

# NEGOTIATING CONSTRUCTION LOAN AGREEMENTS FOR MULTI-FAMILY DEVELOPMENTS

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## NEGOTIATING CONSTRUCTION LOAN AGREEMENTS FOR MULTIFAMILY DEVELOPMENTS

### 1. Introduction.

In this session we will do three things: (1) review basic principles of construction lending; (2) identify the provisions in a construction loan agreement that are frequently negotiated and provide suggestions to borrowers' and lenders' counsel for compromising those provisions; and (3) highlight the provisions in a construction loan agreement that specifically relate to multifamily developments.

### 2. Basic Principles of Construction Lending.

A. Construction loan vs. Permanent Loan. A construction loan (typically 12-24 months) is a short-term loan used to finance the construction or renovation of a project. In contrast, a "permanent" loan is a long-term (typically 5-15 years or longer if agency financing) mortgage loan used to finance the purchase of the property or to pay off existing loans, including an existing construction loan. A construction loan fundamentally differs from a permanent loan in that the collateral supporting a construction loan is incomplete because the buildings and improvements on the property either do not yet exist or are in the process of undergoing reconstruction. This makes construction loans riskier for lenders and their pricing reflects that. The interest rate on a construction loan usually floats with LIBOR and monthly payments are interest only. Most permanent loans bear interest at a fixed rate and are amortized over 10-20 years (again, longer if agency financing).

B. Collateral. Secured lending is based on the value of the collateral. In real estate lending, the primary collateral includes:

1. The real property.
2. The buildings and improvements located on the real property.
3. The income and rents generated by the real property under leases affecting the property.

C. Underwriting. A permanent loan is underwritten based on the actual income stream the property generates. In contrast, in construction financing, the buildings and improvements do not yet exist and, until the building is completed and available for legal occupancy, the property cannot generate rental income, so value is based on a projected income stream. Thus, construction lending is inherently riskier than permanent financing because the construction lender must depend more heavily on the credit of the developer, the developer's guarantors, and other third parties (i.e. architects, engineers, and contractors). This impacts both the psychology and the practical approach that lenders take in making construction loans.

D. Risks; Risk Mitigation. The construction process itself can be plagued by delays, cost overruns and changes in market conditions. Improper pricing or

underwriting can jeopardize the lender's return on investment. A major default by the borrower or the builder can jeopardize completion of the project and repayment of the construction loan at maturity. To partially offset these risks, in construction lending:

1. Loan terms are typically shorter.
2. Interest rates are typically higher.
3. Due diligence/underwriting is more extensive (see below).
4. Disbursement of loan proceeds and loan administration is more tightly managed.
5. Additional collateral securing the loan may be required (i.e. guarantees, letters-of-credit, interest rate swap agreements, payment and performance bonds, reserves, etc.).
6. A written commitment for permanent financing is often required.

E. Construction Loan Due Diligence. In addition to the typical real estate loan due diligence, the construction lender needs to know that:

1. The developer/borrower has the necessary skill and experience to manage the proposed construction project.
2. The developer/borrower and any guarantors can financially support continuation of the construction project if there is an event that interrupts loan advances, a shortfall between the total amount needed to complete the project and carry it during construction and the aggregate amount of advances remaining under the loan, or a time gap that forces the developer to carry the property beyond loan maturity.
3. The architects, engineers, contractors, subcontractors, suppliers, and other key parties have the necessary skill and experience to perform under the key contracts.
4. None of the key parties are in financial distress or have an unacceptably poor credit or financial history.

The due diligence material that a construction lender requires from key parties includes:

5. The developer/borrower's resume, including detailed information of prior construction projects.
6. Background information or resumes from the architect of record, the general contractor, and the engineer for the project.
7. Financial statements, bank statements, and tax returns for the developer and any loan guarantors.
8. The organizational documents of the developer/borrower, including any entity that owns a controlling interest in the developer/borrower.
9. The organizational documents of any non-individual guarantor, including any entity that owns a controlling interest in that guarantor.
10. Evidence of good standing and corporate authorization for all non-individual key parties.
11. Judgment, bankruptcy, litigation, Uniform Commercial Code ("UCC"), and USA PATRIOT Act searches against all key parties.

See Exhibit A for a more detailed list and discussion of construction loan due diligence.

### **3. Construction Loan Agreements.**

Loan agreements are used in multifamily construction transactions as the primary governing document for the loan. The loan agreement will include (1) a description of the project to be constructed and the loan being provided to pay for a portion of the construction costs; (2) the procedures for receiving disbursements of the loan to pay for the construction and development costs (when, how and under what conditions); (3) the interest rate and terms of repayment, and the fees and other charges required to be paid by the borrower; (4) a description of the collateral; (5) requirements for the construction project and precise timelines for the construction process; (6) representations and covenants of the borrower; and (7) a list of events of default and the lender's remedies.

A. Development Agreements, Construction Contracts and Architect Contracts.

B. Defaults; Remedies.

See Exhibit B.

## EXHIBIT A—CONSTRUCTION LOAN DUE DILIGENCE REQUIREMENTS

In addition to the typical due diligence requirements for a permanent loan (i.e. title, survey, UCC searches), construction loan/lender due diligence frequently includes the following:

1. Anti-Money Laundering/Know Your Customer (AML/KYC). Oftentimes, a construction lender is required by regulation to confirm the identity and validity of the borrower and key principals of the borrower. This includes legal entities and each individual with an ultimate ownership stake of 25% or more of the equity interest and at least one individual who exercises significant authority and control over the borrower.
2. Borrower Equity. Proof of all equity (and any subordinate debt) funded to-date in the construction project is required. A detailed breakdown of funds spent towards equity is required with appropriate back-up. If land values are considered towards equity, a copy of the purchase agreement and signed settlement statement must be submitted to the construction lender.
3. Consent to Assignment of Engineer/Architect Agreement and Certificate. A Certificate of Architect must be executed by the Project's engineer and/or architect. This certificate provides evidence the Project will comply with all zoning ordinances, environmental protection laws, governmental rules and regulations related to the Americans with Disabilities Act (ADA), Federal Clean Air Act (FCAA) and Federal Water Pollution Control Act.
4. Consent to Assignment of Contractor's Agreement and Sworn Construction Cost Statement. A Consent to Assignment of Contractor's Agreement and Sworn Construction Cost Statement must be executed by the Project's contractor and borrower. A copy of the schedule of values for the Project is typically attached to this Consent.
5. Construction Disbursement. A budget certified by Borrower that contains a schedule of values for land, hard costs, and soft costs is attached to a disbursing agreement among the construction lender, borrower and disbursing agent (oftentimes a title company).
  - a. Initial Disbursement. If the equity requirement has been satisfied and there are pre-closing expenses to be reimbursed at closing, a closing draw request is submitted to the construction lender and disbursing agent. Copies of all invoices, statements, or other supporting evidence must accompany the request. Any disbursement of loan funds must comply with the terms of the Construction Loan Agreement and Disbursing Agreement. An inspection may be ordered depending upon the status of the Project.
  - b. Funding Instructions. Funds must be disbursed to and through the disbursing agent (e.g. title company) upon the terms and conditions set forth by the construction lender in the Construction Loan Agreement and the Disbursing Agreement.

6. Construction Schedule. A construction schedule outlining the proposed progress of work and anticipated disbursement of loan proceeds must be prepared and provided to all parties.
7. Contracts. Copies of all executed construction, engineering, and architectural contracts must be provided to all parties. This includes any other major contract for the construction of the Project (e.g., environmental remediation, site development, site improvements, shell building, etc.). The Lender will require that the borrower's interest in the contracts be collaterally assigned. The contractor must provide consent to such assignments. In addition, a list of all contractors, subcontractors and material providers for the Project must be prepared and provided to all parties.
8. Development and other agreements. Copies of all agreements related to the operation of this Project or that would affect title need to be provided for review. These items may include: (a) a Development Agreement with the municipality; (b) Operating Agreement; (c) Leasing Agreement with a lease broker; (d) Property Management Agreement; (e) Franchise Agreement (hotel); (f) Reciprocal Easement Agreement; (g) Service Agreement; and (h) any other agreement that is material to the Project.
9. Environmental Assessment. A Phase I Environmental Site Assessment (ESA) will be ordered to identify possible current or historical environmental contamination of the subject Project. Any fees will be paid at closing by the Borrower. The construction lender may agree to utilize a current Phase I ESA previously obtained by the borrower if the report meets the ASTM 1527 requirements. In the event the Phase I is addressed to the Borrower (or other financial institution), a construction lender may agree to utilize a reliance letter. If any adverse environmental conditions are identified during the review of the Phase I, additional testing may be needed to determine the impact to the Project, the cost of remediation and required assurances from state agencies.
10. Insurance. The construction lender will require evidence of property and liability insurance in the form of policies, to include certain declaration pages, endorsements and/or insurance binders or certificates acceptable to the lender prior to closing. Depending upon the complexity of the Project, the lender may engage a third party vendor to review insurance coverages at the borrower's expense.
11. Leases. Copies of all letters of intent, leases, ground leases, or leases for equipment to be incorporated into the Project including all attachments, exhibits, amendments and supplements must be provided to the construction lender. In addition a copy of the standard lease form to be utilized for the Project should be provided to the construction lender.
12. Licenses and Permits. A list of all anticipated grading and building permits and licenses required for this Project must be provided to the construction lender.
13. Management Agreement. If the property is to be managed by anyone other than the borrowing entity, a copy of the Management Agreement should be provided to the construction lender.

14. Organizational Documentation. Below are the requirements for the various organizational entities that must be provided prior to closing. Documentation is required for all Borrower(s), Guarantor(s), General Partners of the Borrower(s) or Guarantor(s) that are classified as entities, General Partners of partnerships, and members of LLCs. In addition, an organizational chart for each Borrower or Guarantor entity must be provided.

#### Partnership

- Fully executed copy of the partnership agreement or joint venture agreement with any and all amendments;
- A certified copy of Certificate of Limited Partnership and all amendments as filed or recorded pursuant to all applicable laws and an original Certificate of Good Standing, for the current year, from the Secretary of State of the state of formation and of the state where the Project is located, and evidence of payment of all applicable current franchise taxes.
- Partnership Resolutions setting forth the names of all partners and those parties specifically authorized to bind the partnership and execute documents required for the loan, and containing the signed consents of all general partners and all other partners required prior to the execution, and
- Evidence of proper Fictitious Business Name, Trade Name Affidavit, or similar filings or recordings as required by law.

#### Corporation

- A complete copy of the Articles of Incorporation and all amendments certified to by the Secretary of State of the state of incorporation;
- A complete copy of the Bylaws and all amendments certified to by Borrower's and/or Guarantor's Secretary;
- An original Certificate of Good Standing, for the current year, from the Secretary of State of the state of incorporation and of the state where the Project is located, and evidence of payment of all applicable current corporate franchise taxes;
- Certified resolutions of the Board of Directors (and, if required, of the stockholders) authorizing the corporation (or corporate general partner) to enter into and/or guarantee the loan and to execute and deliver the documents required; and
- Incumbency certificates setting forth the names and signatures of those officers authorized to execute the loan documents and/or Guarantee.

