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Risk Management

Know When to Walk Away From the Ideal Deal

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Every developer has looked longingly into the eyes of a potential deal that appears just too good to be true. Sure, there are challenges, but if the zoning board grants the necessary variances, if the bank extends the line of credit ever so slightly and if the designers, contractors, subs and suppliers do exactly what they're supposed to do when they're supposed to do it, then this deal just may be that special something you've been waiting for all your life. If all of these "ifs" go your way, this deal will catapult your company to the next level of prestige, power and profit margin. But what happens if they don't?

Although the temptation to gloss over the risks involved in a deal is great, it is important to be realistic and fully informed before proceeding. Like any healthy relationship, the marriage between the developer and the deal needs to be carefully evaluated before it is made official. Unless it is the right fit, the consequences can be dire.

Play Hard to Get

Even when a project is competitively bid, the prudent developer takes his or her time to review the deal and to look past superficial features to get to know its positive and negative attributes. The location may seem perfect, but are the existing utilities sufficient to support the project? The demand for a condominium development in the area is high, but do the local zoning ordinances restrict the availability of multi-family dwellings? The contractor's bid is fair and has a track record that sparkles, but does he or she have the horsepower to complete a job of this size on time?

Wishful thinking and first impressions must be substantiated with thorough research and critical analysis. Become familiar with local building department practices and protocol. Investigate all pertinent environmental and site challenges. Examine your contractor's capabilities and contact their references. Run the numbers and then run them again. This takes time and may require you to incur front-end costs, but knowing what you're about to get into is well worth the investment and may save you substantial money down the line.

Get Those Sweet Nothings in Writing

During the pre-deal dance, the respective parties are typically on their best behavior, telling each other what they want to hear in order to get the deal inked. The engineers tell you the existing sewer is sufficient and that a more costly wastewater treatment facility isn't necessary; the contractors tell you 12 weeks is more than enough time to get to substantial completion; the architect assures you that the design will sail through the permitting process. Hope may spring eternal, but most banks don't accept hope as a form of currency to repay a construction loan.

Try to allocate the risks of something not going as promised onto the party making the promise. Smart contract drafting is the key to risk allocation. If the site contractor tells you not to worry about the possibility of a ledge slowing down construction, draft your contract so that he or she is solely responsible for all delays caused by ledge removal. If the awarding authority's surveyor tells you the site has public water lines, ask for stamped drawings confirming their existence and precise location. If the contractor promises job completion by a certain date, negotiate a strong liquidated damage provision that addresses the contingency of unjustified delay. Likewise, exercise restraint when making promises. Have independent verification to support any claim you make during the negotiation process. No matter how compelling your story sounds when you request an extension of your line of credit, there is not a lender or surety in business who will grant it without thoroughly evaluating your books and records.

Look in the Mirror One Last Time

The undoing of a deal is often the result of developers not being honest with themselves about their own capabilities, or lack thereof. There is a big difference between being the developer you want and hope to become and being the developer you are presently. It may be that a given deal is perfectly suited for the former but couldn't be a worse idea for the latter. The question when evaluating a deal is not simply whether the deal is right for your company, but whether your company is right for this particular deal. While growth necessarily involves pushing yourself out of your comfort zone, you must be prepared to admit when the object of your desire is simply out of your league.

Don't Be Afraid to Break It Off

Maybe it is the right deal, but simply the wrong time; maybe everything seems right but something is just nagging at your gut, telling you problems lie ahead. For many developers, the most successful projects are the ones they decided not to build. It takes more business savvy and foresight to walk away from a deal that isn't right than to take on a project that is perfect.

Too often, developers view their initial estimating and project evaluation costs as a nonrefundable deposit obligating them to go forward with the project, even if it is not in their long-term best interest. A smarter perspective is to view such assessment costs as a necessary investment in the long-term viability of your company.

In the highly competitive, catch-as-catch-can world of commercial real estate, developers often leap before they look at great financial risk. Take the time to get to know the inner workings of the deal. Get promises, expectations and assumptions confirmed in writing. Be realistic and honest about your own capabilities, schedules and costs. And don't be afraid to jump ship if everything doesn't feel right. If the deal of your dreams seems too good to be true, it just might be too good to be true. ■

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