportunity to seek and receive legal advice from skilled legal counsel in the area of financial transactions of the type contemplated herein. Given all of the above, the Guarantor does hereby represent and confirm to the Lender that the Guarantor is fully informed regarding, and that the Guarantor does thoroughly understand:

(i) the nature of all such possible defenses;

(ii) the circumstances under which such defenses may arise;

(iii) the benefits that such defenses might confer on the Guarantor; and

(iv) the legal consequences to the Guarantor's waiving such defenses. The Guarantor acknowledges that the Guarantor makes this Guaranty with the intent that this Guaranty and each of the informed waivers herein will be fully enforceable by the Lender, and that the Lender is induced to enter into this transaction in material reliance on the presumed full enforceability thereof.

20. Notices. All notices, demands, or other communications under this Guaranty will be in writing and will be delivered to the appropriate party at the address set forth on the signature page of this Guaranty (subject to change from time to time by written notice to the Lender and all other parties to this Guaranty). All communications will be deemed served on delivery, or if mailed, on the first to occur of receipt or the expiration of 3 days after the deposit in the United States Postal Service mail, postage prepaid and addressed to the address of the Guarantor or the Lender at the address specified herein; provided, however, that non-receipt of any communication as the result of any change of address of which the sending party was not notified or as the result of a refusal to accept delivery will be deemed receipt of the communication. The Lender's address is as follows:

Friendly Bank, National Association

123 Easy Street

Fullov, Denial 12345

Attn: Loan Administration

21. WAIVER OF RIGHT TO TRIAL BY JURY. EACH PARTY TO THIS GUARANTY EXPRESSLY WAIVES ANY RIGHT TO TRIAL BY JURY OF ANY CLAIM, DEMAND, ACTION, OR CAUSE OF ACTION (A) ARISING UNDER THE LOAN DOCUMENTS, INCLUDING, WITHOUT LIMITATION, ANY PRESENT OR FUTURE MODIFICATION THEREOF OR (B) IN ANY WAY CONNECTED WITH OR RELATED OR INCIDENTAL TO THE DEALINGS OF THE PARTIES HERETO OR ANY OF THEM WITH RESPECT TO THE LOAN DOCUMENTS (AS NOW OR HEREAFTER MODIFIED) OR ANY OTHER INSTRUMENT, DOCUMENT OR AGREEMENT EXECUTED OR DELIVERED IN CONNECTION HEREWITH, OR THE TRANSACTIONS RELATED HERETO OR THERETO, IN EACH CASE WHETHER NOW EXISTING OR HEREAFTER ARISING, AND WHETHER SOUNDING IN CONTRACT OR TORT OR OTHERWISE. EACH PARTY AGREES AND CONSENTS THAT ANY PARTY TO THIS GUARANTY MAY FILE AN ORIGINAL COUNTERPART OR A COPY OF THIS SECTION WITH ANY COURT AS WRITTEN EVIDENCE OF THE CONSENT OF THE PARTIES HERETO TO THE WAIVER OF THEIR RIGHT TO TRIAL BY JURY.

22. INTEGRATION. THIS GUARANTY REPRESENTS THE FINAL AGREEMENT BETWEEN THE PARTIES AND MAY NOT BE CONTRADICTED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS, OR SUBSEQUENT ORAL AGREEMENTS OF THE PARTIES. THERE ARE NO UNWRITTEN ORAL AGREEMENTS BETWEEN THE PARTIES. THIS INSTRUMENT MAY BE AMENDED ONLY BY AN INSTRUMENT IN WRITING EXECUTED BY THE PARTIES HERETO.

IN WITNESS WHEREOF, the Guarantor has executed this Guaranty as of the date appearing on the first page of this Guaranty.

GUARANTOR:

Big Shot Developer

Address of Guarantor:

123 Fast Lane

Iam Inn, Denial 12345