

Completion Guaranties in Construction Lending: Key Provisions for Lenders and Guarantors

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Completion Guaranty Basics

What is a completion guaranty?

A completion guaranty is a guaranty made in connection with a construction loan and is intended to provide the lender assurances that the project will be completed and that all costs associated with the construction will be paid.

Why would a lender require a completion guaranty?

In a construction loan, the lender values its primary collateral (the improvements) on the assumption the construction will be completed. If the construction is not completed, the real estate and improvements are insufficient collateral to secure the loan. The completion guaranty is intended to provide the lender assurance that the construction will be completed even if the borrower defaults.

How does a completion guaranty vary from other types of guaranties?

Limited or full payment guaranty

Non-recourse carveout guaranty

Environmental indemnity

Guaranteed Obligations

What obligations are included in a completion guaranty?

- Completion of improvements and payment of costs
- Carry costs
- Tenant improvements
- Personal property

Guaranteed Obligations

The Guaranteed Obligations shall include (i) construction of the Improvements, in strict accordance with the Plans and Specifications, no later than the Target Completion Date, (ii) installation of all Personal Property by the Target Completion Date, (iii) completion of all Tenant Improvements required under the terms of any Lease by the deadline set forth therein, and (iv) payment in full of all costs, expenses, and other charges in connection with the acquisition of the Real Estate, construction of the Improvements, purchase of the Personal Property, and all other costs set forth in the Development Budget.

Guaranteed Obligations

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Beyond Core and Shell

- Some guarantors may believe that their completion obligations are satisfied once the core and shell of the building are completed
- Most lenders, however, do not view a project as “complete” until the space is ready for occupancy. This means purchase and installation of personal property and completion of tenant improvements

Personal Property

The Guaranteed Obligations shall include ...
installation of all Personal Property by the Target
Completion Date.

- Guarantor concern: Definition of Personal Property; value engineering/substitutions

Tenant Improvements

The Guaranteed Obligations shall include ...
completion of all Tenant Improvements required
under the terms of any Lease by the deadline
set forth therein

- Guarantor concern: TI allowances, scope of Lease definition; tenant notice of default

Carry Costs

The Guaranteed Obligations shall also include all real estate and personal property taxes, assessments, insurance premiums, costs, interest and fees on the Note, utility charges, accounting fees, and all other costs of operating and maintaining the Property.

Carry Costs

Many guarantors may view their obligations under the completion guaranty to being limited to construction.

Lenders, however, view the scope of the guaranteed obligations to include all of the costs of ownership of the property until the construction is completed.

Carry Costs

The Guaranteed Obligations shall include all real estate and personal property taxes, assessments, insurance premiums, costs, interest and fees on the Note, utility charges, accounting fees, and all other costs of operating and maintaining the Property.

- Guarantor concern: Offset for revenue; operational inefficiencies; length of time.

Computing Completion

Guarantor shall cause the Improvements to be constructed, in accordance with the Plans and Specifications, to Completion.

Completion shall mean the satisfaction of all of the following: (i) construction of all improvements by the Construction Deadline, as evidenced by the issuance of a final certificate of occupancy; (ii) all of the Personal Property has been installed or placed in the Improvements; (iii) Lender has been provided unconditional lien waivers or other acceptance of evidence of payment for all persons providing labor or services to the Project; (iv) and Lender has received written certification from the Architect that the Improvements have been completed in accordance with the Plans and Specifications.

Advancing Loan Proceeds

- At the time of the default by borrower, there are likely remaining loan proceeds that have not yet been advanced by the lender.
- The guarantor required to perform the Guaranteed Obligations has a reasonable expectation that it will be able to draw on those funds.
- The lender, however, will be concerned about advancing additional money on a project that has already suffered an uncured default triggering the guaranty

Advancing Loan Proceeds

Typical prerequisites for disbursement of loan proceeds:

- There is no default under the guaranty
- All defaults under the loan documents have been cured
- Borrower and any separate payment guarantor have consented to the disbursements
- All other conditions and requirements of the loan documents for advances have been satisfied

Other Guarantor Covenants

- Obtain necessary licenses, permits, assignments, authorizations, and the like to perform the Guaranteed Obligations
- Keep the Loan in Balance
 - Use of guarantor funds vs. loan proceeds
 - Escrow requirements

Consequences for Failure to Complete

- Most completion guaranties will provide the lender with multiple remedies for failure to perform the guaranteed obligations, including specific performance.
- Case law suggests that specific performance is not a viable remedy for breach of completion guaranty.
- Damages may be difficult to calculate and heavily litigated.

Liquidated Damages

- A liquidated damages provision may be to the benefit of both the lender and the guarantor.

Liquidated Damages

In addition to all other remedies available to Lender at law or in equity, if (i) Guarantor fails to pay and perform all of the Construction Obligations in accordance with the terms of this Guaranty and (ii) Lender does not elect to pay or complete, as applicable, the Construction Obligations in accordance with the terms hereof, then, in Lender's sole and absolute discretion, Lender may elect to have Guarantor pay to Lender liquidated damages (such liquidated damages are hereinafter referred to as the "Liquidated Damages") for Guarantor's failure to pay and perform all of the Construction Obligations in an amount equal to:

(a) the amount of the total of the costs and expenses Lender would incur in the event Lender were to attempt to complete and pay all Construction Obligations which have not been performed or paid, less

(b) the amount of Loan proceeds undisbursed as of the date of election by Lender.

Guarantor concern: Value versus cost; calculation of costs; timing for payment

Additional Considerations

- Does lender already have a fully payment guaranty (likely from the same guarantor)?
- Are there state laws that limit lender's recourse against a payment guarantor?
- Are the completion remedies enforceable?
- What is the availability of obtaining appointment of a receiver to manage and complete construction?