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HIDDEN HAZARDS

Open Permits Open the Door for Legal Complications in a Sale

Often Seen as Minor Part of Deal, They're Sometimes Anything But

BY GARY BUCHMAN AND EYAL SCHWARTZ

SPECIAL TO BANKER & TRADESMAN



Gary Buchman



Eyal Schwartz

Various factors can influence a commercial real estate transaction: market volatility, interest rates, location, potential repairs or renovations, property age or simply supply and demand. One commonly overlooked factor, often sitting idle at the building inspector's office, is open permits.

What many project developers consider a minor component of the transaction can significantly alter the dynamics of buying or selling commercial properties. Open permits open myriad issues, potentially causing transaction delays, financial burdens and even legal complications.

Open permits are permits that have been issued for construction or renovation projects but have not been closed out properly at the local building department, and remain attached to the property's records until properly closed out.

Permits can be left open for a variety of reasons, including construction projects that started but were left incomplete perhaps because required land use or operational approvals were not obtained or the contractor just failed to close out the permit. Since such permits remain attached to the property's records, open permits potentially pose significant challenges during the selling or purchasing of commercial real estate.

On the seller's end, open permits can cause transaction delays – potentially jeopardizing a deal.

Open permits can be especially problematic when a landlord has a multitude of tenants who engage directly with contractors for their tenant improvement projects, especially if permits remain open without the landlord's knowledge. Any miscommunication between landlords and contractors is usually a result of a landlord that is unaware of the specific contractor, which can exacerbate these issues.

The COVID-19 pandemic exacerbated all these issues. The ability to close out permits

during the pandemic was particularly problematic and the tenants that engaged the contractors (and sometimes the contractors themselves) went out of business resulting in numerous permits being left open.

Complicating CRE Transactions

Commercial real estate transactions can become overly complicated by open permits for both buyers and sellers. For buyers, open permits can signal a number of concerns that threaten the success of the transaction, such as potential safety or code compliance issues, or even distrust of the property's integrity.

Additionally, open permits can interfere with the closing process, hindering the purchase as lenders may be hesitant to provide financing on a project with open permits. This raises a red flag to a buyer who is unwilling to take on the potential burden posed by open permits.

On the seller's end, open permits can cause transaction delays – potentially jeopardizing a deal or subsequent price reductions to offset the risks associated with open permits. This results in additional time and money spent as long-standing open permits often result in fines or penalties.

Preventing permits from being left open is critical for mitigating the risk of financial and legal roadblocks in the transaction process, and

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buyers and sellers can take proactive measures to mitigate and prevent harm. Sellers should prioritize closing out permits before listing their properties to streamline the transaction and enhance marketability.

Reducing Risks, Be Proactive

Buyers need to conduct thorough due diligence, seeking out open permits or other potential issues, such as notices of building violations early in the sale process. This can be done by conducting comprehensive inspections of the building's records at the city or town's building department and title searches.

Commercial landlords also have a responsibility to take additional contractual measures with their tenants to ensure these issues do not arise in the first place. Commercial land-

lords should include provisions within their leases requiring the tenant to obtain the landlord's prior consent for any work requiring a permit. Landlords should also require that all open permits be closed within a stated period of time, such as within 30 days of the work being completed, with proof of closure being evidenced.

Landlords can enforce these provisions by mandating that the failure to adhere is an event of default under the lease. They may also include in the lease a stipulation that any security deposit held by the landlord will not be released at the end of the lease term until all open permits attributable to the specific tenant are closed out.

Although open permits can pose significant complexities in commercial real estate trans-

actions, taking proactive measures to prevent permits from being left open is the first line of defense against disruptions or harm during the transaction process. Each party can facilitate smooth commercial real estate transactions by taking proactive steps to seek out and resolve the open permits and any other issues that will delay or pose a threat to the success of the transaction. ◀

Gary Buchman is a partner in Sherin and Lodgen's real estate department, concentrating his practice in commercial real estate leasing, development and financing and in franchising transactions. **Eyal Schwartz** is an associate in the firm's litigation department, representing clients in complex commercial litigation matters in state and federal courts.