



How to Capitalize on 2013 Mid-Year Market Trends

by Jessica Gelande Lingertat, Chair, Real Estate Group

Like many in the struggling Chicago area real estate industry, we have been pleased to find a consistent uptick in activity so far this year. In contrast to the fits and starts of the prior several years, the recent improvement in the market is a bit steadier and more promising this time around. Although the improvements have generally occurred on an industry-wide basis, there are a few key areas that show recurring promise. As we reflect on what we've been seeing in the local real estate market this year, we have noticed several areas experiencing change, which give us hope that our clients will find increasingly greater opportunities to get in on the action!

Here are 5 areas in which we have seen opportunities to capitalize on current market trends:

1. How to win in today's Lending Market. In the past 6 months, we have seen some noted changes in the financing vehicles that our clients are utilizing for their properties. Mortgage financing seems to be more available overall, with increased activity in bank loans, with life insurance companies and with CMBS loan structures. We have even seen construction financing opening up, which is a refreshing change in the marketplace and one we hope will help to open up new development and re-development projects that have been shelved for many years. Although interest rates are now starting to creep back up, CMBS and life companies are still offering attractive deals and we have experienced a noted increase in the number of CMBS loans being considered and closed by our clients. These deals are not without challenges, though, with highly standardized requirements and additional fees and closing costs. Overall, the availability of a broader range of options is good for the market, providing a greater opportunity to tailor a deal that best fits a particular client's needs, whether it is the flexibility of a mid-sized, relationship-based bank loan or a more rigid, but lower interest rate CMBS loan. An experienced financing lawyer or loan broker can help you navigate the options and best-prepare for the financing process.

2. How to win in Land Use. Over the past several years, there has been very little entitlement activity in the market, and what we have seen has been almost exclusively limited to minor changes to modify or re-purpose broken projects for completion. However, local inventory of desirable properties is wearing thin and we are now seeing clients venture into projects involving the new development and entitlement of raw land. Municipalities, eager to help jumpstart new development activity and boost long-stagnant revenues, are becoming more open to entitlement discussions. Municipalities remain cautious and conservative in requiring measures to ensure completion of construction projects, particularly with regard to public improvements and ongoing maintenance obligations. However, they may be more open to change their expectations for the type of uses realistically available for a particular site. For example, sites previously designated for retail use may now be open to another use. In particular, many communities that have historically been reluctant to consider multi-family projects are now warmly embracing apartment projects

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which fulfill a need in the area. The trick here is to act fast! Getting a project through the entitlement process before the rental market becomes over-saturated or in time to maintain a pipeline of single family inventory could provide you with a competitive advantage in the market.

3. How to win under the new changes to Mechanics Lien Laws. Recent changes to the Illinois Mechanics Lien Act have not had an immediate impact in local processes and procedures in the construction industry. However, the new law could change the results of how proceeds are allocated to interested parties after a foreclosure sale, so it is important to understand how the applicable changes to priority and the valuation of improvements could impact your project. For example, when proceeds of a foreclosure sale are insufficient to satisfy all claims, a mortgage lender's claims will have priority in the portion of proceeds attributable only to the value of the land at the time of a construction contract, but mechanics lien claimants will have priority over the portion of the proceeds attributable to the value of all improvements made after the date of the construction contract. As a result, mechanics lien claimants receive the benefit of all subsequent improvements even if they were made by another contractor, and mortgage lenders, even if they funded some of the subsequent improvements, are denied any preference by virtue of such subsequent improvements. Accordingly, mortgage lenders now bear an increased share of the risk of loss in a property's value attributable to a general downturn in the market. Lenders who are knowledgeable about the new law can better evaluate potential mechanics lien risks in the underwriting process to make sure they are appropriately protected from an equity and valuation standpoint in the event of a future conflict.

4. How to win under new Insurance Standards. Insurance is an area that is often overlooked by developers and business owners, but this can be costly in the event of a claim. New changes in insurance standards can impact the availability and scope of coverage which could potentially result in coverage gaps, so we recommend that you periodically review your coverage and contract requirements with an experienced expert in the area. Recently, new additional insured endorsements hit the market which limit the coverage available to additional insured to the limits specified in the contract requiring additional insured coverage. This means that if a contract specifies limits lower than those actually purchased by the named insured, then the additional insured is unable to benefit from the additional coverage in excess of the contract limits. For example, if a construction contract requires a contractor to obtain only \$1 million in general liability coverage and provide additional insured coverage to the Owner, but the contractor buys a \$5 million policy, the limit applicable to the Owner is only \$1 million. Additionally, there is new language designed to limit coverage in cases where states have enacted anti-indemnity statutes. This may create some situations in which the insurance coverage is not sufficient to cover the indemnification obligation. In response to these changes, you may want to consider changing the way you specify insurance coverage, such as: (i) if possible, identifying the limits actually purchased by the downstream party and specifying those limits in the contract; (ii) specifying the older additional insured endorsements, which may be possible in certain cases for a limited time period; or (iii) including language specifying the limits with a qualifier that the limit available to the additional insured shall be higher if the named insured procures insurance with a higher limit. (Please note, however, that this approach carries some risk, as it is yet unclear whether a court would enforce it under the new law).

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5. How to win under new Environmental Considerations. Environmental considerations continue to impact the real estate industry. Companies seeking office space are increasingly drawn to LEED certified buildings. Many large companies even require minimum “green” standards as a condition to approval of rental space. For many reasons, homebuyers and renters are similarly interested in “green” construction methods and furnishings. In addition to an increasing awareness and concern about environmental considerations, people are increasingly aware of potential energy savings and health benefits provided by green products and procedures. Using (and promoting) low VOC materials, providing good air filtration and circulation, making efforts to minimize excess use of water and electricity, installing native landscaping and using energy efficient equipment and appliances can help to bring interested parties to your projects. Environmentally conscious design can also help to maximize revenues and result in cost savings over time. Other hot button topic of late are drainage and flood control measures, which can impact the design, engineering, landscaping and density of a new project. Although it hasn’t yet become widely used in the Chicago market, some parts of the country (including several in the Midwest) are adopting new standards requiring or incentivizing the use of permeable surfaces to improve drainage and limit runoff in new projects.

Although not an exhaustive list of current trends and opportunities, considering these factors could help you to position yourself as an effective and knowledgeable participant in the current marketplace.

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