

Article

Commercial Real Estate Contracts Keep Buyers, Sellers On Same Page

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Although commercial contracts are more complex, the same concepts generally hold true as in buying and selling a home.

In selling a home, the seller wants a substantial deposit from the buyer, does not want to make representations about the home that will get him in trouble later, and wants to walk away from the closing without liability. The seller does not want the buyer coming back later alleging that the condition of the roof was misrepresented and asking for a new roof. On the other hand, the buyer wants to deposit as little money as possible, wants to know about problems in advance and wants to make sure that the home received at closing has no surprise problems.

Understanding key provisions in a commercial contract helps in negotiating the most favorable deal.

- **Property description.** The real estate contract must be in writing, signed by the parties and contain a good legal description of the real property. It is also important to have a good description of leases, service contracts and personal property. Any exclusions from the sale need to be addressed. For example, the rights to architectural plans may be owned by the architect rather than the seller. The seller may also want to exclude its trade name.
- **Earnest money and inspection.** Earnest money, which serves as a pool of funds for the seller to retain if the buyer defaults, is often not at risk until the end of an inspection period. In Texas, a contract with an inspection period is a form of option that is not enforceable without some type of consideration changing hands, so a sum of money in addition to the earnest money is typically paid to the seller.
- **Title and environmental.** Contracts generally allow a buyer to review a title commitment and survey and to obtain an environmental report. A title commitment contains a search of the deed records and discloses record ownership and any encumbrances. The survey drawing should depict the encumbrances. It is key to look at the title commitment and survey together. The 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 detects environmental issues and also provides the buyer with certain defenses to liability under federal environmental laws.
- **Estoppel certificates.** An estoppel certificate is a signed statement from a tenant that confirms the lease documents and material terms of the tenant's lease. The certificate may provide a defense to the buyer in a post-closing lawsuit by a tenant claiming that it had a side deal with the former seller/landlord to change the terms of its lease.
- **Operating covenants.** The buyer will want approval over how the property is operated to make sure that no costly capital improvements are made and no below-market leases or new service contracts are entered into. Prior to the earnest money being at risk, the buyer typically has less approval rights. Once the buyer's earnest money is at risk, the buyer is typically accorded greater approval rights.
- **Representations and warranties.** The seller will generally want to sell the property with limited representations and warranties, while the buyer will want more in order to flag issues. The parties will also often 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, whether a parent company guarantee or post-closing escrow of the purchase price will stand behind them and whether there will be a cap on potential recourse against the seller for breaches.

- **Remedies.** Contract remedies for default are negotiable. If the buyer defaults, the seller is often allowed to retain the earnest money. 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. Buyers often negotiate for the right to recoup out-of-pocket inspection costs in addition to the return of the earnest money. If remedies are to be limited, the contract should clearly state this intention, otherwise a court may construe the list of remedies to be permissive as opposed to exclusive.

Market conditions and resulting leverage drive the negotiations of many contractual provisions. If there is good communication between the parties, reasonable compromises can be made. The seller can hopefully obtain a fair price for the property, while the buyer obtains a property that he wants and in the condition that he expects.

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