Construction Lending News
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Sleepy Housing Market to Awaken in 2011

By Broderick Perkins[1]

The housing market will remain in hibernation this winter and, without the benefit of a federal home buying tax credit, keep snoring right on through the spring, according to two recent studies.

However, by the third quarter of 2011, pent up demand could stir the market from its slumber and generate a modest, groggy recovery.

During its recent NARdigras 2010 Realtor Conference and Expo, the National Association of Realtors (NAR) forecast an "uneven recovery" next year.

"Existing-home sales have shown some improvement, but the foreclosure moratorium is likely to cause some disruption and contribute to an uneven sales performance in the months ahead," said Lawrence Yun, NAR chief economist.

"Tight credit and appraisals coming in below a negotiated price continue to constrain the market. Nonetheless, there appears to be a pent-up demand that eventually will be unleashed as banks resolve their issues with foreclosures and the labor market improves," Yun said.

Likewise, the recent "Fiserv Case-Shiller Home Price Insight" reported that the home buyer tax credit delayed the housing market's slide to the bottom, and that will put off the recovery until late 2011.

Fiserv and Moody's Economy.com expect that home prices will drop over the next four quarters in nearly all metro markets, before prices have a shot at stabilizing by the end of 2011.

"Some of the largest declines in prices will occur in markets that had strong spring and summer 2010 price increases," said David Stiff, chief economist at Fiserv. "This is because the home buyer tax credit delayed the correction in home prices that is necessary to return housing affordability to its pre-bubble levels," Stiff added.

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[1]Broderick Perkins parlayed a 30-year career in old-school journalism into a digital-age news service offering editorial content and related consulting services.

The award-winning consumer journalist, originally from Wilmington, DE, is founder, publisher and executive editor of the bootstrap DeadlineNews Group, a Silicon Valley-based content provider specializing in residential real estate, consumer news and consulting.

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Sleepy Housing Market to Awaken in 2011

(cont'd)

According to NAR, Existing-home sales, down 21.2 percent year-over-year in the third quarter this year, are forecast to drop 24.7 percent in the last quarter this year. The declines reflect the absence of the federal home buying tax credit, available this time last year, NAR said.

Next year, expect smaller sales declines of about 7 percent during the first two quarters, before sales begin to rebound with a near 26 percent year-over-year increase in sales, according to the forecast.

"We've added 30 million people to the U.S. population over the past 10 years, but sales are where they were in 2000, so there appears to be a sizable pent-up demand that could come to the (housing) market once the economy gathers momentum," Yun said.

Yun said existing home sales will rise from 4.8 million this year to 5.1 million next year while housing starts are expected to rise to 716,000 in 2011 from 598,000 this year. Housing starts bottomed out at 554,000 in 2009.

The boost in sales and starts is related to favorable growth in the Gross Domestic Product. NAR says it should grow 2.0 to 2.5 percent over the next two years. A projected and much needed 1.5 million additional jobs over the next two years will push the unemployment rate down to 8 percent by 2013, but it won't return to a normal level of about 6 percent until 2015.

Mortgage interest rates are at record lows now, but by the time housing market recovery is under way, they are expected to rise, creating an average 4.9 percent next year, and 5.8 percent in 2012, Yun said.

Median prices for existing homes, nationwide at $177,100 in the third quarter this year (down 0.6 percent a year ago) are expected to continue to decline to $165,900 into the first quarter 2010, before managing $178,900 by the third quarter next year, an expected peak for the year.

New home prices, $218,000 in the third quarter, 2010 (up 2.5 percent from a year ago), are expected to continue rising each quarter in 2011 and peak out at $224,300 in the fourth quarter.

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2011 Call Schedule:
An email will be sent to notify participants closer to the conference call date.

