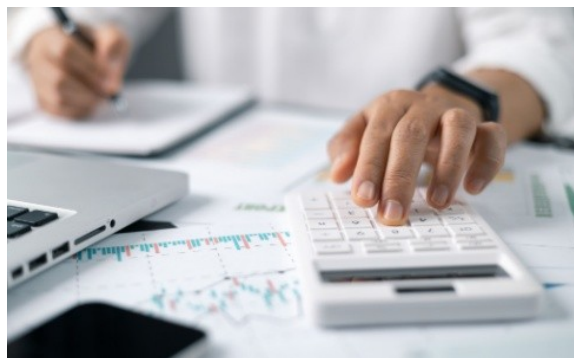


Show Me the Money: The Importance of Owner's Proof of Financing

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Lack of project financing can be a very unpleasant surprise for a contractor (and all players on the project). In a volatile environment — where project costs are increasing and borrowed money, credit, and leverage are increasingly difficult to obtain — what are some approaches for a contractor to address and reduce these risks upfront or during the project?

The best time to address project financing concerns is at the beginning, during preconstruction, and certainly before work has broken ground. Many contractors are hesitant to probe and inquire about project finances. If, however, there is any concern about whether the project will be adequately funded, it is best to ask for the necessary information directly. Representing that it is standard practice and policy may help reduce tension on disclosure of the information. An open and honest discussion on the financing not only ensures that the project does not stall but also is reasonable because a contractor's role in confirming the project costs, schedule, setting contingencies, experience and reputation, and qualifying the trades is a key component to the owner's discussions with the bank to obtain financing. It makes sense that if the owner is reliant on the contractor to help obtain the financing, then, likewise, the contractor should have the ability to confirm that the financing is sufficient, too.

At the start of the relationship, the contractor can communicate to the owner that it expects to receive satisfactory proof of financing that might include any of the following:

- Commitment letter from bank/lender or equivalent term sheet or written confirmation from a lending committee at the bank.
- Oral conversations with the bank/lender to confirm financing.
- Documentation confirming loan amount, terms for the loan and disbursements, and a commitment to a loan closing date.
- Documentation of disbursements, such as disbursement agreements or a disbursement summary.
- If the owner is self-financing the project, it is reasonable to ask that funds be set aside for the project. This could be done with the bank (or a third party) and a statement showing proof of funds.
- It is also reasonable to ask for financial statements, credit reports, and bank strength ratings, especially if it is self-financed by an unfamiliar owner.

Depending on the circumstances, further information might be necessary, including details of the owner's budget for the project. Such details should be set forth in the owner's pro forma or related documents. The documents should identify proper contingencies, reserves, and budgets to cover the various issues that can arise with the owner's land development, design, and construction.

Including clauses in the prime contract that address financing issues is also useful. The contract should include a clause that entitles the contractor to request additional proof of funding or even the right to engage in direct discussions with any lender or

bank. The clause should also express that the contractor has the right to suspend work in the event of slow payments or indications of problems with the owner's financing on the project.

Contractors should also pay particularly close attention to the ownership entity of the land/project. First, the owner should provide adequate information to confirm the record owner of the real estate. If the owner of the real estate is an unknown company or is a "single shot" LLC used for holding the real estate (often indicated by its name, which uses the property address, such as, for example, 35 Main Street, LLC), then, the contractor should realize that the LLC owner of the property likely has no other assets other than the project property itself. In these "single-shot" scenarios, a mechanics' lien right is the best approach to lack of payment because it attaches to the property itself, and, other than the property, the LLC may have limited or no other assets. Also, it is best to obtain the information of the LLC owners (members) if possible because the financials of a single-shot LLC are only as strong as the loan and members backing the LLC. If the contracting party is not the record owner, that creates a few additional wrinkles that must be addressed for both proof of financing and also mechanics' lien rights.

A last point for consideration: Sureties often require disclosure of project finances. One tactic is to bond the project with a surety, which has some benefits aside from this discussion, and use the surety as the reason for all the financial questions. This shifts any tension from the contractor to a third-party surety.

Handling problems with project financing can be a thorny situation at any point in a project. The best practice is to have sound internal protocols and trusted counsel for troubleshooting. Offit Kurman construction attorneys are available to advise and counsel contractors, construction managers, design-builders, design professionals, subcontractors, and developers on construction contracts, risk, and project disputes.