nerej

Buyers beware: Doing due diligence as successor developer

November 04, 2010 - Northern New England

In today's economic climate, buyers of real estate appear to have plenty of bargains from which to choose. Some bargains, however, may not be as good as they first appear, particularly distressed, failed or bankrupt condominium or subdivision projects. The successor owner of any unfinished or insolvent development should be wary of the potentially burdensome obligations and liabilities associated with taking over such a project. From lapsed permits to state registration requirements, buyers need to beware of the several pitfalls before entering into a binding purchase agreement.

If a development has been inactive for any length of time, there is a good chance that one or more permits will need to be revived or extended. Some approvals, particularly the site plan or subdivision approval, may be invalid due to intervening regulatory changes if the project is not sufficiently "vested". Vesting of a project usually requires some actual development within a certain time frame (e.g., in N.H., a site plan may become vested for 4 years if active and substantial development commences within 12 months after approval). Otherwise, the plan may require modification to comply with new regulations. In addition, buyers should carefully review the terms of the approvals to ensure that all conditions have been fulfilled, including whether any local bonding requirements are still being met.

Another area of concern is tax and other property liens. If a developer has not been paying his bank, he likely has not been paying the property taxes or the parties who have furnished labor and construction services to the property. Tax and mechanics' liens create a cloud on title that lenders and title insurance companies will require to be paid off. Keep in mind, too, that tax liens can be converted to tax deeds within strict time frames, leading to forfeiture of title. Also, even if a previous contractor does not have a mechanics' lien, it may possess some leverage to be paid for past due amounts through ownership of plans or other intangible property needed to complete the project.

If a property has been foreclosed, additional concerns are warranted. As seen lately in the news, many lenders are being investigated for "wrongful foreclosures" amidst claims of legal errors committed during the foreclosure process. Defective or missing documentation and procedural oversights could result in purchasers being divested of their title to foreclosed property. Now more than ever, foreclosure proceedings must be scrutinized for compliance with all statutory and other requirements.

Finally, some states, like N.H., have rigorously enforced consumer protection statutes for large condominiums and subdivisions. Before purchasing such a project, buyers should confirm that the project has been registered or exempted from the applicable registration requirements. Even if the development has been registered, a successor developer may need to provide additional information to the regulatory body about its ownership, financial wherewithal and any proposed changes to the original development plan and will need to update public offering statements and related material. All of this can be expensive and time-consuming.

Buying a development project always requires significant due diligence. Buying a development project in a severely depressed market requires an extra level of scrutiny. Legal counsel and other real estate professionals should be consulted prior to entering into a purchase agreement for any distressed project.

Philip Hastings and Elizabeth McCormack are attorneys with Cleveland, Waters and Bass, P.A., Concord, N.H.