#### Limited Liability Company

- A complete copy of the Articles of Organization or Certificate of Organization and all amendments certified by the Secretary of State of the state of organization;
- A complete copy of the Operating Agreement and all amendments certified to by an Officer/Manager;

- An original Certificate of Good Standing, for the current year, from the Secretary of State of the state of organization and of the state where the Project is located, and evidence of payment of all applicable current franchise taxes;
- A Certificate of Authority or Resolutions authorizing the transaction; and
- Incumbency certificates setting forth the names and signatures of those members/managing members who are authorized to execute the loan documents, currently certified by an Officer/Manager.

15. Plans and Specifications. A complete set of plans and specifications should be forwarded as soon as possible to the construction lender. The plans and specifications should include the name and address of the engineer/architect for the Project. Plans may be submitted in an electronic format. The plans and specifications should include a description of the plans and specifications for each the by sheet or page number and date. Usually, the construction lender will employ (at borrower's expense) an independent architect or engineer to evaluate the plans and review the construction contract and cost statements on the lender's behalf.

16. Property Tax Information. A copy of the current property tax statement showing all parcel tax identification numbers assigned to the Project (i.e. county, city, and school), the approximate dates tax statements are issued and the date taxes would become delinquent if not paid should be provided to the construction lender.

17. Recorded Plat. A copy of the recorded or proposed plat for the property must be submitted to the construction lender and lender's counsel. All subdivision plats, common interest community (cic) plats and registered land surveys (rls) must be submitted to the appropriate governmental authority in an acceptable form for review, approval and recording.

18. Rent Roll/Lease Status Report. If there are tenants that will be in occupancy during a renovation, a current certified rent roll/leasing status report will be required prior to closing.

19. Site Plan. A copy of the site plan showing the layout of the Project must be submitted.

20. Soils Report. A copy of a soils report prepared by a licensed engineer must be submitted.

21. Utility Letters. Utility letters for all major utilities are required.

22. Zoning Letter. A zoning letter from Project municipality is required. The letter must indicate all applicable zoning ordinances or restrictive covenants affecting the Project permit the use of the property for its intended purposes and there are no variances, enforcement actions, or other conditions currently outstanding that would affect the zoning as stated. The information must be in a form sufficient to permit the title insurance company to issue an ALTA form 3.0 Zoning Endorsement (unimproved property) or an ALTA form 3.1 Zoning with Parking Endorsement (improved property).

EXHIBIT B—ANNOTATED CONSTRUCTION LOAN AGREEMENT

What follows is an annotated Construction Loan Agreement that is tailored to the following transaction:

- Two to-be-constructed 20-unit market rate apartment buildings.
- Sources and uses of funds for the project:

**Sources**

Construction loan	\$20,000,000
Subordinate loan	3,000,000
Cash equity	<u>2,000,000</u>
Total	\$25,000,000

**Uses**

Land acquisition	\$4,000,000
"Hard" costs of construction	\$17,000,000
"Soft" costs (except reserves for interest and construction contingencies)	2,000,000
Interest reserve	1,000,000
Contingency reserve	<u>1,000,000</u>
Total	\$25,000,000

Note: this is how the construction loan is "balanced."

- Interest rate is floating.
- Loan term is 18 months.
- Lender's required loan-to-value ratio is 75% (so the required appraised value is \$33,334,000).
- Lender's required loan-to-cost ratio is 80% ( $\$20,000,000 \div \$25,000,000$ ).

**CONSTRUCTION LOAN AGREEMENT**

by and between Apartments 'R' Us, LLC  
and  
Friendly Construction Loan Bank  
dated as of: November 2, 2017

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## CONSTRUCTION LOAN AGREEMENT

This Construction Loan Agreement ("**Agreement**") is made as of November 2, 2017, by and between Apartments 'R' Us, LLC, a Minnesota limited liability company (the "**Borrower**"), and Friendly Construction Loan Bank, a Minnesota banking corporation (the "**Lender**").

### RECITALS

A. The Borrower owns [or will own concurrently with the Closing Date under this Agreement] certain real property (the "**Land**") located in Ramsey County, Minnesota, legally described on **Exhibit A** attached to this Agreement.

B. The Borrower intends to construct two 20-unit market rate apartment buildings (the "**Improvements**") on such property.

C. To pay a portion of the costs of construction of the Improvements, the Borrower has requested that the Lender make a loan to the Borrower in the maximum principal amount of \$20,000,000.00.

D. The Lender is willing to make such loan on the terms and conditions set forth in this Agreement.

NOW, THEREFORE, in consideration of the premises and other good and valuable consideration the receipt and sufficiency of which is hereby acknowledged, the Borrower and the Lender agree as follows:

### ARTICLE I – DEFINITIONS

Section 1.01 Defined Terms . As used in this Agreement, the following terms shall have the meanings set out respectively after each (such meanings to be equally applicable to both the singular and plural forms of the terms defined):

"**Acceptable Lease**" means, with respect to a Unit, a legally valid, binding and enforceable written lease agreement with a bona fide tenant (excluding specifically Borrower, General Partner, Guarantor or their Affiliates and employees), providing for an initial lease term of not less than six months nor more than twelve months and complying with all Laws, all requirements set forth in the Subordinate Loan Documents, this Agreement and the Internal Revenue Code.

"**Accessibility Laws**" mean any federal, state or local law, statute, code, ordinance, rule, regulation or requirement, including, without limitation, the United States Americans With Disabilities Act of 1990, as amended (the "**ADA**"), relating to accessibility to facilities or properties for disabled, handicapped and/or physically challenged persons, or other persons covered by the ADA.

"**Advance**" means any advance by the Lender to the Borrower pursuant to Article II hereof.

"**Affiliate**" means a person or entity that controls, is controlled by or is under common control with another person or entity.

"**Agreement**" means this Construction Loan Agreement together with any amendment hereto.

"**Anti-Terrorism Law(s)**" means any laws relating to terrorism or money laundering, including Executive Order No. 13224, the USA Patriot Act, the Laws comprising or implementing the Bank Secrecy Act, and the Law administered by the United States Treasury Department's Office of Foreign Asset Control (as any of the foregoing Laws may from time to time be amended, renewed, extended, or replaced).

"**Appraisal**" means an appraisal of the market value of the completed Project (a) addressed to the Lender, (b) prepared by an appraiser approved by the Lender, and (c) conforming to all laws applicable to the Lender and otherwise in a form satisfactory to the Lender.

"**Architect**" means Apartment Design, Ltd., the architect retained by the Borrower to design the Improvements, including the preparation of the Plans and Specifications.

"**Architect's Contract**" means the agreement between the Borrower and the Architect as to preparation of the Plans and Specifications, together with any amendments thereto, and construction of the Improvements.

"**Assignment and Subordination of Property Management Agreement**" means the Assignment of Property Management Agreement dated as of the date hereof, from Borrower in favor of Lender, together with the consent of the Property Manager, and together with any amendment thereto.

"**Assignment of Construction and Development Documents**" means, collectively, (a) the Assignment and Subordination of Architect's Agreement, dated as of the date hereof, from Borrower to Lender and consented to by Architect, and (b) the Assignment and Subordination of Construction Contract, dated as of the date hereof, from Borrower to Lender and consented to by the General Contractor.

"**Borrower**" means Apartments 'R' Us, LLC, a Minnesota limited liability company.

"**Budget**" means the line item budget for the hard and soft Project Costs for the Project as approved by Lender and attached hereto as **Exhibit B**, as modified from time to time in accordance with this Agreement.

"**Change Orders**" means changes in the Plans and Specifications that have been executed in accordance with the Construction Contract.

"**City**" means The City of St. Paul, Minnesota.

"**Collateral**" means, collectively, (a) all real and personal property, tangible and intangible, and the products and proceeds thereof, that secures the Loans, including but not limited to, the Project and the Personal Property, and (b) all accessions to, substitutions for and replacements, products and proceeds of any of the foregoing, including, but not limited to, proceeds of any insurance policies, claims against third parties, and condemnation or requisition payments with respect to all or any of the foregoing.

"**Commitment**" means the commitment of the Lender hereunder to make Advances to the Borrower under this Agreement in an aggregate principal amount of up to and including the lesser of (1) \$20,000,000.00, (2) seventy-five percent (75.0%) of the appraised value of the completed Project as determined by the Appraisal, or (3) eighty percent (80.0%) of the total cost of the Project as shown on the Total Project Cost Statement.<sup>1</sup>

"**Commitment Termination Date**" means August 1, 2018, or the date of the termination of the Commitment pursuant to Section 6.02 hereof, whichever date occurs earlier.<sup>2</sup>

"**Commencement Date**" means the date that is ten (10) days following the date of this Agreement.

"**Completion Date**" means November 2, 2018 (provided that if the Lender shall extend such date in writing, then the Completion Date shall be such later date), being the date of required completion of the Improvements and satisfaction of the requirements in Section 3.03 hereof.<sup>3</sup>

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<sup>1</sup> Note that the loan amount is the *lesser* of these three amounts. Thus, if the appraised value or the total cost of the Project turns out to be less than anticipated, the Lender may reduce the loan amount. If the appraised value is adequate and the Borrower realizes cost savings, it will "lobby" the Lender to disburse the full amount of the Loan which will result in a return of equity to the Borrower.

<sup>2</sup> The Commitment Termination Date is the last date on which the Lender is required to make an Advance. The parties will want this date to be at least a month beyond the anticipated Completion Date.

<sup>3</sup> The Borrower will want the flexibility to extend the Completion Date for reasons of "force majeure." This may be acceptable to the Lender as long as there is an agreed-upon outside date for completion. Of course, the Project must be completed and a certain percentage of the Units leased before the end of the Loan term. Also, during construction, interest is paid out of Loan proceeds, and prior to closing the parties must make assumptions about the interest rate and the length of time the Loan will be outstanding. This limits the length of time the Completion Date can be extended without putting the Loan out of balance.

"**Contractor**" means any person, including the General Contractor, who shall be engaged to work on, or to furnish materials and supplies for, the Improvements.

"**Construction Contract**" means the agreement between the Borrower and the General Contractor pursuant to which the General Contractor agrees to construct the Improvements in accordance with the Plans and Specifications for a fixed price or guaranteed maximum price.

"**Contingency Reserve**" means the line items for the Hard Cost Contingency and Soft Cost Contingency in the aggregate amount of \$500,000, established in the Budget to pay costs of the Project that are in excess of specific line items in the Budget, whether as a result of price increases, changes in the Plans or otherwise.

