

COMMERCIAL PURCHASE AND SALE AGREEMENTS: DRAFTING AND NEGOTIATION PRACTICE POINTS

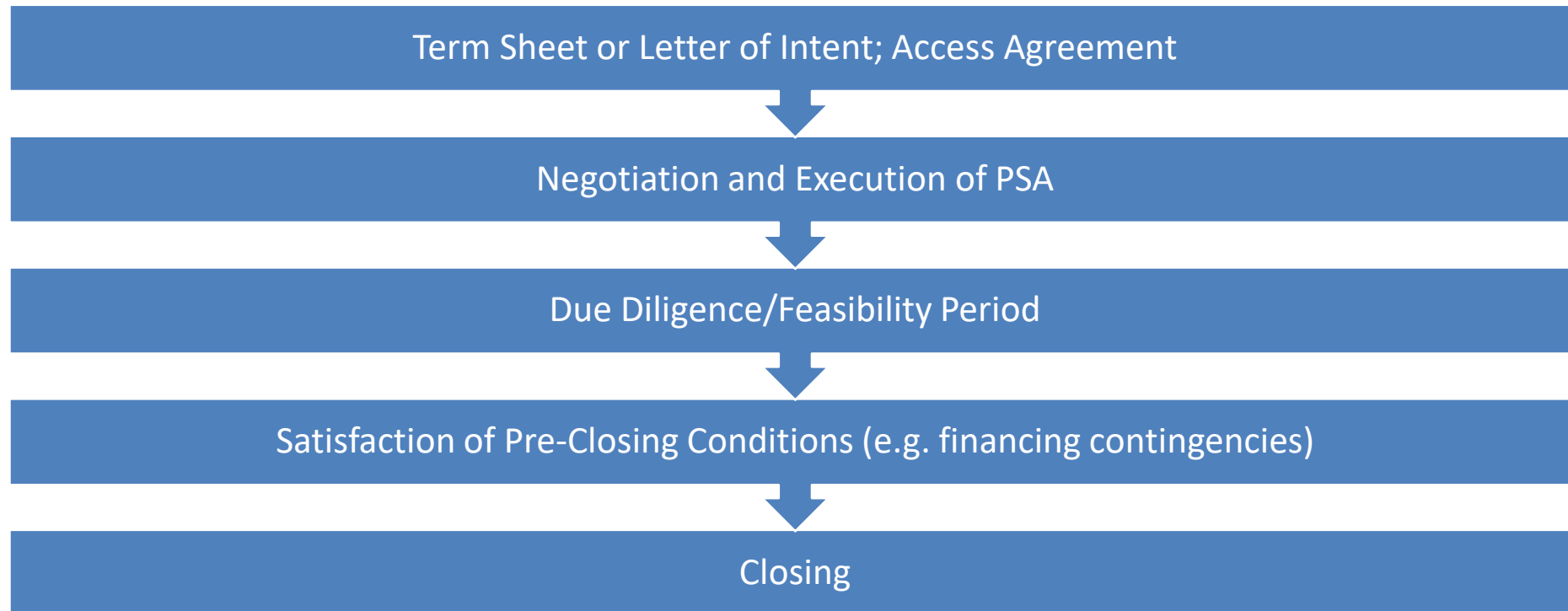
Serena Sayani
Leslie Berkseth
Stokes Lawrence, P.S.

Overview

- Initial Considerations
- Essential Contractual Elements & Key Terms
- Additional Provisions and Considerations
- Q&A

Initial Considerations

Timeline of the Deal



Due Diligence

1. Physical Due Diligence

- Title & Survey Review
- Environmental Testing (Phase I & II site assessments, geotechnical inspections)
- Structural/Engineering Inspections
- Zoning/Land Use; Pre-Development Due Diligence (if target property is a proposed development site)

2. Legal/Business Due Diligence

- For Improved/Occupied Property:
 - Lease agreements, rent rolls
 - Tenant estoppel certificates
 - Service contracts/warranties

