

Lending Institutions – Assignment of Contracts

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Summary

Many clients arrange for construction financing for their projects. It is not uncommon for the lending institutions (lenders) to request from the borrower (owner/architect's client) some form of agreement which will facilitate the lender's ability to protect its interest by completing the construction of the project in the event of a default of the borrower. This often takes the form of an agreement to the assignment of the construction contract (and client/architect contract) to the lender along with acknowledgment and consent from the contractor and architect.

Background

Architects are cautioned not to sign any client/architect contract that binds him/her to future unknown commitments to a third party or to subsequently agree to a contractual responsibility to execute any certificate, opinion or consent that would require knowledge, services or responsibilities beyond the scope or at variance with the General Conditions of OAA 600-2013 Standard Form of Contract for Architect's Services.

As there are various legal and liability issues related to the architect's agreement to assign the client/architect contract to an unknown entity before such a requirement is necessary, architects are advised to analyze the implications of such an assignment and to include the appropriate wording in the client/architect contract and in the agreement to assignment which will protect their interests.

The lender is attempting to protect its financial position should there be any problems affecting the borrower's (the architect's client's) capability to complete the project while meeting the financial obligations to the lender. In order to achieve this, the lender uses a contractual document which requires that any contracts between the borrower and the contractor(s) or the architect shall, in the event of a default, be assigned to the lender in order to facilitate the completion of the project, thereby hopefully protecting the lender's financial position.

Often the architect's agreement to an assignment of its contract is achieved through the architect signing a document acknowledging the terms and conditions of the borrower/lender assignment agreement.

Assignment of the client/architect contract to another entity is normally a business decision. However, the implications arising out of an architect signing a document agreeing to a lender's proposed terms of the borrower's agreement cause more serious considerations. These include:

- agreement of the architect of an assignment to the lender before any default by the borrower or consideration of the circumstances surrounding the actual project at the time of a possible default are even known or can be anticipated,
- agreement that the lender may in turn assign the client/architect contract to another unknown entity,
- agreement to permit the use of the architect's drawings/instruments of service by the new client even though there may be substantial unpaid fees by his/her client (the borrower who has defaulted) with no commitment that outstanding fees will be paid,
- inclusion of terms that the lender or a potential other new entity as client has no liability or responsibility of any kind with regard to the use of the construction documents or client responsibilities in the client/architect contract.

It is not unreasonable for possible assignment of an architect's contract to be part of a resolution due to a major default on the project and it may be a good option for an architect in certain circumstances. It is important that the architect has a choice, realize that it has a choice, and not be pressured unreasonably when faced with a choice. Acceptable wording for assignment of contracts is that any assignment will be by written mutual consent – and consent shall not be unreasonably withheld as stated in OAA 600-2013, GC12.6.

In addition, payment of outstanding fees is a critical consideration before agreeing to permit the architect's drawings and specifications and other documents to be used as instruments of service by anyone other than the original client. Architects should understand that in some instances the lender will not be responsible for any outstanding payments to the architect by the borrower where the monies have already been advanced by the lender prior to default. In these cases the architect will be responsible for pursuing the original client for default of payment.

Suggested Procedure

1. Do not agree to any client/architect contract which commits the architect to providing information to the lender or to an assignment of contract without reviewing the lender's documents. Refer to PT.17 Lending Institutions – Architect's Certificates for advice on reporting of project status.
2. Advise the client of standard wording in OAA 600-2013, GC 12.6 addressing assignment with provision for mutual consent. This allows analysis of the project status and whether such assignment is acceptable to the architect.
3. If the client advises that the lending institution requires assignment of the client/architect contract beforehand, review the lender consent to assignment form with your own legal counsel and include where not already included, wording similar to:

“It is a condition of such acknowledgement and consent by the undersigned that in the event a default shall have occurred under the Financing Agreement, such that written notice is given by the Lender to the undersigned of the exercise of the Lender's rights under the Assignment of Construction Rights Agreement [or other document title as appropriate] in connection with the contract described in Schedule 'A' [or other document title as appropriate], the Lender, notwithstanding the wording of the Assignment of Construction Rights Agreement, shall be bound by the terms of the contract with the undersigned described in Schedule 'A'.”

4. Add as “Other Terms of Contract” (OAA 600-2013, GC 13) wording similar to:

“Notwithstanding clauses 9.2 and 9.3, it is a condition of consent to GC 12.6 that all outstanding fees be paid in full prior to the consent to assignment and in particular the use of any *Instruments of Service*.”

References

PT.17 Lending Institutions – Architect's Certificates

The OAA does not provide legal, insurance or accounting advice. Readers are advised to consult their own legal, accounting or insurance representatives to obtain suitable professional advice in those regards.
