

Preparing a
**Commercial
Real Estate
Purchase**

THE INS AND OUTS FOR THE SELLER AND PURCHASER

Introduction

Preparation of a commercial real estate purchase agreement can be a daunting task for the inexperienced. When signed, its terms should embody the entire agreement; in fact, the agreement should contain language indicating that the document sets forth the entire agreement.¹ While the parties may have a general understanding of the terms of their deal, the preparation and negotiation of the purchase agreement is where the specifics of the transaction are worked out. During this stage, the experienced attorney can craft the transaction to provide economic and logistical benefits to his or her client. This article highlights a few important aspects of the standard commercial real estate purchase agreement from both the seller's and purchaser's perspective.

From the outset, it is important to remember which side of the transaction you represent and the bargaining strength of your client. Commercial realities aside, the seller will want to bind the purchaser to close immediately without providing any representations or warranties. On the other hand, the purchaser will want unlimited time to review the physical, environmental, and legal condition of the land, and not be bound until ready to close. In reality, neither side will get everything they want; however, the parties' bargaining power will determine how far the scale slides.

Typically, the purchaser's counsel will prepare the initial draft of the purchase agreement. As the purchaser's attorney, you should ensure that your client has an adequate opportunity to conduct a property inspection without interference, and that you have sufficient time to review title. Additionally, if your client discovers problems with the land or is otherwise dissatisfied for any reason, you should make sure the transaction can be terminated without any financial detriment to your client.

If the property is located in a rapidly developing market or there are multiple interested purchasers, the seller's attorney may prepare the initial draft agreement. This may result in an agreement favoring the seller, with minimal seller's warranties, short due diligence, and larger earnest money deposits that go hard or become non-refundable to the purchaser soon, if not immediately, after the execution of the agreement. Negotiation often includes disclosure of sensitive materials. To protect the seller in the event the deal falls apart, you should consider including confidentiality provisions.

Earnest Money Deposit

The deposit serves multiple purposes. First, it may act as a condition to, or consideration for, entering into the contract.² Second, it provides a real incentive for the purchaser to timely review due diligence materials. Finally, it can serve as liquidated damages for the seller if the purchaser breaches the agreement. Conversely, stating that the purchaser is entitled only to a refund of the earnest money deposit if the seller defaults may limit the purchaser's ability to obtain specific performance of the agreement.³

The earnest money deposit is typically delivered by the purchaser upon entering into the purchase agreement or shortly thereafter. Although it is common to have a separate escrow agreement, the responsibilities of the escrow agent may also be spelled out in the purchase agreement. By drafting the agreement, you can determine who will hold the deposit in escrow. As counsel representing either party, you will want the terms of the deposit, such as how the deposit is applied, when it is delivered to seller or returned to purchaser, and whether it will be held in an interest bearing account, to be spelled out in detail. If you are acting as escrow agent, you will want to make clear your duties and obligations, as well as provide for an indemnity and hold harmless provision.

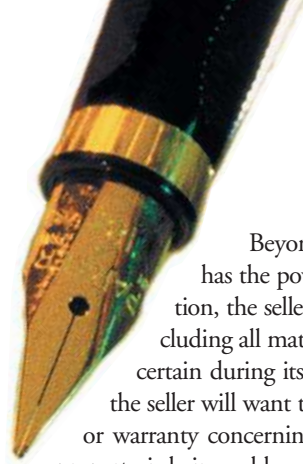
The usual practice is for the deposit to be non-refundable to the purchaser after the expiration of the physical inspection or due diligence period; however, this may be modified based on the parties' bargaining power. If the purchase agreement allows the purchaser to extend the due diligence period, additional deposits may be required.

Due Diligence

The period of time for the purchaser to inspect the property is often very heavily negotiated. The longer the period of time the purchaser has to inspect the property and perform its due diligence, the less the purchaser has to rely on the seller's warranties. Typically, the purchaser will have at least 30 days to examine the property. When drafting the agreement, you should be very clear what triggers the beginning of the inspection period; usually the trigger is the purchaser's receipt of a survey and commitment for title insurance. You may also want to include a separate environmental review period, triggered by the purchaser's receipt of an environmental property assessment.

BY RONALD S. MELAMED AND EDWARD S. GUSKY

Agreement



The purchaser may raise objections to title or the condition of the property prior to the end of the due diligence period. When representing the seller, make sure that the purchase agreement requires that objections be in writing and that the seller shall have a period of time to cure. If the seller does not cure the objections raised by the purchaser, as purchaser's counsel, you will want the option of terminating the purchase agreement and receiving a full refund of all earnest money, or waiving the objections and closing anyway.

