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LITIGATION

2011: commercial real estate's year of 'Who knows what's next?'

By Sblend Sblendorio

In reviewing the economic pundits' reviews of 2011 and expectations for 2012, the most common statement is "we figure 2012 will be better" because "2011 wasn't too good." For real estate legal professionals, this review accurately describes the practice in Northern California.

From my view as a practitioner, the deals were sporadic, but more involved than in previous years. Trends in deal making appear similar to economic trends — shimmers of bright light appear and then are followed by periods of gloom. Many of the deals that managed to close in 2011 involved, more often than not, the reworking of projects that have languished since the recession began. The uncertain times result in a cautious, detailed progression to each deal. Presumably with so few deals, the parties have more time to ruminate every nuance, every revision, and every alternative. Good real estate counsel is needed to keep the deal moving forward.

In 2012, I expect "presumed dead" projects to rekindle. That said, the lesson learned from a look back at the year in commercial real estate is that quality matters. Economic optimism matters only if the market strongly supports the project's location and product. Real estate lawyers need to understand the infirmities of a given project and remedy them with a combination of reducing costs where they can be reduced, such as in fees and construction, as well as with creative financing.

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However, if times improve and we see more deals in 2012, real estate counsel and their clients would be wrong to simply "dust off" projects from the last few years; more is needed. For instance, entitlements must be renewed. Without question, projections must also be updated. And the reality is that developers and their lenders and investors will expect the existing project to be stripped down and evaluated in today's market, which will require additional effort as well.

One of the largest trends we saw in 2011 was widespread difficulty with closings. To complete a real estate project, several pieces must coalesce. The struggle in 2011 — as well as several years prior — has been getting all of those pieces together. The land price is market and the entitlements are procured, but the financing fails. Or, there is financing, but the city in which a given project is located does not have the will to move forward.

I may be proudest of helping close a single family detached housing project in the East Bay in 2011. A regional builder optioned this project in 2007. Then, the housing crash, lack of internal finances and high impact fees caused the project to fall out of escrow after a couple of years. Along the way, the seller made price concessions, the builder redesigned the project, and the city offered to reduce and defer fees — all to no avail. In late 2010, a national builder with a dwindling local inventory of homes picked up the project — albeit at about 60% of its highest price. Because of a dearth in projects, the city gladly expedited processing. Because the sellers were fatigued from their experience with the previous builder, we negotiated an increasing price as time passed. The national builder missed the lowest price, but closed at the second price point. The builder said that the key factors allowing it to move forward were a city that processed the tentative map in six months and a "brightened view of the local market" during those six months. This project is now under construction.

In 2012, I expect to see improved deal flow from two sources: dormant projects that have been re-evaluated in today's market and new projects for products needed in limited geographies. The former category includes houses in areas with little supply or a builder without a supply; grocery-anchored neighborhood retail with good demographics; and office or industrial buildings in strong technology sectors. For real estate attorneys with deals in this category, disciplined review of entitlements and deal structure are paramount. Investors and lenders will expect completely new analysis of these types of projects.

In the latter category, examples include apartments in certain areas of the Bay Area, such as Cupertino, Mountain View and Santa Clara; expansions and new campuses for dominant technology companies (such as Facebook and Google) whose appetite for space does not appear to be nearing an end in 2012; and senior housing to meet the ever increasing demand of baby boomers. For counsel involved in these projects, the challenges may seem similar to those from years ago. But, the clients expect you to deliver more now than they did before. The perception of these types of projects as "job creators" often sets high expectation for quick municipal processing, little public opposition or easy financing. While some of these expectations are justifiable, good counsel must chart a course anticipating the implications of uneasy economic times.

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