

## Construction Loan Documents Must Be Carefully Drafted

December 8, 2009

In the last two years as the economy continued to slump and credit dried up, lenders and borrowers have continued to fight over the funding of loans for projects that seemed unlikely to be successful for possibly a decade, if ever. These decisions usually depend on the clarity and detail contained within the loan agreements because judges inevitably interpret any ambiguity or inference or lack thereof against the lender. The apparent absence of important provisions in a loan agreement was the basis of a recent New York Appellate Division decision in *Destiny USA Holdings, LLC v. Citigroup Global Markets Realty Corp.*<sup>1</sup>

The *Destiny* decision specifically underscores the importance of precise drafting in the standard provision governing the relationship of cost to complete versus funds available.

In 2005, Citigroup agreed to provide financing for the first phase of Destiny Holding's development and construction of a shopping center/tourist destination containing over 800,000 square feet and related facilities and improvements. The "Destiny USA" project was to be funded using a unique financing model for green economic development using money from three sources: Destiny Holdings, proceeds from bonds issued by the City of Syracuse Industrial Development Agency (SIDA) and approximately \$155 million to be loaned by Citigroup.

Pursuant to the Amended and Restated Building Loan, Project Loan and Security Agreement (the "Agreement"), Citigroup acted as both a lender and as the agent for all the lenders. As the agent, Citigroup was responsible for approving all advances of money, regardless of whether the advances came from funds of Destiny Holdings, SIDA or Citigroup. According to the Agreement, although the loan advances were made after Destiny Holdings submitted its monthly draw request and various conditions precedent were met, Citigroup could deny a draw request if it determined that a "Deficiency" existed. A Deficiency occurred when the money required to complete construction of the "Required Improvements" exceeded the money yet to be advanced and other available funds.

In the summer of 2008, Citigroup alleged that the 17<sup>th</sup>, 18<sup>th</sup> and 19<sup>th</sup> draw requests occurred when there were Deficiencies and included allocations for Tenant Improvement Costs (TI Costs) in its calculations of those

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<sup>1</sup> 24 Misc. 3d 1222(A), 2009 NY Slip Op. 51550(u) (4<sup>th</sup> Dept. 2009), modifying 2009WL 2163483, 2009 Slip Op. 515550(u) (Sup. Ct. 2009).

Deficiencies. In November 2008, representatives of both parties met to discuss the inclusion of TI Costs in Deficiency calculations and TI Costs were excluded from Deficiency calculations for the 20<sup>th</sup> through 26<sup>th</sup> draw requests.

The 27<sup>th</sup> draw request was submitted in April 2009, with a funding due date of May 5, 2009. On May 20, 2009, Citigroup sent Destiny Holdings a Deficiency notice, alleging that Destiny Holdings was deficient by over \$15 million. Virtually all of the claimed Deficiency was based on the inclusion of the TI Costs in calculating the Deficiency. When Destiny Holdings failed to cure the Deficiency within ten business days, Citigroup declared the loan in default.

On June 9, 2009, Destiny Holdings commenced an action asserting six causes of action, including one for breach of contract, as well as causes of action seeking a declaratory judgment, specific performance, and both preliminary and permanent injunctions. Destiny Holdings also moved for a preliminary injunction seeking to compel Citigroup "to also fund the pending loan advances . . . or, alternatively, enjoining Citigroup from refusing to fund such pending advances" and also sought to compel Citigroup "to comply with the procedural requirements of the construction loan agreement when approving future loan advances – in particular, the contractually mandated calculation of a 'Deficiency' under that agreement."

In deciding the motion for a preliminary injunction, the Supreme Court: (1) determined that the Notice of Deficiency was null and void and vacated it; (2) determined that the Notice of Default was null and void and vacated it; (3) determined that the term "Deficiency" was not a budget-based term and that TI Costs could not be used in calculating whether a Deficiency existed; (4) determined that Citigroup had breached the Agreement; (5) ordered Citigroup to fund the 27<sup>th</sup> draw request; (6) ordered Citigroup to fund the 28<sup>th</sup> draw request; (7) ordered Citigroup to fund the 29<sup>th</sup> draw request; (8) ordered Citigroup to "pay all future sums due as draws or advances under the [Agreement] as they come due without further delay or interference"; (9) scheduled a hearing to determine whether there was a current Deficiency; and (10) reserved until after that hearing any decision on the nature, amount and type of performance bond.

Citigroup appealed and the Appellate Division concluded that the Agreement did not contain the provisions on which Citigroup based its position nor could they be inferred. It also ruled that the court did not abuse its discretion in granting Destiny Holdings a preliminary injunction but that the order was modified by vacating the 1<sup>st</sup>, 2<sup>nd</sup>, 3<sup>rd</sup>, 4<sup>th</sup>, 8<sup>th</sup> and 10<sup>th</sup> orders described above and by providing in the 5<sup>th</sup>, 6<sup>th</sup> and 7<sup>th</sup> orders that

This memorandum is intended only as a general discussion of these issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your Dewey & LeBoeuf relationship partner.

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the preliminary injunction was granted upon condition that Destiny Holdings post an undertaking in the amount of \$15 million.

However, in the end this entire controversy in a \$365 million project centered around whether an inference could be made in the loan documents that TI costs would be included in calculating a Deficiency. The absence of, perhaps, a phrase in the loan documents left Citigroup with limited recourse.

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