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Pitfalls in Modifying Building Loan Contracts

By Thomas A. Glatthaar

It has been said that no area of New York real property draws more blank stares than the Lien Law. It touches most real property transactions that you see, yet many practitioners do not understand its inner workings. This is particularly so in the area of construction loans. New York's Lien Law, with its use of statutory trusts to protect lien claimants, is unique,¹ and its application, particularly in the area of construction lending, is highly technical and its penalties very harsh. This is so because the governing Lien Law statutes in this area² are primarily disclosure statutes, intended to provide information for the benefit of contractors, materialmen and laborers, as to the net sum of the building loan available to the project.³

One of the areas of construction lending where confusion is greatest, in my experience, is in the context of the restructuring or modification of an existing construction loan during the course of the making of the improvement. The purpose of this article is to shed some light on the Lien Law requirements with respect to the restructuring or modification of an existing construction loan during the course of the making of the improvement. If history is any guide, as the economy weakens, recasting construction loans becomes something of a "growth" industry. Projects drag out, raising funds for equity contributions becomes more difficult, and funds have to be reallocated and budgets redrawn as projects get scaled down or reconfigured. As a result, the loan documents need to be modified, and it is important to be mindful of the various pitfalls in the Lien Law that arise in such a context. The triggering of these problems can result in dramatic consequences for the lender.

A discussion of the background involving building loans is appropriate in order to establish the context

in which our subject matter arises. The term "building loan" is not a defined term in the New York Lien Law. There is, however, ample statutory and case law references to this and related phrases to allow one to conclude that a "building loan" is a loan made by a lender to an owner in consideration of the express promise of the owner to make an improvement upon real property,⁴ which loan is advanced in stages as the improvement is erected.⁵ It is the mutuality of promises (to lend on the one hand and to erect improvements on the real property on the other) that is determinative of the question of whether any particular loan is a building loan.⁶

"New York's Lien Law, with its use of statutory trusts to protect lien claimants, is unique, and its application, particularly in the area of construction lending, is highly technical and its penalties very harsh."

These promises must be contained in the governing loan documents,⁷ which must be in writing and acknowledged in a manner that would entitle them to be recorded.⁸

These mutual promises are contained in a document called a building loan contract. This building loan contract, in addition to the mutual promises aforesaid, contains the various terms and conditions pursuant to which advances are to be made as well as the procedure for requesting such advances, and other information as determined by the parties thereto. This building loan contract must be filed in the Office of the County Clerk where the subject property is located prior to or simultaneously with the recording of the building loan mortgage.⁹ A failure to timely file the building loan contract (that is,

before the building loan mortgage is recorded, or simultaneously with the recording of the building loan mortgage) results in the subordination of the entire interest of the lender to any person who files a mechanic's lien for work done or materials furnished in connection with the making of the improvement.¹⁰

In addition to the information set forth above, the building loan contract must contain an affidavit of borrower that sets forth the consideration paid or to be paid for the loan and the expenses, if any, incurred or to be incurred in connection therewith, as well as the net sum available to the borrower for the improvement. When read in conjunction with Lien Law § 13(3),¹¹ all of this means that the proceeds of a building loan mortgage can be used only for (a) expenses (including consideration for the loan), if any, incurred or to be incurred in connection with the loan provided that such expenses also constitute a cost of improvement,¹² and (b) improvement of the premises.¹³

The purpose of this affidavit, often referred to as § 22 affidavit or a Lien Law affidavit, is to publicly disclose how the building loan proceeds are used or to be used, so that prospective lien claimants can determine compliance with the law and can further determine how much money is available for the making of the improvement itself. This affidavit must be materially correct. Any lender that knowingly files a building loan contract containing a § 22 affidavit that materially misrepresents the net sum available to the borrower for the making of the improvement suffers a subordination of its mortgage to subsequently arising mechanic's liens.¹⁴ The statutory penalty (the threat of loss of priority) is imposed on the lender even though the borrower is the maker of the affidavit,¹⁵ and is intended to act as an effective deterrent to a lender that allows the filing of a