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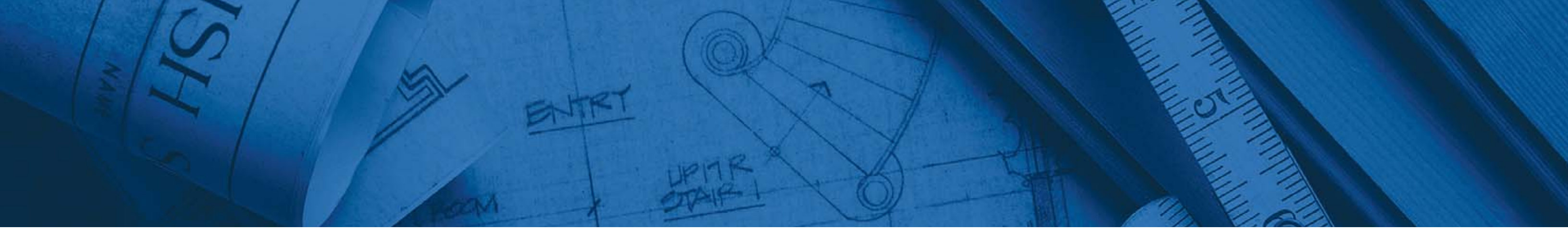

Major Cities Gear Up for Future Sustainability

By Michael Murray[2]

Building codes, mandatory disclosure rules and other energy efficiency regulations are developing quickly in the U.S., said Pike Research, Boulder, Colo.

In *Building Efficiency: Ten Trends to Watch in 2011 and Beyond*, Pike Research reported that new financing options are also emerging to support business cases for energy efficiency retrofits.

Retrofitting existing building stock will be the real challenge in the next decade, said David Borchardt, chief sustainability officer at The Tower Companies, Rockville, Md.

Borchardt said there need to be lease changes that allow landlords to benefit from green retrofits because “85 percent of buildings that will exist in 2020 are already built.”

“Buildings account for about a third of global energy use, and as much as 40 percent of energy consumed in the United States. Therefore, they represent a prime opportunity for efficiency improvements,” said Mike Wapner, senior analyst at Pike Research.

In 2007, California was the first U.S. jurisdiction to establish a commercial benchmarking law, which requires commercial building owners to disclose their benchmark data to prospective tenants, buyers, and lenders. Other jurisdictions followed, including New York City, Seattle and Washington, D.C. as Maryland, Oregon, San Francisco and Portland consider their own rules.

Future tenant demand already has some New York City landlords planning to retrofit properties for sustainability.

David Greenbaum, president at the New York office of Vornado Realty Trust, said sustainability and green buildings in existing portfolios are going to be the single-most important issue in the next five to 10 years.

"We are going to come to a time--five, seven and 10 years from now--where tenants are going to redline buildings that are not sustainable, green new-age buildings, not new-builds but existing portfolios," Greenbaum said. "We are going to see something not dissimilar to what we saw as it relates to asbestos in the 1970s."

Vornado took over half of its space in New York City, nearly 10-plus million square feet, and achieved Leadership in Energy and Environmental Design certification for that space. At 330 Madison Avenue, for example, Vornado is redeveloping the asset to make it sustainable.

"The companies that today need to have the capital, not just for the TIs [tenant improvements] and leasing commissions, but most importantly for tenants to know that when they are going into a building and making a long-term commitment to that building, that the landlord is going to have capital and be prepared to continue to reinvest capital to improve the asset," Greenbaum said.

Pike Research forecast continuing connection between efficient buildings and the smart grid that will grow with increased financing options emerging to support building efficiency programs.

Vornado recently unveiled a 6.3 megawatt co-generation plant at 1 Penn Plaza. The co-generational facility in a 2.5 million square-foot building takes 50 percent of its electrical requirement "off the grid" and produces electricity with natural gas--normally an unused byproduct of electricity production.

Greenbaum said specific returns from a green portfolio are difficult to determine but Vornado gets repaid on its investment "by having fully occupied buildings. In this case, a steam byproduct, which runs the steam turbines, effectively offsets nearly 30 percent of the steam requirement,” he said.

In January 2009, the Department of Energy determined that all states must have significant energy efficiency building codes in place that meet or exceed ASHRAE 90.1-2004, a standard building code. As of now, more than 40 states and the District of Columbia adopted a version of the model energy building code, but many of these are still using old versions of the code.

One of the most popular U.S. benchmarking system, Energy Star, is a voluntary program that evaluates commercial buildings and rewards the top 25 percent of performers with an Energy Star label.

[2]Printed with permission by MBA Commercial/Multifamily NewsLink.

