

Purchasing Or Foreclosing On A Failed Project? You May Be A "Successor Developer"

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In the current economy, there are numerous instances where developers of projects in Florida are unable to either complete developments which were started during the economic boom, or sell out what is left of their completed development to end users. As a result, the failed developer must either sell the remainder of its project in bulk or face foreclosure by its mortgage lender, who may then acquire the project.

In either circumstance, the prospective purchaser or the foreclosing lender should be careful to structure the acquisition so as to avoid unintentionally succeeding to the interest of the owner as the "developer" of the failed project (unless there is a specific reason to do so). If the project is a condominium, the purchaser or foreclosing lender can unintentionally become a "successor developer" under the Florida Condominium Act, subjecting them to unwanted and potentially burdensome obligations, unless affirmative steps are taken to avoid that status. Additionally, any subdivision which is subject to covenants and restrictions recorded by the failed developer may contain burdensome obligations that would be binding on the purchaser or foreclosing lender if it were found to be a "successor developer" under the covenants and restrictions.

In both instances, a court could find the successor developer just as liable as the original developer for prior wrongful conduct of the original developer. This could

include violations of the Condominium Act, violations of the Interstate Land Sales Full Disclosure Act, failure to properly operate an owners' association, failure to properly construct improvements, failure to fund budget deficits or reserves required by an owners' association, misrepresentations to prior purchasers, etc. (use your imagination... this list could encompass every possible thing a developer could do wrong). If a successor developer is found liable for conduct of the original developer, it is possible that parties having claims against the original developer could assert them against the successor developer. The remedies available to these parties may require the payment of damages, and could even require the successor developer to take back lots or condominium units sold by the original developer and refund the full purchase prices paid by the claimants (which, if paid during the economic boom, may far exceed the current value of these lots or units).

If the failed project contains a number of lots or units that were sold at high prices, and there were irregularities committed by the original developer under the Interstate Land Sales Full Disclosure Act, the purchasers may also seek to institute a class action lawsuit against the successor developer. Some attorneys are actively seeking participants to join those kinds of cases.

Although the failed project may have been subject to a defaulted mortgage loan in an amount far in excess of the project's value, once the project is acquired by a purchaser or lender there is likely to be significant equity in the project. This can be attractive to prospective claimants who never would have bothered asserting a claim against a failed developer whose project was not worth the mortgage balance on it, but who may now find the purchaser's or lender's deep pockets attractive.

In the context of a foreclosure, it is not unusual for a lender to routinely foreclose on both the property itself along with all of the right, title and interest of the developer in and to the project, without thinking about the potential downside of foreclosing on "developer rights" (and obligations). The lender's Mortgage usually contains a long list of what constitutes the "mortgaged property," which almost always includes every possible right, title and interest the developer may have in the project. If that kind of description is used in the Foreclosure Complaint, and the lender acquires title at the foreclosure sale, it is very possible that the lender will be subjected to a host of potential problems as a "successor developer" that could have been avoided through discussion and consideration of these issues with experienced counsel at the front end.

It is a simple step for the lender's attorney to revise the description of the property in the Foreclosure Complaint to expressly exclude whatever interests the lender does NOT want to acquire. Lenders should not assume that getting every interest owned by their defaulting borrower is always better.

Of course, if the project is partially completed, the foreclosing lender may NEED developer rights to finish it, or to make it more marketable for a prospective purchaser to finish. Developer rights may also be needed for other reasons, such as the ability to amend the governing documents for the project, or the ability to take advantage of special rights or exemptions that the developer built into the governing

documents for its own benefit that are not available to other owners. However, this should be a conscious and carefully considered decision. When having counsel review a title report or title commitment, the purchaser or foreclosing lender should specifically request its attorney look for documents that may impose these kinds of liabilities on them as a "successor developer," and discuss with them what risks they may face, what risks can be mitigated or eliminated, and what risks may be necessary for the purchaser or lender to assume, BEFORE reaching the end of a title review period or inspection period or commencing the foreclosure sale.