

TABLE of EXPERTS

COMMERCIAL CONSTRUCTION

Long before the ribbon-cutting ceremony, a lot of things have to go right to get a building project off the ground. We talked to two experts in the field about financing, finding the right contractors, the regulations impacting the industry and what the construction outlook is going forward for the Capital Region.

How did you get into the commercial end of things at Whiteman, Osterman & Hanna?

Chris McDonald: I've been doing some variety of commercial real estate litigation for most of my career. Primarily I'm dealing in courts, contractor disputes with owners, subcontractor disputes with contractors, less on the owner to bank side. There seems to be fewer disputes in that, largely because the bank has the money and nobody wants to get them upset. But we do work closely with banks because usually there is a good relationship with the owner. I would say I do primarily owner-side stuff as opposed to contractor-side stuff, so I do deal with the financing component of it.

Have you seen some kind of growth in the commercial arena?

Joseph Fleming: Yes. We've seen excellent growth in construction lending as well as all the other types of real estate in the Capital Region. Again, we've got more of a local focus. And I think that kind of puts us in a position to understand our markets, as well as in many cases to know the people that are coming to us to borrow money. We work primarily with local legal firms, local engineers, contractors, builders.

What are some of the things that parties can do during the contracting phase of a project to position themselves when a dispute arises?

McDonald: I would say the biggest thing is to be very careful in the drafting of whatever contract is going on ... There are a lot of things that can happen on a construction project that can lead to litigation from the simple contract disputes. A lot of people can use an [American Institute of Architects] or a consensus form document. I would just caution people that forms can be a little bit dangerous. Those forms aren't always designed to protect everybody's interest to the greatest extent possible. So you want to look at your stuff, make sure it has the provisions you need from your perspective, whatever that may

be – the bank, the owner, the contractor – and make sure it has the type of protections that you need.

Do you find, with the parties that you're working with, that people have become more sophisticated over the last few years?

McDonald: Certainly. With the amount of information that's out there and the internet, people have a very good sense of what they want to do with the project, what direction they want to go, before we even get involved.

Fleming: All of our lenders tend to be generalists in that we don't limit them by product, or certainly not geography. So they're all well-versed in [commercial and industrial] real estate construction lending. One of the most important things is: Use experienced people.

McDonald: Do you find you put a lot of input into the owner-[general contractor] contract?

Fleming: Not a lot, but we do want to review it to make sure that it's a solid contract and so we know where our money's going because the AIA is not of any value at all if it's not a good, solid, detailed contract.

Are there different things you can do during the project itself to stave off litigation?

McDonald: The biggest thing there is, once you've gotten this nice contract that's got all the terms and conditions that you like about it, follow it. There's a practical issue of people want to get their project built. Sometimes you don't want to go back to your office and write out, "This is a formal notice" ... That's a little laborious. But if you do that or you have a person on your staff who's devoted to doing those kinds of contractual notices, it really helps you later on ... I do litigation, but I often advise clients, "Look, you want to get your project built. You want to start making money. Avoid litigation. Do

what you can to avoid it."

Is that something you've had much experience with?

Fleming: Yeah. From the bank's perspective, you want to make sure you have good processes in place. We talk about the lender and getting the deal together, but you need a good credit team, you need a good servicing team, because you need to track the progress of the project right from the word go to make sure that what you think you're paying for is what's happening ... We're starting to see long-term rates move. That can be a 50 to 100 basis point movement in interest rates that you may or may not have been prepared for. I think one of the other things we look at is liquidity of the borrower, either the entity or the project sponsor. Do they have the depth to add additional capital into a project to keep it moving?

McDonald: If you get stuck or if you get jammed up for a period of time, that can kill it.

Fleming: Right. And we've seen that where the sponsors had to step in and start making payments to keep the project moving while the attorneys are figuring out a solution.

We're in a pretty strong economy right now. A lot of projects are out there. Does this happen more often where folks are having to step in? What's the landscape?

Fleming: We're really not seeing a lot of that. I think you've got such a strong market of financing options, attorney firms with good experience, builders. And there's liquidity out in the market right now. So we're really not seeing a lot of builder disputes at all right now.

McDonald: My view is a little skewed anyway. Everything I see is a dispute. I would say the volume seems to be roughly the same as it has been historically, for me personally. I can't speak to what other people

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are seeing. But I can say we have some clients who do a lot of deals, and it's not like every one of their deals is engaged in litigation. It's usually one project, something very specific has happened or there's a specific relationship issue that led to the litigation.