Recently, in states where the "land bubble" has been expanding the fastest, such as Arizona, Florida, Nevada, and Virginia, sellers have great bargaining strength. This has allowed sellers to negotiate agreements where a large portion of the earnest money becomes non-refundable with little or no due diligence periods, and a limitation of the seller's warranties to matters of title only. How purchasers will adjust to absorbing these risks for undeveloped property, and whether the land bubble will burst or only slowly deflate, remains to be seen.

Representations and Warranties

Due diligence and representations and warranties are inversely related. The longer the due diligence period the purchaser receives, the less representations and warranties the seller will give, while the shorter the inspection period, the more representations and warranties will be required of the seller. Thus, in addition to knowing that the seller has all requisite power and authority to enter into the transaction, the purchaser will want representations and warranties covering those matters that the purchaser may not be able to ascertain from its due diligence investigation. Such matters include seller's representation that there are no unrecorded liens on the property, there is no pending litigation or judgments against the seller, there are no outstanding leases or other parties with any rights in the property, the property is in compliance with all laws and ordinances (including zoning), there is no environmental contamination on the property, and that all information given to the purchaser by the seller is true and accurate.

Many of these matters will overlap with the items the title insurance company will require the seller to cover in an owner's affidavit given by the seller to the title company at the closing. It is very important for the purchaser to get strong representations and warranties by the seller in the purchase agreement, and to not simply rely on the title insurance for the condition of the property. This is true because claims made on the title insurance policy may take a long time to process, and may face significant resistance by the title insurer. Finally, title insurance does not cover environmental matters, such as if the seller had underground storage tanks on the property.

Fast Facts:

It is important to remember which side of the transaction you represent and the bargaining strength of your client.

The commercial real estate purchase agreement should contain language indicating that the document sets forth the entire agreement.

The preparation and negotiation of the purchase agreement is where the specifics of the transaction are worked out.

Beyond requiring the purchaser to warrant that it has the power and authority to enter into the transaction, the seller's concerns are going to be centered on excluding all matters that the purchaser should be able to ascertain during its due diligence investigation. Consequently, the seller will want to minimize or eliminate any representation or warranty concerning environmental matters. Moreover, if the property is being sold as-is, the warranty of the property's condition should be specifically excluded. The seller may also want to limit its representations and warranties only to those matters of which it has received written notice.

A hot topic of negotiation is the survival of representations and warranties post-closing. Generally, pursuant to the merger doctrine, delivery of a deed operates as a satisfaction and discharge of the terms of the purchase agreement.⁴ The merger doctrine is subject to exceptions,⁵ and use of a survival provision will enable the preservation of a claim under the representations and warranties section of a purchase agreement. In representing the purchaser, you will want some representations and warranties to survive indefinitely, including matters pertaining to title and the seller's authority. The seller's attorney will want a short survival period (typically six months to two years), especially for claims relating to the physical condition of the property.

Remedies

The remedy section of the agreement is another area that is heavily negotiated. If the seller breaches, the purchaser will want to be entitled to specific performance, as well as all other remedies available at law. Considering that the purchase agreement is an embodiment of the mutually agreeable terms for the transaction, a seller's attorney should require that any specific performance be on the terms, and in full satisfaction of, the purchase agreement.

In the event the purchaser breaches, typically the seller's remedy will be limited exclusively to the deposit. Thus, it is very important for the deposit to be significant enough to compensate the seller for the time the property is off the market, and to deter the insincere purchaser.

No matter how precise you may be in your drafting, there may come a time when a deal goes sour. If you drafted the agreement, the other side may try to use that fact against the interests of your client.⁶ Therefore, the drafter should always attempt to define how the contract will be interpreted.⁷

USA Patriot Act

Executive Order 13224 (Order) mandates blocking "all property and interests in property" of those persons designated as Specially

Designated Nationals (SDNs) or blocked persons. In addition to blocking an SDN's right to hold and acquire interest in property, the Order also prohibits any transaction dealing in property or interests in property. A purchase agreement clearly qualifies as such a transaction. Therefore, a seller must be diligent in making sure the purchaser is not an SDN. A full and comprehensive list of all SDNs is published by the Department of the Treasury, Office of Foreign Assets Control (OFAC) and can be found on their website.⁸

The penalties for violating the Order range from civil to criminal and can be quite harsh.⁹ These penalties may be mitigated or waived based upon the circumstances.¹⁰ When representing the seller, it is vital that you ensure the seller obtains sufficient information concerning the purchaser's identity.