§ 22 affidavit it knows to be false,¹⁶ or a lender that is indifferent to the truthfulness of the § 22 affidavit.¹⁷

A § 22 affidavit does not materially misrepresent (overstate) the net sum available to the borrower for the making of the improvement if it includes sums to pay for improvements completed prior to the issuance of the construction loan.¹⁸ It does not materially misrepresent the net sum available to the borrower for the making of the improvement if it includes sums previously advanced to borrower under notices of lending made prior to the execution of the building loan contract.¹⁹ The § 22 affidavit also does not materially misrepresent the net sum available to the borrower for the making of the improvement if the lienor (claimant) has been paid more than the net sum as stated in the § 22 affidavit;²⁰ or if the net sum includes interest on the building loan that accrues during the making of the improvement and provided that the § 22 affidavit contained a statement to that effect.²¹

By contrast, a § 22 affidavit does materially misrepresent the net sum available to the borrower for the making of the improvement where roughly 3% of the loan amount was in fact used to pay off and satisfy a prior existing mortgage and where the § 22 affidavit does not disclose such use of funds;²² where more than one-third of the loan amount was used to acquire existing mortgages by assignment and where the § 22 affidavit does not disclose such use of funds;²³ and where the net sum available was invaded to pay accrued and unpaid interest on the earlier mortgages made by the lender²⁴ provided that the amount thereof was material.

With the knowledge of how building loans work, how these loans are documented and how the proceeds are to be used, and understanding the unusual statutory penalties imposed by the Lien Law, we turn now to the unique problems that arise by the modification of a building loan.

As with the original building loan agreement, a modification must be in writing and must be acknowledged. It, too, must contain a § 22 affidavit that sets forth the consideration paid or to be paid for the loan and the expenses, if any, incurred or to be incurred in connection therewith, as well as the net sum available to the borrower for the improvement.²⁵ This affidavit must be materially correct, and the filing of a § 22 affidavit that materially misrepresents the use of the building loan proceeds or the net sum available for the making of the improvement will result in the imposition of a penalty subordinating the lien of the building loan mortgage to the lien of all claimants that file liens arising from the making of the improvement. The modification must be filed within 10 days after the execution thereof (as distinguished from the filing of the original building loan agreement and the recording of the building loan mortgage, the order of recording/filing of the modification of the building loan agreement and the modification of the building loan mortgage not being relevant);²⁶ if the modification of the building loan agreement is not filed within 10 days of its execution, the subordination penalty described above is imposed, subordinating the lien of the building loan mortgage to the lien of all claimants that file liens arising from the making of the improvement.

Further, any such modification of the building loan agreement does not affect the rights of any person who has performed work, furnished materials or provided services to the project that could result in the filing of a mechanic's lien, or any person who contracted²⁷ prior to the date of filing of the modification to perform work, furnish materials or provide services to the project that could result in the filing of a mechanic's lien. The rights of this protected class of persons are governed by the original (unmodified) contract. This means that, so long as the original building loan agreement and building loan mortgage comply with the law, mem-

bers of this protected group can assert priority over the lien of the building loan mortgage to the extent (and only to the extent) that such persons are impaired by reason of the modification. For example, members of this group could assert priority over the lien of a building loan mortgage where the building loan agreement was modified, resulting in a reduction of the net sum available for the improvement, to the extent of this reduction. These members could also assert priority over the lien of a building loan mortgage where the building loan agreement was modified in a non-monetary manner (i.e., that did not reduce the net sum as aforesaid), but that otherwise affected the ability of the claimant to be paid in full.²⁸ This result would hold except, and to the extent that, such persons would agree in writing to consent to the modification and to have their rights governed by the building loan agreement as amended thereby.²⁹

