STALLED CONSTRUCTION PROJECTS: HOW TO MINIMIZE LOSSES

By William W. Weisner

As of February 2010, the New York City Department of Buildings listed more than 500 sites in the five boroughs as projects at which construction had stalled. The reasons for so much stalled construction varied, and included:

• The construction lender stopped funding because the loan was “out of balance.”

• The construction lender stopped funding because of its own financial difficulties.

• Equity sources did not meet their capital contribution requirements, either because of their own financial difficulties or because they did not want to put money into projects that appeared to be “under water.”

William W. Weisner

A new season has arrived and as the economy emerges from its long winter, we face the new decade with refreshed optimism. As our clients’ needs have demanded, we have added attorneys who bring new and valuable skill sets to our expanding practice.

Andrew S. Koerner has joined the firm to establish a new Business Immigration Practice Group to facilitate our clients’ access to the global work force for the 21st century. Andrew represents numerous national and international companies in their efforts to recruit and retain top multinational staff.

Eric Zipkowitz joined TKD in January as a partner to spearhead an expansion of our real estate, construction and finance practice areas. Eric’s abilities are widely recognized in connection with complex real estate, construction and financing transactions.

We look forward to your meeting Andrew and Eric and accessing their extraordinary talents.

The articles in this issue of The TKD Advisor address three issues faced by many of the firm’s clients: how to minimize losses in stalled construction projects, what to do when you are served with a summons and complaint, and new FINRA rules for investment bankers. I hope that you will enjoy this issue and will not hesitate to contact me or the authors with feedback and suggestions for topics for future issues.

Alan M. Tarter
Managing Partner
Email: atarter@tarterkrinsky.com
Direct dial: 212.216.8010
• Changed market conditions led to an inability to secure financing.

• Crane collapses or other construction problems at the site led to stop work orders.

• Litigation caused delays – e.g., in the case of Forest City Ratner’s Atlantic Yards project.

• Disputes with contractors, including demands for additional compensation, stalled construction.

• Inexperienced developers failed to manage their projects properly, leading to one or more of the above issues.

• After construction commenced, city agencies determined that a project did not conform to its permits or to zoning restrictions.

Among the many adverse consequences of stopping construction are:

• Increased construction costs resulting from demobilization, remobilization and extended general conditions.

• Increased project costs resulting from the extension of the construction period, including loan interest, default interest, real estate taxes, insurance premiums and implementation of a safety monitoring plan.

• Costs associated with procuring additional equity and/or debt required to restart and complete construction.

The cost of this capital is typically significantly higher than the terms of financing available at the project’s inception.

• Legal fees incurred to analyze and address the consequences of defaults under financing documents and construction contracts and the expiration of building permits or other permits or entitlements.

• Disputes among partners and disputes with lenders, contractors and other vendors.

• Prospective buyers and tenants avoiding commitments to buy or lease space in the project.

• Risks to the general public if the site is not properly secured and a site safety plan implemented.

• Impact on the surrounding community.

Tarter Krinsky & Drogin has recently represented many clients involved with stalled projects. These matters raise many legal, business, tax, financial and other issues. Unfortunately, the solutions to these situations almost invariably result in a significant impairment of the owner’s equity in the project. The solutions also often result in architects, contractors, subcontractors, suppliers and other vendors receiving reduced payments. Lenders usually have to choose between foreclosing on the property securing their loans, which in most cases will result in recovery of less than the full amount due on their loans, or working with the owners to restructure the debt and allow the introduction of new capital at some level in the capital stack to finance completion of construction and sale or lease-up of the project.

We have seen a variety of resolutions for these distressed site situations, including:

• The lender agreed to increase its loan on the condition that the owner engage a new construction manager recommended by the lender and raise additional equity as well, diluting the equity of the existing partners of the owner. The construction manager issued a guaranty of completion to the lender in return for the right to receive additional compensation if it meets completion
targets and the property achieves certain revenue targets.

• The owner transferred its property to a new developer identified by the lender. In exchange, the lender released the existing owner and guarantors from liability for the loan.