"**Cost of Completion**" means \$25,000,000.00, being the total amount estimated by the Borrower as necessary to acquire the Land and to complete the Improvements, as set forth in the Total Project Cost Statement.

["**Debt Service**" means, for any period, the sum of (a) all principal and interest payments due and payable under the Loan Documents during the period (or that would be due and payable based on scheduled principal and interest payments even if amortization has not commenced under the Loan Documents during the period (but excluding any amounts required to be paid under Section 2.5 for changes in capital adequacy regulations), and (b) all required payments under the Subordinate Loan Documents during such period.]

["**Debt Service Coverage Ratio**" means, for any period, the ratio of (i) Net Operating Income for such period divided by (ii) Debt Service for such period.]

"**Default**" means an event which with notice, lapse of time, or both would become an Event of Default.

"**Default Rate**" means the lesser of five percent (5%) per annum in excess of the Loan Rate or the maximum lawful rate of interest which may be charged, if any (computed on the basis of a 360-day year, actual days elapsed).

["**Developer**" means \_\_\_\_\_, a Minnesota corporation.]<sup>4</sup>

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<sup>4</sup> If a developer is developing the Project, the terms are set forth in a Development Services Agreement between the Borrower and the Developer. As with the other construction documents, Lender will require that the Development Services Agreement be subordinate to the Loan.

["**Developer Fee**" means the developer fee in the amount of \$\_\_\_\_\_ payable to Developer pursuant to the Development Services Agreement, provided that no more than the Permitted Developer Fee Payment as set forth on the Budget shall be made during the term of the Loan.]

["**Developer Fee Subordination Agreement**" means the Developer Fee Subordination Agreement of even date herewith between Borrower, Lender and Developer, together with any amendment thereto.]

"**Development Agreement**" means the Development Agreement, dated as of the date hereof, between the Borrower and the City, together with any amendment thereto, that has been approved by the Lender in writing.<sup>5</sup>

"**Disbursement**" means, as the case may be, disbursements approved by Lender in accordance with this Agreement made by Title in accordance with the Disbursing Agreement of (a) Advances of proceeds of the Loan; (b) Equity deposits; (c) Proceeds of the Subordinate Loan(s); and (d) other funds on deposit in the Construction Disbursement Account and Bank Controlled Account.

"**Disbursing Agreement**" means the Disbursing Agreement, dated as of the date hereof, among the Borrower, the Lender and Title, pertaining to Disbursement of the Project Costs to the Borrower, together with any amendment thereto.

"**Draw Request**" means a request for Disbursement made on the form attached as **Exhibit C** and in accordance with Section 2.02 hereof.

"**Environmental Indemnity**" means the Environmental and ADA Indemnification Agreement, dated as of the date hereof, from the Borrower and the Guarantors to the Lender, together with any amendment thereto.

"**Equity**" means \$2,000,000, being the amount the Borrower is required to expend for Project Costs in accordance with the provisions of Section 3.01(o).

"**Event of Default**" means one of the events of default specified in Section 6.01 hereof.

"**Financing Statements**" mean UCC financing statements naming the Borrower as debtor and the Lender as secured party describing the collateral as the personal property and fixtures covered by the Mortgage.

"**Force Majeure**" means any act of God; acts of terrorism; strikes, shortage or unavailability of labor or materials; lockouts or labor difficulty, explosion;

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<sup>5</sup> If a municipality is providing financial assistance to the Project (including tax increment financing), the terms of the assistance are set forth in a Development Agreement between the municipality and the Borrower.

sabotage; accident; riot or civil commotion; act of war; fire or other casualty; legal requirements; and causes beyond the reasonable control of Borrower.

**"Funding Sources"** means the Loan, the Subordinate Loan, the Equity deposits, and any amounts deposited by the Borrower to keep the Loan In Balance.

**"General Contractor"** means Apartment Builders, Inc.

**"Governing Authorities"** means the City and any other local, state or federal governing authority having jurisdiction over the Project.

**"Guarantors"** mean collectively, Jane A. Doe and John B. Smith.

**"Guaranty"** means the Personal Guaranty Agreement of even date herewith wherein each Guarantor jointly and severally guarantees performance (including payment) of all obligations of the Borrower under this Agreement, the Note and the Security Documents.

**"Improvements"** mean two multifamily apartment buildings each containing 20 apartment Units, and related improvements including without limitation (i) standard finishes for all Units, (ii) 20 underground parking spaces below each building, and (iii) surface parking for 20 vehicles, all of which to be constructed by the Borrower in accordance with the Plans and Specifications and this Agreement, and any other buildings, improvements, fixtures and equipment owned by the Borrower and located on the Land at any time.<sup>6</sup>

**"In Balance"** has the meaning set forth in Section 2.03.

**"Inspecting Architect/Engineer"** means Inspecting Architects & Engineers, Inc.

**"Land"** means the land in Ramsey County, Minnesota, upon which the Improvements are located, which is legally described in the Mortgage.

**"Lease"** means any lease, sublease or sub-sublease, letting, license, concession or other agreement (whether written or oral and whether now or hereafter in effect), pursuant to which any person is granted a possessory interest in, or right to use or occupy, all or any portion of any space in the Project, and every modification, amendment or other agreement relating to such lease, sublease, sub-sublease or other agreement entered into in connection with such lease, sublease, sub-sublease or other agreement and every guarantee of the performance and observance of the covenants, conditions and agreements to be performed and observed by the other party thereto.

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<sup>6</sup> The **"Improvements"** are what the Lender and Borrower intend will be constructed. They are described in the Plans and Specifications prepared by the Borrower and approved by the Lender and its Inspecting Architect/Engineer.

"**Lender**" means Friendly Construction Loan Bank, a Minnesota banking corporation.

"**Loan**" means the loan in the amount of the Commitment to be made by the Lender pursuant to the terms of this Agreement.

[ "**Material Adverse Occurrence**" means any occurrence of whatsoever nature (including, without limitation, any adverse determination in any litigation, arbitration or governmental investigation or proceeding) which Lender shall determine could materially adversely affect the then present or prospective financial condition or operations of Borrower, Guarantor, the value of the Improvements or the Project, or any other material Collateral securing repayment of the Loan, or impair the ability of Borrower or Guarantor to perform its obligations as and when required under any of the Loan Documents, as determined by Lender in its discretion.]<sup>7</sup>

"**Mortgage**" means the Combination Mortgage, Assignment of Rents, Security Agreement and Fixture Financing Statement of even date herewith, from the Borrower as Mortgagor to the Lender as Mortgagee, creating a first lien on the Project and a security interest in all of the personal property located thereon as security for payment of the Note, together with any amendment thereto.

"**Note**" means the Promissory Note of the Borrower, dated as of the date hereof, evidencing the Advances to be made hereunder, together with any amendment thereto.

"**Organizational Documents**" means the following documents each of which shall be in form and substance acceptable to the Lender:

- (1) a copy of the Borrower's Articles of Organization, duly certified as of a current date by the Minnesota Secretary of State;
- (2) a copy of the Borrower's Operating Agreement, duly certified as of a current date by an officer or manager of the Borrower;
- (3) a Certificate of Good Standing of the Borrower, duly issued as of a current date by the Minnesota Secretary of State; and
- (4) a copy of the resolutions of the Borrower's members authorizing execution, delivery and performance of the Loan Documents and the transactions contemplated thereby, duly certified by an officer or manager of the Borrower.

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<sup>7</sup> Most construction lenders will require a "Material Adverse Change" provision. Borrowers should try to obtain objective standards to what constitutes a "MAC". At minimum, the Lender's discretion to invoke a MAC should be qualified.

**"Permanent Lender"** means Wall Street Perma Bank, a national banking Association.

**"Permanent Lender Commitment"** means the commitment for permanent financing between the Permanent Lender and the Borrower.

**"Plans and Specifications"** means the plans and specifications for the Improvements, prepared and signed by the Architect, approved by the Lender and the Inspecting Architect/Engineer, and as set forth on **Exhibit E**.<sup>8</sup>

**"Project"** means the construction and/or rehabilitation of the Improvements as shown on the Plans and Specifications, together with the Improvements and the Land.

**"Project Agreement"** means each agreement entered into by Borrower in connection with the Project, including but not limited to the Construction Contract and Development Agreement.

**"Project Costs"** means the costs shown on the Total Project Cost Statement.<sup>9</sup>

**"Security Documents"** means the Mortgage, Financing Statements, Disbursing Agreement, Guaranty, Subordination Agreement, Environmental Indemnity and any other documents securing the Loan.

**"Subcontractor"** means any person who contracts with the General Contractor to perform any of the work or supply any of the materials necessary to complete the Improvements.

**"Subcontract"** means any contract between the General Contractor and a Subcontractor.

**"Subordinated Loan"** means the \$1,500,000.00 loan to be made by the Subordinate Lender to the Borrower pursuant to the Subordinated Loan Documents, which loan is subordinated to the Loan pursuant to the Subordination Agreement.

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<sup>8</sup> It is extremely important that the Lender and the Borrower agree on the Plans and Specifications for the Project. A list of Plans and Specifications should be attached to the Construction Loan Agreement, and that list should match the list contained in the General Contractor's Contract.

<sup>9</sup> The Borrower will want to be reimbursed (or have paid directly) all pre-funding costs in the Initial Advance (i.e. costs of acquisition, financing, design, title, survey, legal, architectural, etc. Typically, the Lender will allow these reimbursements (or direct payments) provided they are consistent with the Project Budget. Often there is a negotiation over the payment (or partial payment) of the Developer Fee and overhead expenses.

**"Subordinated Loan Documents"** means the \$1,500,000.00 Promissory Note and the Mortgage, Security Agreement and Fixture Financing Statement from the Borrower to the Subordinate Lender, each dated as of the date hereof, together with any amendment thereto approved by the Lender in writing.

**"Subordination Agreement"** means the Subordination Agreement, dated as of the date hereof, pursuant to which the Subordinate Lender has subordinated its rights under the Subordinated Loan Documents to the Lender's rights hereunder and under the Note and the Security Documents.

**"Survey"** means an ALTA/ASCM survey of the Property, prepared by a surveyor licensed in the State of Minnesota and acceptable to Lender, containing a certification satisfactory to Lender and to Title, and conforming to the other requirements set forth in Section 3.01 of this Agreement.

