Article

Negotiating Real Estate Purchase Agreements

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The buyer has identified the property and initially underwritten the acquisition. It is now time to negotiate the purchase agreement, inspect the property and close the transaction. Understanding key provisions in real estate purchase agreements helps in negotiating the most favorable deal.

The purchase agreement must be in writing, signed by the parties and contain a description of the property in order to be enforceable. It is also important to have a good description of leases and service contracts. Any leasing costs that the buyer is to assume after closing should be specified.

Most purchase agreements require that the buyer deposit in escrow with the title company a sum of money called the "earnest money" which serves as both an expression of the buyer's interest in the property and a source of funds for the seller to retain if the buyer defaults. The earnest money is usually not at risk until the end of an inspection period during which the buyer performs due diligence on the property. In some states, the inspection period has been construed as an option requiring consideration independent from the earnest money.

During the inspection period, the buyer will review a title commitment and survey and obtain an environmental report. A title commitment contains a search of the deed records and discloses record ownership of the property and identifies any encumbrances on title. The survey contains a pictorial drawing of the property and should depict the encumbrances shown in the title commitment. It is important to review the title commitment and survey together. A utility easement in the title commitment may look harmless, but the survey may show that it runs through the middle of a building. An environmental report prepared by an environmental consultant identifies environmental issues and also provides the buyer with certain defenses to liability under federal environmental laws.

The buyer will want estoppel certificates from existing tenants of the property. An estoppel certificate is a signed statement from a tenant confirming the lease documents and verifying the terms of the tenant's lease. If a tenant executes an estoppel certificate, the tenant will later be legally prevented from claiming that the terms of the lease are different from those stated in the estoppel certificate. The estoppel certificate may also provide a defense for the buyer against a post-closing claim by the tenant that it had a side or oral agreement with the former seller/landlord.

The buyer will want approval over how the property is operated in order to make sure that no below-market leases or new service contracts are executed or unwanted capital improvements are made. The extent of the buyer's approval rights generally depends upon whether the inspection period has expired and the buyer's earnest money is at risk. Prior to the earnest money being at risk, the buyer typically has less approval rights; and once the buyer's earnest money is at risk, the buyer is accorded greater approval rights.

The seller will want to sell the property with limited representations and warranties, while the buyer will want greater disclosure of issues. The parties will negotiate whether the representations and warranties are to be qualified to the knowledge of only certain individuals, the length of time they will survive closing and whether the liability of the seller for breaches will be limited to a capped dollar amount. If the seller is a special purpose entity without assets other than the property being sold, the buyer may require that a parent company guarantee or post-closing escrow of a portion of the purchase price provide credit support for any post-closing claims of the buyer.

Purchase agreement remedies for default are negotiable. If the buyer defaults, the seller typically retains the earnest money as its sole remedy. If the seller defaults, the buyer is often given the choice of either terminating the contract and receiving the earnest money back or suing for specific performance. The buyer will negotiate for the right to recoup its due diligence costs from the seller up to an agreed upon dollar amount. If remedies are to be limited, the purchase agreement should clearly state this intention, otherwise a court may construe the list of remedies to be permissive as opposed to exclusive.

Most purchase agreement issues can be successfully resolved. Market conditions and leverage determine the outcome of many of the provisions. Good communication between the parties throughout the process helps in achieving a successful closing.

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