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CAVEAT EMPTOR

Many Options For A Successful Due Diligence Process

Protecting Buyers And Sellers From Unpleasant Surprises

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SPECIAL TO BANKER & TRADESMAN

Whenever a buyer wants to acquire real estate, due diligence can make or break the deal. For obvious reasons a buyer wants not to buy a pig in a poke.

The buyer wants ample time to inspect the property's structural integrity, zoning and environmental compliance, review the back title and study the seller's books and records, including any leases.

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Is the cash flow for the property as represented by the seller? If there are liabilities to be assumed, what may they be? The purpose for due diligence is to give the buyer comfort that what has been offered for the property is justified by the facts on, under and over the ground. The buyer also wants enough time to obtain a commitment for financing since many sellers won't accept a financing contingency.

If the results of the due diligence are not to the buyer's liking, but the property is still desired, a price adjustment may be negotiated. But if the seller won't retrade, the deal is off and the buyer should be able to terminate the agreement and have the deposit returned. An alternative may be additional representations and warranties of the seller to give the buyer further comfort. If the seller wants top dollar, the buyer may pay it, but only with representations and warranties and a survival period that the seller may ordinarily not give.

The due diligence period, moreover, need not start from the date of the purchase agreement. There is typically a signed letter of intent or offer between the parties and the buyer may have started examining title, zoning and documents from the seller before the purchase agreement is signed. The seller may, therefore, require a shorter due diligence period in the purchase agreement. The seller wants the purchase agreement to "go hard," meaning the buyer's contingencies have been satisfied and any deposit becomes non-refundable except for the seller's default. The sooner a purchase agreement goes hard, the less risk of a retrade with the buyer.

The duration of the due diligence period may be a definite term of weeks or months.

Multiple Deadlines Are An Option

Alternatively, the parties may negotiate a due diligence period that starts to run only after the buyer receives certain documents from the seller such as a title commitment and survey. However, the seller should avoid a due diligence period that only starts after all due diligence documents are provided to the buyer unless the documents are identified in the purchase agreement and the seller confirms before signing are either in its possession or control.

The parties may also negotiate different due diligence periods for certain items. There may be a shorter period for the buyer to review title and survey matters, and more time to review zoning, environmental and other matters. The parties may also negotiate additional deposits for extensions of the due diligence period.

Treatment of the additional deposits must also be negotiated. Are they applied to the purchase price at closing, added to the purchase price, escrowed or released to the seller before closing?

The foregoing attempts to provide some of the salient deal points on due diligence typically negotiated in a purchase agreement for commercial real estate. ■

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