If you have folks that you dealt with in the past where you have had some legal issues, does that impact any decisions?

Fleming: The bank tries to stay as neutral as possible because you generally find the truth to be somewhere in the middle. We'll stay on top of it. We may engage local counsel if we need to. Generally, those disputes are between the contractor and the owner or the sponsor of the project, so it's not something we need to really get involved in unless it gets really, really ugly or there's a potential for financial loss.

McDonald: My experience is that the banks sort of monitor it. But sometimes you'll see people affirmatively sue the bank because they want to increase the leverage, because you don't want to have a claim against your lender. They're saying, "I'm not involved in this. This is between you guys."

How about when a mechanic's lien is filed? How do parties respond to that?

McDonald: Most lending documents that I've seen would make the filing of mechanic's liens at least an arguable default, or an event where they could call a default. The first thing an owner would want to do is reach out to the bank, see what their tolerance is for a particular type of lien. You can have a material man who's way down the chain who's filing a lien for \$10,000 or something. I would think a bank would be more likely to say, "Hey, that's not a huge deal." If you got your main general contractor filing a lien for the balance of the contract price, several million dollars, that's a different category. One of the things that private owners at least can do is bond off



Joseph Fleming from Pioneer Bank, left, and Chris McDonald from Whiteman, Osterman and Hanna

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a lien. And what that basically does is that switches the lien from being a lien against the real property that is the subject of the project, and converts it to a bond as opposed to a surety, and usually what that does is that allays any concerns that lender has about impacting their security on their building.

Fleming: You just want good communication. The bank never wants to be surprised.

Chris, what is Lien Law Article 3-A Trust?

Fleming: I even looked it up yesterday. I still don't understand it.

McDonald: This admittedly is a little bit of a dense and technical area of the law. Basically, this was an

effort by the legislature – and mechanic's liens are a similar kind of effort – to make sure that people who are doing work on projects are getting paid. And one of the ways the legislature decided to do that is to create these statutory trusts. And basically, any money that is devoted towards the project, each person at various tiers is a trustee for the benefit of the folks below them. So the owner is a trustee for the benefit of the general contractor, the general contractor is a trustee for the benefit of the sub-contractors, and so on and so forth. And the idea is you hold it in trust. You don't have an interest in the money until everybody below you gets paid.

Now, Article 3-A has some very specific requirements. There are provisions in the building loan agreements that have to be in there in order for

MEET THE PANELISTS



CHRIS MCDONALD

Partner
Whiteman, Osterman and Hanna

Chris McDonald is a Partner with Whiteman Osterman & Hanna and is a member of the firm's litigation, arbitration and mediation practice group. His principal area of practice is commercial litigation with an emphasis on construction law, real estate and land use disputes, and administrative law. Chris has represented clients across the state at the trial and appellate levels in both state and federal court.

Prior to joining Whiteman, Chris was an associate with Shanley, Sweeney, Reilly & Allen P.C.

Chris was awarded a Juris Doctor, magna cum laude, from Albany Law School of Union University, and received a Bachelor of Science degree in Psychology from Union College. He is a member of the New York State and American Bar Associations.



JOSEPH FLEMING

Senior Vice President and
Chief Lending Officer
Pioneer Bank

Joseph Fleming joined Pioneer Bank's executive management team as its senior vice president and chief lending officer. He is responsible for all aspects of lending, including residential, consumer and commercial where he oversees Pioneer Bank's entire commercial lending team. Joseph brings over 30 years of experience to Pioneer from various positions, most of them in lending.

Joseph earned his Bachelor of Science in Business Management from SUNY Empire State College and graduated with honors from American Banking Association's National School of Banking. He currently serves as a board member for the Troy Area United Ministries and enjoys fishing and spending time with his family.

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the lender to have their priority, their filings, they have to make notices of lending and things like that, so they preserve their priority against the property. And there are also some relatively stringent accounting requirements for each trustee. People need to be very careful as their project is going forward to make sure that they're aware of what those accounting requirements are and that they're following them.

One of the claims that you'll usually see in litigation is that somebody has committed a diversion of Article 3-A Trust assets. The sort of classic example is the contractor is paid \$100,000. He owes \$100,000 to all the guys down the line, but he buys a boat. You can't do that. The boat's not part of the improvement.