• The existing owners teamed with a new partner to purchase the existing construction loan from the lender at a discount and then raised new capital in the form of a preferred equity investment to finance future development costs.

• A stalled construction site was sold to a new owner, in exchange for the right of the selling owner to receive a share of proceeds after the new owner completes construction and achieves certain levels of financial returns.

• The modification of an existing construction loan was combined with closing of a mezzanine loan that will bring the project’s sources and uses back into balance.

The prospects of significant positive financial returns are low in most of these cases, but the losses likely to be incurred by the lenders, investors, contractors and others have been greatly reduced from the losses that would have been incurred in a foreclosure or owner bankruptcy. In cases where the owner has invested significant equity, the resumption and completion of construction preserve the possibility of recovering at least some of that equity.

In many projects reported in the press, the lenders have foreclosed on their collateral after a project stalled and a negotiated resolution could not be achieved. The new owners generally have reported that they intend to complete construction eventually and then sell or lease the properties. Investors should be aware that some municipalities outside of New York are threatening to revoke entitlements unless construction is promptly recommenced and completed.

LOCAL LAW ASSISTS DEVELOPERS

In contrast, New York City has taken some steps to assist developers of stalled sites. In October 2009, Local Law No. 70 was enacted in New York City. This law provides, among other things:

• All permits issued by the Commissioner of the Department of Buildings (DOB) will expire if the permitted work or use is not commenced within 12 months from the date of issuance of the permit (six months for work in an area of special flood hazard), or if the work is commenced but is thereafter suspended or abandoned for a period of 12 months.

• However, the Commissioner was authorized to establish a program under which permits for such sites can remain in effect and even be renewed if the owner applies for inclusion in the program and complies with the program requirements, which are primarily focused on maintaining the safety of sites where work has not commenced or is suspended.

• On January 15, 2010, the DOB issued Buildings Bulletin 2010-001, which established such a program. An owner applying for the program must submit a “Safety Monitoring Plan” for DOB review and approval and request a site meeting with the DOB. If the plan is approved, the owner must continuously apply for renewal of permits, maintain proper insurance, submit monthly monitoring reports, make the site accessible to the DOB for periodic inspection, and comply with the Safety Monitoring Plan and other requirements of the program.

• It is important to note that renewal of DOB permits does not necessarily include renewal or vesting with respect to landmarks, zoning and other entitlements.

The cessation of construction prior to completion leads to numerous complex business, legal, financial, marketing, construction and safety issues. However, with proper planning, prompt action and the development of a plan that takes into account the many issues involved, losses to all parties involved can be minimized.

About William W. Weisner, Partner

Bill is a Partner in the Real Estate, Construction, and Banking and Finance Practice Groups. He handles a wide variety of commercial real estate and finance matters for lenders, developers, investors, landlords and tenants nationwide. Bill focuses on designing creative yet practical and efficient solutions to real estate issues and client needs. He has been repeatedly named as a leading real estate lawyer in the New York Metro edition of Super Lawyers magazine and has been recognized by Chambers USA since 2008. Bill can be reached at 212.216.8095; wweisner@tarterkrinsky.com.
You’re about to leave your office on a Friday afternoon and the receptionist calls you. A process server has just handed her an envelope that contains a summons and complaint naming your company as a defendant. Suddenly you envision your exciting weekend plans quickly evaporating and you break into a cold sweat. Luckily, you can take a deep breath and relax, because although there are several things that should be done after you are served with a summons and complaint, they can wait until you are back from the weekend. (Service of an Order to Show Cause, on the other hand, may be a different story!)

The first thing that you should do upon your receipt of a summons and complaint is to make a note of how and when the papers were served. If they were personally delivered to you or to someone else at your office (or home), write down who was served and the date. Your receptionist and other office staff should be instructed to immediately advise you upon receipt of any summons and complaint. If the papers were received in the mail, jot down the date that the envelope was received, and whether it was by regular mail, FedEx or some other means. The manner in which the summons and complaint were served will be important in determining whether service was proper, and in calculating the timing of an answer or other response to the complaint.