**"Sworn Construction Statement"** means a sworn construction statement attached as *Exhibit D*, duly executed by the Borrower and the General Contractor showing all Contractors having contracts or subcontracts for specific portions of the work on the Improvements and the amounts due or to become due each such Contractor, and including all costs and expenses of any kind incurred and to be incurred in constructing the Improvements and fulfilling the obligations of the General Contractor under the terms of the Construction Contract.<sup>10</sup>

**"Title"** means Midwest Title, LLC, as agent for Windy City Title Insurance Company.

**"Title Policy"** is as defined in Section 3.01.

**"Total Project Cost Statement"** means a total project cost statement duly executed by the Borrower incorporating the Sworn Construction Statement and setting forth all costs and expenses of any kind incurred or to be incurred by the Borrower in connection with (1) development of the Project, (2) acquisition of the Land, and (3) completion of the Improvements, including all so-called "hard" and "soft" costs.<sup>11</sup>

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<sup>10</sup> The Sworn Construction Statement is a statement of all "hard" costs. These are the actual costs of construction that are paid by the Borrower to the General Contractor under the General Contractor's Contract.

<sup>11</sup> This includes **all** costs to be incurred by the Borrower up through completion of the Improvements and the lease-up period until the Project has "stabilized," that is has become able to pay all its operating expenses and debt service with a "cushion" that is reflected in the debt service coverage ratio. Typically included are interest on the Loan, fees to the Lender, professional fees, carrying costs such as real estate taxes, and marketing expenses. The Lender will want this list to be as comprehensive as possible. The Borrower, on the other hand, may want to exclude certain costs because as total costs rise so does the Borrower's equity requirement (remember: total costs = equity + loan amount).

"Unit" means each of the 40 residential living units included within the Project, together with all improvements therein.

Section 1.02 Singular and Plural Terms. Any defined term used in the plural in any Loan Document shall refer to all members of the relevant class and any defined term used in the singular shall refer to any number of the members of the relevant class.

Section 1.03 Accounting Principles. Any accounting term used and not specifically defined in any Loan Document shall be construed in conformity with, and all financial data required to be submitted under any Loan Document shall be prepared in conformity with, generally accepted accounting principles applied on a consistent basis or in accordance with such other principles or methods as are reasonably acceptable to Lender.

Section 1.04 References and Other Terms. Any reference to any Loan Document or other document shall include such document both as originally executed and as it may from time to time be modified. References herein to Articles, Sections and Exhibits shall be construed as references to this Agreement unless a different document is named. References to subparagraphs shall be construed as references to the same Section in which the reference appears. The term "document" is used in its broadest sense and encompasses agreements, certificates, opinions, consents, instruments and other written material of every kind. The terms "including" and "include" mean "including (include) without limitation".

Section 1.05 Exhibits Incorporated. All exhibits to this Agreement, as now existing and as the same may from time to time be modified, are incorporated herein by this reference.

Section 1.06. Inconsistency. In the event of any inconsistency between the provisions of this Agreement and the provisions of any of the other Loan Documents, the provisions of this Agreement govern.

## ARTICLE II – COMMITMENT TO MAKE ADVANCES, DISBURSEMENT PROCEDURES AND DEPOSIT OF FUNDS AND PARTIAL RELEASE OF COLLATERAL

Section 2.01 The Advances. The Lender agrees, on the terms and subject to the conditions hereinafter set forth, to make Advances to the Borrower from time to time during the period from the date hereof to the Commitment Termination Date in an aggregate principal amount of up to and including the maximum amount of the Commitment. All Advances shall be used to pay Project Costs.<sup>12</sup> The obligation of the Borrower to repay the Advances shall be evidenced by the Note which contains terms relating to maturity, interest rate, payments, acceleration and other matters. Interest shall be payable at the rate provided therein only on such portions of the Loan proceeds as actually have been disbursed pursuant to this Agreement.

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<sup>12</sup> Note that all Loan proceeds must be used to pay Project Costs, which are the costs shown on the Total Project Cost Statement.

## Section 2.02 Disbursement Procedures

- (a) Whenever the Borrower desires an Advance, which shall be no more often than once in any period of thirty (30) days,<sup>13</sup> the Borrower shall submit to the Lender a Draw Request, duly executed on behalf of the Borrower, setting forth the information requested therein. Each Draw Request shall be submitted at least seven (7) days before the date the Advance is desired. Each Draw Request shall be limited to amounts equal to (i) the total of such costs actually incurred and paid or owing by the Borrower to the date of such Draw Request for work performed on the Project that the Lender has committed to finance pursuant to Section 2.01 hereof, plus (ii) the cost of materials and equipment not incorporated in the Project, but delivered to and suitably stored on the Land; less, (iii) retainage of five percent (5%);<sup>14</sup> and less prior Advances. Notwithstanding anything herein to the contrary, no Advances for materials stored on the Land will be made by the Lender unless the Borrower shall advise the Lender of its intention to so store materials prior to their delivery, and provides suitable security for such storage.<sup>15</sup> Each Draw Request shall constitute a representation and warranty by the Borrower that all representations and warranties set forth in Article IV are true and correct as of the date of such Draw Request.<sup>16</sup>

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<sup>13</sup> Borrower's counsel should determine whether the Borrower has a need for more than one Advance each month.

<sup>14</sup> The retainage provisions must match those set forth in the General Contractor's Contract. Often the General Contractor will negotiate what from its point of view are more favorable retainage provisions, such as the following: "retainage of 5% from the 'hard' costs of construction (not including materials) until the Improvements are 50% complete and 3% thereafter." These are frequently accepted by the Lender and incorporated into the Construction Loan Agreement. In any event the retainage provisions of the General Contractor's Contract and the Construction Loan Agreement should be consistent. One concept unique to construction loan funding is retainage. Retainage is a contractual device in which the owner retains a specified portion of earned progress payments. It is common practice in the construction industry for the owner to hold back from each program payment a portion, usually 5-10% of the amount due to the contractors. By doing so, the owner gives itself leverage to cause the contractors to correct any defects before they receive final payment. The construction lender likewise withholds an equal amount from each of its advances to the owner/borrower. Retainage is typically released at the end of the project if there are no claims, though owners sometimes reduce retainage during the project if progress is satisfactory. Contractors and subcontractors likewise retain money from progress payments to their subcontractors. Note that effective August 1, 2016, Minn. Stat. Sec. 337, Subd. 4(b) was amended to cap retainage at five percent under all contracts and subcontracts, public and private, entered into from and after the effective date.

<sup>15</sup> The Borrower will want Advances for stored materials. Lenders typically will not provide Advances for stored materials but may be willing to do so if given adequate security/protection.

<sup>16</sup> This provision essentially requires the Borrower to restate all the representations and warranties every time it makes a Draw Request. Borrower's counsel should seek modifications of this

- (b) At the time of submission of each Draw Request, the Borrower shall also submit to the Lender and Title the materials required under the Disbursing Agreement, including (without limitation) a written lien waiver from each Contractor for work done and materials supplied by it which were paid for pursuant to the next preceding Draw Request.
- (c) If on the date an Advance is desired, (i) the Borrower has performed all of its agreements and complied with all requirements therefor to be performed or complied with hereunder including satisfaction of all applicable conditions precedent contained in Article III hereof, (ii) the Borrower has performed all of its obligations under the Disbursing Agreement, and (iii) the Lender receives a current construction report from the Inspecting Architect/Engineer confirming the accuracy of the information set forth in the Draw Request, the Lender shall pay to Title the amount of the requested Advance, and Title will disburse such funds pursuant to and in accordance with the terms of the Disbursing Agreement. Each Advance disbursed to Title shall bear interest at the rate provided in the Note from the date such Advance is disbursed to Title.

Section 2.03 Deposit of Funds by the Borrower . If the Lender in its sole discretion shall at any time determine that the undisbursed amount of the Commitment is less than the amount required to pay all unpaid costs and expenses of any kind which reasonably may be anticipated in connection with the completion of the Project (including reserves which in the Lender's opinion are adequate to pay all interest projected to be payable on the Loan and to provide for construction contingencies, and including all other Project Costs), and shall thereupon send written notice thereof to the Borrower specifying the amount required to be deposited by the Borrower with Title to provide sufficient funds to pay all such costs and complete the Project, the Borrower agrees that it will, within seven (7) calendar days of receipt of any such notice, deposit with Title, in a non-interest bearing account, the amount of funds specified in the Lender's notice. The Borrower agrees that any such funds deposited with Title may be disbursed by Title, before any further disbursement of Loan proceeds from the Lender, to pay any and all costs and expenses of any kind in connection with completion of the Project.<sup>17</sup>

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because facts and circumstances true at the time of execution of the Construction Loan Agreement may change for reasons totally beyond the Borrower's control. For example, included in the representations and warranties is a provision stating that there has been no material adverse change in the financial condition of the Borrower or the Guarantors (see Section 4.01(f) below).

<sup>17</sup> This Section requires that the Loan stay "*in balance*" throughout its term, and the Borrower is required to deposit in cash an amount equal to any increase in total Project costs (this is sometimes referred to as an "*equity call*"). Borrower's counsel will want to (a) request notice and cure rights, (b) have the right to have a third party determine whether or not the loan is "in balance" based upon an agreed upon method of calculation, and (c) extend the time period to come into compliance. Lender's counsel may reject some or all of these requests. At a minimum, the Lender's discretion should be qualified with "reasonable" or "in good faith"

Section 2.04 Advances Without Receipt of Draw Request . Notwithstanding anything herein to the contrary, the Lender shall have the irrevocable right at any time and from time to time to apply funds which it agrees to advance hereunder to pay interest on the Note as and when it becomes due, and to pay any and all of the expenses referred to in Section 7.04 hereof, all without receipt of a Draw Request from the Borrower.

### ARTICLE III – CONDITIONS OF ADVANCES

Section 3.01 Condition Precedent to Initial Advance . The obligation of the Lender to make the initial Advance shall be subject to the condition precedent that the Borrower shall be in compliance with the conditions contained in Section 3.02 and the further condition precedent that the Lender shall have received on or before the date of the initial Advance hereunder the following, each to be satisfactory to the Lender in form and substance:<sup>18</sup>

- (a) The Note duly executed by the Borrower;
- (b) The Disbursing Agreement duly executed by the Borrower, Title and the Lender;
- (c) The Mortgage duly executed by the Borrower;
- (d) The Financing Statements duly executed by the Borrower;
- (e) The Environmental Indemnity duly executed by the Borrower and the Guarantors;
- (f) The Guaranty duly executed by the Guarantors;
- (g) A copy of the Plans and Specifications;
- (h) A report of the Inspecting Architect/Engineer approving the Plans and Specifications, the Construction Contract and the Sworn Construction Statement.
- (i) Copies of the Construction Contract and the Architect's Contract, together with written consents of the General Contractor and the Architect to the assignment of their respective contracts from the Borrower to the Lender;

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concepts. While it may agree to be reasonable in some circumstances, the Lender may resist that in this context (although good faith will likely be implied in any case).

<sup>18</sup> For a variety of reasons, the parties may decide to close the Loan before all of the required items have been delivered to the Lender. The parties should not leave the closing table without an agreed-upon list of the items that must be completed before the Borrower can qualify for the first Advance.

