

3 Ways Developers Can Get Through The S. Fla. Condo Slump

By Nathan Hale

Law360, Miami -- With sales slowing and construction costs climbing in South Florida, pressures are mounting for developers of high-rise condominiums, but lawyers say that following some basic steps can help them avoid legal tangles with lenders, buyers or builders.

Cranes still tower over the region's hottest locations, from Miami to Palm Beach, and by all accounts, the industry is not expecting a full repeat of the dramatic downturn that hammered this market in 2007 and kept attorneys busy with countless foreclosures and other litigation. But a retreat by the flocks of foreign buyers — especially from South America and Russia — who drove the recovery has hurt prices, even at the highest end of the market, contributing to fears of stalled projects and a new wave of legal disputes.

“It’s been affecting condominium developers in an impactful way, and it’s been rather quick,” said Josh M. Rubens, a partner in commercial litigation at [Kluger Kaplan Silverman Katzen & Levine PL](#), noting the market changes have been noticeable since the first quarter of 2016.

The average sales price of condos in the Miami coastal and mainland market dipped nearly 4 percent, from \$367,116 to \$352,895, between the first quarter of 2015 and the same period this year, and the number of condo sales fell off nearly 20 percent while inventory climbed more than 15 percent, according to data released by [Douglas Elliman Real Estate](#).

In South Florida, condo developers likely already have location on their side, but the slowdown has made clear the importance of timing as well as proper financing, attorneys said.

Coming out of the downturn, most area condo developers adopted the Latin American model of requiring deposits of 50 percent upwards to 90 percent from unit buyers prior to closing with the aim of ensuring they would have sufficient funds to deliver their projects, but while the upfront funds have made a sequel to the last cycle less likely, there is still the potential for buyers to come up short financially, said Michael N. Kreitzer, chair of the litigation group at [Bilzin Sumberg Baena Price & Axelrod LLP](#).

And the model brings its own set of complications should things turn sour, noted Thomas R. Lehman of [Levine Kellogg Lehman Schneider & Grossman LLP](#), whose specialties include bankruptcy and insolvency matters.

For projects that have not started construction, developers must ask whether to move forward. But for those already going vertical — and there are scores of them — the only protection might just be to just “finish the darn project,” as Lehman put it.

Here are some measures developers can take to avert a storm of litigation, experts say.

Check Your Financing

For developers confronting problems completing a project, they need to determine whether the issue is a lack of capital, whether as a result of poor financial analysis or the confluence of rising construction costs while the prices they are able to demand has dropped, Lehman said.

The flipside to requiring larger deposits up front is that if you find yourself coming up short, you do not have the ability to squeeze more from the buyers, he noted.

“You have to evaluate how much is left to tap the buyers, and if that's tapped out, in other words if there are no other deposits to demand, then you have to evaluate ‘What's the value of my project and how much can I borrow on it to complete it to get it opened up to get the closings done?’ ” Lehman said.

Under the high-deposit model, litigation stemming from an incomplete project could be more complicated, with not just a single lender but dozens of unit buyers also involved. Lawyers said they anticipate a different situation than during the last downturn, when buyers who had typically put down 10 percent to 20 percent would simply not show up to close.

“In this environment, they have more at stake that they don't want to lose,” Rubens said. “So they have an incentive to close; however, they also may be more inclined if they don't want to close to sue the developer to try to get back their 50 percent.”

Profits also come into play. Kreitzer said he has not had clients take out additional financing yet but has had numerous conversations with developers about having the capacity to “hang out longer” to realize hoped-for prices. He offered the example of a high-end luxury building he worked on recently where all but four units were sold — but those last units represented most of the profit for the developer.

“We want to make sure that the clients can hold on long enough to sell those units and hopefully not discount them excessively,” Kreitzer said.

Bridge financing should be readily available, because developers have substantial equity in these projects and unit buyers typically have agreed to a subordination clause saying they will take a back seat to any future lender, Lehman said.

“They have plenty of opportunity to get rich financing in this market,” he said.

Check Your Schedule

Avoiding disputes on the financial side can only be helped by keeping everything moving according to plan on the construction end. With fears that the market is headed into a slowdown, developers and their attorneys have recognized they need to make sure contractors are delivering on time, Kreitzer said.

“In the past, clients may have been more lenient in allowing contractors to slow down off their schedules. That's not happening now,” he said.

From a practical standpoint, that means being on-site more often and communicating with contractors more frequently about delays, he said.

Kreitzer also said that most of the construction project contracts he has drafted in the past few years have included provisions requiring the contractors to make up time if they fall behind. He and his developer clients also are demanding that contractors put extra workers on projects to catch up, even at the

contractors' own costs, and that their agreements with subcontractors contain the same conditions.

These demands have resulted in some disputes with contractors over the make-up schedules because they do not want employees or subcontractors incurring overtime pay, Kreitzer said, but he and his clients have been very aggressive to make sure the provisions are followed and that there is "proper acknowledgement of who is responsible for those costs."

"It was something we learned from the last downturn that we wanted to make sure we had enough leverage over the contractor to make sure that the project was going to be completed on time," he added. "Because there's such a demand for subcontractors and laborers, you have to have penalties big enough to make sure the contractors are going to hire the people to get the project done on time and with a quality product at all costs."

Check Your Contracts

Faced with a project not meeting its financial projections or construction schedule, developers might be inclined to look for project adjustments to right the ship, but attorneys caution about running afoul of sales agreements or loan terms, which could land them in court.

To trim construction costs, a developer might consider modifying designs or changing certain amenities, but that could open the door to buyer lawsuits, attorneys warned.

"You don't want to impact the promises you made to the buyers, because of course you can run into issues there because the buyers obviously put down 50 percent based on the builder saying the building is going to look a certain way, the building is going to have certain amenities," Rubens said.

Kreitzer said that in the past 90 days, he has seen more instances of customers raising these types of complaints as they start having second thoughts and are seeking options to avoid closing.

"That's something that occurred even in the last downturn, but now we are even more focused on making sure that when we deliver a product, that it's the same product that we had promised," he said.

Lawyers should also make sure developers are aware of all of the provisions in their loan terms. With sales slowing, an apparent option would be to lower unit prices, but loan agreements sometimes place restrictions on those changes, Rubens noted.

"That's obviously a business decision about lowering prices, but it may impact a loan agreement," he said. "There are certain covenants in loan agreements regarding minimum prices for units, and so obviously the developer needs to be aware of the prices they can charge for their units."

--Editing by Patricia K. Cole.