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Major Cities Gear Up for Future Sustainability *(continued)*

Robert Selsing, senior vice president and regional manager of Boston Properties, New York, said Boston Properties also embraces retrofitting existing buildings with sustainability features. Its 510 Madison property will be a LEED Gold building, and it is using Energy Star on all of its properties while watching those "ratings very carefully."

"We wouldn't even conceive of doing a new building that was not LEED Gold," Selsing said.

Building codes, mandatory disclosure rules and other energy efficiency regulations are also developing quickly around the world and country, Pike Research reported.

"The commercial building sector is becoming an increasingly attractive market for technology and service companies alike," Wapner said. "From energy management systems to LED lighting, the industry is in a period of strong technological innovation."

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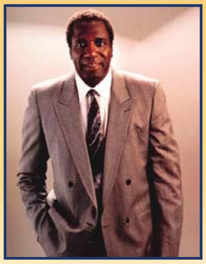

Meadowlark has played in 16,000 career basketball games. He was inducted into the NBA Basketball Hall of Fame in 2003 and received the NBA Lifetime Achievement – John Bunn Award in 2000. He currently has his own comedic basketball team, the Meadowlark Lemon's Harlem All Stars™.

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Information Management Network (IMN): 4th Bank & Special Asset Executive Forum on Distressed Real Estate
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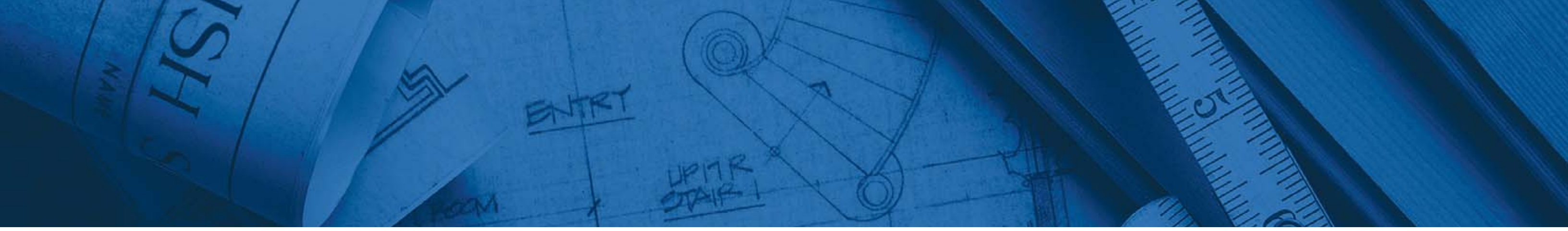
New York, NY



Real Estate Outlook: Builders Regain Optimism

by Carla Hill[3]

Housing starts rose in December, indicating that builders may be starting to feel more optimistic about the market.

Starts rose 3.9 percent last month, this being the first rise in new-home production since August. According to data from the U.S. Commerce Department, this rise was thanks to a 7 percent gain in single-family home building.

According to the National Association of Home Builders, "Regionally, starts activity showed gains in all but one part of the country in November. The Midwest, South and West each posted gains, of 15.8 percent, 2.3 percent and 2.1 percent, respectively, while the Northeast posted a 2.5 percent decline."

NAHB Chief Economist David Crowe says, "The modest increase in single-family starts and permits in November is consistent with a very low inventory of unsold new homes and our member surveys that have shown a degree of optimism among builders with regard to sales expectations in the next six months. However, builders continue to find it extremely difficult to obtain credit for acquisition, development and construction activities, and this is weighing on their ability to initiate viable new projects that could generate much-needed job growth."

Credit has been difficult topic for many consumers, as well. Tightening of lending by banks has meant fewer buyers have been able to attain the goal of homeownership. Many lenders were wary of extending credit for good reason. Defaults were rampant.

Now, after a three-year slowdown, The New York Times is reporting that credit card offers are again on the rise. Lenders are “tiptoeing their way back into the higher-risk pool of customers,” says John Ulzheimer, president of consumer education at SmartCredit.com.

According to the Times, the industry is using new terminology to define borrowers -- all based on credit scores. This should be even more incentive to buyers to get a handle on their credit.