Regulation-wise, are things becoming more difficult or less difficult in general?

Fleming: I think in general, regulations are always increasing. When things are going well, there's always some section of commercial loan portfolios that our regulators are concerned about. You're in an historically low rate environment. We do sensitize all of our loans or interest rate increases. We try to sensitize for higher than projected vacancy rates, lower than projected rental rates, those kinds of things. Because, again, we don't like to live in the world of surprises. Generally, on a construction project, you're working on pro formas. So we do take a look at what could happen, or what's the best estimate of what could happen. We also try to look at different portfolios to make sure – are they sensitive to capitalization rates, are they sensitive to vacancies, those kinds of things, as a portfolio. The regulators come and look and they want to know that you're paying attention to your portfolio as well as the individual loans. While I run the commercial lending team, a big part of my job is managing the risk piece of the loan portfolios.

addressed this.” One thing I find now, people are communicating by email, by text message. There's a lot of communication, a lot more than you used to see. And one of the things you have to do in litigation, generally, is you have to produce all of that stuff. You have to produce your project file. And that can be a very time-consuming process, it can be a very expensive process. It's a lot of document chasing from the litigation perspective at least. But you want to make sure that you have all of those documents, they're easily accessible, they're sort of easy to get through, because hopefully that will make the process easier going forward.

Joe, is there a standard procedure that you follow?

Fleming: Certainly, the level of dispute will have an impact on our processes. But in general, we're going to at least have a conversation with our legal counsel to find out what we need to do to protect ourselves, as well as the project and in some cases the borrower. But we're definitely going to engage legal counsel. We're going to make sure that we've got everything that we should have and that everything's been reviewed properly.

Let's shift over to more of the economic landscape or the climate that we're in. Joe, you mentioned a couple times that rates are starting to shift a little bit. Long-term rates have recently begun to rise. What impact do you think that increase will have on future construction?

Fleming: I think it can go one of two ways depending on the project sponsor. It will either move people that have been thinking about doing things off the sidelines and getting involved now because they see where rate are potentially headed, or people may pull back because rates are headed up and the proj-

those kinds of things.

Joe, are you becoming concerned that we could be reaching saturation point in the market with certain types of projects?

Fleming: The way I look at it and the way the bank looks at it, we're kind of in a nice space because our decision-making is local with our president, Tom Amell, being in Albany, and myself, as a chief lender, being local. We don't really have to create boxes by which we put different categories of projects in. So what we really look at is the profit. I don't see any one industry that I'm getting nervous about as much as it is just sticking to good credit standards, good borrowers, good projects.

Chris, when there are big shifts in the market one way or the other, not necessarily with rates, are you seeing an increase or decrease in the types of cases and clients that you're handling?

McDonald: No, not really. It's pretty steady in terms of the type of disputes that you see. They really are on a project-by-project basis. But sometimes, depending on the marketplace, you may have somebody who's trying to get into a market and so they kind of underbid the job a little bit, and that can get you into a bad spot, because if the numbers aren't accurate, you're going to have a problem. It's going to turn into a change order dispute down the road or there's going to be a claim that the owner didn't fund enough.

Fleming: That very much goes back to having an experienced team around you when you decide to start a construction project.

One of the things we were seeing when we came out of the recession is that a lot of people who were bidding on projects said there wasn't a lot of profit on the jobs and they were bidding really tight. How do you handle that? Does that concern you?

Fleming: I wouldn't say the lowest bid is always the best bid. But again, tell me who the contractor is, tell me who's running the project, and I can tell you an awful lot about how well the project is going to go just based on the experience of what we've seen with our customers. When we're putting a loan deal together, we're not really looking at the margins as much as we are looking at who is the contractor ... How strong is the project sponsor personally to be able to carry the project if somebody backs out of a lease or goes out of business? Or if it's an owner-occupied project, how strong is the business that is going in this? Owner-occupied is nice because you actually can see the financial statements for the operating company that's going to be paying rent to cover the loan payment. It's really the strength of the borrower, but we do look at who the contractors are and we've had some concerns at times if it's a contractor we're not comfortable with.

McDonald: There's performance and payment bonds that sort of go in place if you have a [general contractor] that you have concerns about. Do you ever require an owner to get one of those?

Fleming: There's nothing really better than getting bonding to protect the bank if you're concerned about a contractor. A lot of that is about project size.