Disclosure Requirements

1. Seller Disclosure Statement (RCW 64.06.013)
 - Applies to “commercial real estate”
 - Parties may waive delivery of Seller Disclosure Statement
 - Exception: Seller must complete and deliver “Environmental” section of if answer to any environmental question is “yes”
 - Buyer’s statutory right to rescind PSA within 3 business days after receipt of statement
 - May be waived by Buyer
 - Failure to deliver statement; inaccurate responses
2. Common Law Duty to Disclose: negligent misrepresentation

Essential Contractual Elements & Key Terms

Purchase Price and Earnest Money Deposits

1. Total Purchase Price

- Specify reductions for existing loan assumptions, credits and prorations, and allocations for personal property
- Specify method of payment

2. Earnest Money

- Delivered to and held by title/escrow company
- Include statutory liquidated damages/“Safe Harbor” language (see RCW 64.04.005) – may not exceed 5% of purchase price

Prorations/Allocation of Costs

1. Property-related costs/revenue typically prorated as of Closing (at 12:00am)
 - Seller responsible for costs incurred and revenue received/accrued prior to Closing
 - Buyer responsible for costs incurred and revenue received/accruing on and after Closing
2. Standard Property Costs:
 - Real estate taxes/assessments
 - Includes taxes applicable to pre-Closing period but assessed after Closing
 - Utilities (meter reads vs. estimation/post-Closing “true-up”)
 - Contractual obligations

Prorations/Allocation of Costs (cont.)

3. Typical Property-Related Revenue:

- Rental revenue
 - Responsibility and rights of parties to collect pre-Closing arrears after Closing
- Security deposits, CAM expenses

4. Allocation of Transactional Costs – varies by jurisdiction

- Seller: standard title policy; transfer taxes; ½ escrow fee
- Buyer: extended title policy/endorsements/loan policy; recording fees; diligence costs; ½ escrow fee
- Attorneys' fees: each party pays their own attorneys' fees & costs

Description of the Property

Two considerations:

1. What will be sold/purchased?
 2. What will be retained/excluded?
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1. Real Property – must contain legal description of property
 - Include all appurtenant easements and covenants
 - “Real property” includes affixed buildings and improvements
 2. Intangibles – permitting/governmental approvals (e.g. certificates of occupancy), licenses, IP
 3. Warranties – structural, equipment
 4. Leases (including rents, security deposits, guaranties)

Description of Property (cont.)

5. Contracts (maintenance/service contracts, construction contracts, management agreements)
 - Confirm whether contracts are assignable
6. Property-related studies, reports, plans (architectural drawings, prior environmental tests, development plans, etc.)
7. Personal Property
 - Include exhibit with inventory of personal property to be sold with the property
 - Excluded property: document personal property to be retained by Seller (and specify timeline for removal)

Disclosure of Property Condition; Liability

1. “AS-IS, WHERE-IS, WITH ALL FAULTS”
2. Environmental Liability
 - Federal: Comprehensive Environmental Response, Compensation and Liability Act (“CERCLA”)
 - State: Washington Model Toxics Act (“MTCA”)
 - Both laws impose liability for hazardous substance remediation on past and present owners
 - Exemptions: Innocent purchasers, lenders

Seller's Representations & Warranties

Important considerations: scope of R&Ws and post-Closing survival

1. Standard Seller R&Ws:

- Power and Authority: Seller can enter into PSA and sell property; PSA duly executed
- No Violation: PSA/sale will not violate other agreements
- No Litigation: absence of litigation/proceedings that may affect property
- Governmental Notices: Seller has not received notice of:
 - violations of laws/regulations (e.g., environmental laws, land use laws)
 - pending condemnation/eminent domain action
- Not a Foreign Person or "Prohibited Person"
- No Pending or Threatened Bankruptcy

Seller's Representations & Warranties (cont.)

