

# Caveat Emptor: “Let The Buyer Beware” - Due Diligence In Commercial Real Estate Purchases

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If you are considering the purchase of commercial real estate, either for your business or as an investment, you should include a due diligence period as a crucial element in your negotiations and in the contract. Generally, a due diligence period is the time afforded a purchaser to enter into and upon the site to study, examine and inspect all aspects of the property. This time period is also commonly referred to as the “feasibility period”, “study period” or “investigative period.”

Unlike [residential home purchases](#) that have certain consumer protection laws applicable to them, the purchase of commercial real estate has few protections and leaves a purchaser to examine, judge and decide for themselves whether a particular piece of property is suitable for their needs.

By conducting proper and adequate due diligence, the purchaser can make themselves aware of all material facts and defects about the property to determine whether the purchase is a good acquisition at a fair price.

## Commercial Real Estate Due Diligence

Due diligence provisions in commercial real estate can vary, but they generally afford a purchaser the right to enter the property to inspect, examine and test any and all aspects of the property as the purchaser deems, in their sole discretion, appropriate or necessary. These investigations can include:

- reviewing title and survey,
- inspecting the physical, environmental and ecological condition of the property, and
- physical inspections of all structures and mechanical systems located on and servicing the property.

All investigations during this feasibility period are generally at the purchaser's sole cost and expense.

## When Does the Due Diligence Process Start and How Long Does It Take?

Due diligence can occur prior to or after signing the purchase and sale contract. However, if it occurs prior to contract signing, a seller will typically require some form of confidentiality or early access agreement. A typical due diligence period for a commercial property is between 30 and 60 days. Longer or shorter periods of time are often negotiated depending on the parties' particular needs.

For example, if a purchaser requires confirmation of zoning or governmental permits and approvals, this may require a longer due diligence period. Finally, the purchaser must negotiate the right to terminate the contract, at any time during the due diligence period upon written notice to the seller, if the purchaser determines, in his sole discretion, that the property is not suitable for the purchaser's needs.

A proper and timely termination of the transaction by the purchaser will entitle them to a return of any good faith deposit. Unlike purchasing a house, a commercial contract will not require a negotiation between the purchaser and the seller for repairs or credits to address property defects or deficiencies.

## Seller's Requirements During the Due Diligence Process

A seller should be required to deliver to the purchaser or their attorney all relevant property information, including:

- tax bills
- leases
- service contracts
- financial statements and reports
- the title insurance policy
- any surveys, building inspection reports, and environmental studies

A seller should also turn over for examination:

- any site plans
- architectural drawings
- zoning documents
- governmental permits
- approvals and certifications
- and disclose the existence of any property or building-related litigation

The contract should specify when the seller must deliver the property information, and the purchaser's due diligence period should not begin to run until the seller has completed delivery of the contract. A purchaser must not, however, rely solely on reviewing these seller documents and information, but must conduct their own independent investigation to confirm the reliability and accuracy of the information turned over by the seller.

Almost all contracts will have numerous disclaimers which provide, among other things, that a seller makes no warranties or representations concerning the truth or accuracy of the information that she gives a purchaser, and that the property is being sold "as is" with all faults.

## What Does a Commercial Real Estate Due Diligence Attorney Do?

The purchaser and their attorney must be meticulous in proceeding with due diligence after signing a contract to make sure that a thorough investigation of the property is completed within the time period negotiated. After contract signing, a purchaser will typically arrange for structural, engineering, building, and mechanical inspections.

The types of inspections and tests performed will vary depending upon the type of property being acquired. The purchaser's attorney will order a survey, and a title search and commitment. Upon receipt of the title report, the purchaser's attorney will carefully review it and determine if there are any title defects. If so, the purchaser's attorney will immediately notify the seller's attorney. The purchaser must review and evaluate any existing leases or service contracts concerning the property.

As to any leases, the purchaser needs to determine whether the income generated from the leases will continue and for how long, whether there exists any tenant or landlord defaults, and whether the tenants have any renewal options or other rights affecting the purchaser's future plans and rents for the property.

## Environmental Investigations in the Due Diligence Process

Another important area for due diligence during the study period is the purchaser's environmental investigations. The purchaser will need to consider obtaining what is commonly known as Phase I Environmental Assessments. These types of environmental assessments can give certain federal and state protections and defenses against claims for environmental liability.

Hiring the right environmental company to perform these assessments is crucial and a purchaser should not overlook this aspect of due diligence. Some of these assessments can take significant time to compile and complete. Therefore, a purchaser should order environmental assessments as soon as possible after contract signing.

In addition, if the Phase I assessment discloses areas of concern, the purchaser may be required to conduct follow-up invasive testing which can require the seller's prior written consent.

## Land Use and Zoning Review

Another key aspect of due diligence that is often overlooked by a purchaser is [land use and zoning requirements](#). If a purchaser intends to acquire the property for their business, the purchaser must investigate and review local zoning ordinances, together with any prior zoning approvals affecting the property, in order to confirm that all of the purchaser's intended uses are permitted in the particular zone.

The extent of land use and zoning review is much more significant for raw, undeveloped land, and will require an extensive evaluation, most likely with the assistance of site engineers and planners, to

determine whether the purchaser's future development complies with all zoning requirements.

## What Should Sellers Consider in Due Diligence Negotiations?

From a seller's standpoint, the due diligence section of the contract will cover such aspects as insurance requirements and indemnities regarding the purchaser's consultants entering upon the property and conducting tests.

The seller will also include a prohibition on construction liens, and a requirement that the purchaser restore the property to its pre-inspection condition. Most likely, the seller will require that the purchaser obtain the seller's consent to perform any invasive environmental testing, and will further require that the purchaser keep its environmental reports confidential.

Finally, a seller will often attempt to negotiate that the purchaser must turn over all of its due diligence materials, if the purchaser elects to terminate the transaction, with no reimbursement to the purchaser for any investigative costs. Often, this provision is the subject of negotiation between the parties.

Making an informed and conscious decision to acquire commercial property, knowing the conditions and the risks, and determining whether the purchase price is fair is in the control of the purchaser of the property. The purchaser must be willing to incur some up-front costs at the risk of discovering a condition that could lead to termination of the transaction.

The costs of due diligence should not be a limitation on the extent of investigation that a purchaser is willing to conduct because to conduct little or no due diligence could lead to financial ruin if, after closing, a problem is discovered.

Since commercial real estate purchases are "as is" with little consumer protections, there will most likely be no recourse against a seller of commercial real estate for any defects that the purchaser could have discovered during due diligence investigations.

***Caveat Emptor.***

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