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The Distressed Construction Project: To Complete or Not to Complete – Let Me Count the Reasons



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If you're a lender, and your borrower can't or won't complete the construction or development project they started, what's next – and how do you decide? The primary considerations are:

1. At what stage of completion is the project?
2. Does the project require discretionary public agency approvals that haven't yet been obtained or that have expired?
3. Is there existing environmental risk and/or some form of environmental remediation required?
4. How much will it cost, and how long will the project take to complete?
5. Does your staff have relevant construction and development management experience to complete the project?
6. Do you have the existing third-party design, entitlement, contractor, and developer relationships needed to complete the project?
7. Is the value added by completing the project worth the time, effort, and risk?

Because a lender can't be viewed as interfering with a borrower's project without a forbearance agreement,

a receiver, or a completed foreclosure, gathering the necessary information for informed decision-making can often be problematic.

At what stage of completion is the project?

If the project has just started or hasn't really begun, and there's no valuable discretionary development approvals at risk of expiring or otherwise being lost, then likely there's not much to be gained by completing the project.

On the other hand, if the project appears to be nearly complete and/or valuable discretionary development approvals are nearly approved, then it's likely there's significant value to be gained by obtaining the entitlements or completing the project. The trick here is to obtain sufficient information to accurately determine the status of completion, what's needed to complete it, and the associated risk. If the project was so close to completion, why wouldn't the borrower complete it? For example, it's not unusual to see projects substantially completed but waiting to obtain gas or electricity from the respective utility providers for many months, and sometimes for more than a year.

The most difficult decisions are associated with projects well underway but far from completion. This is typically compounded by the fact that the project has often stalled and been idle for some time, adding the challenge of getting accurate information, reassembling the team, and working through the challenges required to complete the project. If it's a renovation project, unknown and hidden conditions can be hard to quantify in terms of time, cost, and risk. These types of projects usually cost more and take much longer than expected, particularly when



completed by a lender or receiver, given the necessities of institutional decision making and risk management.

Does the project require discretionary public agency approvals that haven't yet been obtained or that have expired?

It's important to determine if discretionary public agency approvals are still needed or have already been obtained. If they have already been obtained, are the approvals still in place or have they expired – and are the entitlements still valuable? For example, if a condominium project's conditional use permit has expired before it was complete, the project can only be rented and sold as an apartment building.

Is there existing environmental risk and/or some form of environmental remediation required?

If there are meaningful environmental issues, it's likely the lender will not want to assume the chain-of-title risk without putting a receiver in place to complete the project in any event. Lenders often have a much more conservative view of environmental risk than private sector borrowers. Evaluating the type of remediation necessary, the time, cost, and agency approvals needed to remediate the risk, and any related potential third-party environmental claims all become important.

How much will it cost, and how long will the project take to complete?

There's an old saying in the construction trades: It always takes longer and costs more than you expect. This largely remains true, particularly for complex renovation projects that involve hidden conditions. If you double the cost and time to complete the project, would you still complete the project? As noted above, lenders' more risk-averse and layered approval

processes can add significant time and requirements to complete a project.

Does your staff have relevant construction and development management experience to complete the project?

Lender oversight of a construction or development loan is a very different skill set from making actual construction and development decisions. Lenders tend to understandably foster risk-management cultures, while construction and development requires constantly assessing managed risk in real time. That skill set only comes from having direct project decision-making experience with supportive senior management. In some cases, bringing in a trusted third-party developer with the requisite risk management and decision-making experience may be a solution.

Do you have the existing third-party design, entitlement, contractor, and developer relationships needed to complete the project?

As with decision making, having a stable of pre-existing development and construction relationships to draw from is important. Considerable time and effort can be involved in identifying and qualifying the professionals needed to evaluate and complete a project. Different types and sizes of projects require different professionals. Consultants, contractors, and developers must be matched to a project by size, skill set, and a temperament suited to working with normally risk-averse lenders. Any significant mismatch here can add significant challenges to a project.

Is the value added by completing the project worth the time, effort, and risk?

Ultimately, this is the key question: Is the value added worth the risk? While completing distressed projects can be an interesting challenge and opportunity for lenders, it is important to keep in mind that lenders are in the business of managing risk by lending money, not managing risk by making construction and development decisions. If there is no clear and significant value added to a project by completing it, then generally the smart decision is not to complete it. Sell the loan or the real property and let someone else take on the risk – and the potential upside – of completing the project. ■