

The dynamic between buyers and sellers in the current market are in a state of transition

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The current market conditions present an ideal opportunity for buyers to carefully consider the provisions in a purchase and sale agreement for the acquisition of development real estate. Given the challenging market, the dynamic between buyers and sellers is in a state of transition.

Until recently, it was common for a seller to be in the driver's seat, with multiple suitors for the same development parcel. Sellers extracted non-refundable payments from a buyer for the privilege of obtaining a due diligence period to confirm the viability of the real estate and project. Upon expiration of the due diligence period, sellers would often require that monthly payments be non-refundable and non-applicable to the purchase price. As an aside, any provision which states that a deposit is non-refundable should be qualified to exclude a default by the seller as well as other events that would potentially result in a windfall if the seller were to retain the deposit. For example, if the development parcel is subject to a significant taking or casualty and if the seller is entitled to the condemnation award or insurance proceeds, it may be appropriate for the buyer to receive a refund of the deposit. This assumes, of course, that the buyer does not go forward with the transaction; otherwise the buyer should be the beneficiary of both the insurance proceeds and condemnation award at the closing (provided the full purchase price is paid).

Exacerbating the current market conditions is the deal stress between a buyer, as developer, and the prospective tenants. In addition to the time constraints involved in any real estate transaction relating to due diligence and the extensive time involved in obtaining the necessary permits and approvals, the tenant sponsorship needs to be carefully considered. Tenants in various retail industries, for example, are beginning to walk from transactions or to seek to renegotiate deal terms.

In addition, formerly attractive tenants are experiencing financial issues of their own.

As a result, provisions in purchase and sale agreements that were often viewed casually have paramount importance. Given the market conditions and the difficulty in obtaining financing, a buyer must promptly examine the seller's title in order to determine whether the property is encumbered by a mortgage and, if so, the relationship between the mortgage amount and the purchase price. A well drafted agreement will limit the ability of the seller to encumber the property. A buyer may discover that his seller has no equity in the property and that the money that the buyer spends on the project is at risk. The seller may be at risk of defaulting under its mortgage and there may be little chance in refinancing the loan. In fact, this writer is in the process of negotiating in a couple of transactions for a type of recognition agreement with the existing mortgagee which would address the possible exercise of mortgagee remedies.

With respect to the potential tenants, the provisions in any agreement with the ultimate end user must be carefully scrutinized as they may contain either an express or a "disguised" option to consummate the transaction. An agreement to enter into a ground lease, for example, which limits

the liability of the prospective tenant to a deposit is tantamount to an option in favor of that tenant. In addition, agreements often contain a variety of provisions (including extensive representations or requiring that approvals be satisfactory to the tenant in its sole discretion) which would provide the tenant with a basis for walking from the transaction.

Sellers need to appreciate the challenges that a buyer will face under the existing market conditions.

The economics of the transaction must be realistic and the pricing of any payments must take into consideration the allocation of risk and reward. In addition, a seller is well advised to temper his desire to obtain the best price with the need to team up with the strongest development group possible. As in past cycles, a seller will not win by signing an extremely favorable purchase and sale agreement with a developer who does not have the horsepower to make the transaction happen. A great location, in and of itself, will not help a weak buying team to cross the finish line.

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