Notwithstanding the language in § 22 that ". . . any modification (of a building loan contract) . . . must be in writing and . . . any subsequent modification of any such building loan contract so filed must be filed within ten days of execution," it is not every modification of a building loan agreement that must be filed.³⁰ Only those modifications that are "material" must be filed in accordance with § 22.³¹ A "material modification" is not limited only to those modifications that result in a change to the net sum available;³² it is also one that alters the rights and liabilities otherwise existing between the parties to the agreement or enlarges, restricts, or impairs the rights of any third party beneficiary,³³ or one where an essential term of the building loan contract is changed, such as the amount or the manner of payment.³⁴

Among the kinds of modifications that have been deemed material are: the waiver (by failure to enforce) of a building loan contract provision requiring borrower to obtain a payment bond as a condition to

the advance of loan proceeds;³⁵ the amendment of a provision of the building loan agreement authorizing the conversion of the property to condominium;³⁶ and the amendment of a provision of a building loan agreement which requires that other sums or sources be made available for payment of contractors or suppliers aside from the loan proceeds.³⁷

By contrast, the waiver of a building loan contract provision calling for borrower to obtain a payment bond that could, *in the discretion of the lender*, be required;³⁸ a straight extension of time that left the parties with the same rights and liabilities;³⁹ and the waiver of the right to hold borrower in default even though the building loan agreement would allow the lender to do so,⁴⁰ are all examples of modifications that were determined to be non-material which, accordingly, did not require the filing of a modification.

* * *

Let us assume that a loan closing occurred on Blackacre on December 1, 2007. The loan is intended to fund construction of a 15-story building containing 150 luxury condominium units and ground floor commercial space, with a total construction budget of roughly \$80 million. The total loan amount is \$65 million. The loan is comprised of two parts: a building loan component of \$57.5 million, and a project loan component of \$7.5 million. At the time of the closing, the borrower executes several notes, a building loan mortgage in the amount of \$57.5 million, a project loan mortgage in the amount of \$7.5 million, a building loan agreement in the amount of \$57.5 million, a project loan agreement in the amount of \$7.5 million, and various ancillary loan documents. The building loan agreement contains all of the relevant terms and conditions required by law and agreed to by the parties. It has, as an exhibit a § 22 affidavit made by the borrower that recites the following salient information:

- a) That the consideration paid for the loan is \$287,500, which is to be paid out of the loan proceeds;
- b) That the borrower has incurred or will incur the following expenses in connection with the loan or the project, and which are to be paid out of the loan proceeds: mortgage tax of \$1,330,000; recording fees of \$400; bank attorney fees of \$250,000; title insurance premiums and search and examination of \$168,048; expenses incurred to acquire prior mortgages by assignment of \$10,000,000; architect fees of \$60,000; real estate taxes, and water charges and sewer assessments that accrued prior to the commencement of the improvement of \$12,000, and also real estate taxes, water charges and sewer assessments that accrued during the making of the improvement of \$45,000; interest accruing on the building loan during the construction period of \$2,910,000; and survey fees of \$6,500.⁴¹
- c) That the net sum available for the making of the improvement is \$42,430,552.

Construction has been ongoing for more than nine months, and the project is running behind schedule and over budget. The main commercial tenant has filed Chapter 11 and rejected the lease, so that virtually all of the commercial space in the project is not leased. In addition, unit sales are going very slow and, in the down market that we are experiencing, there is little chance that sales will pick up soon, since the market is currently flooded with units in similar price ranges. Roughly \$50 million has been advanced to date under the building loan mortgage and building loan agreement. The borrower is looking for a restructuring of the building loan in order to give it some breathing room. It needs additional time to finish the project, and to sign up some commercial tenants it is negotiating

with and locate others. It also plans, in view of the housing market, to change the property over to a luxury rental, and is requesting flexibility in the project loan funds in order to use up to \$2.5 million of that loan to help pay for improvements. The borrower is offering to increase its equity contribution in exchange for these concessions, as well as offering certain other financial assurances. As a result of these discussions, the borrower and the lender enter into a series of instruments affecting these amendments, including amendments to the building loan mortgage and building loan agreement, and the project loan mortgage and project loan agreement. The amounts of the building loan mortgage and the project loan mortgage were unchanged, and the modification documents merely reflected the extension and the change in the nature of the project and the business deal between the parties. The amendment to the building loan agreement did the same, and, again, has, as an exhibit, a § 22 affidavit made by the borrower that recites the following salient information:

- a) That the consideration paid for the loan is \$287,500, which is to be paid out of the loan proceeds;
- b) That the borrower has incurred or will incur the following expenses in connection with the loan or the project, and which are to be paid out of the loan proceeds: mortgage tax of \$1,330,000; recording fees of \$650; bank attorney fees of \$300,000; title insurance premiums and search and examination fees of \$168,048; expenses incurred to acquire prior mortgages by assignment of \$10,000,000; architect fees of \$90,000; real estate taxes, and water charges and sewer assessments that accrued prior to the commencement of the improvement of \$12,000, and also real estate taxes, and water charges and sewer assessments that accrued during the making

of the improvement of \$45,000; interest accruing on the building loan during the construction period of \$4,850,625; and survey fees of \$6,500.

- c) That the net sum available for the making of the improvement is \$40,409,677.

The amendment that has been agreed to by the parties results in a reduction of the net sum available for the improvement by just over \$2 million.

* * *

Let us now analyze the facts presented in light of the legal principles heretofore set forth:

Obviously, the modification is a "material" one on at least two bases: the net sum available is being reduced,⁴² and the project is being converted from a condominium project to a rental.⁴³ Accordingly, the modification of the building loan contract must be filed in the Office of the County Clerk, and this filing must occur within 10 days of execution of the modification; if the modification is not filed within 10 days of its execution, any lien filed by a claimant who files a mechanic's lien for work done, materials furnished or services rendered in connection with the making of the improvement will take priority over the lien of the building loan mortgage.

Even assuming a timely filing of the modification of the building loan contract, however, all those persons who have, prior to the date of the filing of the modification of the building loan contract, (i) done work, furnished materials or provided services in connection with the making of the improvement, or (ii) who have entered into a contract to perform work, furnish materials or perform services in connection with the making of the improvement, will have priority over the building loan mortgage as modified, at least to the extent that the net sum available was reduced pursuant to the modification.⁴⁴ What this means is that, in the

event of a foreclosure, liens filed by these claimants would be entitled to be paid before the last \$2,020,875 (or such larger amount to the extent that the lien claimants can successfully assert impairment) of building loan proceeds were paid, regardless of whether the liens were filed before or after the building loan proceeds were fully advanced. Because of this issue, the lender will generally impose a requirement that borrower get consents to the modification from all persons who have performed work, furnished materials or provided services to the project that could result in the filing of a mechanic's lien, or any persons who contracted prior to the date of filing of the modification to perform work, furnish materials or provide services to the project that could result in the filing of a mechanic's lien.

In addition, we need to make a determination on whether the § 22 affidavit is materially correct. As with the failure to file the required modification in a timely fashion, the penalty for a § 22 affidavit that is not materially correct or that materially misrepresents the net sum available is that the entire mortgage (even the portion previously advanced, the priority of which, arguably, ought to have been determined at the time these funds are advanced) is subordinated to any lien filed by a claimant who files a mechanic's lien for work done, materials furnished or services rendered in connection with the making of the improvement.⁴⁵

One other fact in our example merits discussion, and that is the statement that the borrower was "requesting flexibility in the project loan funds to use up to \$2.5 million of that loan to help pay for improvements."

A project loan and project-loan mortgage are vehicles intended to allow a borrower to use loan proceeds to pay for expenses related to the construction project, but which expenses cannot be paid out of building loan proceeds because of the statutory constraints on the uses of building loan funds.⁴⁶ Subject to the constraints imposed by Lien Law §

13, project loan proceeds can be used for all sorts of purposes, and could even be used to pay for the making of the improvement.

