



# Tips, Tricks, & Techniques for Updating Real Estate Development Agreements in 2010



**Grant McCorkhill & Tara Scanlon, Partners at Holland & Knight**

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# About the Webinar Speakers

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- Grant McCorkhill is a Partner in the Chicago office of Holland & Knight LLP and is a member of the firm's Real Estate Transactions Group and the firm's Retail Leasing and Development Group. Grant has been practicing law for over 22 years and is experienced in all aspects of real estate acquisitions, development, leasing and dispositions. He has worked with real estate developers, institutional investors, national tenants and municipalities on real estate development agreements for projects of all sizes, from large mixed use projects to single tenant stand alone developments.
- Tara Scanlon is a Partner in the Washington, D.C. office of Holland & Knight LLP, is a member of the firm's Real Estate Transactions Group and is a Co-chair of the firm's Retail Leasing and Development Group. Tara has been practicing law for over 19 years. She is experienced in negotiating Development Agreements in many different contexts. She has represented retail owners and developers in connection with development agreements with anchor tenants, both developers and institutional owners and investors in connection with development agreements in connection with complex mixed use projects, and Fortune 200 companies in connection with build to suit head quarter projects.

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# Overview

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Managing Existing Development Agreements: The current difficulties with leasing and obtaining capital are testing many of the assumptions that were made when parties entered into existing Development Agreements.

Heightened Demand for Accountability and Flexibility in New Development Agreements: Due to the uncertain times for real estate development, parties are no longer willing to enter into Development Agreements and rely on the good will of the other party to work out the details later. Each side is demanding more flexibility on their part and tighter obligations and remedies be imposed on the other.

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# What to Know

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- Financing Joint Effort by Developer and Owner.
- Due Diligence Period for Developer.
- Performance Bonds – Viability of Developer and Contractors.
- The impact of a receivership or mortgagee in possession.
- Impact on Fee calculations given longer development phase, how to treat accrued fees, promoted interests.
- Developer liability for project contracts and agreements, who signs construction and development agreements, what types of guaranties/ indemnities are customary.

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# 8 Most Important Sections to Update in 2010

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- Number 1 - Control over choosing Contractors.
- Number 2 - Milestones/ Owner right to Self-Help.
- Number 3 - Due Diligence Period for Developer.
- Number 4 - Rights to Terminate.
- Number 5 - Effect of delay/ loss of funding on Development Fees.

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# 8 Most Important Sections to Update in 2010

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- Number 6 - Impact of new equity on Developer equity stake or promoted interest.
- Number 7 – Developer’s and Owner’s contractual obligations and types of indemnification or security backing obligations undertaken by Developer.
- Number 8 – Anchor Tenant SDA – consistency between lease and SDA.

# What to Update

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- Control over choosing Contractors.
  - Because of dearth of construction work, the low bid may not be the best bid.
  - Developer needs control of choosing contractors if Developer is to meet Development Agreement requirements.
  - Owner needs to be assured chosen contractors are viable and can perform.
  - List criteria for an acceptable contractor in Development Agreement.

# What to Update

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## • Milestones/ Self-Help

- Owner needs right to self help if Developer fails to meet approval, construction, leasing and other milestones. Developer needs same rights if Owner fails to obtain financing or other Owner milestones.
- Self-help only after right to cure. Self-help paid through construction budget, not at expense of failing party.
- Self-help with no right to cure. Self-help paid at expense of failing party.
- Establish dispute resolution, alternative A if failure through no fault of performing party, but B if failure result of failure of performing party.
- Performance timing is crucial, so parties will want penalties for failure to perform.

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# What to Update

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- Due Diligence Period.
  - If Developer is concerned about viability of project, add provision for Developer to have contingency period to terminate if Developer determines project is not viable as agreed to.
  - Developer cannot be committed to price or milestones if contingencies to completion exist. For example, TIF financing, financing, environmental issues, approvals or leasing.
  - Developer cannot use due diligence period as excuse to renegotiate.
  - Outline specific limited enumerated contingencies which would give Developer right to fee increase of termination.

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# What to Update

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- Right to Terminate.
  - Remedies section needs to provide right to either party to terminate upon major defaults or failure of major contingencies including bankruptcy of either party or major contractor, failure/ withdrawal of financing, failure to meet major milestones.
  - Parties will want right to cure before termination occurs.
  - Timing is everything, right to cure could cause delay and jeopardize entire project.
  - Enumerate specific major contingencies which will grant unilateral right to terminate.

