

Client Alert

Recording Complications May Delay NY Real Estate Construction Financings

On March 18, 2020, in response to the COVID-19 pandemic, Governor Cuomo issued Executive Order No. 202.06 which stopped all “non-essential” construction in New York State. According to subsequent guidance issued by the Empire State Development Corporation, “essential” construction which is permitted to continue includes projects for infrastructure, affordable housing, homeless shelters, hospitals and health care facilities. In addition, emergency construction required to complete work that would otherwise endanger the health and safety of the occupants or the public if left unfinished, is also permitted to be completed on any project.¹

New York State has taken measures to allow certain facets of real estate transactions to be conducted electronically (such as, for example, permitting notarization and witnessing of documents using audio-video technology and allowing for electronic recording of executed documents such as deeds and mortgages). However, at the present time, with the physical County Clerk’s offices temporarily closed, certain documents applicable to construction loans are not able to be “filed” in person, making it difficult to satisfy requirements particular to New York construction loans.

Specifically, pursuant to §22 of the N.Y. Lien Law, in order for a building loan mortgage to have priority over subsequent mechanic’s liens, the building loan agreement and a related affidavit itemizing the expenses to be paid by the borrower from the proceeds of the building loan must first be “filed” with the County Clerk’s office in the County where the mortgaged property is located. This filing of the building loan agreement² must be made on or before the date the building loan mortgage is recorded.

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Additionally, any agreement which constitutes a “material” modification to the building loan agreement is also required to be filed with the County Clerk within ten (10) days following such modification. Examples of material modifications include, without limitation, increases to the loan amount or changes to the amount or manner of payment, or assignment of the building loan agreement by the original lender to a new lender. Failure to comply with these recording requirements may very well result in a lender losing priority of its mortgage lien to a subsequently filed mechanic’s lien. Such loss in priority would be applicable to advances on the building loan which were made both before and after the recording of a mechanic’s lien.

Thus, even though electronic recording of mortgages is permitted through the Automated City Register Information System (ACRIS) in NYC, as well as many other counties throughout the State, the inability to file a building loan agreement and related documents in-person with the applicable County Clerk’s office may prevent a lender from complying with the required statutory recording procedure. In some circumstances it is possible that “filings” may still be made by Federal Express or mail, rather than in-person. However, whether a filing by mail satisfies the applicable requirements is not entirely clear and is subject to some differences of opinion. It is also important to consider that filings by mail, once delivered to the County Clerk’s office, may not actually be filed for some time due to the backlog of documents to be recorded.

A related difficulty with closing such construction loans is that under the current conditions some title companies may be temporarily unwilling to insure New York construction loans. One approach which has emerged in recent days is for construction loans to close in escrow, so that no title insurance will be issued, or loan proceeds advanced by the lender, until such time as the building loan agreement has actually been filed with the County Clerk. Other title companies may be willing to insure transactions up to a certain dollar amount (for example, up to \$10 million) with an appropriate gap indemnity delivered by the borrower (or related creditworthy entity) which indemnifies the title company against any loss resulting from the recording delay. Under the circumstances, title companies will also likely avoid committing in an escrow agreement to record the documents within a certain number of days following the closing.

Given the particular recording requirements of the N.Y. Lien Law, at this time any NY construction loan which is a newly originated loan or a loan being “materially” modified is susceptible to having additional requirements, delays or complications with respect to issuance of title insurance. From the lender’s perspective, all of these recording issues must be discussed and resolved on a case-by-case basis with the title company at the outset to ensure that the loan closes with the requisite title insurance and the priority of the lender’s lien on the mortgaged property is not impaired.

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Until business operations return to some degree of normal and in-person “filings” of building loan agreements are permitted, issues with the timely recording of building loan agreements and related documents with the applicable County Clerk’s office will continue to be of concern to both title companies and lenders financing construction projects in New York. We will continue to provide periodic updates as warranted.

¹ All essential or emergency construction which is permitted to continue must comply with appropriate social distancing measures including with respect to elevators, meals, entry and exit. Sites that cannot maintain distance and safety best practices must close.

² Under the N.Y. Lien Law, § 2(2), 2(4) and 2(13), a “building loan” is defined as a loan made for the express purpose of funding the construction, renovation and/or demolition of an improved property.

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