Due to the lack of definitive standards for compliance, simply including a representation and warranty in the purchase agreement that a purchaser is not an SDN may not, by itself, insulate a seller from liability. It is recommended that the purchase agreement also requires the purchaser to certify its full and complete name (including all assumed names and aliases) and provide its employer identification number or social security number to the purchaser.¹¹

It is important for the seller's attorney to advise the seller that the above representation and certification alone does not guaranty compliance. The seller (or seller's attorney) should then compare the purchaser's identification with the OFAC's list. In the event of a possible match, the seller should evaluate the quality of the match and contact the OFAC's Compliance Programs Division at 1-800-540-6322.

Conclusion

Preparation of the commercial real estate purchase agreement provides an essential outlet for negotiation and clarification of terms of the transaction that your client may not have considered when he brought the deal to you. Attention to detail is vital. ♦

Ronald S. Melamed is an associate at Evans & Luptak, P.L.C. in Bloomfield Hills, Michigan. His areas of practice include real estate development and finance, corporate law and finance, and commercial transactions. Mr. Melamed has acted as counsel for numerous residential and commercial developers nationwide. He is a member of the State Bar of Michigan's Business Law and Real Property Law Sections, and Publications and Website Advisory Committee.

Edward S. Gusky is an associate at Evans & Luptak, P.L.C. in Bloomfield Hills, Michigan. His areas of practice include real estate development and finance, corporate law, and commercial transactions. His experience in real estate includes representing developers of multifamily housing projects, assisted living facilities, and condominiums. Mr. Guskky has extensive experience representing borrowers and lenders in connection with multifamily loans insured by HUD/FHA under sections 221(d)(4), and 223(f) of the National Housing Act.

Footnotes

1. "This Agreement constitutes the entire agreement between the parties and all prior discussions, negotiations, agreements, representations or warranties are merged into this Agreement."
2. See the recent unpublished opinion, *EJS Properties LLC v Ferguson*, 2004 WL 257257 (Mich App 2004).
3. See the recent unpublished opinion *JR Development Company v Hamame*, 2004 WL 1124817 (Mich App 2004).
4. *Chapdelaine v Sochocki*, 247 Mich App 167, 171; 635 NW2d 339 (2001).
5. *Id.*
6. *DeMello v McNamara*, 178 Mich App 618, 623; 444 NW2d 149 (1989).
7. A sample of such a provision is:

Each party acknowledges and agrees that it has consulted competent legal counsel in connection with the negotiation of this Agreement and that it has bargaining power equal to that of the other party in connection with the negotiation and execution of this Agreement. The parties agree the rule of contract construction that an agreement shall be construed against the draftsman shall not apply in the construction or interpretation of this Agreement.

8. <http://www.treas.gov/offices/enforcement/ofac/sdn/>.
9. The penalties include civil penalties of up to \$1,000,000 per violation, as well as jail terms of up to 10 years for individual violators 31 CFR 501.701.
10. 31 CFR 501.703.
11. An example of such a provision is:

Purchaser is not named, and is not acting, directly or indirectly, for or on behalf of any person, group, entity, or nation named by the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, Pub L 107-56, 115 Stat 272 ("USA Patriot Act"), Executive Order #13224 or any other Executive Order or the United States Treasury Department as a terrorist, "Specially Designated Nation and Blocked Person," or other banned or blocked person, entity, nation, or transaction pursuant to any law, order, rule or regulation that is enforced or administered by the Office of Foreign Assets Control. Purchaser is not engaged in this transaction, directly or indirectly on behalf of, or instigating or facilitating this transaction, directly or indirectly on behalf of, any such person, group entity, or nation.

Purchaser's full, legal, and complete name(s) is/are _____ . Purchaser is not known as, and does not employ any other names or aliases. Purchaser shall deliver to Seller such proof of identity that Seller may reasonably require.

FROM THE OUTSET, IT IS IMPORTANT TO REMEMBER WHICH SIDE OF THE TRANSACTION YOU REPRESENT AND THE BARGAINING STRENGTH OF YOUR CLIENT.

IN REALITY, NEITHER SIDE WILL GET EVERYTHING THEY WANT; HOWEVER, THE PARTIES' BARGAINING POWER WILL DETERMINE HOW FAR THE SCALE SLIDES.