(j) Copies of such Subcontracts as the Lender may request, together with a letter from each Contractor under such Subcontracts permitting the Lender, upon its election to complete the Improvements in accordance with the provisions of Section 6.02(d) hereof, to acquire the interest of the Contractor under such Subcontracts;

(k) The Sworn Construction Statement;

(l) The Total Project Cost Statement;

(m) The Appraisal;

(n) Evidence satisfactory to the Lender that the Borrower has expended not less than \$2,000,000 (being the Cost of Completion less (i) the amount of the Subordinated Loan and (ii) the amount of the Commitment) of Equity in payment of Project Costs which would otherwise be properly payable from an Advance, together with satisfactory lien waivers for lienable work and/or materials paid with such funds;<sup>19</sup>

(o) An ALTA extended coverage mortgagee's title insurance policy (ALTA 2006 Loan Policy of Title Insurance), which policy shall be (i) issued by Title to Lender in the amount of the Loan, (ii) insuring the Mortgage to be a valid first, prior and paramount lien upon the fee title to the Property, subject only to the Permitted Exceptions and to customary exceptions for pending disbursements of the Loan, (iii) specifically insuring against any lien claims that could arise out of the construction of the Improvements, (iv) containing comprehensive, zoning, location, access, tax parcel, contiguity, environmental lien and plans and specifications endorsements (in ALTA or other form acceptable to Lender), and such other endorsements as Lender may require and (v) in form and substance acceptable to the Lender (the "**Title Policy**");

(p) A Survey, dated or updated to a date not earlier than ninety (90) days prior to the date hereof and executed by the person who prepared the Survey, which Survey shall be made in accordance with the current survey standards of the American Title Association and the American Congress on Surveying and Mapping ("**ALTA**") including items 1, 2, 3, 4, 6, 7(a), 7(b)(1), 7(c) 8, 9, 10, 11(a) and (b), 13, 14, 16, 17, 18, 19, 20(a) and 21 of Table A thereof and showing: (i) all "setbacks" and other restrictions applicable to the Property pursuant to requirements of Governing Authorities and applicable covenants, conditions and other private restrictions; (ii) the proposed location (and, in the event of prior construction, the location) of all foundations, driveways, parking areas, number of parking spaces, fences and other improvements on the Land, including the Project; (iii) the location (and recording numbers, to the extent recorded) of all visible or recorded easements (including appurtenant

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<sup>19</sup> It would be unusual for the Borrower to satisfy its equity requirement by depositing cash. Instead the Borrower will "prove up" its equity requirement by showing that it has already paid certain Project Costs.

easements), licenses, water courses, drains, sewers, public and private roads (including the names and widths thereof and recording numbers for the dedications thereof), other rights of way, and curb cuts, if any, within, adjacent to or serving the Property or to which the Property are subject; (iv) that all portions of the Project will have direct access to dedicated public roads; (v) the common street address of the Property and the dimensions, boundaries and acreage or square footage of the Land; (vi) that there are no encroachments onto the Land or any of the Improvements from improvements located on adjoining property; (vii) the location and course of all utility lines; (viii) if the Property is comprised of more than one parcel, interior lines and other data sufficient, in the determination of Title, to insure contiguity; and (ix) such additional information which may be required by Lender or Title. The Survey shall further include a certification satisfactory to Lender and Title (the "**Surveyor's Certification**") pursuant to which person who prepared the Survey certifies to Lender and Title that the Survey was made on the ground and in accordance with the and in accordance with the current Minimum Standard Detail Requirements for ALTA/ACSM Land Title Surveys as adopted by ALTA, and that the Survey is correct and complete, that access to the Property, and utilities shown on the Survey, are sufficient and in accordance with applicable requirements, that the Property does not fall within a designated flood hazard area, identifying the Table A items included on the Survey, and as to such other matters as Lender reasonably requires;

(q) A copy of the plat for the Project conforming to all platting requirements, or evidence that a plat is not required or has been waived by the appropriate Governing Authority;

(r) Appropriate searches conducted in the required offices in the State of Minnesota showing no tax liens, bankruptcies, judgments or other liens affecting the Borrower or the Project, and Uniform Commercial Code searches conducted disclosing no security interests existing against the Project including the equipment, fixtures and personalty;

(s) The site plan prepared by the Architect showing the proposed Improvements;

(t) Copies of all building permits and such other licenses and permits as may be required to construct the Project;

(u) Evidence that the Improvements when constructed in accordance with the Plans and Specifications will comply in all respects with all applicable ordinances, zoning, planned unit development, subdivision, platting, environmental and land use requirements, without special variance or exception, and such other evidence as the Lender shall request to establish that the Project and the contemplated use thereof are permitted by and comply with all applicable use or other restrictions and requirements in prior conveyances, zoning ordinances, environmental laws and regulations, water shed district regulations and all other applicable laws or regulations, and have

been duly approved by the municipal and other governmental authorities having jurisdiction over the Project;

(v) Soil reports describing the soil conditions and indicating any corrective action that may be necessitated because of such conditions, together with evidence that the Plans and Specifications incorporate such corrective action, if any;

(w) A Phase I Environmental Site Assessment prepared by a licensed environmental engineer consultant approved by Lender in strict conformance with the Standard Practice for Environmental Site Assessment Process, ASTM Standard E1527-13 (2013), together with any additional investigations and analysis necessary for the consultant to conclude there are no "recognized environmental conditions" associated with the Project, dated within twelve (12) months of the date of this Agreement and otherwise acceptable to Lender in form and substance (the "**Environmental Report**"). The Environmental Report shall be subject to Lender's approval in its sole and absolute discretion. If the Environmental Report reveals contamination or conditions warranting further investigation in order to establish baseline data, Lender may require, in its sole and absolute discretion, a written report (also referred to herein as the "**Environmental Report**") based on additional testing and investigation in order to define the source and extent of the contamination or to establish baseline data, as well as to provide relevant detailed information on the area's geological and hydrogeological conditions. Any additional Environmental Report prepared pursuant to this requirement shall be subject to Lender's approval, in its sole and absolute discretion;

(x) Evidence establishing that all utilities necessary for the construction and operation of the Project are available at the boundaries of the Land, including without limitation water, sewer, electricity, gas, cable television and telephone, and that the Borrower has the right to connect to and use such utilities;<sup>20</sup>

(y) Copies of policies or certificates of insurance covering the Project as described on **Exhibit F** hereto, with all such insurance in full force and effect;

(z) A flood zone certification acceptable to Lender indicating that the Project is not located in a flood plain or any other flood-prone area as designated by any governmental agency; provided, however, that if the Project is so located, Borrower shall provide proof of flood insurance acceptable to Lender;

(aa) The Organizational Documents;

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<sup>20</sup> A requirement to provide evidence of utilities sometimes seems like overkill, particularly for urban real estate. Even in a city, however, utilities may not be properly sized to handle certain projects, and reconstruction of utilities can be very expensive.

(bb) A signed copy of an opinion of counsel to the Borrower and the Guarantors;

(cc) The Subordinated Loan Documents together with evidence that the \$3,000,000.00 Subordinated Loan has been fully disbursed to pay Project Costs;<sup>21</sup>

(dd) The Subordination Agreement; and

(ee) The Permanent Lender Commitment.

Section 3.02 Further Conditions Precedent to All Advances . The obligation of the Lender to make each subsequent Advance shall be subject to the condition precedent that the Borrower shall be in compliance with all conditions set forth in Section 3.01, and the further conditions precedent that on the date of such Advance:

(a) No Default or Event of Default hereunder shall have occurred and be continuing and all representations and warranties made by the Borrower in Article IV shall continue to be true and correct as of the date of such Advance.

(b) No determination shall have been made by the Lender that the undisbursed amount of the Commitment is less than the amount required to pay all costs and expenses of any kind which reasonably may be anticipated in connection with the completion of the Project; or if such a determination has been made and notice thereof sent to the Borrower, the Borrower has deposited the necessary funds with Title in accordance with Section 2.03 hereof.

(c) The disbursement requirements of Section 2.02 hereof shall have been satisfied.

(d) If required by the Lender, the Lender shall be furnished with a statement of the Borrower and of any Contractor, in form and substance required by the Lender, setting forth the names, addresses and amounts due or to become due as well as the amounts previously paid to every Contractor, subcontractor, person, firm or corporation furnishing materials or performing labor in connection with the construction of any part of the Improvements.

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<sup>21</sup> It is critical to the Lender to know that all funds necessary to pay all Project Costs, except Loan funds, are paid in prior to the first Advance of Loan funds. If any source of funds will not be contributed prior to the first Advance, the Lender will want to assure itself that it can cause those funds to be advanced if the Borrower defaults. At a minimum, this will involve an assignment of the Borrower's rights under the documents through which the funding is provided, and an estoppel agreement from the entity providing the funding assuring the Lender that it can "step into the shoes" of the Borrower. Negotiation of these agreements can be difficult and time consuming.

(e) The Borrower shall have provided to the Lender such evidence of compliance with all of the provisions of this Agreement as the Lender may reasonably request.

(f) No license or permit necessary for the construction of the Improvements shall have been revoked or the issuance thereof subjected to challenge before any court or other Governing Authority.

Section 3.03 Conditions Precedent to the Final Advance. The obligation of the Lender to make the final Advance shall be subject to the condition precedent that the Borrower shall be in compliance with all conditions set forth in Sections 3.01 and 3.02 and, further, that the following conditions shall have been satisfied prior to the Completion Date:

(a) The Improvements, including all landscape and parking improvements, shall have been completed in accordance with the Plans and Specifications and the Lender shall have received a Certificate of Completion from the General Contractor and the Architect certifying that (i) work on the Improvements has been completed in accordance with the Plans and Specifications and all labor, services, materials and supplies used in such work have been paid for and (ii) the completed Improvements conform with all applicable zoning, land use planning, building and environmental laws and regulations of all Governing Authorities.

(b) The Lender shall have received satisfactory evidence that all work requiring inspection by municipal or other Governing Authorities has been duly inspected and approved by such authorities, and that all requisite certificates of occupancy and any other approvals for occupancy and operation of the Project have been issued.

(c) The Lender and Title shall have received a final lien waiver from each Contractor for all work done and for all materials furnished by it for the Project.

(d) The Lender shall have received an "as-built" survey of the Land meeting all of the requirements set forth in Section 3.01(p) and showing that the Improvements as completed are entirely within the exterior boundaries of the Land and any building setback or restriction lines and do not encroach upon any easements or right-of-way, and showing such other information as the Lender may reasonably request.

