Cracking Down On Bailing Buyers

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In this weak real estate market, new condo developers possess relatively little in their arsenals to arm themselves against the onslaught of purchasers seeking to back out of contracts. But there are a few measures developers can take to protect themselves without scaring off potentially legitimate buyers.

Some developers, for instance, are using new clauses designed to prohibit buyers from litigating their way out of deals.

Real estate attorney Adam Leitman Bailey pointed to clauses in which the buyer agrees to refrain from citing ILSA, the United States Department of Housing and Urban Development's Interstate Land Sales Full Disclosure Act, as an excuse to break a contract. Bailey claimed that such a clause is not enforceable.

Under ILSA, a 41-year-old consumer protection law, condo developers with more than 99 units are required to file a project report with HUD, present a copy of the document to each buyer prior to the purchase agreement signing, and guarantee delivery of the apartment within two years.

As The Real Deal has reported, Bailey is representing between 150 and 200 buyers seeking to get out of contracts at approximately 20 projects throughout New York City, based on claims that developers did not comply with ILSA.

Another clause being enacted by some developers requires that the buyer forfeit a "certain amount of the deposit" and cover the sponsor's legal fees if they back out, Bailey said. This might entail the forfeiture of 10 to 15 percent of the purchase price based on a 20 percent deposit, he noted, saying that he believes such a clause is enforceable.

Sponsors are requesting this of buyers in exchange for offering discounted purchase prices, he said.

Another loophole buyers are now looking to in efforts to rescind contracts has to do with a project's "outside date," or planned completion date. Buyers are generally able to back out of

contracts if the first closing does not occur before the outside date defined in the offering plan, private practice real estate attorney Michael Dym said.

Real estate lawyer Jeffrey Schwartz, a partner at Wolf Haldenstein Adler Freeman & Herz, added that developers have become more "careful" about setting outside dates in new offering plans. He said this is happening with some of the few new projects that are on the market now. Developers are making certain these dates are far enough out to be reasonably met, and can be extended if the buyer requests additional work on the unit, he said.

Schwartz said that developers must be careful about setting tight outside dates because "building completions and financing extensions are taking longer to get done [now]."

A group of 23 buyers at the Rushmore at 80 Riverside Blvd. are embroiled in a lawsuit with the building's sponsors, Extell Development and the Carlyle Group, due to what could be a very expensive clerical error involving an outside date. The offering plan stated that buyers would have the right to back out if the first closing did not occur before Sept. 1, 2008 -- which was supposed to have read Sept. 1, 2009, the New York Times reported.

Real estate attorney Richard Cohen has filed an application with state Attorney General Andrew Cuomo's office requesting deposit refunds for the buyers, which would amount to roughly $10 million.

Strict adherence to building specifications is also atop the buyers' loophole list, but developers are trying to protect themselves against that now, too.

Jonathan Miller, president of real estate appraisal firm Miller Samuel, said sponsors are now particularly cautious about how building specifications are detailed in offering plans. If specifications call for 9-foot ceilings, and the completed project has 8-foot, 11-inch ceilings, the buyer may try to annul, he quipped.

To skirt such situations, some developers are inserting qualifying language in new offering plans, such as the phrase "within reason," to avoid locking into rigid specifics, Miller said.

Meanwhile, forcing buyers to put more skin in the game via larger deposit requirements may be a risky strategy in this market, but some sponsors are doing it as a way to deter serious buyers from extricating themselves from deals.

In some cases, condo sponsors are implementing "stepped" deposit plans requiring the buyer to pay 10 percent upfront and another 5 percent to 10 percent 30 days later, said Schwartz.

While stepped deposits had been used even more prevalently prior to the crash, they are still being employed by some developers now as a form of protection, mostly in higher-demand luxury buildings, Schwartz said.

He noted that the larger deposit requirements increase the commitment of buyers and "does them more harm if they terminate."

Attorney Robert Braverman said, "If a project is a year away [from completion], the developer may take another 10 percent [in addition to a previous down payment] six months down the

line." Braverman said the tactic has been used at a $10 million new construction condo unit in Greenwich Village in which he represented the buyer.

However, increasing deposit requirements now is clearly a gutsy move, as it may scare off buyers who are being wooed with incentives and price drops elsewhere.

David Von Spreckelsen, senior vice president at development firm Toll Brothers, said his firm has refrained from boosting deposit requirements, "because if you make anything more onerous, people won't sign contracts."

Toll Brothers has, in fact, gone in the opposite direction at its Northside Piers project in Williamsburg, where it has ramped up incentives for buyers to get them to sign contracts.

Dym noted that a sponsor cannot increase deposits midstream because contract terms can't be altered unilaterally.

He also mentioned another way sponsors could potentially prevent buyers from backing out of deals: by "building some of [a building's] units out, rather than selling on plan." He added, "rushing a few units to finished state to show people what they are getting could prevent potential disputes."

Amid this new culture of real estate litigation, the best defense may be early offense. Matthew Blesso, president and founder of Blesso Properties, said his firm has sidestepped lawsuits by prescreening buyers' finances.

Blesso offers its buyers a mortgage contingency clause if they opt to buy a mortgage from the firm's mortgage brokerage partner, Universal Mortgage. Having a partner examine each buyer's finances enables Blesso to filter out those who may encounter difficulties at closing, he said.