In general, in New York an answer will be due either 20 days or 30 days after service of the complaint, depending on whether or not the summons and complaint were “personally” served on the defendant (i.e., in-hand service on the defendant). You should reach out to your attorney well before the time to answer has expired. However, if you are unable to do so, you should contact the plaintiff’s attorney to obtain an extension of time to answer, which should be in writing. The worst thing you can do is ignore the deadline to answer the complaint, because that would entitle the plaintiff to seek a default judgment against you – and you likely would not find out about the judgment until after it has been obtained.

Another important step to be taken upon receipt of a summons and complaint is to determine whether any of your company’s insurance carriers need to be notified of the complaint. Your rights to coverage may be adversely affected if notice is not given in a timely fashion. In general, the obligation to notify your insurance carrier may arise as soon as you learn of facts that may lead to a claim being made against you.

Upon receipt of a summons and complaint – or beforehand if you anticipate that the litigation may be commenced – you should ensure that all employees with documents concerning the matter, including emails and other electronic documents, retain all of these documents, as well as all computer hard drives and PDAs in which relevant documents may exist. It is imperative that written instructions about retaining documents be issued to all employees who may have documents concerning the matter. The best time to consult with your attorney for assistance with preparing an appropriate communication is before litigation is commenced, so that a notice can immediately be sent to all employees after an action is brought against the

Continued on inside page
YOU’VE BEEN SERVED WITH A SUMMONS AND COMPLAINT — WHAT NEXT?

Continued from next page

company (or before if you anticipate that an action may be commenced).

You also need to bear in mind that if, after commencement of the action, you or your coworkers create any internal or external documents concerning the matter (including emails) or speak to third parties about the matter, these documents and communications – unless they are with or for your attorney – are not privileged and may be subject to disclosure in the litigation.

Finally, you should resist the urge to immediately shoot off a letter or email to the plaintiff setting forth your position or attempting to settle the matter before consulting with your attorney or serving an answer to the complaint. Unbeknownst to you, certain statements may constitute admissions that will be binding in the litigation. Although we strive to resolve cases before the litigation becomes full-blown and expensive, the timing, tenor and content of communications concerning settlement are important and could have an impact on the litigation if the matter is not resolved.

Hopefully these tips on initial steps after you’ve been served with a summons and complaint are helpful, and the next time that you get that call from your receptionist at 5 p.m. on Friday, the first thing you will do is relax and enjoy the weekend.

About Debra Bodian Bernstein, Counsel
Debra is a Counsel in the Litigation Practice Group. She has handled a wide range of complex business disputes and other litigation from inception through trial and appeal, including contract and insurance coverage disputes, mortgage fraud litigation, attorney malpractice, trademark and copyright infringement, libel and employment discrimination. She can be reached at 212.216.8027; dbernstein@tarterkrinsky.com.
What do you find most satisfying about practicing law?
I love helping people grow and protect their businesses. I am fortunate that my profession involves a great deal of creativity in structuring deals and exploring options with clients to solve problems or take advantage of new opportunities.

What has been the most important change in the practice of law since you graduated from law school?
Computer technology amazes me on a daily basis, whether it’s transmitting emails and documents from a Blackberry, reviewing public records for a remote county in Georgia from my office in New York, or finding wireless from a fishing boat.

Who has had the greatest influence on your legal career?
After graduating from law school, I had the opportunity to work as a law clerk for The Honorable Michael J. Davis, then a state court judge and now Chief Judge of the United States District Court, District of Minnesota. His competence, integrity and professionalism are beyond compare, and I consider myself very fortunate to have been mentored by him for more than 20 years.

If you weren’t a lawyer, what would you be?
A photographer or writer or some other creative professional. I am very visual and love photography, and I’m a huge fan of art, music, theater, film and almost every type of creative art.

What are your colleagues and clients most surprised to learn about you?
That I once played both professional basketball and golf but haven’t picked up a club in over 10 years.

