CARLTON FIELDS

best practices

REAL ESTATE ASSET VALUATION:

Acquiring a Fractured Condominium Project

situation

A bank is foreclosing or has already foreclosed a mortgage loan encumbering a fractured condominium project—where some units were sold to third-party purchasers, but most remain unsold. Your company is evaluating whether to purchase the loan documents or acquire title from the bank of this REO (real estate owned) property.

in-house counsel challenge

As counsel for the purchaser, you have been asked to assist in the due diligence process by 1) identifying the legal issues and liabilities your client might inherit if it purchases the loan or the property, 2) suggesting ways to minimize the liabilities and 3) outlining alternative use options that may enhance the value of the asset.

approach adopted

Any valuation begins with due diligence. If you are buying the loan, the initial step is to review the underlying loan documents. Determine whether there are defects in the documents and identify the events of default and the available remedies.

Order a title search/foreclosure title insurance commitment, tax and lien searches on the borrower, the project and, if necessary, any guarantor of the loan.

Real estate tax and certain municipal liens have priority over the mortgage lien. The buyer will have to pay them, including any penalties and interest, if it purchases the loan or the property and they remain unpaid. Identifying contractors' and other liens that were subordinate to the mortgage is critical. The purchaser may need the contractors to complete construction and warranty work. The status of these liens can determine the appropriate future course of action.

If additional construction is required, are the permits in good standing? Government agencies may still be waiting for payment on existing permits, or may impose new requirements or financial obligations if new approvals are needed.

Provide the buyer with a checklist of the condominium documents, including all condominium association records, to be reviewed. Make sure the condominium documents comply with all government requirements. Look for potentially misleading material statements, as well as any obligations and restrictions imposed on the developer.

If the project is a conversion, are there obligations to fund reserve accounts or provide developer warranties? Are there ways to minimize potential successor developer liability for construction defects, reserves, warranties and/or deposits?

Review any existing purchase and sale agreements. Determine the status of deposits and the likelihood of closing. Were the deposits handled in accordance with legal requirements? Is there any obligation to refund them? Are they in escrow? If any of the unsold units are currently leased, get copies of the leases to identify termination rights and any purchase options.

Once the status of the project is firmly established, determine whether it is possible to reposition the asset. There are likely alternative uses for unsold units or undeveloped phases. Provide an analysis of all potential issues and opportunities.

implementation steps

- Review the underlying loan documents, if necessary.
- Identify real estate, tax, municipal and contractors' liens.
- Review condominium documents to ensure compliance with state regulations, and identify any false or misleading statements.
- List all developer obligations or restrictions, such as reserve account funding and/or project warranties.
- Review all third-party purchase and sales contracts.
- If additional construction is required, ensure the permits are in place and paid for.
- Consider ways to reposition the asset.

measuring success

A thorough review of all legal issues, liabilities and obligations, combined with suggestions on how to possibly reposition the asset, will allow your client to determine whether or not to proceed with the acquisition.

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