McDonald: Yeah, we see that infrequently in the privates. Public, we see it ... but privates very rarely. I think it's because the owner says, “Well, if I require them to be bonded, it's just a pass-through cost to me, and why do I want to increase the cost?”

“A lot of the projects we’re seeing are local people putting money back into the community rather than trying to come in and make a splash.”

JOSEPH FLEMING, senior vice president and chief lending officer at Pioneer Bank

Now, to wrap up the litigation area side of things, what do you do if you find yourself in litigation over a construction project?

McDonald: Well, the self-serving answer is you get a good attorney. But seriously, hopefully, you're in a spot where, you know, the summons and complaint gets filed, you should have known it was coming before it happened. You've been in touch with your lender. You've been in touch with your attorney. You've started making efforts to compile the information you need to address whatever the claim is. There can be a wide variety of claims, so specific advice depends on the situation. But a few of the things are, you need to know what the issue is, and hopefully, you're going back in your well-kept records and you're looking for these notices. You're looking for communications you have on the issues so you can pretty easily say, “Look, we already

ect may not work. You have to produce a certain ability to cover your debt, and as debt increases, it makes your project more expensive.

Chris, being on the litigation end of things, when the rates start to shift, do you tend to see any trends or different things happening in the disputes that come to you?

McDonald: In my experience, there's a little bit more of a sensitivity to getting disputes resolved sooner because you want to manage that uncertainty. There are some mechanisms in the litigation that can address that. There's something known as delayed damages. So if your project gets jammed up, and as a result of that claim, you start losing money because interest rates change, you might be able to potentially shift some of that onto whoever the party at fault was. A lot of contracts waive



From left, Joseph Fleming, senior vice president and chief lending officer at Pioneer Bank, moderator Robin K. Cooper, senior reporter at Albany Business Review, and Chris McDonald, partner at Whiteman, Osterman and Hanna.

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Fleming: It's not something the bank generally requires, but the bank never disagrees with having it.

What are some of the other factors you take into consideration in your reviews?

Fleming: We've covered most of them. Experience of the sponsor. Quality of the team around them as far as who the contractor is. Ability, you know, cash flow. Cash flow pays loans back. And quality of the tenants and their ability to meet the terms of their leases. Location. Everything that hopefully the sponsor's looking at, we're looking at, too.

Has that changed over the years?

Fleming: No, I don't think so. You still want to know who you're doing business with.

What makes the Capital Region a good place to do construction projects?

Fleming: We've seen a relatively steady economy. I'm not saying we didn't see a slowdown in the last recession, but the workforce has been steady, if not improving, with all the tech projects that have come into the area. You've got a relatively educated pop-

ulation, you've got a steady population. Some areas are seeing some growth. And I think there's demand. And again, it's the localness of the community that there's plenty of local talent that you don't need to reach outside of your area to get a project done in most cases. A lot of the projects we're seeing are local people putting money back into the community rather than trying to come in and make a splash.

From your time working in commercial real estate, what takeaways do you have? You have a sizeable practice.

McDonald: I agree that it's sort of the talent of the local owners, contractors, banks, people involved. They have a tie to the community that they're doing the project in, and I think that gives them a level of involvement. It's not some guy however many miles away saying, "I'm building a thing over in AL-BAN-EE or something." They're paying attention.

We've seen a steady stream of projects basically since we came out of the recession. Do you see that continuing? Do you see things shifting a little bit?

Fleming: We haven't seen a slowdown. Interest rates

are the one thing that could impact future projects. I have no idea where the presidential election will take the economy, but as long as the economy remains steady, I don't get the sense that people are starting to get concerned about it.

Are more people talking about what impact the election could have?

Fleming: Not really. I'm not sure what people think right now about the election. It's going to take some time to play out. I don't know, at the local level, if it really matters or not. This economy can stay strong. Again, if you stick with experienced people – I keep going back to that – they're going to lead the way. There are still markets that have room for growth, and we are trying to identify where the next big market's going to be. It seems like the area keeps getting smaller. People are not afraid to commute anymore. I don't see a reason for it to slow down. If interest rates go crazy, which I don't think is necessarily going to happen, that could have a major impact. If they move up a point or two, I don't think that's going to slow anything down.

McDonald: I think there's a lot of uncertainty generally with the presidential election. I'm not seeing any effect on it that I can quantify. ■

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