[Section 3.04 Extension of Completion Date. The Completion Date shall be extended for a period equal to the period of any delay caused by Force Majeure, provided Borrower furnishes Lender with written notice of the Force Majeure event within ten (10) Business Days from the occurrence of the delay. In no event, however, shall the time for completion of the Improvements be extended beyond the earlier of (i) the date occurring [**ninety (90)**] days after the Completion Date for the Improvements, or (ii) the date for completion of the Improvements set forth in

any Subordinate Loan Document or the Development Agreement, or (iii) the date 30 days prior to the expiration of the Permanent Lender Commitment.]<sup>22</sup>

Section 3.05 No Waiver . The making of any Advance prior to fulfillment of any condition thereof shall not be construed as a waiver of such condition, and the Lender reserves the right to require fulfillment of any and all such conditions prior to making any subsequent Advances.

#### ARTICLE IV – REPRESENTATIONS AND WARRANTIES

Section 4.01 Representations and Warranties . The Borrower represents to the Lender and warrants as follows:

(a) The Borrower is a limited liability company duly organized, validly existing and in good standing under the laws of the State of Minnesota, and has all requisite power and authority to own the Land, to construct the Improvements, and to execute and deliver and to perform all of its obligations under this Agreement, the Note and the Security Documents and the execution and delivery thereof and the carrying out of the transactions contemplated thereby will not violate, conflict with or constitute a default under the terms of the Organizational Documents or under any note, bond, debenture or other evidence of indebtedness or any contract, loan agreement or lease to which the Borrower is a party or by which the Project is subject, or violate any law, regulation or order of any Governing Authority, or any court order or judgment in any proceeding to which the Borrower is or was a party or by which the property of the Borrower is bound.

(b) The execution, delivery and performance by the Borrower of this Agreement, the Note and the Security Documents have been duly authorized by the Borrower.

(c) This Agreement constitutes, and the Note and the Security Documents when delivered hereunder will constitute, legal, valid and binding obligations of the Borrower, enforceable against the Borrower in accordance with their respective terms.

(d) The Borrower has obtained all necessary licenses and permits required for construction of the Improvements and operation of the Project, except those which cannot be obtained until completion of the Improvements.

(e) The Improvements will be constructed strictly in accordance with the Plans and Specifications; will be constructed entirely on the Land; and will not encroach upon or overhang any easement or right-of-way. The Project, both during construction and at the time of completion, and the contemplated use thereof, will not violate any applicable zoning or use statute, ordinance, building code, rule or regulation, or any covenant or agreement of record. The

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<sup>22</sup> Borrower will want the Completion Date to be extended for delays caused by Force Majeure. Lender will want some outside date and protection from other defaults.

Borrower agrees that it will furnish to the Lender from time to time reasonably satisfactory evidence with respect thereto.

(f) Any and all financial statements of the Borrower and the Guarantors heretofore delivered to the Lender by or on behalf of the Borrower or the Guarantors are true and correct in all respects, have been prepared in accordance with generally accepted accounting practice, and fairly present the financial condition of the subject thereof as of the respective dates thereof. No materially adverse change has occurred in the financial conditions reflected therein since the respective dates thereof and no additional borrowings have been made by the Borrower or the Guarantors since the date thereof other than the borrowing contemplated hereby or approved by the Lender. None of the aforesaid financial statements or any certificate or statement furnished to the Lender by or on behalf of the Borrower or the Guarantors in connection with the transactions contemplated hereby, and none of the representations and warranties in this Agreement, contains any untrue statement of a material fact or omits to state a material fact necessary in order to make the statements contained therein or herein not misleading. To the best knowledge of the Borrower, there is no fact which materially adversely affects or in the future (so far as the Borrower can now foresee) may materially adversely affect the business or prospects or condition (financial or other) of the Borrower or the Guarantors or any of its or their properties or assets, which has not been set forth herein or in a certificate or statement furnished to the Lender by the Borrower or the Guarantors.

(g) There is no suit, action, proceeding or investigation pending or threatened against or affecting the Borrower (or any basis therefor) at law or in equity or by or before any court, arbitrator, administrative agency or other federal, state or local governmental authority which individually or in the aggregate, if adversely determined, might have a material adverse effect on, or affect the validity as to the Borrower of, any of the transactions contemplated by this Agreement or the ability of the Borrower to perform its obligations hereunder or as contemplated hereby.

(h) No consent, approval, order or authorization of or registration, declaration or filing with any governmental authority is required in connection with a valid execution and delivery of this Agreement, the Note, the Security Documents or of any and all other agreements and instruments herein mentioned to which the Borrower is a party or the carrying out or performance of any of the transactions required or contemplated thereby, or, if required, such consent, approval, order or authorization shall have been obtained or such registration, declaration or filing shall have been accomplished prior to the initial Advance.

(i) The proceeds of the Loan, together with (A) the Equity to be contributed toward the payment of Project Costs by the Borrower, and (B) the proceeds of the Subordinated Loan, all as shown on the Total Project Cost

Statement, will be sufficient to pay the entire cost of acquiring, constructing, equipping and otherwise rendering the Project suitable for its intended use.

(j) The membership interests in the Borrower are owned by the persons and in the percentages shown on Schedule 2 attached hereto.

#### ARTICLE V – ADDITIONAL COVENANTS OF THE BORROWER

Section 5.01 Affirmative Covenants . The Borrower agrees that:

(a) The Borrower will (i) diligently proceed with construction of the Improvements according to the Plans and Specifications and in accordance with all applicable laws and ordinances, (ii) complete the Improvements and satisfy the requirements of Section 3.03 on or before the Completion Date,<sup>23</sup> and (iii) use the proceeds of the Advances solely to pay Project Costs.

(b) The Borrower will use all reasonable efforts to require each Contractor to comply with all rules, regulations, ordinances and laws bearing on its conduct of work on the Project.

(c) The Borrower shall maintain accurate and complete books, accounts and records pertaining to the Project. The Borrower will permit the Lender, acting by and through its officers, employees and agents during normal business hours and upon notice to the Borrower, to examine all books, records, contracts, plans, drawings, permits, bills and statements of account pertaining to the Project and to make extracts therefrom and copies thereof.

(d) The Borrower will prepare or cause to be prepared at its expense and deliver to the Lender (in such number as may reasonably be requested):<sup>24</sup>

(i) As soon as practicable after the end of each fiscal year of the Borrower, and in no event later than ninety (90) days thereafter, unaudited financial statements of the Borrower as at the end of such fiscal year consisting of the balance sheet of the Borrower and the related statements of income and changes in financial position of the Borrower for the fiscal year then ended, setting forth in each case in comparative form the figures for the previous fiscal year, all in reasonable detail.

(ii) As soon as practicable after the end of each calendar year, and in no event later than sixty (60) days thereafter, the personal financial statements of the Guarantors as at the end of such calendar year, all in such detail as the Lender may reasonably require.

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<sup>23</sup> Again, the Borrower will want to negotiate some flexibility in the Completion Date (see footnote 3 above).

<sup>24</sup> Borrower's counsel should confirm each of these reporting requirements and dates with the Borrower/chief financial officer.

(iii) As soon as practicable after the end of each fiscal year of the Borrower (or more frequently if requested by the Lender), unaudited operating statements of the Project.

(iv) As soon as practicable and in no event later than thirty (30) days after they are filed with the United States Internal Revenue Service, the annual federal income tax returns of the Borrower and the Guarantors.

(v) Immediately upon becoming aware of the existence of any condition or event which constitutes, or which after notice or lapse of time or both would constitute, an Event of Default, written notice specifying the nature and period of existence thereof and what action the Borrower has taken, is taking or proposes to take with respect thereto.

The items specified in paragraphs (i) and (iii) shall be certified as accurate and complete by an officer or manager of the Borrower.

(e) The Borrower shall maintain its operating accounts (i.e., accounts for depositing revenues and paying expenses) for the Project with the Lender until all amounts owing to the Lender under this Agreement, the Note and the Security Documents have been fully repaid.

(f) The Borrower shall, at all times until the Loan has been fully repaid, maintain, or cause to be maintained, in effect, insurance policies as required under the terms of *Exhibit F* attached hereto.

(g) On the date of this Agreement, the Borrower shall pay to the Lender a non-refundable financing fee of \$150,000.00 (0.75% of the Commitment).

(h) Upon request by the Lender, the Borrower shall furnish the Lender with a current appraisal of the Project, provided that the Borrower shall not be required to provide such appraisal more than once in any twelve (12)-month period. At no time shall the ratio of (i) the sum of the outstanding principal balance of the Loan plus the amount of Loan proceeds that remain undisbursed to (ii) the appraised value of the Project (excluding any Units that have been sold) exceed seventy-five percent (75.0%), and the Borrower shall prepay a portion of the Loan if necessary to maintain such ratio.<sup>25</sup>

(i) The Borrower is and shall remain, so long as any portion of the Loan remains unpaid, a single-asset entity which owns no property other than the Project.

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<sup>25</sup> The Lender wants to know that the 75% loan-to-value ratio will be maintained throughout the life of the Loan. This provision requires the Borrower to prepay a portion of the Loan if the loan-to-value ratio ever exceeds 75%. A Borrower can sometimes be successful in arguing that a decline in value of the Project is a risk that both parties take, and that if there is no other default the Lender should not have the right to force a prepayment.

Section 5.02 Negative Covenants . The Borrower agrees that, without the prior written consent of the Lender, it will not:

(a) Voluntarily, involuntarily or by operation of law agree to, cause, suffer or permit (i) any sale, transfer, lease, sublease or conveyance of any interest of the Borrower, legal or equitable, in the Project; (ii) any sale, transfer or encumbrance of any of the membership interests in the Borrower; or (iii) any mortgage, pledge, encumbrance or lien to be outstanding against the Project or any portion thereof, or any security interest to exist therein, except as created by the Mortgage or the other Security Documents or as explicitly permitted therein, without, in each instance, the prior written consent of the Lender.<sup>26</sup> If the Borrower breaches the foregoing covenant, the Lender may, at its election, declare all amounts owing under this Agreement, the Note and the Security Documents to be immediately due and payable, without notice to the Borrower (which notice the Borrower hereby expressly waives), and upon such declaration all such amounts shall be immediately due and payable.

No transfer, conveyance, lease, sale or other disposition shall relieve the Borrower from personal liability for its obligations hereunder or under the Note, whether or not the transferee assumes such obligations. The Lender may, without notice to the Borrower, deal with any successor owner of all or any portion of the Project in the same manner as with the Borrower, without in any way discharging the liability of the Borrower hereunder or under the Note.

Notwithstanding the foregoing, Borrower may enter into residential Leases (and amendments) in the ordinary course of business with bona fide third party residential tenants without Lender's prior written consent if Borrower uses the lease form approved by Lender.<sup>27</sup>

(b) Without the prior written consent of the Lender, agree or consent to any "material" (as hereinafter defined) (i) change in the Plans and Specifications, (ii) change order under the Construction Contract, or (iii) change in the terms and provisions of the Construction Contract, the Architect's Contract or any of the contracts specifically identified in Section 3.01. For purposes of this paragraph (b), the term "material" shall mean a change which by itself, or when aggregated with any other changes that have not been approved in writing by the Lender, would increase or decrease the total cost of the Improvements by more than \$50,000.00. Regardless of whether the Lender's consent is required hereunder, the Borrower shall notify the Lender of any change in the Plans and

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<sup>26</sup> This is the "due-on-sale-or-encumbrance" clause. With respect to the equity ownership interests in the Borrower, the Lender's chief concern is that the individuals in whom it has faith continue to control the Borrower's activities. This leaves room for negotiation, for example, the Lender may be willing to allow the transfer of up to 49% of the equity ownership interests, or transfers to trusts for estate planning purposes, as long as the key individuals remain in control.