These terms include: “strategic defaulters,” meaning those (many times investors) that walked away from a mortgage; “first-time defaulters” who may have lost their home after losing a job in the recession; “sloppy payers,” who don't always pay all of their bills on time; “abusers,” who just don't pay; and “distressed borrowers,” who are unable to pay.

The bottom line is credit is still tight, but there is hope on the horizon. Potential buyers should make their best efforts to repair damaged credit in order to move forward in the real estate market.

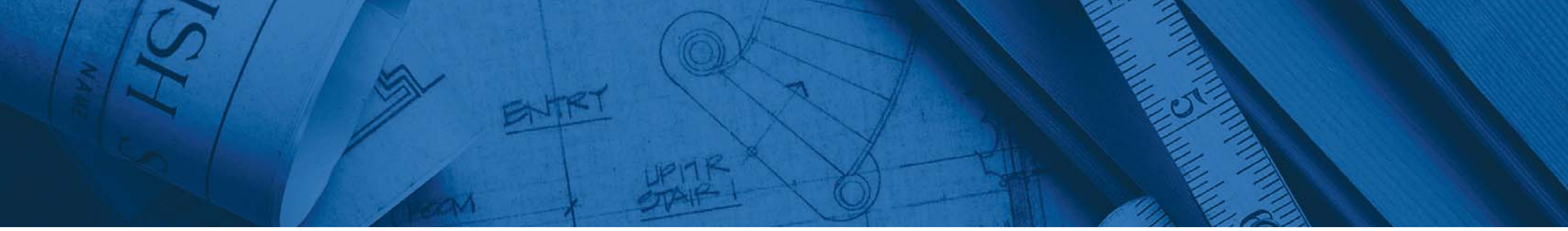
Construction-at-a-Glance

	Oct. 09	Oct. 10
Total Monthly Housing Starts*	529	534
One Unit	476	435
Multifamily	53	99
YTD Permits-Single Family*	451	404
YTD Permits-Multifamily*	101	148
Monthly New Home Sales*	396	283
Unemployment Rate	10.1%	9.6%

**Thousands of Units*

Source: U.S. Bureau of the Census, Construction Reports, Series C-20, Housing Starts. U.S. Bureau of Labor Statistics.

[3]Carla Hill, M.A., works on the Realty Times staff as Managing Editor for our online publication. She also is Producer for the real estate news channel, seen daily on RealtyTimes.com and on video newsletters nationwide. She currently works out of the Realty Times corporate office and studio in Dallas, TX. Any questions can be sent to Carla at carladavis@realtytimes.com.



The Construction Money Mortgage in Arkansas

by Junius Bracy Cross, Jr. [4]

In Arkansas, the stated purpose of the loan can change the materialmen's lien priorities. In the case of a mortgage with the stated purpose of funding for a construction project, a special priority is granted. We will discuss how a construction lender can take advantage of this priority and protect itself from an uncertain construction climate. There have been a number of changes in Arkansas law over the last few years that have materially changed the landscape faced by a construction lender. Some of these changes were by amendments to the materialmen's lien laws and some through the courts. How these developments affect a construction lender can result in unexpected and adverse consequences. This article should help you in navigating around these problems. The distinction between residential and commercial construction largely affects the types of notices required to establish a lien and not the priority and substance of the lien laws. The issues discussed in this article will apply to residential and commercial projects, unless noted otherwise.

In this article, we will examine issues that are important to a construction lender doing business in the state of Arkansas. There are two broad areas of concern: (1) the priority assigned to a mortgage verses a materialmen's lien; and (2) strategies for dealing with materialmen's liens once the project has started. The lien priorities are affected by the date that construction project is deemed to have been "commenced" in relation the mortgage filing date. We will discuss the exception granted for a 'construction money' mortgage and special rules that apply. The law regarding pre-existing liens has changed and new procedures established regarding division of the foreclosure proceeds. Finally, we will discuss a number of strategies for dealing with a construction project by a lender during and after construction. This will include: the role and protections offered by a construction surety bond; the new rules that affect the ability of a lender to obtain information from the contractor; and, the means for removal of materialmen's lien once filed.

