

REAL ESTATE

Jimmy Holmes: Lastly, we have Frank Ruttenberg, Partner with Haynes and Boone, LLP. Frank, you are a transactional lawyer with a practice in real estate law. What do you see as some of the challenges facing the San Antonio real estate market?

Frank Ruttenberg: Like much of the state of Texas, San Antonio has been experiencing a prolonged period of increasing values and prosperity in the real estate industry. For those of us who have been in the industry for a while, we know that real estate is cyclical, and a robust market will, at some point, go through a slow down or correction. When this occurs, it is inevitable that legal issues will arise. The good news for those of us who live and work here in San Antonio is the fundamentals driving the success of our real estate boom are continuing to strengthen. For those who felt a bust in the cycle was imminent, it seems all indications are this will not occur in the immediate future. With all this good fortune, you might conclude legal issues relating to real estate matters may be on the downturn. However, due to the frenetic nature of the real estate market, there seems to be no shortage of legal disputes in this area of the law. There is plenty of room for people to make good investments in real estate in San Antonio, but they need to avoid making costly legal mistakes.

Holmes: What are some of the most common legal mistakes you have seen clients experience?

Ruttenberg: While legal disputes come in all shapes and sizes, in my 37 years of experience they usually can be traced back to one of three sources, not doing your homework as to the property you are buying or leasing, not understanding and documenting the business deal you are making and, if you have partners in your investment, not doing your homework on the partners and properly documenting your relationship with your partners.

Holmes: Can you share with us some of way to avoid these problems?

Ruttenberg: With real estate you must do your due diligence on the property. You have to have title reviewed, review any applicable restrictions on use, obtain a good survey of the land and improvements, an environmental audit, and a thorough study of the improvements as to their condition and their compliance with the law. Your contract should also require the seller to provide information they know of the property that would be helpful for your review. Many of these same issues are important even if you are only leasing the property. Every one of these steps is important. Missing any one of them, or taking a shortcut, raises the likelihood of a mistake. Since most people who purchase or lease real estate do so somewhat infrequently, they need to have the help of professionals such as title companies, surveyors, engineers and, yes, real estate lawyers to help with this process. We have all watched the shows about flipping houses. It seems they are now on every channel at all times of the day and night. They make the process look fun and exciting, even when they find a costly surprise. We all know friends who have gotten involved in a real estate transaction and discovered a costly surprise after the fact. Maybe we have even experienced this ourselves. While it's fun to watch on TV, we know it is not fun or exciting and can be very costly and raise the possibility of serious legal disputes. Good documentation with professionals who can guide you through this process will help to avoid that scenario.

Also, do not underestimate the importance of confirming that your use of the property will comply with all laws. Often people see that a piece of real



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Frank Ruttenberg discusses legal issues affecting the real estate market in San Antonio.

property is currently in use and conclude that if the current use is OK their use will be OK too, so why check with the authorities. Current uses may be grandfathered so a change in the law does not affect a use. When the change in use occurs, this may trigger a need to alter the property to be in compliance with all laws. Getting a letter from building inspectors, after the fact, which requires very expensive changes to the real property, is never a pleasant experience.

Holmes: You mentioned that another mistake often made is not documenting the business arrangement. Can you talk a bit more about that?

Ruttenberg: There is a common saying in the real estate industry. "You make your money on real estate when you buy it, not when you sell." This is a short way of saying you don't want to overpay for real property. When you buy or lease real estate, it is important to know the nature of the asset so that you can determine its value. Mistakes are made in real estate when there are surprises, and these surprises often lead to disputes. You can get some assistance from third party appraisers. However, appraisers will tell you the value of property based, in part, on historical comparables, current replacement costs and, where appropriate, current income projections. What an appraisal may not reflect is where the market may be going for this property in the future and what influences may affect future value, such as the neighborhood, market conditions, and added value you may create through your hard work and efforts. To avoid legal mistakes, spend time getting to know what is taking place around the property and consider what influence this may have on the value of your investment. Make certain these matters are addressed in your analysis of the property and, if appropriate, in the contracts relating to your transaction. Remember, each piece of real estate has unique qualities. You need to have looked at the market and studied the unique nature of the property and other possible influences to fully understand the nature of the deal you are making. You then need to make certain your documents for the transaction properly reflect that business deal.

Because real estate is a capital intensive investment, an owner may also have to incur mortgage debt as a part of the transaction. Just as it is important to understand the economics of the real estate asset, you also need to understand the terms and conditions of your financing. This includes understanding when a default to the lender can occur, and what can cause the economics of the loan to change. As we pass through the 10th anniversary of the economic recession of 2008 and recall the impact of the subprime loans, it is a stark reminder of just how important understanding you're financing can be.

When we help clients build their business relationship, we stress the need for a complete understanding of what each party is bringing to the table and what their expectations may be. All of the parties understand life will change and plans will need to be altered, but if the parties have a clear understanding of how these changes are to be addressed and who is responsible for them, the parties can better manage their expectations. We have found that when parties do not take the time to address these issues up front, there is a much greater likelihood for disputes in the future. It is not always easy to go down this path. Typically, the clients are thinking about the upside of the deal, as well they should. However, we all know that relationships have a way of changing as time goes by. Recognizing that will occur, discussing the possible impact changes may have on the business deal, and planning for change in advance always seems to provide a better result.

Holmes: Frank, any other suggestions for avoiding legal pitfalls in real estate transactions?

Ruttenberg: As I mentioned earlier, we are in a very extended upward cycle in real estate. Often, when the market is good for a long period of time, it is easy to skip over some of the analysis or protections and planning that might be helpful in a more difficult market. People will take shortcuts because the market is there to bail out small mistakes. As our friends in the retail sector are aware, even in the best of times, there are dynamics that can quickly cause a market to throw you some curveballs. It's important to put in the work on your real estate transactions; that is, do the due diligence on the property, fully understand and properly paper the economics of your deal, and if you invest with partners, talk about the beginning middle and the end of the investment to make certain your investment goals match. With proper planning and a game plan for managing expectations, real estate investments have always proved to be the very best and most rewarding investment a person can make.

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