

Behind the Deal: Omission of Two Little Words Almost Kills \$11M Deal

By Alex Finkelstein

Largo, FL—Buyer and seller were each rolling the dice. The apartment buyer defeased a mortgage and closed the transaction one day after the formal loan commitment was received. He would have lost more than \$1.5 million at the last minute if the lender hadn't come through. The seller would have lost a three-year, \$3-million profit. The buyer's 11th hour financing problem forced the seller to cancel his upleg exchange for a \$15-million multifamily transaction. The seller had all but formally signed a deal for the exchange, and canceling put up to \$250,000 in earnest money and costs in jeopardy.

All of the problems centered on the omission of two little words in a lender's document. The omission almost killed the \$11.11-million sale of the Whispering Palms apartment complex in Largo, FL, a deal that began with a letter of intent in Sept. 2005 and concluded in Dec. 2006, nine months later than expected.



Johnson

represented the buyer, says the transaction was "a learning experience for me. It was definitely one for the books."

After three scheduled closings, **Whispering Palms Condominiums LLC** of Miami Lakes, FL finally purchased the 21-year-old, 100%-occupied, 108-unit apartment community in Southwest Florida from **Amistef Largo LLC** of Englewood, FL for a less than replacement cost of \$102,960 per unit. The deal was originally expected to close in March 2006, based on the seller's servicer's assurance that a CMBS loan could be defeased after the second year from the date of securitization.

"Unfortunately, about three weeks before the March closing, the Kansas servicer notified the seller that the defeasance could not take place until Oct. 28, three years from the date of the original loan," Johnson says. The attorney, who had been contracted by the original California lender to write the loan documents in 2003 when the seller acquired the property, had included language not normally used in these notes, the broker explains.

The document stated the collateral for the loan could be defeased following the second year from securitization and three years from the date of securitization. Johnson says the "and" in the document should have read "or," or "and/or" from the date of securitization. "I specifically questioned that language before taking the listing and was told two years from defeasance,"



Whispering Palms

Whispering Palms Apartments

Location: 13200 Wilcox Road, Largo, FL
Number of units: 108
Constructed: 1985
Seller: Amistef Largo LLC, Englewood, FL
Buyer: Whispering Palms Condominiums LLC, Miami Lakes, FL
Price: \$11.11 million or \$102,960 per unit
Seller's broker: Darrell H. Johnson, Smith Equities Real Estate Advisors, Orlando
Buyer's broker: Lazaro C. Menendez, Fortune International Realty Inc., Miami
Defeased loan amount: \$5.3 million
Deal's significance: Erroneous language in loan document almost kills deal.

he adds. "As a concession for the bad information, the seller's servicer agreed to waive a defeasance charge of \$10,000 for the buyer, who was paying the defeasance bill." The mortgage loan that had to be defeased carried a balance of approximately \$5.3 million.

At this point, when the defeasance date was changed from March to October, "The buyer could have walked from the deal without loss or penalty of any kind, since the seller's lender had made the error," Menendez explains.

Meanwhile, between March and Oct. 2006, the multifamily market was gradually changing. "The market became more saturated with condo conversions and lenders were forced to pull back on both terms offered and, for the most part, on all outstanding unfunded commitments," Johnson continues. "Instead of the property being appraised as a condo conversion, lenders were pushed to value the property as an operating apartment complex. This cash flow-based valuation, which prevails today, caused the buyer to invest additional equity of about \$2 million to close."

All together, the buyer wound up putting roughly \$4 million into the deal, not including about \$500,000 defeasance, plus his agent's commission and a \$50,000 closing extension fee. The buyer's earnest money deposit, as the deal was approaching a final close, was \$1.1 million. Menendez confirms that had his client walked at this stage of the negotiations, he would have lost a considerable sum.

"I had protected my seller by insisting the buyer release from escrow \$500,000 to the seller when the contract was extended in March for a Nov. 2006 closing," Johnson explains. There also was an additional \$100,000 left in escrow. But in mid-September, "like many developers, the buyer lost his original loan commitment when all lenders pulled back," he continues. At this point, with 30 days until scheduled closing, the buyer "had the choice of walking away, losing \$600,000 or negotiating an extension" to a new closing on Dec. 15. "The seller's attorney, on my advice, made the buyer deposit an additional \$500,000, which it agreed to do, even though it did not have a firm loan commitment", Johnson says.

The buyer understood he was taking "a well-calculated risk" in staying in the deal at this point, Menendez explains. But because the buyer had been previously approved for a condo conversion loan in March 2006, "he felt confident in obtaining financing" for the new closing date, he tells *Debt & Equity Journal*. However, Menendez acknowledges his client didn't expect to lose his original loan commitment. "Although aware of the changes to come in how banks were writing new apartment conversion loans, the buyer was not prepared for how soon those changes would take place," he adds.

A California bank eventually provided the buyer with acquisition financing totaling about 70% of the appraisal amount. "Fortunately, this is an excellent condo conversion, as condo conversions go, and the buyer had the dollars to make it happen," Johnson says.

Menendez, who has represented the buyer on three other conversion deals without comparable financing snags, says the \$102,960 per unit price is the most his client has ever paid for a multifamily property. However, he says that "with soaring construction prices, you couldn't build it today for what the buyer paid. It's still a safe investment."

As the Whispering Palms transaction was nearing a close, another behind-the-scenes scenario was also unfolding. With Johnson acting as the broker, the seller, from the start, had been actively searching for multifamily deals from Atlanta to Ohio that would be suitable for a 1031 Exchange transaction. The seller finally located a \$15-million property in September, a month before the Whispering Palms deal was scheduled to close. While Johnson was negotiating the final pieces of the deal, the closing delay issue at Whispering Palms brought everything to a halt.

"Frustrated by the slow progress of the Whispering Palms closing and not wanting to put a large deposit at risk, should the down leg transaction ultimately fall apart, the seller decided to cancel any further exchange activity," Johnson says. Had the seller walked from the Whispering Palms deal, he would have lost about a \$3-million profit after owning the apartment complex for only three years. Johnson also represented the seller when he purchased the property in 2003. "I spent a lot of time and didn't earn a commission on the planned \$15-million exchange but that is the risk we all take as brokers," Johnson says. "With a happy client, there is always an opportunity for tomorrow."