

INSIDER'S OUTLOOK

Opinion: Don't take a haircut on problem buildings

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In any commercial property sale, especially in the city, there's usually some "hair" of some kind somewhere – something about the property that makes it less than perfect.

In a frenzied seller's market, buyers sometimes overlook that hair. In a more buyer-friendly market, such as today's, it's different. Any variance from perfection creates a hook for negotiations, price adjustments, and contingencies. Something a buyer might have overlooked in 2013 leads in 2017 to agonized conference calls, long meetings, and complex contractual clauses and procedures.

That dynamic plays out, at its worst, if the buyer doesn't identify the hair at the outset of the transaction, the parties sign a contract with a due diligence period, and the buyer discovers the problem through due diligence. By then, the other potential buyers have gone on to other things. Unless the

seller wants to start over, the seller just has to deal with the hair, often with a price adjustment, a delayed closing, a contingency, a larger holdback, or some other unappealing measure.

To avoid these problems, a seller should know more about its property than any buyer will ever figure out. The seller needs to get ahead of the process. If it knows about a possible issue it should try to do something about it before it becomes a problem. Ideally, before the seller lists the property the seller will identify all issues with the property and solve them, so buyers can't express concern about them.

That isn't always possible, of course. Sometimes the seller doesn't necessarily want to "solve" a "problem" with the property unless there's a closing. For example, if the "problem" consists of a long lease that will impede development, that lease might not be a problem at all – it might be a good thing – if the seller doesn't sell. There, the

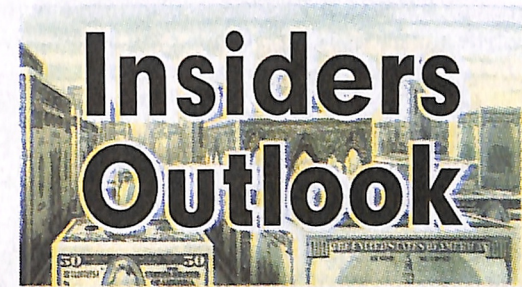
seller might negotiate an option to terminate the lease if the property actually does go to contract and close.

If the seller knows of problems, might it make sense to do nothing and hope the buyer doesn't notice? That might have worked in 1956. It doesn't work in 2017. Today's buyers, with lenders and equity investors looking over their shoulders, are typically smart, careful, and well represented. They find things. When they do it's usually worse than if the seller had been forthcoming from the beginning.

So it's up to the seller to investigate its own property at least as carefully as any buyer will. That means understanding any issues in the leases. It means ordering a title report and looking for surprises and problems. A pragmatic seller that wants to avoid problems may also order an environmental assessment and an updated physical report. In short, the seller should seriously consider doing all the due diligence a buyer will do.

Aside from preventing problems later, that approach can also reduce uncertainty and burdensome terms in the contract.

First, if the seller gives the buyer all the information the buyer will discover through its own due diligence, that can speed up or perhaps even short circuit the buyer's due diligence. Instead of demanding 60 days for due diligence, the buyer may be able to



justify only 30. Of course, the most important investigation any buyer performs in its due diligence period consists of determining whether it can raise the money it needs to close. The seller can't help much with that.

Second, the seller's investigations can define a baseline for the property. The seller, if lucky, may be able to negotiate that the buyer can terminate for due diligence only if it discovers anything the seller didn't disclose as part of the baseline. Buyers may find that arrangement a bit claustrophobic, though.

Third, the seller may be able to handle the problem or even solve it before the parties go to contract. The problem won't be a surprise and, ideally, won't be an issue.

Caveat emptor may sound great, but in practice it's the seller who should start out by being aware and preventing problems before they arise. In Latin, the phrase is *caveat venditor*.

