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What to do when a new or replacement developer starts building a stalled project after a long delay

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The market for condominiums is starting to heat up again. This brings to the forefront the recurring problems that surface when a developer or a successor developer of a stalled (multi-phase) project starts building again after a hiatus of many years. In this article I will summarize the problems and give my solutions to each problem.

CONSTRUCTION ISSUES

Mass. provides significant protection to unit owners. Successor developers are liable, for example, for implied and express warranty claims involving the earlier phases of the development.

A successor developer can be responsible for construction defects that are the result of defective construction by the original developer. The successor developer may try to rely on the statute of limitations and/or statute of repose as a defense, and attempt to place responsibility on the organization of unit owners.

Under Mass. General Laws, Chapter 260, Section 2, there is a 6 year statute of limitations for an action of contract, i.e., an action of contract must be commenced within 6 years next after the cause of action accrues.

Under Section 2B of Chapter 260, an action for tort arising out of any deficiency or neglect in the construction of an improvement to real property must be commenced within six years after the earlier of (a) the opening of the improvement to use, or (b) substantial completion of the improvement and taking of possession for occupancy by the owner.

Unit owners need to prove that the construction is truly defective. An issue such as sound insulation may be very costly to remediate and total remediation is very often impossible. There will always be a certain amount of noise transfer in a multifamily building, and this should be a risk unit owners accept.

The statutory and case law in Mass. (Chapter 183A, Section 22, and Maloney v. Boston Five Cents Savings Bank, 422 Mass. 431 (1996)) has centered on whether a foreclosing lender is liable in addition to the developer. The law has been that the successor developer can not get the benefits of the development without also assuming the burdens.

The Mass. Appeals Court has recently held that "a condominium unit owners' association may recover damages in tort from a responsible builder-vendor for negligent design or construction of common area property in circumstances in which damages are reasonably determinable, in which the association would otherwise lack a remedy..." Wyman, et al. v. Ayer Properties, LLC, Lawyers Weekly No. 11-176-12. This case strengthens the association and probably will make developers more willing to enter into a reasonable settlement agreement.

FINANCIAL ISSUES

A developer quite often will not have funded either the working capital reserve or the replacement

reserve on unsold units in a distressed development.

The developer or successor developer seeking 6(d) certificates when selling units might be forced to enter into a settlement agreement with the board of trustees. In this agreement, the developer contributes to the working capital reserve and to the replacement reserve, but might not have to contribute 100% of the amount due if the developer has any leverage. Something is better than nothing.

Also, the settlement agreement should require the developer to make a partial monthly condominium fee payment on a newly phased in unit until the unit is sold. Developers often provide in the condominium documents that they do not owe condominium fees until a certificate of occupancy is obtained for a unit. While there may be some justification for this, a partial payment is a more equitable approach.

In return, the board of trustees agrees to give "clean" 6(d) certificates.

UNFUNDED WORKING CAPITAL CONTRIBUTIONS

FNMA working capital guidelines require working capital. The requirement is that the budget "includes allocated line items to ensure sufficient funds are available to maintain and preserve all amenities and features unique to the project." Two months of condominium fees collected at each closing has been customary for working capital. The developer is required to turn these fees over to the initial unit owner board. The condominium trust usually requires compliance with FNMA. As original trustee, the developer is obligated to comply with FNMA guidelines on working capital reserves.

UNFUNDED REPLACEMENT FUND CONTRIBUTIONS

Chapter 183A, Section 10(i), requires only "an adequate replacement reserve fund collected as part of the common expenses and deposited in an account separate and segregated from operating funds." However, FNMA requires "funding of replacement reserves for capital expenditures and deferred maintenance in an account representing at least 10% of the budget." Because the condominium trust usually requires compliance with FNMA, the unit owner trustees will have a strong case as to the failure of the developer to have established or maintained a reserve fund.

DEVELOPER CONTROL

Perhaps the most vexing problem involves the developer who keeps control of the board of trustees until the statute of limitations and the statute of repose have tolled, making it difficult if not impossible for the unit owner trustees to sue the developer successfully for construction defects. As part of any settlement, the problem involving construction defects in the common areas have to be addressed.

LEGAL ISSUES

There often are legal issues when a developer wants to begin to build the remaining phases in a condominium after a construction hiatus of many years. The most vexing issue occurs when the time period under the Master Deed has expired. The good news is that Chapter 183A, Section 5(b)(2)(iii), provides a mechanism for extending or reviving rights to develop the condominium, including the right to add additional units or land to the condominium. The bad news is that the extension or revival requires not less than 75% consent based upon percentage interest of the unit owners, and in some cases 51% in number of the first mortgagees. The consent of the unit owners gives the unit owners leverage to extract concessions from the developer which will be incorporated into the settlement agreement.

CONCLUSION

In the settlement agreement, the developer should agree to fund the reserves. The organization of unit owners should agree to extend or revive the development rights, to give the developer "clean" 6(d) certificates and a full release as to all fiscal and construction claims, and to indemnify the developer as to any claim by the unit owners regarding common area construction defects. Such a settlement agreement will allow a developer to finish the un-built phases. In the long run, everyone will benefit.

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