

DEALING WITH DISTRESSED PROPERTIES: EMPTY STRIP MALLS, FRACTURED CONDOMINIUMS, AND FORECLOSED HOMES

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Introduction

The front page of Business Week's July 7, 2008, edition is titled "Housing Abyss." In the July 2008 edition of the ABA Journal is "Homing in on Foreclosure." Are there empty strip malls, "fractured" condominiums, and foreclosed homes? You betcha. So how do we deal with these distressed properties? It is not a pretty picture. As Peter Coy and Mara Der Hovanesian, authors of the Business Week article state "Why the worst may be yet to come as forces battering the market gain strength. And the remedy coming from Congress? It's likely to fall short of the mark."

Delinquent mortgage loans, empty lease spaces, malls going dark, condo purchasers suing to recoup their deposits, abandoned homes, bankruptcy courts inundated with Chapter 7, 13 and 11 proceedings all over the country, and the like, constitute the 2008 real estate world. The meltdown may already be out of control. We're told that Congress has a huge legislative package designed to prevent more foreclosures and produce first time home purchasers, but it hasn't happened yet. The congressional jury is still out regarding their consideration of the Barney Frank/Chris Dodd legislation, and other bills referred to later in this paper.

The Florida Attorney General sued Countrywide Financial in Broward County (Ft. Lauderdale), Florida on June 30, 2008.

The following outline will attempt to highlight the issues facing not only lawyers, but developers and planners.

The State of the Market

Foreclosed Homes:

- **Celebrities in Foreclosure**

- Encino, CA - José Canseco loses his \$2.5 million, 7300 square foot home, saying that it didn't make financial sense to keep paying on his home. He chalked it up to taxes taking 41% of his money and then having to take care of his whole family. He says he cannot provide for his family on a take home of only about \$17-18 million.

- Ed McMahon may lose his Beverly Hills home due to health problems. The home has been on the market for 2 years at \$6 million. He is \$650,000 in arrears on a \$4.8 million Countrywide mortgage.
- **Selling and Buying a Foreclosed Home**
 - **Foreclosure bus tours** have emerged in response to the recent glut of foreclosed homes
 - Santa Rosa, CA - A group of real estate agents took a small group of house hunters on a 2-hour tour of 3-4 bedroom houses built between 2000 and 2003 and ranging in price from \$277,000 to \$375,000. The tour also offers entertainment such as trivia contests and icebreaker games. Buyers on such a tour are looking for investments and great deals, but only about ¼ are actually looking to buy. The agent behind this tour was formerly involved in the high-end market, but, ironically, turned to foreclosure tours to make ends meet.
 - Orlando, FL - This 6-hour tour stops only at empty homes and includes house information, teaching sessions, breakfast, lunch, and warnings to pay special attention to their own budgets to avoid a vicious cycle of foreclosure. In this market, buyers include, again, those looking for great deals and even foreigners trying to take advantage of the comparatively weaker dollar.
 - **Short Sales** have become common and occur when the seller arranges to sell to a buyer, but persuades the lender to accept less than the unpaid mortgage balance. The I.R.S. may not be nearly so forgiving, however, and may demand taxes from the seller even though money is really lost on a “profitable” short sale.
 - **How the Buyer Saves**
 - Fallbrook, CA - A couple saved about \$200,000 when they bought a home for \$680,000, but the bargain came with a price. The home needs a lot of work.
 - Many internet firms, such as Homeforeclosures.com and RealtyTrac.com, are catering to buyers looking for homes in pre-foreclosure.
 - While unemployment is the leading cause for foreclosure, many potential buyers are unable to take advantage of the possible bargains because of their own unemployment.
 - **Sellers have developed strategies of their own, however.** In California, sellers set the price low, spark many offers, get buyers competing and get more than asking price through intense competition. One buyer offered \$6,000 over asking

price just to stand out. Another buyer in Murieta offered \$250,000 on a home listed at \$225,000 to stand out against 8 other offers. In an extreme case, a house listed in Woodland Hills was listed at \$250,000 and was bid up over the market price of \$500,000.

