



CONSTRUCTION LAW ALERT

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Lender Liability Claims Involving the Disbursement of Construction Loans

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The construction lender often faces exposure to lender liability claims from its borrower and other third parties. One area of potential lender liability involves disbursements. There are various factual scenarios that may give rise to liability of a construction lender. Consider a lender who does not fulfill a promise to extend financing or continue financing in accordance with the terms of the loan documents. Is there liability if a contractor earmarks construction funds for a specific part of a project and the lender disburses loan proceeds for another purpose?

Failure to Disburse Loan Proceeds as Designated

If problems with the project have developed to the point that the lender must consider refusing to make any more advances, it must first decide whether state laws require that the lender notify contractors and other construction lien claimants of its decision. Statutes may impose substantial liability on a lender who decides not to fund but fails

to give written notice in a timely manner to the parties affected.

Section 713.3471 of the Florida Statutes, outlines the lender responsibilities to the owner and the contractor. The lender is responsible for providing the written form notice set forth in the statute to an owner prior to making any loan disbursement to the owner on any construction loan secured by real property. The notice warns the owner that the disbursement is directly to him or her and to protect themselves they need to require the contractor to get them lien releases from each lienor who has sent the owner a Notice to Owner each time they make a payment to the contractor.

If the lender decides to cease further advances on a construction loan, written notice must be given to the contractor, or any lienor giving notice to the lender, within five business days of making the decision. Failure to give the contractor notice renders the lender liable to the contractor to the extent of the actual value of the materials and direct labor

costs furnished by the contractor plus 15% for overhead, profit and other costs from the date the notice should have been served.

The statute also provides procedures when the lender and the borrower have designated a portion of the construction loan proceeds. The borrower may not authorize the lender to disburse the designated funds for any other purpose until the contractor and any other lienor who has filed a Notice to Owner is given written notice of the decision and the amount to be disbursed.

This section does not apply to a residential project of four units or less or construction loans of less than \$1 million. A contractor or other lienor cannot waive this right to receive notice under this statute. However, neither the owner nor the lender is required to give notice to the contractor or any other lienor unless the total amount of funds improperly disbursed by the lender of the designated construction loan proceeds exceeds 5% of the original amount so designated or \$1 million, whichever is less.

A lender that ceases construction funding, under some circumstances, may be compelled to complete the funding. In one case, a New York court compelled a lender to fund approximately \$29 million in pending loan advances for the construction of a shopping center. The court held that a construction loan was like a contract to sell real property, the loss of which automatically constitutes irreparable harm because of the unique nature of land as an asset, which cannot be properly remedied by money damages. The court held that injunctive relief is available to prevent a lender's breach of a loan agreement that is an essential part of a contract to sell or develop real property if the failure to fund the loan would harm the underlying project to develop the property.

Lender liability claims can also arise if a lender directly disburses construction funds to a contractor, subcontractor or material supplier pursuant to loan documents or a course of practice (as opposed to disbursing the proceeds to the borrower, who, in turn, pays the contractors).

Finally, the risk of lender liability increases if a lender represents to subcontractors that construction funds are available to do work if it ceases funding without justification. This is the case even though although there is no common law duty for the lender to insure the financial viability of the project for the benefit of subcontractors.

Minimizing the Risks of Lender Liability

Although there is no way full proof way to eliminate all lender liability exposure, there are various ways a lender may attempt to minimize the risk of lender liability claims. Lenders must follow the requirements of Florida law governing the disbursement of construction loans. Loan documents should clearly state that the lender, by making loan disbursements after inspections, does not make any warranty or owe any duty to the borrower or third parties regarding the quality of the construction.

Loan documents should also expressly negate any partnership, joint venture, agency, or relationship other than lender

and borrower and state that the relationship between the parties is strictly limited to that of debtor and creditor, that the lender has not accepted or assumed any duty or obligation, fiduciary or otherwise, to or on behalf of the borrower, that the borrower has not solicited and the lender has not offered or given any advice to the borrower in any manner whatsoever under the loan documents and/or the underlying transaction, and that the borrower has not relied upon any representation by the lender not contained in the loan documents.

Finally, if the borrower is not in compliance with the terms of the loan documents, the lender should document such non-compliance and put the borrower on written notice of the breach or default. ■

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