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# Lenders - include specific performance milestones in construction loan agreements

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On November 13, 2009, the New York State Supreme Court Appellate Division upheld a lower court decision granting an injunction requiring Citigroup Global Markets Realty Corp. (Citigroup) to continue funding what it believes to be a failing project. The so-called Destiny USA project consists of an extension to the Carousel Mall located in Syracuse, N.Y. and is designed to include development of a shopping, entertainment, dining and tourism center displaying the latest in modern green technology. In 2005, Citigroup contracted with Destiny USA Holdings, LLC (Destiny) to provide a $155 million construction loan to finance the project. The project was also funded with $40 million from Destiny and $170 million in bonds from the City of Syracuse Industrial Development Agency.

The project loan was structured as an "advancing term loan," whereby Citigroup was charged with approving advances of all loan proceeds, regardless of their source, pursuant to monthly draw requests submitted by Destiny. If a Deficiency existed, as defined in the loan agreement, Citigroup had the authority to deny such a request. Although at times disputes existed, all draw requests were paid by Citigroup until May 2009 when Citigroup refused to fund further draw requests and subsequently sent Destiny a Deficiency notice alleging a Deficiency in excess of $15 million. Almost the entire amount of that Deficiency was based on the inclusion of Tenant Improvement costs in the Deficiency calculation. When Destiny failed to cure the alleged Deficiency, Citigroup declared the loan in default and thereafter Destiny sought an injunction to compel Citigroup to continue to make advances.

The dispute before the State of New York Supreme Court Appellate Division hinged on whether it was appropriate for Citigroup to include Tenant Improvement costs in its Deficiency calculation. The court began its analysis by examining the definition of Deficiency found in the loan agreement. Under the loan agreement, a Deficiency is to be measured, in relevant part, according to the amount by which the balance of the loan proceeds yet to be advanced plus other available funds, is less than the actual sum estimated to be required to complete construction of the Required Improvements in accordance with the Plans and Specifications. The parties both agreed that Tenant Improvements, which under the loan agreement refers to costs incurred in obtaining leases relative to the property, were not included as Required Improvements in any of the Plans and Specifications. Thus, the court held that under the plain language of the party's agreement, Tenant Improvements were not part of the Deficiency calculation and therefore Destiny had demonstrated a likelihood of success on the merits sufficient to permit the issuance of an injunction requiring Citigroup to continue to fund the project.

Citigroup had argued unsuccessfully in the lower court that the measure of a Deficiency was to be based on the entire budget concerning the project and further that it should not be required to fund a project it alleges to be a failure due to an alleged lack of committed tenants. The lower court held that the parties agreement, by its terms, did not include the existing budget as a consideration in calculating a Deficiency, nor did it contain any requirement that there be any committed tenants at this phase in the project. This time, Citigroup argued that although the Plans and Specifications submitted to the court did not include Tenant Improvement costs, as the project progressed, such costs inevitably would be included in subsequent revised Plans and Specifications. Further, Citigroup argued that such costs should implicitly be included as Required Improvements, otherwise the definition would only require the building of a "core and a shell" and not a "shopping center and tourist destination." However, based on the plain language of the loan agreement and the Plans and Specifications on record, the court concluded that it could not read Tenant Improvement costs into the calculation of a Deficiency. Nonetheless, the court required Destiny to post a $15 million bond to reimburse Citibank for damages in the event it may be later determined that the injunction should not have been issued.

This case serves as an important reminder to lenders of the need to include specific performance milestones in construction loan agreements to protect against the danger of being trapped funding a potentially failing project. As this case demonstrates, courts may not be willing to imply such terms in a loan agreement, even if, logically speaking, they may have been part of a party's basic understanding of the basis of the bargain.

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