1. Priority.

Arkansas, as most states, follows the first in time rule with regard to lien priorities.[5] The statutes concerning materialmen's liens alter this rule and the relative value of an encumbrance. The most important aspect of this is the definition of the actual 'commencement' of a project. Prior to 1995, these rules were ent irely determined by court cases. The lending and title community developed some standard expectations and procedures based on the court cases. However, in 1995 amendments to the lien statutes dramatically altered the definition of commencement in a way that left the standard procedures from the past in doubt.

Ark. Code Ann. §18-44-110 (1995), provides that construction or repair commences when there is a visible manifestation of activity on real estate that would lead a reasonable person to believe that construction or repair of an improvement to the real estate has begun or will soon begin, including but not limited to the following: (A) delivery of a significant amount of lumber, bricks, pipe, tile, or other building material to the site; or (B) grading or excavating the site; or (C) laying out lines or grade stakes; or (D) demolition of an existing structure.

This statute is very different from the previous statute that required actual work to have commenced on the building. The list of examples given in the revised statute specifically overturned previous case precedent regarding 'commencement'.[6] Under the previous statute, lenders and title companies could protect themselves with a simple photograph of the building site without improvements. Photographs are helpful, but the lender should make sure that if they use photographs then they should show the full property in sufficient detail. Proof of non-commencement is

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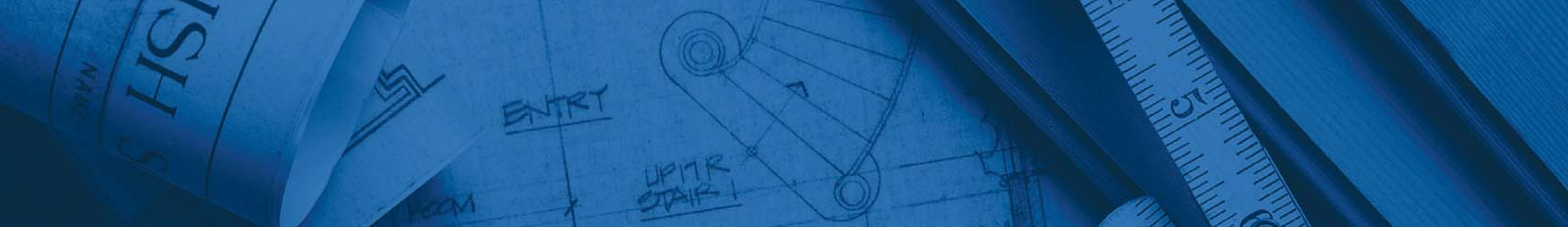
[4]Mr. Junius Bracy Cross, Jr. has practiced in the field of construction law in Arkansas for thirty years and has recently been chair of the Arkansas Bar Association Construction Law Section. Mr. Cross regularly represents prime contractors, subcontractors, suppliers, architects, engineers, owners and construction surety companies. Mr. Cross may be reached at 308 East 8th Street, Little Rock, AR 72202, 501-374-2512 Fax 501-324-8938, E-mail jbcross@cei.net. Much more information is available about both Mr. Cross and Arkansas lien laws at www.jbcrossconstructionlaw.com.

[5]*Dempsey v. Merchants Nat'l Bank*, 729 S.W.2d 150 (1987). "Priority is generally determined by the maxim "prior in time, prior in right." Comment, Priority of Liens on Real Property in Arkansas: Mortgages, and Mechanics' and Materialmen's Liens, 12 Ark. L. Rev. 170 (1958). The rights of a materialman's lien are set by statute. Ark. Code Ann. § 51-60- 51-642 (Repl. 1971). This being a case of new construction, any lien a materialman has relates back to the time when work commences. *Wiggins v. Searcy Fed*. S & L, 486 S.W.2d 900 (1972). Consequently, such a lien takes priority over any claims perfected after that time. It is settled law that a mortgage filed after work commences will be subordinate to any liens base on the commenced work. *Dempsey v. McGowan*, 722 S.W.2d 848 (1987); *Lyman Lamb Co. v. Union Bank of Benton*, 374 S.W.2d 820 (1964); *Planters Lumber Co. v. Jack Collier East Co.*, 356 S.W.2d 631(1962). A mortgage becomes a lien at the time it is recorded and not before. Comment, 12 Ark. L. Rev. 170 supra."