The problem with this use stems from the requirement that a building loan contract be filed in accordance with Lien Law § 22 for every "building loan." Since, under our facts, the borrower is to use this \$2.5 million to pay for improvements, is the project loan now a building loan in the statutory sense, therefore mandating that a building loan contract be filed? If so, since the mortgage is presumably already of record, the statutory requirement that the building loan contract be filed prior to, or simultaneously with, the recording of the building loan mortgage cannot be complied with, which will result in the imposition of the subordination penalty. But will this subordination apply only to the \$2.5 million portion of the project loan now being used for improvement purposes, or will it apply to the entire project loan? The entire building loan?⁴⁷ Since this portion of the project loan is going to be used to pay for improvements, perhaps one could sever this piece off of the project loan note and mortgage, recast this piece as a supplemental building loan mortgage and file a building loan contract for this loan prior to the recording of substitute (supplemental building loan) mortgage?

There is no case law on these points. Some practitioners argue that, if the \$2.5 million portion of the project loan is really going to be used to cover expenses related to the improvement, the safest vehicle would involve the severance of the project loan into \$2.5 million and \$5 million portions, with a substitute mortgage recorded for the smaller piece as a supplemental building loan mortgage. The parties would also execute an amended building loan contract that includes the additional \$2.5 million of "new" building loan proceeds (which amended building loan contract would need to be filed within 10 days of its execution in accordance with Lien Law § 22). Such

a mechanism would not be used, however, where the parties' intent is to give the borrower flexibility to use the \$2.5 million as needed, including the ability to use these funds to pay for the improvement.

Others argue that, especially where the funds are not earmarked to be used to pay for the improvement, a single, lump-sum advance from the project loan to be used to pay for improvements does not, of itself, transform a project loan into a building loan or impose any of its requirements. I suspect, however, that the advance of these funds in installments would make it more likely that the loan would be viewed as a building loan; the fact that one-third of the loan is being used to pay for improvements would also make such a finding more likely, though there is no "magic number" below which such a change in use of proceeds could safely be made.

Again, it is difficult to say how courts would react to an agreement between borrower and lender to take a substantial portion of project loan funds and use them for building loan purposes, and it would be better, absent guidance from the courts, to avoid such agreements.

If, however, the funds were flowing in the opposite direction (that is, building loan proceeds were being used for project loan purposes), the results would be clearer, though still somewhat problematic. Such a change would result in a reduction in the net sum available for the improvement; as described above, a modification of the building loan agreement would need to be filed and, in all likelihood, consents to the modification from all persons who have performed work, furnished materials or provided services to the project that could result in the filing of a mechanic's lien, or any persons who contracted prior to the date of filing of the modification to perform work, furnish materials or provide services to the project that could result in the filing of a mechanic's lien. Further, because use of building loan

proceeds for unauthorized purposes would result in the imposition of the subordination penalty, the amount of the building loan mortgage would need to be reduced and the project loan side increased. This could be accomplished by an amendment which reduces the building loan amount (coupled with the making of a new project loan mortgage, on which mortgage tax would be due), or by a severance of the building loan mortgage and the recording of a substitute project loan mortgage.

* * *

In conclusion, the stringent requirements of the New York Lien Law in the area of the modification of building loan contracts, and the severe penalties for a failure to comply, even in a strictly technical sense, impose significant hurdles for the real estate lending practitioner. It is important to be conversant with the statute and its requirements, and to be able to work closely with the borrower to obtain accurate information so that both lender and borrower can take the steps necessary to protect themselves and the project while the loan gets modified to reflect the new "acts on the ground."

Endnotes

1. See New York Lien Law § 13 and New York Lien Law Article 3-A. No other state creates statutory trusts operating in the manner that New York law does for the purpose of protecting inchoate lien claimants.
2. New York Lien Law § 22 (McKinney, 2005).
3. *Howard Sav. Bank v. Lefcon P'ship*, 209 A.D. 2d 473 (2d Dep't 1994).
4. New York Lien Law § 2(13) (McKinney, 2005).
5. *Weaver Hardware Co. v. Solomovitz*, 235 N.Y. 321 (1923); *Finest Inves. v. Sec. Trust Co. of Rochester*, 96 A.D. 2d 227 (4th Dep't 1983), *aff'd.*, 61 N.Y. 2d 897 (1984); *Juszak v. Lily & Don Holding Corp.*, 224 A.D. 2d 588 (2d Dep't 1996).
6. *Weaver Hardware Co. v. Solomovitz*, 235 N.Y. 321 (1923).
7. *In re 455 CPW Assocs.*, 192 B.R. 85 (B.C., SDNY, 1996), *aff'd.*, 225 F.3d 645 (2d Cir. 2000).
8. *Sullivan v. Young*, 95 Misc. 658 (Sup. Ct., N.Y. Co. 1916).

