

## THE RECESSION and its affect on real estate



by Linda DeBene, Esq.

**OVER THE VARIOUS ECONOMIC DOWNTURNS** in the construction and real estate industries — and that of the “dotcom” crash — one could count themselves fortunate if they provided both litigation and transactional lawyering in these fields. Now the real estate industry is frozen as a result of the sub-prime and global economic meltdowns. While residential and multifamily residential construction industries are crashing in on themselves, and entire law firms that relied heavily on that business in the real estate and construction arenas seeming to go “poof” overnight, a study of the global economic

effects still shows that there is work to be done by lawyers.

The *good news*: Our clients, sadly, are suffering and still turn to legal counselors for help; and the domestic markets in real estate and construction are not as bad as those in the U.K. The *bad news*: There have been dramatic changes over the last year — projects are canceling, left and right, and those that *have been* started are grinding to a halt. Fueling the shift from private development is the fact that funding sources are drying up completely. Multifamily units are the hardest hit. Multifamily condominium private money-backers are

shifting to more rental units and looking elsewhere, such as to government projects using design build private-public partnership models. Even here, the approaches are difficult due to the government budget crunches and few financing sources.

To say it is impossible to finish a residential project may be an overstatement. But the difficulties in bringing residential projects to closure — because equity coming into the projects has all but disappeared — are rampant. Profit margin is no longer a word that has meaning ... as even if inventory is moving, there are no profits. Credit is

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tight to non-existent. Lender confidence is down and becoming more cynical by the day. Players with private equity funds may be out there, but are holding on to see if, how and when the market turns. Troubled banks are being closely watched to see if final funding will come through. Any blip in the latter will be a death knell. Retail and commercial are trending down, and new construction and planning is scarce.

A local East Bay architectural firm was quoted not long ago in the *San Francisco Chronicle* as “holding on” by the skin of their teeth because of their work in China, Dubai and India. That article printed on the day of the Mumbai terrorist attacks. Simply put, there is nothing happening on the design side and investors are pulling out of uncompleted projects. No region or sector is fully protected because no one knows how to forecast the turn, no one knows the long-term impacts of all the government bailouts, and no one knows how the U.S. dollar will withstand the burden of the U.S. debt.

There is a glimmer of the positive in the health care market (hospitals and health care facilities for prisons) and education facilities (K1-12 and junior colleges). Becoming more prevalent are public-private collaborations and other alternative delivery methods (lean construction, integrated project delivery, design-build) where private equity is finding a more reliable place to provide

financing to drive construction, replacing obsolete buildings and providing sophisticated technologies to make the new projects last longer with re-engineered workflows. School districts connecting with private equity on lease-leaseback deals are resulting in situations where completion of the projects is more realistic than under the old own-and-build model.

How will this affect the court systems in the Bay Area? Of course, there will be claims from the old deals gone bad. There may even be claims over the new contract models before the economic downturn turns back up if those private developers struggling to find a way to close a deal or finish an existing project only to find that it still goes under.

At November’s MCLE Spectacular, the “First Aid for Victims Stuck in the SubPrime Mud” program (dealing not only with the subprime debacle, but with the resulting economic harm and effects on title companies, D&O and E&O insurance, and bankruptcy claims), Judge Thomas Maddock warned that the cases currently filed are only the “tip of the iceberg.” All panelists and the audience agreed: There will be claims — lots of claims — but when they will come and how they will be handled depends on the length and breadth of the economic crises the U.S. and other global economies are facing.

While the claims may be hard on the clients, new and hard to deal with

because of the economic dislocations of the parties, the U.S. and the world, this should not be seen as a novel or insurmountable occurrence. Every day, lawyers help clients deal with changes that challenge their lives, their businesses and their environments. As in life, change is one constant in the legal profession. Changing laws, changing interpretations of existing law, changing techniques and strategies, and changing technology are all matters legal professionals face in daily practice. Now we add to that a changing economic paradigm. To counsel clients in this global economic climate, all must stay abreast of the next shoe dropping, lest we become less effective in serving our clientele.

It will be a bumpy ride. For all the bumps and flat tires, when the rubber meets the road, the claimants will need counsel. In turn, counsel will need the courts and other methods of dispute resolution to resolve issues and stop further financial devastation.

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