[6]These cases have been specifically overturned under the current statute. *See Mark's Sheet Metal v. Republic Mtg. Co.*, 414 S.W.2d 106 (1967); this court explained that the commencement of buildings and improvements "means some visible or manifest action on the premises to be improved, making it apparent that the building is going up or other improvement is to be made . .. This must be done with the intention and purpose then formed to continue the building to completion." and *See Jim Walter Homes v. Bowling Bldg. Supply*, 521 S.W.2d 828 (1975), Removing the foundations of old buildings on the premises, commencement of leveling operations and the establishment of cut and fill elevations are not sufficient evidence of commencement. *Clark v. General Elec. Co.*, supra. An inspection and measurement of the premises and the placing of a wooden peg to determine the location of a proposed house on the premises are not sufficient.



Construction Money Mortgage in Arkansas

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important because mortgages or encumbrances filed after commencement are inferior to the lien of the all of the materialmen on that project, even those who start after such mortgages are filed.

The materialmen's lien statutes do provide an exception for a mortgage when the funds are intended for funding construction or repair of the improvement. Arkansas is not a 'trust fund' state and a bank, once it places the proper 'construction loan language' in its mortgage,[7] is not required to take much action to make sure that the loan proceeds actually go to pay for the project.[8] The mortgage must meet the following requirements: (1) the mortgage must be executed and recorded before commencement of the building; (2) the mortgagee must be unequivocally bound to advance money for construction; and (3) the recorded mortgage must show that the mortgagee is unequivocally bound. The courts in Arkansas look to the purpose rather than the actual use. However, from a purely practical standpoint the construction lender should be concerned that the funds are not diverted, as the value of an incomplete project may not be sufficient to support the loan amount.

In addition, recent case law has changed the interpretation of an Arkansas statute that establishes priority between a materialmen's lien and any prior mortgages. For many years, the words in the statute would have made it appear that a materialmen's lien would be superior to a pre-existing mortgage. However, case law from early times had largely rendered this statute void. This was changed by the case Simmons First Bank v. Bob Callahan Serv., 13 S.W.3d 570 (2000), the Arkansas Supreme Court changed the remedy and in effect revived the materialmen's lien priority in the improvement. The case turned on the ancient law of fixtures and a detailed analysis of the statute, which you will be spared. From a practical standpoint, the prior mortgage holder retains a first interest in the value of the real property and the materialmen's lien is given a preference in the value of the improvement. This is done by use of a double appraisal; the property is appraised without any improvement and then again with the improvement. This establishes the relative value of each and the foreclosure proceeds are distributed on a pro rata basis. Neither party is left out in the cold.

2. Strategies for protection.

There are a number of strategies that a construction lender may use to protect itself from real world issues that materialize during the construction process. While a construction money mortgage does not require the lender to be hyper vigilant over the use of the loan proceeds to maintain priority, the simple fact that an incomplete project is worthless ought to require some protective measures. No amount of inspections can protect the lender from the financial condition of the contractor. The insolvency of a contractor can strike even those that are large, well managed and established.

The best protection against liens and insolvency is the requirement on commercial projects that the contractor produce a payment and performance bond. These bonds protect from not only unpaid subcontractors and suppliers, but also provide a source of funds and a means to finish the project. When the contractor fails to pay its subcontractors, labor, and suppliers it loses the ability to do any further work. The threat to the lender's collateral then is not the priority of lien claims, but the fact that a lot with an unfinished house or office building on it may have no value at all. The lender of course always has recourse to its customer, but the average property owner, residential or commercial, generally lacks the knowledge and ability to resurrect the project. The recent trend is that project designers have largely withdrawn from the supervision of the projects, leaving the owner and lender to handle problems. A payment and performance bond will provide a source of funds and perhaps some practical aid in completion.

