

The pitfalls on the real estate market at a time of recession



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Developers constitute the group that has to solve the biggest problems today. On the market of real estate investments, the crisis manifested itself in 2008 in the form of limited business transactions, and some time later banks, under the pressure of circumstances, virtually stopped providing any credits for costlier projects. Of course, credits are still provided, but the conditions are much tougher for loan applicants than in the past - the banks insist that a significant portion of the investment has to be covered from the developer's own resources and require a high share of the flats in each project to be sold or rented before construction itself. "We're virtually getting back to the budgets and financing structures of the late 1990s. Only safe projects will be funded, which will balance supply and demand. As regards development projects, it is also possible that we will return to guarantees for advances on preliminary sales," Pavel Kühn, from the Development Centres Department of Česká spořitelna, ponders.

Magical MAC clause

However, what else can developers do when they find out that they do not have enough money for the project? Disregarding a loan, another option is to persuade a new partner to enter the project. It is necessary to consider the benefits and risks of this step. Another alternative is to sell the project, but this depends fully on the current supply and demand and requires a thorough legal, financial and technical audit.

One of the last options to face a shortage of money is to conserve the project. It is essential for this option to stipulate suitable provisions in the related contracts. The so-called MAC clauses and their incorporation in contract documents are a useful instrument here. „A MAC clause gives the party the right to terminate the contract unilaterally if a certain negative circumstance occurs. This refers to any material adverse change in assets, payables or market conditions that occurs during the term of the contract. At present MAC clauses are appearing in a growing number of contracts. Their final form depends largely on the communication abilities of both parties and in general their use is considered an indicator of market uncertainty,“ explains Aleš Klech, lawyer of the law office Havel & Holásek. According to him, the times when the developer was the absolute master of the project are coming to an end.

New bankruptcy law - real threat

The new Bankruptcy Act, which came into force at the beginning of this year, is not a mere amendment, but a completely new legal instrument that changed over 120 existing regulations. The positive impact of this step is generally recognised, but according to some people the new law has innumerable weaknesses as well. Ivan Barabáš, of Havel & Holásek for example points at the persecuting petition in insolvency, which could cause huge reputation problems to the enterprise. And we have already seen several such cases. The thing that a petition in insolvency can be virtually filed by anyone, even without any explanation, and the court is obliged to publish this fact on the Internet within two hours and has to start acting in this respect. „In combination with the media, this kind of petition could completely bring the enterprise down. The only defence is a rapid massive campaign directed at strategic partners, banks and other stakeholders. It is also possible to file an action for a compensation of damages, but if the company goes under, the compensation won't help the company any more,“ Barabáš warns.

In today's hard times, a good knowledge of the right of lien can often rescue property owners. This right has many specific features whose knowledge can help you avoid many problems if the value of properties is falling, just like the enterprise's or the household's solvency. It is important to bear in mind that declining prices of properties can affect the value of the pledge. In consequence of its reduction, the pledger should provide an additional loan security without undue delay, because the pledger's lower financial standing has no effect on the scope of guarantee. „It's important to verify the effects of the recession on the value of the pledge, to analyse receivables past maturity or to find out if there are any disadvantageous provisions in the contract. Forward-looking negotiations with the bank and an agreement on another change if the property's value grows again are also of importance,“ Tomáš Běhounek, lawyer of bnt- pravda & partner, recommends.

10.02.2009 08:00, Vítězslav Fejfar