9. New York Lien Law § 22 (McKinney, 2005).
10. *Id.* See *Atlantic Bank of N.Y. v. Forest House Holding Co.*, 234 A.D. 2d 491 (2d Dep't 1996) (holding that the use of the phrase "entire interest" operated to subordinate that portion of lender's building loan mortgage that was originally purchase money and was taken by assignment as part of the building loan closing).
11. New York Lien Law § 13(3) requires that the proceeds of a building loan mortgage will be received . . . as a trust fund first for the purpose of paying the cost of improvement, and that borrower will apply the same first to the payment of the cost of improvement before using any part of the total of same for any other purpose.
12. New York Lien Law § 2(5) (McKinney, 2005).
13. New York Lien Law § 2(4) (McKinney, 2005), which is generally referred to as "brick and mortar," though the definition also covers costs of demolition, architect's plans and specifications and certain other items.
14. *Nanuet Nat'l Bank v. Eckerson Terrace, Inc.*, 47 N.Y. 2d 243 (1979).
15. *HNC Realty Co. v. Golan Heights Developers, Inc.*, 79 Misc. 2d 696 (Sup. Ct., Rockland Co. 1974).
16. *Id.*
17. *Nanuet Nat'l Bank v. Eckerson Terrace, Inc.*, 47 N.Y. 2d 243 (1979).
18. *Ritz-Craft Corp. of Pa, Inc. v. Nat'l Electric Benefit Fund*, 234 F.3d 114 (2d Cir. 2000); *United States of America v. Eljos Assocs.*, 1986 U.S. Dist. LEXIS 20351 (S.D.N.Y. 1986).
19. *Adirondack Trust Comp. v. Thomas J. Bien & Assocs., Inc.*, 168 Misc. 2d 919 (Sup. Ct., Saratoga Co. 1996).
20. *FDIC v. Kisosoh Realty Corp.*, 1994 U.S. Dist. LEXIS 17884 (S.D.N.Y. 1994).
21. *Realty Improvement Funding Co. v. Stillwell Gardens, Inc.*, 91 Misc. 2d 718 (Sup. Ct., Westchester Co. 1977). The more common practice today is to include a separate cost of improvement line item for interest on the building loan that accrues during the making of the improvement.
22. *Ulster Sav. Bank v. Total Communities, Inc.*, 55 A.D. 2d 278 (3d Dep't, 1976). Note that the New York Lien Law does allow building loan proceeds to be used to satisfy prior mortgages provided that such use is disclosed on the Section 22 affidavit and the funds so used are not included in the net sum available.
23. *HNC Realty Comp. v. Golan Heights Developers, Inc.*, 79 Misc. 2d 696 (Sup. Ct., Rockland Co. 1974). Note that the New York Lien Law does allow building loan proceeds to be used to acquire prior mortgages by assignment provided that such use is disclosed on the § 22 affidavit

