

Navigating Buyers and Developers Through New Construction Deals

Foundation Member John M. Desiderio recently co-authored an article printed on May 3, 2010 in the prestigious New York Law Journal on strategies and tactics that buyers of condominiums may use should the developer fail to deliver a condo as promised. An attorney in the Manhattan-based law firm, Adam Leitman Bailey, P.C., Mr. Desiderio and co-author Adam Leitman Bailey drew on their experience with over 100 clients to outline problematic issues that grew out of the condo boom in Manhattan. Mr. Desiderio is the Chair of the Real Estate Litigation Practice Group of the firm, and Mr. Bailey is the firm's founding partner. The extensive article on the detailed subject has been highly abridged to fit the space allotted here and is being published without endnotes or specific citations to relevant cases. The full article may be found at www.alblawfirm.com/NavigatingBuyers.

In late 2008, the real estate sky had started to fall and fall quickly. As a result of the loss of financing and wages, many purchasers in contract to buy a unit in a newly constructed building were either no longer able or willing to close on their units. The perfect real estate storm became a hurricane when many developers no longer had the capital to deliver the building as promised in the marketing materials.

Since neither financial hardship nor changed economic circumstances provide legal grounds for rescinding valid contracts, real estate lawyers enmeshed in this unprecedented set of circumstances, which continue to affect the current market, utilized the legal tools available to them—sophisticated laws and technical arguments from a detailed analysis of legal documents and offering plans—to spur negotiations that would lead to closings, wherever possible, despite the crisis.

The most adept developers realized that, even if a discount had to be made to close a deal, a sizable portion of their loan could be paid off with the sale of each unit. The available legal tools became opportunities for both sides to negotiate.

The Contract Terms

The most obvious tool to reverse a deal is the buyer's contract itself. The typical condo purchase agreement is designed to bind buyers to the deal and force them to close as early as possible after the issuance of the Temporary Certificate of Occupancy.

Typically, buyers find themselves forced to close when the building and its promised amenities, in their view, are still in a construction mode. Nevertheless, the condo contract does provide the buyer with one very significant right—the right to a pre-closing inspection of the premises—that may enable the buyer to identify a basis for rescinding the deal. Demand should always be made that the official walk-through include an inspection of the building's roof and other common elements.

Sponsors can be expected also to characterize the demand for such an inspection as a “fishing expedition” intended for no other purpose than to find an “excuse” for not closing. But recently, in *Alligory Business Ltd. v. 86th & 3rd Owner LLC* and *Related 86th & 3rd Owner LLC*, New York County Supreme Court held (a) that the condo buyers' causes of action for breach of purchase agreement, rescission, and refund of their deposits, for sponsor's refusal to allow inspection of the common elements, could proceed, and (b) that “if plaintiffs prove an entitlement to inspection of the restricted areas, and upon inspection find material noncompliance with the plans and specifications of the building, they may seek to recover damages proved.” (The authors' firm represents the buyers in *Alligory*.)

The Martin Act

Although buyers may not sue to rescind their contracts due “solely” for omissions from the offering plan of any required disclosures, buyers may nevertheless seek refunds of their deposits under terms in their contracts and offering plans that are mandated by the Martin Act and the Attorney General's implementing regulations.

Sponsors must offer the right of rescission for failing to meet certain deadlines, and some sponsors have appeared to speed up construction which often results in shoddy finishing that causes great dissatisfaction and cause for complaint even among buyers who do not wish to back out of their contracts. To avoid offering the right of rescission in some cases, developers may hold a “first closing” within the deadline period with an “insider” friend of the sponsor, which is therefore a sham closing. Where such sham first closings can be documented, rescission of all contracts necessarily follows.



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Interstate Land Sales Act (“ILSA”)

In 2009, buyers' attorneys in New York, for almost the first time in nearly forty years, had reason to seek the protections and remedies provided to their clients by ILSA, a federal consumer protection statute that is intended to protect purchasers of new residential housing that purchasers contract to buy prior to the completion of construction. Where ILSA applies, sponsors who have violated its provisions are liable to refund all of the moneys received from buyers who revoke their contracts within two years of the contract's execution date.

ILSA had been virtually unknown to most New York real estate attorneys since its initial enactment in 1968. There is not yet an authoritative body of New York federal or state case law interpreting ILSA's application to New York real estate transactions. Whether newly constructed New York condominiums are exempt from ILSA is a question that is currently being litigated in New York courts and will be decided over the next few years.

Conclusion

New York real estate attorneys have used each of the legal tools noted in this article to negotiate substantial price discounts and partial deposit refunds for their buyer clients. Faced with meeting urgent financial obligations to construction lenders, and needing to complete the most sales possible, to avoid possible bankruptcy and loss of their investments, many developers have been willing to negotiate substantial contract price reductions.