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New York Condos in Despair: Workouts in 2009



June 11, 2009



The Law: Martin Act

- New York's securities law
- Sponsor must register all public offerings of condos with the AG
- Sponsors have duty to fully disclose all material facts
- The AG enforces the act
- Sponsor principals are personally liable in AG actions
- The AG currently favors mediation



The Practice: AG Has Significant Influence Over Offerings

- May mandate offers of rescission
- Arbitrates disputes concerning the disposition of down payments following failure to close
- May involve itself in foreclosure actions
- Will bar attempts to make a public offering of units by receivers during a foreclosure action
- Might mandate rescission at a project because of another failed project by the same developer
- Will mediate the issue of whether a successor sponsor must fully complete the project



Should the Lender Foreclose or Replace a Developer?

- Can the project physically be completed as originally planned?
- Can the developer be relied upon if it is likely to lose all its equity?
- Can sufficient condo units still be sold?



Should the Lender Foreclose or Replace a Developer? (cont.)

- Does the FNMA 70% sale requirement create a barrier?
- Can and should the construction lender open its loan window?
- Will the AG mandate rescission?



Should the Lender Foreclose or Replace a Developer? (cont.)

- What is necessary to put potential purchasers' minds at ease to sell units?
- Will the lender be better off allowing a condo to be formed or renting the entire project?
- Can the units be temporarily rented?
- What is the lender's view?



Due Diligence

- Determine the legal status of the project
- Analyze the financials of the project
- Review the physical condition
- Evaluate the offering plan and amendments



Due Diligence (cont.)

- Understand the legal position of the purchasers, contract vendees and tenants
- Contact the AG to determine its position
- Determine if sponsor is in compliance with Interstate Land Sales Full Disclosure Act



If the Sponsor Must Be Replaced

- Foreclosure
 - More time and expense
 - Offer and acceptance of rescission more likely
 - Sales effort will lose momentum
 - Expect an AG investigation
 - Should wipe out mechanics liens
- Deed in lieu or sale to a third party
 - Offer or acceptance of rescission less likely
 - Subordinate liens remain of record



Should Project Be Converted to a Rental?

- Requires the plan not have been declared effective
- Review tax exemption status
- Review proposed state legislation
- Future conversion will be much more difficult than a new construction plan



Should the Plan Be Declared Effective?

- Some units sold, remainder rented
 - Can and should the sponsor be kept in place temporarily?
 - Is the offering plan written to permit unlimited renting?
 - 15% of the units must be in contract
 - Evaluate tactics to encourage contracts
 - More likely for a condo to avoid rent restrictions



Taking Over: Resolving Development Issues

- Establish how responsibility under the Martin Act will be allocated
- Determine how the project will be completed or changed
- If the project is continued, determine staffing issues
- Determine if it makes more sense to sell the loan



Overview of Section 421a Program

- Enacted in 1971
- Integral part of new construction costs
- Completion of construction
 - 36-month rule
 - Proposed rules may permit a mortgage foreclosure to extend beyond 36 months



Today's Market

- Conversion from condo/co-op to rental under Section 421a
 - Rent stabilization
 - Rent stabilization rider for all Section 421a leases



Today's Market (cont.)

- HPD permits 421a applicants to be amended from condo/co-op to rental provided:
 - HPD sets rents according to complex formula
 - HPD approved rents may be in excess of today's market rents
 - HPD process to amend existing Section 421a application from condo to rental
 - Preferential rent v. legal maximum rents established by HPD
 - Rent increases under existing statute – proposed new statute



Heads-up: Potential New York State Legislative Actions

- Change method of rent stabilized lease increases using preferential rather than legal maximum rent as basis
- Possible delegation to New York City Council
- Current Section 421a legislation sunsets on December 28, 2010

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