- and the funds so used are not included in the net sum available.
24. *FDIC v. Skyhaven Landing Corp.*, 207 A.D. 2d 519 (2d Dep't 1994).
 25. The § 22 affidavit that is filed in connection with a modification will reflect the overall numbers for the use of the loan proceeds as modified by the modification being made. It is not intended to reflect only the undisbursed portion of the building loan at the time the modification is entered into.
 26. New York Lien Law § 22 (McKinney, 2005).
 27. There is no expressed requirement that such a contract be in writing.
 28. For example, a modification that allowed for the release of a portion of the mortgaged property without a paydown of mortgage debt, or a modification waiving the requirement that the borrower maintain performance or completion bonds.
 29. Such an agreement cannot constitute a waiver of the right to file or enforce a lien, which is void as against public policy in accordance with Lien Law § 34, or a subordination of a lien, but is merely an acknowledgement that such a person's contractual and statutory rights, including the priority of any lien filed, is to be governed by the building loan agreement, *as modified*.
 30. *Pa. Steel Co. v. Title Guarantee & Trust Co.*, 193 N.Y. 37, rehearing denied, 193 N.Y. 682 (1908); *Sec. Nat'l Bank v. Vill. Mall at Hillcrest, Inc.*, 85 Misc. 2d 771 (Sup. Ct., Queens Co. 1976).
 31. *N.Y. Sav. Bank v. Wendell Apartments, Inc.*, 41 Misc. 2d 527 (Sup. Ct., Nassau Co. 1963).
 32. *In re Admiral's Walk*, 134 B.R. 105 (W.D.N.Y. 1991).
 33. *Howard Sav. Bank v. Lefcon P'ship*, 209 A.D. 2d 473 (2d Dep't 1994).
 34. *Sec. Nat'l Bank v. Vill. Mall at Hillcrest, Inc.*, 85 Misc. 2d 771 (Sup. Ct., Queens Co. 1976).
 35. *HNC Realty Comp. v. Bay View Towers Apartments, Inc.*, 64 A.D. 2d 417 (2d Dep't 1978); *Yankee Bank for Fin. and Sav., FSB v. Task Assocs., Inc.*, 731 F. Supp. 64 (N.D.N.Y. 1990).
 36. *Sec. Nat'l Bank v. Vill. Mall at Hillcrest, Inc.*, 85 Misc. 2d 771 (Sup. Ct., Queens Co. 1976). It is interesting to note that the subordination penalty was deemed available in this case even though to change the project to a condominium was disclosed on documents executed by the borrower and lender, recorded on the public record.
 37. *In re Admiral's Walk, Inc.*, 134 B.R. 105 (W.D.N.Y. 1991).
 38. *In re Grossinger's Assocs.*, 115 B.R. 449 (S.D.N.Y. 1990).
 39. *N.Y. Sav. Bank v. Wendell Apartments, Inc.*, 41 Misc. 2d 527 (Sup. Ct., Nassau Co. 1963).
 40. *Howard Sav. Bank v. Lefcon P'ship*, 209 A.D. 2d 473 (2d Dep't 1994).
 41. It is important to remember that the purpose of the § 22 affidavit is to set forth how the proceeds of the building loan are being used; it is not (necessarily) reflective of the project budget. Accordingly, the budgeted expense for some or all of these items may be higher than the figure used in the § 22 affidavit, with the balance being paid from other sources, e.g., equity.
 42. *Howard Sav. Bank v. Lefcon P'ship*, 209 A.D. 2d 473 (2d Dep't 1994).
 43. *Sec. Nat'l Bank v. Vill. Mall at Hillcrest, Inc.*, 85 Misc. 2d 771 (Sup. Ct., Queens Co. 1976).
 44. That is, at least \$2,020,875, which is the extent of direct financial impairment. To the extent that these persons can establish further impairment, say, because of the change from a condominium to rental project, they could assert priority over a larger portion of the building loan mortgage.
 45. *Nanuet Nat'l Bank v. Eckerson Terrace, Inc.*, 47 N.Y. 2d 243 (1979).
 46. In fact, the use of building loan funds for purposes other than (i) expenses incurred or to be incurred in connection with the loan provided that such expenses also constitute a cost of improvement as defined in Section 2(5) of the Lien Law, or (ii) improvements, as defined in Section 2(4) of the Lien Law, would constitute an improper diversion of building loan funds, resulting in the same total subordination penalty described above, as well as other penalties.
 47. *Atlantic Bank of N.Y. v. Forest House Holding Comp.*, 234 A.D. 2d 491 (2d Dep't 1996).

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