



Short but not Sweet: Lender-Required Consents and Subordinations from Contractors

Ideally, once a developer breaks ground on a project, they can proceed seamlessly to the completion and opening of the project without issue. Unfortunately, this is not always the case. Circumstances can arise mid-construction that bring a developer's operations to a halt.

This scenario poses a significant risk to construction lenders. They likely have rights to foreclose upon the project, but if they exercise those rights and take ownership of the project, they acquire a work in progress. To address this risk, in addition to the right to foreclose, the lender will want to be able to acquire direct rights under the developer's contracts for work on the project, as well.

Construction lenders typically require collateral assignments of a developer's contracts with their general contractor, architect, project engineer, and perhaps other professionals involved in the project as well. The lender will require its borrower to obtain the consent of each such professional to the assignment of their contract prior to closing the loan. Many times, these agreements are presented at the eleventh hour prior to closing.

A relatively short document (in the world of loan documents) titled "Consent" can appear innocuous. However, it could have a significant impact on the contractor's contractual rights and obligations. It should be reviewed carefully, with counsel if possible.

The contractor may be asked to sign a consent or assignment document that would significantly modify its rights in the event of non-payment or delayed payment by the developer at any time the developer is delinquent with loan payments. The document may also include ongoing requirements of the contractor even in the absence of borrower default, such as requirements for consent from the lender for change orders.

There are no standardized forms among lenders for these consents or assignments. They widely vary among lenders – from the benign to the extraordinarily burdensome. The contractor will also typically be asked to subordinate its lien rights to the lender. This subordination is not a waiver of its right to file a lien on the project, but, in Texas, where mechanics and materialmen's lien rights are very valuable and would otherwise have priority, this may put a significant dent in the contractor's remedies.

The misconception is that these consents or assignments are completely non-negotiable. While difficult to negotiate in some cases, do not assume that the consent cannot be altered at all. This is yet another reason to review as early as possible in the process.

Facilitating the developer's financing is obviously important to the general contractor and other professionals who will be paid from the loan proceeds. However, given enough advance notice before closing, the general contractor or professional may be able to negotiate better balance into the documents it is asked to sign in the process. The ultimate goal for all the parties is to finish the project or asset backing up the loan in the event of a catastrophic default on the loan. Working together to balance the construction contractor and professional's risk in doing so is of paramount importance.

For more information, please contact [Mike Cortez](#) or [Susan George](#).