

2015 CONSTRUCTION LAW SUMMIT
POWERED BY BRUNER & O'CONNOR ON CONSTRUCTION LAW

FAEGRE BAKER DANIELS

National Welcome
 Michael Lapicola, Partner
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**Unique Risks in Multifamily Construction:
 Risk Management Strategies for
 Today's "Red Hot" Market**

Shawn Doorhy, Attorney

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Multifamily Construction



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- ▶ Freddie Mac Multifamily Research Perspectives: 2015 Multifamily Outlook (Feb. 2015):
 - ▶ "Multifamily starts and completions are expected to continue their upward trend."
 - ▶ "The number of starts will continue to rise through 2015 and perhaps 2016."
 - ▶ "We expect completions to surpass the long-run annual average in 2015 and remain above the average for **several years to come.**"

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Multifamily Construction

- ▶ Freddie Mac Multifamily Research Perspectives: 2015 Multifamily Outlook (Feb. 2015):
 - ▶ "Multifamily rental housing fundamentals outperformed many market forecasts in 2014; **strong demand** absorbed the increased supply of new units introduced to the market."
 - ▶ "The amount of multifamily supply that will be delivered in 2015 will surpass pre-recession averages, but favorable demographics and a sturdier economy will produce another strong year for multifamily."

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- ▶ "By 2020, a surge of residential construction, mostly high-rent apartment buildings, will result in **as many as 30,000 residential units** in the area, according to projections by Downtown Indy, a public-private partnership that promotes activities and living in the heart of the city."
 - ▶ Indianapolis Star, Report: Downtown apartment market booming, with more units on the way, John Russell, (Feb. 25, 2015)



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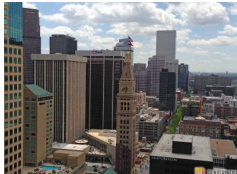
- ▶ "The second half of 2015 will welcome a slew of new deliveries around the metro area, with annual supply reaching roughly 5,500 units by year-end. **This elevated delivery schedule will continue into 2016** based on proposed and under-construction projects, testing vacancy and rent growth, particularly in the urban core."
 - ▶ Colliers International, Minneapolis - St. Paul: Apartment Market Report - Mid Year 2015



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- ▶ "A total of 6,273 multifamily residential units have been completed within a 1.5 mile radius of the iconic D&F Tower since January 2010. The historic tower's location at 16th and Arapahoe serves as a good geographic central point to Downtown Denver. **Another 4,556 units are currently under construction.**"
 - ▶ Denverinfill.com, Downtown Denver Residential Projects: June 2015 Update, June 12, 2015



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- ▶ "More than 3,100 housing units are scheduled for delivery in core Chicago submarkets in 2015, according to Colliers International, with an additional **6,400 units scheduled for completion in 2016.**"
 - ▶ Multihousingnews.com, Market Snapshot: Chicago Multifamily Demand to Outgrow Supply in 2015, (Feb. 26, 2015)



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- ▶ "The Chicago area multifamily pipeline's steady flow shows no signs of slowing in 2015."
 - ▶ Bisnow.com, CHICAGO'S 5 BIGGEST MULTIFAMILY DEVELOPMENTS (Jan 2, 2015)
- ▶ Chicagoagentmagazine.com, Multifamily Housing is Driving New Construction in 2015 (June 17, 2015)
- ▶ Chicagogmag.com, Condo Construction Is Back in Downtown Chicago (June 27, 2014)



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Multifamily Construction

- ▶ Conclusions?
 - ▶ Multifamily projects are a hot commodity
 - ▶ Mostly rentals
 - ▶ Condo construction is (coming) back following the Great Recession
 - ▶ Condo conversions are likely on the horizon
- ▶ Why?
 - ▶ Pent up demand following the Great Recession
 - ▶ Low interest rates
 - ▶ Rental rates high
 - ▶ Millennials

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Multifamily Construction Risks

- ▶ Observations from the lawyer's perspective:
 - ▶ Multifamily projects are afflicted by many of the same issues impacting other types of projects
 - ▶ Defects
 - ▶ Delays
 - ▶ Payment disputes
 - ▶ Warranty liability
- ▶ However, the risks are uniquely enhanced on multifamily projects

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Multifamily Construction Risks


- ▶ Why?
 - ▶ Increased likelihood of construction defects in multifamily projects
 - ▶ Water infiltration (windows, building skin & envelope)
 - ▶ Noise
 - ▶ Ventilation



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Multifamily Construction Risks


- ▶ Organized owner associations
 - ▶ Potential for a dissatisfied owner is amplified
 - ▶ Fiduciary duties to pursue developer, et.al.