# What to Update

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- Development Fee structure and calculations
  - In some agreements, the fee was calculated based upon the budget in place at execution. Developer was then paid a monthly installment calculated based on dividing the total Development Fee per the budget by the number of months in the projected development phase.
  - Must have the right to adjust a monthly fixed fee if development phase is delayed and lengthened beyond expectations.
  - May want right to hold back greater percentage of fee until certain major milestones are met with project such as funding of construction loan, leasing thresholds etc.

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# What to Update

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- Development Fee structure and calculations (cont'd.)
  - Need right to adjust fee if elements beyond Developer's control materially expand scope of work.
  - Identify which elements that can expand time and scope are within control of Developer and Owner, to incentivize each party to control what they can. Also, discuss and agree which party will bear the risk for delays or cost increases beyond both parties control.

# What to Update

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## · Impact of New Equity on Developer

- In the current economic climate, many projects need more equity than originally anticipated in order to proceed.
- Need flexibility to restructure to meet demands of new equity investors.
- Need protections against dilution if that is the business deal.
- Need to understand the impact of a transfer of the asset to a new joint venture in which the original owner has an interest will affect any accrued fees or promoted interest.
- The parties need to clearly agree on the impact of an equity shortfall and draft that into the documents. What is neutral or fair will depend on the business deal.

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# What to Update

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- Developer execution of project contracts (ex. General contractors contract, development agreements with municipalities...)
  - In the past many institutional owners would require the developer to sign these types of documents as a way of insulating themselves from liability. With the increased uncertainty regarding debt and equity funding, this practice has become much more dangerous for Developers.
  - If Developer agrees to do this, Developer should require a list of the specific documents it will need to sign. It should require that Owner i) sign on as a guarantor of those obligations with direct liability to the other party to the agreements, ii) indemnify Developer for liabilities under those agreements, and iii) if necessary, provide adequate security or evidence of ability to honor those obligations.
  - Again, this will depend on the business deal between the parties, but it is essential that each parties expectations and obligations are clearly spelled out in the Development Agreement.

# What to Update

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- Anchor Tenant Site Development Agreements

- More and more deals that were signed are not making it to the finish line. The standard anchor tenant site development agreement has extensive obligations for the landlord/ owner to perform.
- Ability to condition landlord's performance of its work on tenant reaching the point of no return under its lease.
- Consistency between remedies and termination rights in the lease and the SDA.
- Self help and remedies if requisite landlord work is not done.
- Language requiring work to be performed in manner that meets tenant's specifications.
- Creating a construction schedule where neither party gets too far ahead of the other on their work on the site.

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# Case Studies

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- Case Study # 1 - Development Agreement between a developer and a municipality for a recreation center with retail component.
- Developer required ultimate choice over contractors to ensure viability, but each contractors had to meet initial threshold qualification testing before could bid.
- All contracts were in municipality's name and municipality was responsible for financing.
- Developer responsible for leasing so long as tenants met agreed uses and financial viability.

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# Case Studies

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- Case Study # 2 - Development Agreement for national retailer on land owned by retailer.
- Developer required due diligence period because Developer did not acquire land for retailer. Retailer required fixed cost development with a fixed fee for Developer.
- Developer fee provided Developer would retain all cost savings if project came in under budget.
- Retailer required hold-back for up to a year to ensure construction, punchlist and warranties.
- Established specific thresholds for release of holdback.

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# Case Studies

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- Case Study # 3 – Mixed Use Project which has lost construction funding due to failure to meet leasing thresholds
- Needed better language regarding adjustments to milestones and development fee in the event that financing was not available.
- Option to terminate agreement or continue with status quo, does not provide sufficient flexibility for either party.
- Language determining how to meet leasing thresholds worked well and allocated responsibility well.

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# Conclusions

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- **FLEXIBILITY** – Be mindful of how to handle disruptions in the plans for the project such as receivership, bankruptcy, new equity, new or additional financing, longer periods to lease up, get approvals or complete construction.
- **CONTROL MATCHES OBLIGATIONS** - Try to link obligations for insuring performance to the party who controls the decisions.
- **FINANCIAL STABILITY** – Create mechanisms to test and monitor financial stability of Owners, Developers, contractors and any other key parties.

# Before It's Too Late

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