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Condominiums: Operating effectively in the current market is important

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The current condominium market is a troubled market. Lenders are becoming key players along with developers and unit owners.

A review of how to handle a distressed condominium is important.

Of course, there are no easy solutions. We cannot count on being able to find a buyer for a distressed condominium. Likewise, we cannot count on being able to find a new lender who will take out the present lender.

The developer may find a buyer who takes over the project for little or no cash and agrees to pay the seller if, as and when he is able to turn the project around and make it a successful venture. It is not easy, however, to find someone to buy a losing project.

The worst thing to do in a troubled condominium development is for the parties to panic. The partiesâ€"the lender, the developer, the contractor, and their advisorsâ€"should get together and try to work things out. There are two approaches involved in dealing with a troubled condominium: (1) the developer continues his involvement in the project; (2) the developer's involvement in the project is severed. This article will address only the first approach.

The Workout

The first approach is usually called a workout. Regardless of the cause of the collapse, a workout between the developer and the lender may provide a greater measure of recovery than will a foreclosure.

Taking the project from a competent and honest developer who is hurting because of the economy may not accomplish anything; the reputation of the project suffers when the developer is removed. The developer and his contractor/subcontractors are already on the job and usually they are in the best position to finish the job.

A workout normally involves reorganizing and restructuring the condominium development. This is documented by a forbearance agreement

between the developer and the lender. There are many ways to rescue a condominium venture by means of a workout. For example:

1. Get mortgage relief in the form of a mortgage increase and a moratorium on debt service. Junior mortgagees will get wiped out in a foreclosure by the first mortgagee. It is normally easier to get mortgage relief from a junior mortgagee than from the first mortgagee. However, first mortgagees will often give mortgage relief. The lender must be careful that new disbursements have the same priority over intervening lienors as disbursements made at the time mortgage was first recorded. The lender must also be concerned with its prior position if an extension of the note occurs.

2. Change the mix and nature of the project; for example, build mixed-use instead of just residential; build gardenâ€"not high-rise; rentalâ€"not condominium. In the case of an age restricted

condominium, amend the special permit to allow a part of the development to be sold without age restrictions. The condominium documents will have to be amended to accomplish these changes.

3. Get a new equity partner or partners who will bring fresh money into the job and who may also provide construction and marketing expertise and bonding capacity.

4. Get the developer to put more of his owner money into the project or to borrow from other sources and put this money into the project. If the developer is personally liable on the construction note, and if he has additional funds available, this is certainly an avenue to be exploredâ€”although it is difficult to advise someone to throw good money after bad money.

5. Get the developer's present investors to put more money into the project. The developer will have to make concessions to get this; e.g., allocate to the investors more equity and cash flow, and subordinate his fees to the investors' position in the deal. Fresh equity dollars may encourage the lender not to foreclose.

6. Pledge other property of the developer in order to get the lender to be patient and to fund more money.

7. Have a workout plan to pay off subcontractors and other creditors.

8. Hire an auctioneer to sell by an auction the remaining unsold condominium units.

If the lender goes along with the workout plan, the lender will insist upon greater control over the project. The lender may suggest that the developer appoint a construction manager to supervise construction and a sales manager to take charge of sales. The construction manager will supervise the completion of the project. The borrower will obey all instructions of the construction manager. Direct payments will be made to subcontractors. Al subcontracts will be administered by the construction manager, and no other contracts would be entered into without his consent. All requisitions will have to be approved by the construction manager. Likewise, the sales manager will take charge of sales, the sales staff, the execution of purchase and sales agreements, and all marketing contracts. All sales proceeds will go to the lender.

As part of a condominium workout the lender may want control of the condo trust, e.g., put its representative on as a trustee and give him a veto over all trust decisions.

A workout is often better for the lender and the developer than a foreclosure or a deed in lieu of foreclosure.

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