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Multifamily Construction Risks

- ▶ Developer's role in setting budgets for condominiums
 - ▶ *Henderson Square Condominium Ass'n v. LAB Townhomes, LLC*, 2014 IL App (1st) 1307664 (1st Dist. 2014)



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Multifamily Construction Risks

- ▶ Lingering warranty liability
 - ▶ Statutory home warranties in some states
 - ▶ Implied warranties imposed by case law
 - ▶ i.e. implied warranty of habitability

Minton v. The Richards Group

Insolvent Builder-Vendor: The Richards Group of Chicago, Inc. (connected to Plaintiff via Purchase Contract)

Subcontractor: International Decorating, Inc. (connected to Plaintiff via a dashed line labeled 'Allowed Minton claim')

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Multifamily Construction Risks

1324 W. Pratt Condo. Ass'n v. Platt Constr. Group

Insolvent Developer-Vendor: 6801 N. Wayne, LLC (connected to Plaintiff via Purchase Contracts)

Solvent General Contractor/Builder: Platt Construction (connected to Plaintiff via a dashed line labeled 'Allowed Minton claim')

Subcontractor: EZ Masonry (connected to Plaintiff via a dotted line labeled 'Possible Minton claim if plaintiff establishes no recourse against Platt due to insolvency')

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Multifamily Construction Risks

- ▶ Project delays are more impactful
 - ▶ Units are pre-leased or pre-sold
 - ▶ Consequential damages can be enormous
 - ▶ Liquidated damages for delay may be inadequate
 - ▶ i.e. student housing
- ▶ Payment disputes can be more problematic
 - ▶ Is apportionment of a mechanic's lien necessary?

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Multifamily Construction Risks

- ▶ Potential for a condominium conversion in the future
 - ▶ Project participants may have priced the risk for a single owner apartment project, but a subsequent conversion exposes them to condo project risks
- ▶ Coordinating tenant improvements with ongoing construction
 - ▶ No privity with tenant's contractors
 - ▶ Schedule interruption

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Risk Management Strategies

- ▶ Risk management devices
 - ▶ Quality control
 - ▶ Contract terms
 - ▶ Insurance program



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Risk Management Strategies

- ▶ Quality Control:
 - ▶ Hire a third-party roofing and building skin inspector
 - ▶ Hire a third-party consultant for preparation of maintenance budgets



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Risk Management Strategies

- ▶ Limit warranties where possible
 - ▶ Carefully disclaim all implied warranties
 - ▶ Including specifically and by name the Implied Warranty of Habitability
 - ▶ Note specific features of disclaimers required in each jurisdiction
 - ▶ Offer express limited warranties instead
- ▶ Ability to do this may be constrained by statute
- ▶ Consider recording in the land records a notice that implied warranties have been waived

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Risk Management Strategies

- ▶ Require notice and an opportunity to cure
 - ▶ May be required by statute in some jurisdictions



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Risk Management Strategies

- ▶ Regulate claims procedures:
 - ▶ Threshold level of unit owner approvals to bring a claim
 - ▶ Alternative dispute resolution provisions
 - ▶ Ensure dispute resolution procedures are consistent for all project participants
 - ▶ Certificate of merit
 - ▶ Shorten the statute of limitations by agreement
 - ▶ Claim waiver if procedure not followed

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Risk Management Strategies

- ▶ Protect against condo conversions
 - ▶ Require of indemnity if there is a conversion
 - ▶ Require that any conversion must contain claim regulation provisions

- ▶ Indemnity provisions need to be carefully drafted to be enforceable
 - ▶ "Anti-indemnity" laws differ in each jurisdiction

- ▶ Attorney fee shifting provisions
 - ▶ For enforcing indemnity obligations
 - ▶ For enforcing alternative dispute resolution provisions

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Risk Management Strategies

- ▶ Liability limitations
 - ▶ Consequential damages waivers
 - ▶ Liability caps

- ▶ Adequate and properly obtained insurance
 - ▶ Additional insured endorsements to CGL policies
 - ▶ Certificate of insurance may be inadequate
 - ▶ Consider a Controlled Insurance Program
 - ▶ OCIP/CCIP

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HARDIN

"We've considered every potential risk except the risks of avoiding all risks."

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