<sup>27</sup> The Lender may have additional parameters for these Leases, i.e. no one tenant may lease more than one unit; no term may be longer than 12 months; the rent must be "market" or in accordance with proforma projections; the lease must be "arm's length", etc.)

Specifications, change order in the Construction Contract or change in the Construction Contract or Architect's Contract.<sup>28</sup>

(c) Agree or consent to any modification, amendment or termination of the Development Agreement.<sup>29</sup>

(d) Incorporate in the Project any materials, fixtures or property which are subject to the claims of any other person, whether pursuant to conditional sales contract, security agreement, lease, mortgage or otherwise.

#### ARTICLE VI – EVENTS OF DEFAULT AND RIGHTS AND REMEDIES

Section 6.01 Events of Default . Each of the following shall constitute an Event of Default.

(a) The Borrower shall fail to pay, when due, interest on or the principal of the Note;<sup>30</sup>

(b) Any representation or warranty made by the Borrower herein, in the Security Documents or in any financial statement, certificate, report or Draw Request furnished pursuant to this Agreement or the Security Documents shall prove to have been untrue in any material respect as of the time such representation or warranty was made;

(c) The Borrower shall be in default in the performance of its obligations under Sections 5.01(g) or (l) or under Section 5.02(a), (b) or (c).<sup>31</sup>

(d) The Borrower shall fail duly to observe or perform, any of the terms, conditions, covenants or agreements required to be observed or performed by the Borrower hereunder (other than terms, conditions, covenants or agreements otherwise specifically dealt with in this Article VI), and such failure shall continue

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<sup>28</sup> Few (if any) construction projects are completed precisely in accordance with the initial plans. Typically the Lender will allow changes that do not increase or decrease the total costs by more than a certain amount. Note, however, that the Lender requires that it be notified of **every** change.

<sup>29</sup> The Lender will also want the right to approve any changes to other important contracts, such as the Development Agreement covering the terms of the subordinate financing.

<sup>30</sup> The Lender will probably agree to a short grace period, but it likely will not agree to provide written notice of payment defaults ("everyone knows when the payments are due"). Also, given the operating account is held with the Lender (as well as any interest reserve account), the payments are likely to be made electronically via intra-bank transfer.

<sup>31</sup> In most loan agreements, violation of certain covenants results in an immediate default without any notice or grace period. Typically these are "really bad things," such as failure to maintain insurance, or violations that cannot be remedied, such as a sale of the property.

for a period of thirty (30) calendar days after written notice of such failure has been given by the Lender to the Borrower;<sup>32</sup>

(e) The Borrower shall be in default under or in breach of any of the covenants contained in any of the Security Documents and such default or breach shall not be cured or waived within the period or periods of grace, if any, applicable thereto;

(f) An Event of Default as defined in the Mortgage shall occur and be continuing;

(g) The Project shall be materially damaged or destroyed by fire or other casualty and the loss, in the reasonable judgment of the Lender, shall not be adequately covered by insurance actually collected or in the process of collection or by other funds available to the Borrower;

(h) The Lender shall have given notice to the Borrower pursuant to Section 2.03 hereof to deposit additional funds with Title and the Borrower shall have failed to do so within seven (7) calendar days;

(i) At any time title to any part of the Project shall not be satisfactory to the Lender by reason of any lien, encumbrance or other defect (even though the same may have existed at the time of any prior Advance) except those matters affecting title which have at any time been consented to in writing by the Lender, and subject to the Borrower's right to contest liens as provided in the Mortgage; and such lien, encumbrance or other defect shall not be corrected to the Lender's satisfaction within thirty (30) days after notice to the Borrower;

(j) There shall have been a cessation of the making of the Improvements for any period after the date of commencement of the making of the Improvements in excess of twenty (20) successive calendar days, unless the conditions of each of subparagraphs (1), (2) and (3) below shall have been satisfied:

(1) the cessation of the making of the Improvements shall have been caused by conditions beyond the control of the Borrower, including, without limitation, acts of God or the elements, fire, strikes, labor disputes, delays in delivery of any material;

(2) the Borrower shall have furnished to the Lender satisfactory evidence that such cessation of the making of the Improvements shall not adversely affect or jeopardize the rights of the Borrower (or the Lender in the

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<sup>32</sup> The Borrower should request that the following be added at the end of this paragraph: "provided that if the Borrower promptly commences and diligently pursues a remedy for such failure but such remedy cannot reasonably be accomplished within thirty (30) days, then the Borrower may have an additional reasonable time within which to remedy such failure." The Lender may accept this, but more likely it will want to limit the additional cure period to 30 to 60 days.

event the Lender succeeds to the interest of the Borrower) under the Construction Contract or any of the Purchase Agreements; and

(3) from time to time upon the Lender's request therefor during any such cessation of the making of the Improvements, the Borrower shall furnish to the Lender satisfactory evidence that (notwithstanding such cessation of the making of the Improvements) the completion of the Improvements can be accomplished on or before the Completion Date.

(k) The Borrower shall fail to comply with any requirement of any Governing Authority within thirty (30) days after notice in writing of such requirement shall be given to the Borrower by such Governing Authority, subject to any rights of the Borrower to contest such requirement as provided in the Mortgage;

(l) The Borrower shall not disclose to the Lender the names of all persons with whom the Borrower contracted or intends to contract for the making of the Improvements or the furnishing of labor or any materials therefor or shall fail to exhibit to the Lender, upon request, copies of all such contracts;

(m) A petition in bankruptcy or for reorganization or for an arrangement under any bankruptcy or insolvency law or for a custodian, receiver or trustee for any of its property shall be filed by the Borrower or any Guarantor, or a petition in bankruptcy or for reorganization or for an arrangement under any bankruptcy or insolvency law or for a custodian, receiver or trustee of any of the Borrower's or any Guarantor's property shall be filed against the Borrower or any Guarantor and shall not be dismissed within ninety (90) days, or a custodian, receiver or trustee of any property of the Borrower or any Guarantor shall be appointed and shall not be discharged within ninety (90) days, or the Borrower or any Guarantor shall make an assignment for the benefit of creditors or generally shall not pay its debts as they become due, or the Borrower or any Guarantor shall be adjudged insolvent by any state or federal court of competent jurisdiction, or an attachment or execution shall be levied against any substantial portion of the property of the Borrower or any Guarantor and shall not be discharged within ninety (90) days;

(n) The Permanent Lender Commitment is terminated and not immediately replaced with a new commitment acceptable to Lender in its sole discretion;<sup>33</sup>

(o) The Guaranty or any third party security interest securing the Loan shall be repudiated or revoked, or purported to be repudiated or revoked by any Guarantor or third-party pledgor;

(p) Any Guarantor shall die or shall become legally incompetent;<sup>34</sup>

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<sup>33</sup> The Lender's intent here is obvious, but the Borrower can forcefully argue that the permanent financing commitment may terminate through no fault of its own, and that the Lender should have some flexibility here.

(q) The Borrower shall be dissolved or terminated; or

(r) The occurrence of any Material Adverse Occurrence in the business or financial condition of Borrower or any event that materially increases Lender's risk or materially impairs the Collateral.

Section 6.02 Rights and Remedies . Upon the occurrence of a Default or an Event of Default and at any time thereafter, the Lender may by notice in writing to the Borrower, refrain from making any further Advances hereunder (but the Lender may make Advances after the occurrence of such an event or an Event of Default without thereby waiving its rights and remedies hereunder).<sup>35</sup> Upon the occurrence of an Event of Default the Lender may, at its option, exercise any and all of the following rights and remedies (and any other rights and remedies available to it):

(a) The Lender may terminate the Commitment.

(b) The Lender may, by written notice to the Borrower, declare immediately due and payable all unpaid principal of and accrued interest on the Note, together with all other sums payable hereunder, and the same shall thereupon be immediately due and payable without presentment or other demand, protest, notice of dishonor or any other notice of any kind, all of which are hereby expressly waived; provided, however, that upon the filing of a petition commencing a case naming the Borrower or any Guarantor as debtor under the United States Bankruptcy Code, the principal of and all accrued interest on the Note shall be automatically due and payable without any notice to or demand on the Borrower or any other party.

(c) The Lender shall have the right, in addition to any other rights provided by law, to enforce its rights and remedies under the Security Documents.

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<sup>34</sup> The Lender wants to know that the individuals it underwrote remain alive during the Loan term, but this is tough on the Borrower. Typically the Lender is willing to accept the addition at the end of this paragraph of something similar to the following: "unless his or her estate acknowledges, in writing, his or her obligations under the Guaranty and the Environmental Indemnification within ninety (90) days after the date of his or her death or incompetency, and unless the Borrower replaces him or her with another guarantor acceptable to the Lender or pays the Loan, in full, within one hundred twenty (120) days following the date of his death or incompetency, upon the completion of which replacement the Lender shall release his or her estate from all liability under the Guaranty and the Environmental Indemnification." If this is added, the Lender will want an additional companion event of default as follows: "The estate of any deceased Guarantor distributes assets thereof to beneficiaries thereof before a replacement guarantor or guarantors acceptable to the Lender is provided to the Lender (or the Loan is paid in full), other than to pay costs of administration, funeral expenses, medical expenses and reasonable support for the deceased's surviving spouse and dependent children (if any)."

<sup>35</sup> The Lender must have the right to refuse to make additional Advances immediately upon the occurrence of a default without regard to notice requirements or cure periods.

