Neither a Borrower nor a Lender Be?

Despite Shakespeare’s Famous Advice, Construction Lenders Can Cut Their Risk by Being a Fully Involved Partner

Construction lending is a high-risk business and every specialty contractor should be familiar with some of the new pressures that lenders are encountering. Sooner or later, contractors will be confronted by lender action which is a response to the new emphasis on money that is conditioning the response of bankers to construction lending.

As nearly every contractor knows, at almost all stages of the construction loan cycle, the collateral is not a completed and occupied property, but an asset with various components either in storage or being fabricated at offsite locations.

Apart from market fluctuations, most project failures are tied to the time frame between loan closing and occupancy of the building, or the construction period. For this reason, loan making and administration is being given increased emphasis by lenders.

Historically, many construction lenders have considered their responsibility as ending upon approval of funds for construction. The emphasis was upon the commitment of permanent lenders to fund the project’s completion and upon the construction team to complete the project within budget and schedule.

Construction lenders then assigned loan accounts to administrators who would tour projects monthly and approve monthly requisitions. Because lenders assigned little importance to loan administration, lenders were frequently unprepared for project failures and the resultant claims and litigation.

This situation has led to the development of a variety of consultant services which lenders are employing today at an increasing rate. Bankers may understand money, but they are not conversant with construction. A regular visit to the job site by a contractor will reveal to the experienced eye the progress of the job, the difficulties present and anticipated and a host of other job related information. To the average banker, a job site is a confused assembly of people and material which is somehow brought together at the last minute into a completed project. The key to successful project administration, lenders have discovered, is the ability to recognize and resolve project problems promptly and initiate action that will repair any damages already sustained. The emphasis is especially on problems that from a lender’s standpoint frequently contribute to project failures.
These particular construction problems that lenders are now expressing interest in include:

**Contractor Section**

Selection of the general contractor is frequently a critical element in the decision of whether or not to extend a loan on a project. At the same time, lenders are now looking below the GC decision and taking a critical look at the various prime and specialty contractors who are no less critical to the success of the project.

For this reason, the specialty contractor should have a program in place that will address itself to the more critical examination by lenders. Admittedly, many lenders do not yet address the importance of selecting key specialty subcontractors, but more and more projects—the big ones at least—apply a critical review of specialty capabilities.

When lenders do investigate and approve specialty contractors they often restrict their interest to the subs’ financial strength and prior experience. No less critical to a careful loan administrator’s attention are the contractors’ readiness to comply with the reporting requirements necessary to monitor the project.

In preparing information on your company you should allow for the loan administrator to track work progress, monitor quantities in place, observe contractor coordination, and participate in decisions to modify the schedule when necessary.

To the average contractor such monitoring and reporting may seem like interference from inexperienced personnel, but make no mistake about it: bankers and lenders are playing the loan administration game in dead earnest. A contractor employed in any given project without these necessary capabilities—regardless of the competitive nature of their bid, could easily disallow the loan administrator its ability to track the project’s progress.

More importantly, a contractor who responds negatively to a lender’s request for a project schedule, is inflicting irreparable damage to his reputation because he is creating concern on the part of the administrator. Remember, that lender will get the information with or without your cooperation and it simply doesn’t pay to make enemies of bankers and lenders.

**Project Shop Drawings**

To any good loan administrator, what’s really desirable is the early time frame in which shop drawings are submitted, approved, and when necessary, resubmitted and approved.

After all, shop drawings constitute the actual plan by the subcontractor on his intent to supply, fabricate, and erect components in the structure. They, in fact and in deed, represent the sub’s understanding of the actual bid documents. These drawings are vitally important and their delay in submission or approval, or submission of inadequate drawings, is essential because they can adversely effect any project.

As any contractor knows—and as lenders have discovered—incomplete or unapproved shop drawings are the major culprit in causing a deviation from the schedule upon which the lender made the loan in the first place.

Because of the importance of adhering to the bid documents and the planned schedule, you should look forward to the lender or the lender’s representative beginning to attend all project meetings between the architect, engineers, and contractors. It’s understandable: the lender wants to be present and protect his interests when some decision is made regarding a revision to design, substitution of materials, or an alteration in the working schedule.

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The growing importance of being in on the decision team can be traced in large part to the increased reliance on fast track, multiple track and accelerated scheduling that has become so prominent in recent years.
That's why any lender presses for a realistic project schedule in the first place. And it's also why the lender is so insistent upon including in each weekly or monthly progress meeting an update on such items as project delays, change orders, and other factors that directly and indirectly influence the project’s time frame.

**Project Change Orders**

Change orders pose the most significant threat to any construction project in terms of both cost and schedule.

A number of management mechanisms are available to minimize the need for excessive change orders on a project and most of these obviously come in the preconstruction phases of a project.

It’s there where you can expect pressure from lenders to attempt to “lock in” the building team with mandates not to revise the project design during construction. The best strategy at this juncture is to develop a communications system on the project that will reduce the lack of coordination between the design professionals, the contractors, and the vendors.

Once that step is taken, encourage the lenders to attend regular progress meetings so that potential conflicts can be identified and corrective action taken.

Recently, another trend has been noted in this same general area. More lenders are now asking for a review—and approval—of each contractor’s agreement. They want to ensure that the contracts are complete and uniform with other agreements, especially with subcontractors.

**Project Schedule**

When a construction project stops or runs into an undue delay, lenders face their moment of truth. Do they work with the present developer or go into foreclosure?

You can be certain that a good loan administrator won’t wait long to make a decision. Foreclosures can be a lengthy proces-
respondence between building team members. Be particularly attentive about responding promptly and accurately: untimely or unresponsive answers from others pinpoints you as a poor performer. Watch carefully, too, the tone you put into your messages and that element along with frequency—and the subject itself—will allow a loan administrator to uncover disputes before they impact the project.

When you get the minutes from a progress or schedule meeting, read them carefully and comply with everything that involves your role in the project. You can be certain that the loan administrator is reading them and comparing notes, and then perhaps touring the site regularly as a double check.

**Disputes**

Even on the most professionally run project disputes occur. It’s virtually impossible to eliminate disagreements but timely and effective resolution separates the well-managed project from the ones plagued with delays.

Most project managers or general contractors will have a disputes system in place even before a job starts. In any event, you can be certain that the lender is now putting emphasis on implementing an effective means for managing disputes.

In the last few years, construction managers have stressed the pursuit of a resolution on a dispute immediately upon its discovery lest it fester and have impact on the entire project. You can be certain that many loan administrators will be watching the action and final resolution. Indeed, some administrators even want to be present during the resolution or arbitration proceedings.

**Conclusion**

In today’s changing construction management environment, the lender is taking a more forceful role and one that will increasingly, directly involve all contractors on a project.

Not only is the lender today demanding—and receiving—representation on contractor selection and project tours, but he is involving himself in the details of the job, e.g., shop drawing approvals and submissions, project change orders, project schedules and dispute management.

Their construction know-how at this moment in history is not all that great but they are acquiring insight. This improving job knowledge is coming from the loan administrator himself or the consultants that he is hiring to look out for the lender’s interests.

The prudent wall and ceiling contractor will recognize this emerging trend and take immediate steps to accommodate it when and if the need arises.

*About the Authors:* Al Schaer and Dennis Kakol are CEO and President, respectively of Schaer Associates, Inc., and international construction consultants with offices in ten U.S. cities and five foreign countries,