Tell me about your hobbies.
I’m an active and enthusiastic bridge player and can be found intensely engaged in late-night games at the Manhattan Bridge Club two or three times a week. I also enjoy reading, going to movies, and eating at new food joints throughout the city – spicy food preferred, and a great cup of coffee mandatory.

What is your idea of a perfect way to spend a weekend?
I love taking a Sunday afternoon drive out of the city, stopping in at diners and local shops to get that familiar feeling of my small hometown in Minnesota.

What is the best vacation you’ve ever taken?
When my daughter was in grade school, we took a road trip to the “top” roller coaster parks. Cedar Point in Sandusky, Ohio was the best, rating an A+.

About Kelly A. Skalicky, Counsel
Kelly is a Counsel in the Banking and Finance and Compliance Practice Groups. Her practice concentrates on banking and regulatory compliance, secured transactions and commercial finance, loan workouts and debt restructuring, and creditor’s rights and remedies. She has been counsel to a nationwide lender focusing on commercial construction and residential development projects.

TKD ATTORNEYS GIVE SEMINARS ON BROAD RANGE OF TOPICS

Over the past few months, TKD attorneys have given seminars and workshops on a wide variety of topics, addressing audiences that ranged from commercial customers of a major bank to parishioners of a Manhattan church:

Stalled Construction Sites: Options and Opportunities – This seminar, sponsored by the New York Construction User Council, was moderated by William W. Weisner, a Partner in the Real Estate, Construction, and Banking and Finance Practice Groups. Panelists at the April event included David J. Pfeffer, a Partner who co-chairs the Construction Practice Group, and Robert D. LiMandri, Commissioner of the New York City Department of Buildings.

Stalled Construction Sites: Options and Opportunities – This seminar, sponsored by the New York Construction User Council, was moderated by William W. Weisner, a Partner in the Real Estate, Construction, and Banking and Finance Practice Groups. Panelists at the April event included David J. Pfeffer, a Partner who co-chairs the Construction Practice Group, and Robert D. LiMandri, Commissioner of the New York City Department of Buildings.

Staffing Services’ Role in Workplace Harassment Complaints – This January seminar of the New York Staffing Association (NYSA) was held on Long Island with Richard Steer, a Partner in the Labor and Employment Practice Group, as one of the speakers. In April Rich spoke at another NYSA seminar in Manhattan on Hiring Issues and Risk Management. He was also invited to give a seminar on Current Hot Topics in Labor and Employment Law for customers of Citibank Commercial Banking in April.

Legal Issues for Interior Designers: Creating Contracts That Protect You – This seminar, part of the New York School of Interior Design’s continuing education program, was conducted in January by Aaron Abraham, a Partner who co-chairs the Construction Practice Group, and Michael R. Wood, an Associate in the Construction and Real Estate Practice Groups.

The Importance of a Will – Counsel Joan T. Palumbo of the Trusts and Estates Practice Group gave this seminar at St. Vincent Ferrer Church in Manhattan in February. The event was also sponsored by the Archdiocese of New York.

TKD EXPANSION PLANS
We are currently constructing the first phase of our office expansion, which will be ready for occupancy this summer. In 2009, we signed a 13-year lease renewal and expansion to provide space to meet our strategic objectives and grow to 60 attorneys within five years. Within the past year, we have added eight new attorneys and new practice groups in several areas.

The information contained in The TKD Advisor is of a general nature and does not constitute legal advice. Consultation with our personnel is recommended before taking action based upon any of this information. Under the rules of certain jurisdictions, this material may be considered attorney advertising. Prior results do not guarantee a similar outcome.

Circular 230 Disclosure Notice: To ensure compliance with Treasury Department rules governing tax practice, we inform you that any advice contained herein (including in any attachment) (1) was not written and is not intended to be used, and cannot be used, for the purpose of avoiding any federal tax penalty that may be imposed on the taxpayer, and (2) may not be used in connection with promoting, marketing or recommending to another person any transaction or matter addressed herein.