- **The consequences** of the foreclosures include owners looting their foreclosed homes, leaving them as uninhabitable as possible. In St. Petersburg, FL, one homeowner leased a Bobcat excavator and uprooted a privacy fence and 5 trees. Others left a team of half-starved dogs. Insurance claims are only filed occasionally, but the worse the damage the more likely it is that insurance will be called to pursue the former owner.

Empty Strip Centers:

- **Vacancies** are at a 12 year high, and many chains are **downsizing**. Linens N' Things is closing 120 stores, Ann Taylor 117, Home Depot 15, and Starbucks 100. Retail vacancy in San Antonio, TX is expected to up 20% over the next year with similar numbers echoed in Kansas City at 17%.
- Some cities have **adopted ordinances** that void contract provisions preventing property owners from marketing vacant structures to competing retailers and others are requiring developers put up demolition bonds should the structure be abandoned.
- The market is attempting to cope, however. In 2002, a Georgia retail center that was almost completely empty moved a couple tenants around and did some major renovations to reposition itself as an upscale convenience center. It upgraded its tenant mix successfully. In Northridge, California, a sale of neighborhood shopping center in 1999 was a breath of fresh air. The center was more attractive because it was half empty and full of opportunity. A facelift, coupled with good location has to attract a different kind of tenant to make the project worthwhile. Still, some tenants are moving to street locations.

“Fractured” Condominiums:

- **Definition:** All units previously offered for sale as condos, but remarketed as rental units, then sold as an apartment project.
- **Examples**
 - At Legacy Place in Palm Beach Gardens, Florida, some condos have closed as sales but others are still available to rent. Owners feel that renters don't provide the benefit of social interaction with neighbors and careful ownership. If the majority of units don't sell then the developer may retain control over the association depending on state condo law and the particular condo documents.

- The Strand in West Palm Beach, Florida is a 15 story tower that sold in March 2005 for \$91 million. 80 of 275 condos were sold and then the tower changed ownership. While rentals are taking off, some buyers are canceling their reservations.
- On the extreme end, The Strand in Delray Beach, Florida returned \$15 million in deposits and has unraveled completely.
- **Mortgage Fraud** is also a problem. Squatters and non-owners are *posing as lawful landlords* and renting vacant units to unsuspecting tenants. The Club at Brickell Bay in Miami, Florida, where 260 of the 640 units are in foreclosure, deactivated 8000 keycards to get a handle on who was rightfully there. 1400 unlawful card carriers were eliminated.
- **Investor Response**
 - CB Richard Ellis is listing 43 Florida fractured condo communities with 5000 units on its website. Investors and investment groups are expected to buy parcels of 20-200 condo units **and** these institutional buyers will convert back to renting entirely.
 - San Benito, TX - BMC Capital arranged for a \$568,000 loan in January 2007 to acquire a 17 unit fractured condo, Sunshine Townhomes.
 - La Jolla, CA - A condo converter sold its unsold units to an investor who wants to operate as rental. The transfer is complex but seems to be following the current trend in the market.
- **The continuing validity of entitlements** (constitutionally or otherwise “vested”) in a workout of a “fractured” condo or other commercial venture required to put on the breaks during a severe economic meltdown making the originally timed availability of a project impossible to achieve.

“Certified Distressed Property Expert (CDPE)”:

- Acronym that a licensed realtor from Kendall, FL uses to describe himself that suggests he’s had more extensive training to mitigate a foreclosure and negotiate a short sale. He is, perhaps, self-certified.

Legislation

- **Cities**
 - The cities’ efforts to deal with distressed properties, particularly those abandoned before or after foreclosure, are expressed in various ordinances. There is an increase in code enforcement, but affording due process slows down enforcement efforts. In Riverside, California, the mayor’s efforts to persuade owners from abandoning their homes have not been very successful. In addition, there are