The construction lender does have some new tools to deal with liens once they have been filed. Under Ark. Code Ann. § 18-44-108 (2010), "[r]efusal to list parties doing work or furnishing materials," provides a mortgage holder the right to issue a demand

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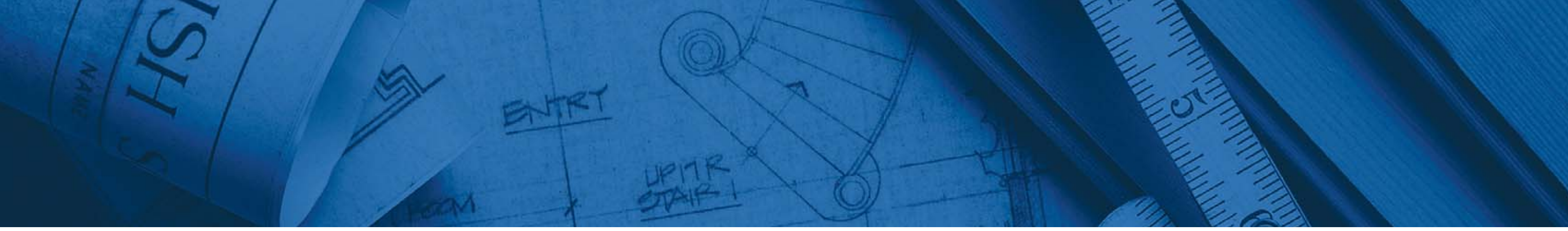
[7]*Dempsey v. McGowan*, 722 S.W.2d 848 (1987) In order to establish a construction money mortgagee's priority over materialmen's liens, the following conditions must be satisfied: (1) the mortgage must be executed and recorded before commencement of the building; (2) the mortgagee must be unequivocally bound to advance money for construction; and (3) the recorded mortgage must show that the mortgagee is unequivocally bound. *Planters Lumber Co. v. Jack Collier East Co.*, 356 S.W.2d 631 (1962).

[8]*Dempsey v. McGowan*, 722 S.W.2d 848 (1987) "Some of the funds released by the mortgagee were used by the mortgagor for purposes other than construction; however, when determining priority of liens we consider the purpose for which the funds were supplied rather than the use which was made of the money." *Sebastian Bldg. & Loan Ass'n v. Minten*, 27 S.W.2d 1011 (1930). See *Spickes Bros. Paint Cont.v. Worthen Bank & Trust Co.*, 771 S.W.2d 258 (1989) "Although we have encountered cases where a portion of the proceeds from the construction money loan was applied other than for the payment for improvements either with or without the knowledge of the mortgagee, we have never ruled that the materialmen had liens superior to the amount of the construction money mortgage lien as finally determined when the above conditions have been met."



Construction Money Mortgage in Arkansas *(continued)*

to the contractor to furnish within five days a list of subcontractors and suppliers for the project and the amount owed. This has been the law for some time but until 2009, there was not a practical enforcement mechanism. There is now a right for civil action to force this information from the contractor. How the courts will treat this right and whether lenders will make use of it remains to be seen. The right exists whether or not there is any 'probable cause' and can be used at any time. A careful lender has the tools now to make sure that funds paid to the contractor have been properly applied.

Arkansas has had a process to allow liens to be 'bonded off' of a project for many years. Recent changes should make this procedure easier to use. Ark. Code Ann. § 18-44-118 (2010), allows a property owner or contractor to file a surety bond to which liens are attached and are thus removed from the property. The bond previously required that the bond amount be double the amount of the lien claim; now, it requires only as much as the lien claim. This should have the practical effect of making it easier to bond around a lien. This same statute provides a summary proceeding to allow frivolous liens, filed without the proper notices, to be removed in an expedited manner. This was brand new in 2009 and no one knows how the courts will interpret this new right. However, it does provide a means for certain liens to be cleared without some of the delays associated with litigation.

The principal distinction between residential and commercial construction relates to the types and timing of the various notices required. Since a construction lender will never file such a materialmens' lien and the length of the article is limited, these notices have not been discussed. The most important take away points for this article are the effect and definition of the commencement of a project, the lender's ability to secure pertinent financial information while the project is ongoing, and consideration for the use of payment and performance bonds. While surety bonds are largely unavailable in the residential context, they should be a consideration on all commercial projects. The Arkansas Materialmen's Lien statutes provide the lender with many protections, but the lender must be careful and vigilant.