

Foreclosing on Subdivisions—Beware of the Set Aside Letter!

(Article 1 of 2)

A lender is never in a better position to gain the assistance and support of a Borrower than when a Notice of Default is imminent. But before you declare your default, record the NOD and move toward foreclosure, you need to evaluate several critical documents.

The first analysis should answer the question: what is my liability under the Set Aside Letter the Bank issued? Do not assume that any and all disbursements of line items in the onsite and offsite budgets serve to reduce your liability. They don't.

Locate the Subdivision Agreement (sometimes referred to as the Site Improvement Agreement) and the original Engineer's Estimate of Costs. There should be a dollar correlation between the Set Aside, the Engineer's Estimate and the Surety Bond.

The Engineer's Estimate will list the various improvement costs by category and assign estimates of the cost to complete each category of the site work. Some Engineer's Estimates are quite detailed, delineating as many as 10 line items for a single major category such as "Sewer Improvements," others show only gross totals for each improvement category.

The Engineer's Estimate will include a contingency based on a percentage of the total, usually 20%. The Engineer's Estimate plus the contingency form the basis of the Bond and the Set Aside Letter, which are usually (but not always) the same dollar figure.

If you are fortunate, your Loan Administration Department has segregated the bonded work and set up the line items in the project disbursement file matching the categories in the Engineer's Estimate. That being the case, you need only glance at the undisbursed column to determine your remaining Set Aside liability. However, if the line items do not match either in dollar or categories, you will have to go back and create a spreadsheet for all the site work disbursements, using the budget presented in the Engineer's Estimate. Upon completion of that effort, you will be able to determine any remaining liability under the Set Aside Letter.

Whether you believe you have liability remaining under the Set Aside or not, be sure that your disbursement files are sufficiently detailed so that if the bonds are called by the city or county, you can prove that the funds disbursed for the bonded work were actually paid for those improvements. We are finding that most recent Set Aside Letters issued guarantee not only the performance of the work but the payment as well. Review the Set Aside to determine exactly what the Lender agreed to in that document. If your Set Aside obligation extended to payment for the improvements, you should have documentation to support payment: cancelled checks, vouchers and lien releases. If the Set Aside only covered performance and not payment, there should be inspections and certifications supporting the work completed. If any of these supporting documents are not in the file, you should obtain what you can from the Borrower while he is still being cooperative.

KOREK LAND COMPANY, INC.

15230 BURBANK BLVD. SUITE 101 ❖ SHERMAN OAKS, CA 91411 ❖ (818) 787-3077 ❖ FAX (818) 787-9677
www.korekland.com ❖ mail@korekland.com ❖ CA DRE Lic. 00861992 | NV RED Lic. B.1000713.Corp

Understand that the Bonding Companies do not want to pay for any site improvements. If the bonds are called, the Bonding Company will notify the Lender and request any remaining Set Aside funds be sent to them. If you respond to the Bonding Company that your liability has been completely or partially extinguished, the Bonding Company will then request copies of your disbursement file in an effort to identify deficiencies that serve to muddy the water and increase the Lender's remaining obligation.

This can all happen before, during and after foreclosure; the timing depends on the beneficiary of the bond—the city or county. It has nothing to do with the status of your loan. But spending some time on this issue before the situation with your Borrower becomes adversarial and before the bonds are called can save the Lender significant dollars.

One last warning about Set Aside Letters, a recent court decision held that a Set Aside Letter survives loan repayment. So, if the Lender has issued a Set Aside Letter and the loan is repaid (through Borrower funds, sale or refinance), you must require that the Set Aside be returned to you. This should always be an element of your Beneficiary's Demand. Do not be lulled into thinking that just because your loan is repaid, the Set Aside is no longer operative. The Set Aside is valid as long as the bonds are outstanding.

KOREK LAND COMPANY, INC.

15230 BURBANK BLVD. SUITE 101 ❖ SHERMAN OAKS, CA 91411 ❖ (818) 787-3077 ❖ FAX (818) 787-9677
www.korekland.com ❖ mail@korekland.com ❖ CA DRE Lic. 00861992 | NV RED Lic. B.1000713.Corp