(d) The Lender may enter upon the Land and take possession thereof, together with the Improvements, and proceed either in its own name or in the name of the Borrower, as the attorney-in-fact of the Borrower (which authority is coupled with an interest and is irrevocable by the Borrower) to complete or cause to be completed the Improvements, at the cost and expense of the Borrower. If the Lender elects to complete or cause to be completed the Improvements, it may do so according to the Plans and Specifications or according to such changes, alterations or modifications in and to the Plans and Specifications as the Lender may deem reasonable and appropriate; and the Lender may enforce or cancel all contracts let by the Borrower relating to construction of the Improvements, and/or let other contracts which in the Lender's sole judgment may seem advisable; and the Borrower shall forthwith turn over and duly assign to the Lender, as the Lender may from time to time require, contracts not already assigned to the Lender relating to construction of the Improvements, blueprints, shop drawings, bonds, building permits, bills and statements of accounts pertaining to the Improvements, whether paid or not, and any other instruments or records in the possession of the Borrower pertaining to the Project. The Borrower shall be liable under this Agreement to pay to the Lender, on demand, any amount or amounts expended by the Lender in so completing the Improvements, together with any costs, charges, or expense incident thereto or resulting therefrom, all of which shall be secured by the Security Documents. In the event that a proceeding is instituted against the Borrower for recovery and reimbursement of any moneys expended by the Lender in connection with the completion of the Improvements, a statement of such expenditures, verified by the affidavit of an officer of the Lender, shall be prima facie evidence of the amounts so expended and of the propriety of and necessity for such expenditures; and the burden of proving to the contrary shall be upon the Borrower. The Lender shall have the right to apply any funds which it agrees to advance hereunder and any funds which the Borrower has then on deposit with Title to bring about the completion of the Improvements and to pay the costs thereof; and if such moneys so agreed to be advanced and funds of the Borrower then on deposit with Title are insufficient, in the sole judgment of the Lender, to complete the Improvements, the Borrower agrees to promptly deliver and pay to the Lender such sum or sums of money as the Lender may from time to time demand for the purpose of completing the Improvements or of paying any liability, charge or expense which may have been incurred or assumed by the Lender under or in performance of this Agreement, or for the purpose of completing the Improvements. It is expressly understood and agreed that in no event shall the Lender be obligated or liable in any way to complete the Improvements or to pay for the costs of construction thereof.<sup>36</sup>

#### ARTICLE VII – MISCELLANEOUS

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<sup>36</sup> Similar provisions are included in almost every construction loan agreement, but note that some of them are unenforceable, particularly the right to immediately take possession of the property. Borrower's counsel must take account of this if it is giving an enforceability opinion.

Section 7.01 Inspections . The Borrower and the Architect shall be responsible for making inspections of the Project during the course of construction and shall determine to their own satisfaction that the work done or materials supplied by the Contractors to whom payment is to be made out of each Advance has been properly done or supplied in accordance with the Construction Contract and the other applicable contracts with the Contractors. If any work done or materials supplied by a Contractor are not satisfactory to the Borrower and/or its Architect and the same is not remedied within fifteen (15) days of the discovery thereof, the Borrower will immediately notify the Lender in writing of such fact. It is expressly understood and agreed that the Lender and the Inspecting Architect/Engineer may conduct such inspections of the Project as either may deem necessary for the protection of the Lender's interest, and that any inspections which may be made of the Project by the Lender or the Inspecting Architect/Engineer will be made, and all certificates issued by the Inspecting Architect/Engineer will be issued, solely for the benefit and protection of the Lender, and that the Borrower will not rely thereon.

Section 7.02 Indemnification by the Borrower . The Borrower shall bear all loss, expense (including attorneys' fees) and damage in connection with, and agrees to indemnify and hold harmless the Lender, its agents, servants and employees from all claims, demands and judgments made or recovered against the Lender, its agents, servants and employees, because of bodily injuries, including death at any time resulting therefrom, and/or because of damages to property of the Lender or otherwise (including loss of use) from any cause whatsoever, arising out of, incidental to, or in connection with the Project or the construction of the Improvements, whether or not due to any act of omission or commission, including negligence of the Borrower or any Contractor of its or their employees, servants or agents, and whether or not due to any act of omission or commission of the Lender, its employees, servants or agents.<sup>37</sup> The Borrower's liability hereunder shall not be limited to the extent of insurance carried by or provided by the Borrower or subject to any exclusions from coverage in any insurance policy. The obligations of the Borrower under this Section shall survive the payment of the Note.

Section 7.03 Additional Security Interest . In the event an Advance is to be made for materials then being fabricated or stored, or both, for later use in the completion of the Improvements but which are not then stored upon the Land or installed or incorporated into the Project, then such Advance shall be made only after the Borrower has given to the Lender such security instruments and insurance on such materials as the Lender may reasonably request.

Section 7.04 Fees and Expenses . Whether or not any Advance shall be made hereunder, the Borrower agrees to pay all fees of Title and the Inspecting Architect/Engineer, appraisal fees, survey fees, recording fees, license and permit fees and title insurance and other insurance premiums, and agrees to reimburse the Lender upon demand for all reasonable out-of-pocket expenses actually incurred by the Lender in connection with this Agreement or in connection with the transactions

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<sup>37</sup> Borrower's counsel will want to qualify this indemnity for the negligence or misconduct of the Lender or its agents.

contemplated by this Agreement, including, but not limited to, any and all reasonable legal expenses and attorneys' fees sustained by the Lender in the exercise of any right or remedy available to it under this Agreement (whether or not suit is commenced) or otherwise by law or equity and all reasonable fees and disbursements of counsel for the Lender for the services performed by such counsel in connection with the preparation of this Agreement and the other documents and instruments contemplated hereby.

Section 7.05 Notices . All notices or other communications which are required or permitted hereunder shall be in writing and sufficient if (a) delivered personally or sent by email in PDF format, (b) sent by nationally recognized overnight courier or (c) sent by certified mail, postage prepaid, return receipt requested, addressed as follows:

(a) If to the Lender at:

Friendly Construction Loan Bank  
123 Yellow Brick Road  
Moneyapolis, MN  
Attention: Vice President, Commercial Real Estate Department  
Email: \_\_\_\_\_

(b) If to the Borrower at:

Apartments 'R' Us, LLC  
456 Hopes and Dreams Avenue  
Brainpower, MN  
Attention: \_\_\_\_\_  
Email: \_\_\_\_\_

or to such other addresses as the party to whom notice is to be given may have furnished to each other party in writing in accordance herewith. Any such communication shall be deemed to have been given (i) when delivered if personally delivered or sent by email during a business day, (ii) on the business day after dispatch if sent by nationally recognized, overnight courier or if sent by email on other than during a business day, and (iii) on the third day after dispatch, if sent by mail.

Section 7.06 Time of Essence . Time is of the essence in the performance of this Agreement.

Section 7.07 Binding Effect and Assignment . This Agreement shall be binding upon and inure to the benefit of the Borrower and the Lender and their respective successors and assigns, except that the Borrower may not transfer or assign its rights hereunder without the prior written consent of the Lender.

Section 7.08 Waivers . No waiver by the Lender of any default hereunder shall operate as a waiver of any other default or of the same default on a future occasion. No delay on the part of the Lender in exercising any right or remedy hereunder shall operate as a waiver thereof, nor shall any single or partial exercise of

any right or remedy preclude other or future exercise thereof or the exercise of any other right or remedy.

Section 7.09 The Lender's Remedies Cumulative . The rights and remedies hereby specified are cumulative and not exclusive of any rights or remedies which the Lender would otherwise have.

Section 7.10 Governing Law and Entire Agreement . This Agreement shall be governed by the laws of the State of Minnesota without regard to conflict of laws principles. This Agreement, the Note and the Security Documents contain the entire agreement of the parties regarding the Loan. Without limiting the generality of the foregoing, this Agreement, the Note and the Security Documents supersede any term sheet, loan application or commitment letter issued by the Lender or submitted by the Borrower in connection with the Loan.

Section 7.11 Counterparts . This Agreement may be executed in any number of counterparts, each of which, when so executed and delivered, shall be an original, but such counterparts shall together constitute one and the same instrument.

Section 7.12 Inconsistency . In the event that any of the terms and provisions of this Agreement are inconsistent with any of the terms and provisions of the Note or Security Documents, the terms and provisions of this Agreement shall govern.

Section 7.13 Conditions of Advances . All conditions of the obligation of the Lender to make Advances hereunder are imposed solely and exclusively for the benefit of the Lender, and no other person shall have standing to require satisfaction of such conditions in accordance with their terms or be entitled to assume that the Lender will refuse to make Advances in the absence of strict compliance with any or all thereof, and no other person shall, under any circumstances, be deemed to be a beneficiary of such conditions, any or all of which may be freely waived in whole or in part by the Lender at any time if the Lender, in its sole discretion, deems it advisable to do so.

Section 7.14 Amendments . Neither this Agreement nor any provision hereof may be amended, changed, waived, discharged or terminated orally, but only by an instrument in writing signed by the party against whom enforcement of the change, waiver, discharge or termination is sought.

Section 7.15 Participation . The Borrower acknowledges that the Lender may, and shall have the right to, sell participation interests in the Loan. In the event any of Lender's participants shall require any additional items, Borrower shall use all reasonable efforts to obtain and deliver such items.

Section 7.16 Sign . During construction of the Project the Lender shall be permitted to erect and maintain on the Project a sign indicating the source of the financing.

Section 7.17 Jurisdiction . The Borrower hereby irrevocably agrees that any legal action or proceedings against it with respect to this Agreement may be brought in the courts of the State of Minnesota, or in any United States District Court in the State of

Minnesota, and by the execution and delivery of this Agreement, the Borrower hereby irrevocably submits to the jurisdiction of each such court and hereby irrevocably waives any and all objections that the Borrower may have as to jurisdiction or venue in any of such courts. The Borrower acknowledges that it has received sufficient consideration for any inconvenience which may be caused by any legal action brought in the State of Minnesota, and agrees that the enforcement of the provisions of this paragraph against the Borrower would not be unreasonable or unfair under all the circumstances of the Loan or this Agreement.

Section 7.18 WAIVER OF JURY TRIAL . THE LENDER AND THE BORROWER HEREBY VOLUNTARILY, KNOWINGLY AND INTENTIONALLY WAIVE ANY AND ALL RIGHTS TO TRIAL BY JURY IN ANY LEGAL ACTION OR PROCEEDING ARISING UNDER THIS AGREEMENT, REGARDLESS OF WHETHER SUCH ACTION OR PROCEEDING CONCERNS ANY CONTRACTUAL OR TORTIOUS OR OTHER CLAIM. THE BORROWER ACKNOWLEDGES THAT THIS WAIVER OF JURY TRIAL IS A MATERIAL INDUCEMENT TO THE LENDER IN EXTENDING CREDIT TO THE BORROWER, THAT THE LENDER WOULD NOT HAVE EXTENDED SUCH CREDIT WITHOUT THIS JURY TRIAL WAIVER, AND THAT THE BORROWER HAS BEEN REPRESENTED BY AN ATTORNEY OR HAS HAD AN OPPORTUNITY TO CONSULT WITH AN ATTORNEY IN CONNECTION WITH THIS JURY TRIAL WAIVER AND UNDERSTANDS THE LEGAL EFFECT OF THIS WAIVER.

[Signature page follows]

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed as of the day and year first above written.

**BORROWER:**

APARTMENTS 'R' US, LLC

By \_\_\_\_\_  
Its \_\_\_\_\_

**LENDER:**

FRIENDLY CONSTRUCTION LOAN BANK

By \_\_\_\_\_  
Its \_\_\_\_\_