

Daily Development for Friday, May 7, 2010

by: Patrick A. Randolph, Jr.

Elmer F. Pierson Professor of Law

UMKC School of Law

Of Counsel: Husch Blackwell Sanders

Kansas City, Missouri

dirt@umkc.edu

MORTGAGES; CONSTRUCTION LOANS; PRELIMINARY INJUNCTION TO LEND: The borrower under a construction mortgage loan structured as an advancing term loan may obtain a preliminary injunction requiring the lender to fund draw requests.

Destiny USA Holdings, LLC v. Citigroup Global Mkts. Realty Corp., 889 N.Y.S.2d 793 (N.Y. App. Div. 2009).

In 2005, defendant lender (the "Lender") agreed to provide financing to plaintiff borrower (the "Borrower") in connection with its construction of a shopping center using a novel financing structure for green economic development. The total loan commitment from this lender was \$155 million, which was only part of the overall construction cost. Pursuant to the financing agreement, the Lender was permitted to deny a draw request by Borrower if a "Deficiency" existed. In 2009, the Lender sent the Borrower a Deficiency notice alleging that the Borrower was Deficient and declared the Borrower in default after the cure period had passed and the Borrower failed to cure the Deficiency. At this time, the project was 90% complete and the parties were facing the hardest edge of the recent financing crisis - there was very little money available to borrow at any price.

The claimed deficiency was Borrower's failure to fund Tenant Improvements as part of the Construction Fund. The total amount of such improvements was about \$15 million. The Borrower brought a claim against the Lender for the methods it used to calculate such Deficiency and also sought a preliminary injunction ordering the Lender to fund the unpaid draw requests.

The Appellate Division affirmed the lower court's grant of a preliminary injunction, holding that the applicable three-prong test was met: (i) interpretation of the definition of Deficiency is a matter for the court's consideration, (ii) irreparable injury would occur if provisional relief was withheld, and (iii) a balance of the equities necessitated relief because the burden to the Borrower of not imposing an injunction would be greater than the burden to the Lender of imposing the injunction.

First, and most significantly, the Appellate Division affirmed the federal district court's holding that cases of construction mortgages are an exception to the general rule that irreparable injury cannot be established where monetary damages are calculable. A construction mortgage is "not a simple contract to lend money. It is an integral part of a contract to sell [or develop] real property."

The Appellate Division further held that the unprecedented nature of the project, focusing on sustainable design and renewable energy, made it sufficiently unique that no established market existed and damages could not be easily calculated.

Finally, the Appellate Division recognized that the enormous potential harm to the Borrower's reputation for failure to complete the project validated the injunction.

Significantly, however, the Appellate Division reversed the lower court's decision not to require a bond, and ordered that borrower put up a bond of \$15 million pending resolution of whether it in fact was required to fund the Tenant Improvements.

Comment 1: Any decision ordering a lender to actually lend money, rather than simply pay money for refusing to loan, is a standout case. It is further significant that this decision carves out construction loans for special consideration, thus strengthening the position of construction borrowers in future cases. On the other hand, the court took judicial notice of the financial crisis, and this was taken into account in assessing borrower's predicament.

Comment 2: It is not clear whether the \$155 figure was for all phases, or only Phase One, which was the only construction in dispute. Even if we are talking only about Phase One, if the project was 90% complete, it would appear that the missing loan disbursements amounted only to about \$15 million dollars or so (at most). If borrower is required to post a \$15 million bond to force the disbursements to be made, has it really gained much?

Comment 3: Perhaps timing explains the issues discussed in Comment 2 above. At the present time, everything having been delayed during the appeal, it may be possible for the borrower to obtain the balance of the funds. The financial crisis had eased. And the question of whether an injunction was warranted at time of first hearing may be little more than academic.

Comment 4: This was a 3-2 decision of a five judge panel. What's it really worth except for the language?

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