2. Other R&Ws:

- Accuracy of disclosures
- Condition of title
- Leases/rent rolls
- Agreements, contracts and obligations affecting property
- “AS-IS” – Seller disclaims any R&Ws re: property condition, defects, hazardous substances

Buyer's Representations & Warranties

1. Focus of Buyer R&Ws is to confirm solvency and ability of Buyer to purchase property
 - Power and Authority; Good Standing
 - No Violations
 - No Pending or Threatened Bankruptcy
2. R&W re: no reliance on Seller's disclosures and sufficiency of Buyer's due diligence

Buyer's Remedies for Breach of Seller's Representations & Warranties

Pre-Closing:

1. “Anti-sandbagging provision” - if party had knowledge of other party's breach of R&W and proceeded to Closing, then breach is waived

Post-Closing:

1. Typical survival period: 3 – 18 months
2. Limitations on Seller's liability: floors/caps
 - Floor: damages caused by breach of R&Ws must total at least \$X for Buyer to seek recovery
 - Cap: maximum amount for which Seller is liable

Closing Conditions & Contingencies

Due Diligence/Feasibility Contingency

1. Physical and legal/business due diligence
 - Buyer and contractors/consultants had opportunity to visit/inspect property
2. Seller disclosure and delivery of property-related documents and materials
3. Financial feasibility
4. “Buyer may terminate for any reason or no reason.”
5. Deemed waiver of feasibility contingency/election to proceed vs. deemed termination of PSA

Title/Survey Contingency

1. Review of title commitment and title exceptions
2. Survey (new, recertification of existing)
3. Title and survey objection process; Seller's opportunity to cure
4. Deemed elections (cure, waiver of objections, termination of PSA)
5. Prohibited encumbrances: financing; liens

Performance of Seller and Buyer

1. Delivery of Closing Documents
 - Typical purchase and sale documents:
 - Deed
 - REETA
 - Bill of Sale
 - Assignment and Assumption Agreement (intangibles, leases and contracts)
 - Other documents: FIRPTA, settlement statements, tenant estoppels, loan documentation
2. Satisfaction/completion of other pre-Closing requirements (e.g., subdivisions or boundary line adjustments, approval of entitlements (permitting, tax credits, etc.))

Property Condition

1. No material changes to property between execution of PSA and Closing (including casualties and condemnation/eminent domain)
2. Seller responsible for loss prior to Closing
3. Consider effect of *de minimis* or immaterial changes
4. Adjustment of purchase price for significant changes

Accuracy of Representations & Warranties; Liability

1. R&Ws to be accurate as of Closing
2. Certificates of Representations and Warranties
3. Knowledge of Seller
4. Limitations on liability: no personal liability;
recovery limited to actual loss

Indemnification

1. General indemnification (for losses associated with breach of PSA, inaccuracy of R&Ws, or contract breaches or tort claims at the property)
2. Indemnification by Buyer for investigation activities (damage to property, injury, liens)

Defaults (by BUYER)

Seller's Remedies:

1. Retention of Earnest Money – remember 5% cap on liquidated damages, “Safe Harbor” language
2. Termination of PSA; no further obligations
3. Return of property documents/materials (and conveyance of Buyer's diligence materials)

Defaults (by SELLER)

Buyer's Remedies:

1. Termination of PSA and return of Earnest Money
2. Reimbursement of third-party due diligence/inspection costs
3. Specific performance
4. Waiver of default and proceed to Closing

Additional Provisions

Confidentiality/Exclusivity

1. Confidentiality

- Protect identity of Buyer and existence/occurrence of transaction
- Protect confidentiality of Seller and property-related disclosures
- Protect Buyer financial and corporate information
- Protect tenant confidentiality

2. Exclusivity

- Buyer wants to make sure that Seller is not advertising/marketing property or soliciting other offers while under contract

3. Not ready to sign a PSA? Consider pre-PSA confidentiality, access, and exclusivity agreements.

Pre-Closing Covenants

1. Operation of Property

- Continue of customary business practices
- Continue routine maintenance and repairs
- No new capital improvements or demolitions

2. New Contracts/Agreements/Leases

- Restrict Seller's ability to enter into new property-related contracts or leases

Standard Terms and Conditions

1. Broker Disclosure – responsibility/indemnification for broker claims
2. Governing Law – typically the state in which the property is located
3. Attorneys' Fees and Costs – “substantially prevailing party” in proceeding entitled to attorneys' fees and court costs
4. Assignment – Seller/Buyer considerations
5. Calculation of Time
6. Counterparts – electronic signatures/transmission
7. Notice requirements
8. 1031 exchange cooperation

Questions?

Serena Sayani

Serena.Sayani@stokeslaw.com

206.892.2105

Leslie Berkseth

Leslie.Berkseth@stokeslaw.com

206.892.2173