

## FOCUS ON LEGAL ISSUES

### GETTING READY TO SELL A PROPERTY

by Edwin "Brick" Howe, Jr., CRE



Some years ago, one of the institutional real estate clients of my law firm in New York City promoted the executive who had been dealing with us for some years and put a new man in that position. One of the first things the new arrival told me was: "I am here, *inter alia*, to prove that legal services are a commodity." I responded that I considered it my responsibility to prove to him that they are not. You will sense that I eventually made my point (else I would not be starting the column with this anecdote).

Though the lawyer on the "sell" side of a real estate transaction has less occasion to exercise informed judgment and to make sound analyses and decisions than the buyer's counsel, the seller's lawyer is no more a "commodity" than his counterpart on the "buy" side. More often than not—even in that deceptively simple-appearing legal horror of horrors, the residential sale—there are problems that must be resolved, often with thoughtful, creative solutions, and the seller's lawyer is normally an important member of the team that produces the solution.

Having said the foregoing, my firm has, over the years, worked up a checklist of items to consider *before* marketing a property. With thanks to the firm's partners for authorizing me to do so, I have adapted that checklist for publication in this column. Please remember, however, that having the checklist does not entitle you to consider your lawyer a commodity—far from it. Rather, the idea is for you and your counsel to be as knowledgeable as possible about the property before you go to market and to have dealt with (or at least prepared for) any obstacles that do not emanate solely from the minds of the team on the other side.

#### *First & Foremost*

- Determine whether there are any outstanding *rights of first refusal*, option or the like. Thirty years ago or thereabouts, it was very common for a purchaser to extend a right of first refusal, first offer, etc., to *his* seller as a simple courtesy. These days, the original seller or his successors are as likely as not to use such a right against you as a weapon that has to be bought out. Even in more recent years these rights have been granted because they were part of the price you or your client had to pay to get the property. They are a serious threat to a property's marketability and price; in one recent case a client was given an estimate by his broker of a 15-30 percent discount from what would otherwise be the market price. So try to settle these matters before you go to market, unless the right is a so-called deal-in-hand right of first refusal held by a person who just says *No*, in which case you're simply stuck.

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I have dealt with the first subject at some length, because it is of such vital importance (and perhaps because it has been the source of substantial damage to the author's stomach lining in recent years). The exposition of the other points will be in far more summary fashion.

#### *Alternatives to Sale*

- Don't rush into a sale without considering *other marketing or quasi-marketing strategies*, such as re-development, refinancing, sale of air rights, etc. In this connection, if sale is not your only alternative but things are a little tight for you and the market is soft, think carefully through what you can do to hold on to the property until market conditions improve. Of course, you need to consider rights of first refusal here, too. They may be an obstacle — or your alternative may be the way *around* the obstacle.

#### *Brokerage Agreements*

- Look for *existing brokerage agreements* that might cover the sale, and don't say a word about selling to any other broker or "intermediary" until you're certain that you are free to do so.

#### *Tenant Matters*

- *Leases*: Locate, analyze, and catalogue all leases and ancillary agreements, including tenant correspondence that may be of a contractual nature.
- Prepare *rent roll* with a summary of major lease terms. Write it in English, not code or jargon, so that the lawyers' paralegals (or secretaries) on both sides of the deal can efficiently follow and check them against the leases.
- *Security Deposits*: List them and note any interest obligations. Determine what can be done with deposits in letter-of-credit form (e.g., assignable?).
- Review possibility of tenant or landlord *defaults* and of curative action underway or indicated.
- *Build-Outs*: Review and list status of same, whether undertaken by landlord or tenant, and any landlord obligations to perform or reimburse. (Some sellers prefer to include this in the rent roll.) Review and list outstanding construction contracts.

- Determine status of, and schedule, any *free rent* not burned off. (Again, some make this part of the rent roll.)
- *Estoppel Certificates*: If mortgage is not due on sale, determine form required by mortgage and check against tenants' lease obligations. (Some would put this off until seller knows buyer is not going to refinance.) In *any* event, determine what form you would want to get in the buyer's shoes and see how this matches up with tenants' obligations. Work out a preliminary strategy for dealing with any discrepancies.

#### *Building Operations*

- Review *management agreement* and (if separate) the *agreement with the leasing agent* for any landlord obligations regarding assignment, termination, or notice, and also any outstanding commitments regarding leasing fees on renewals or extensions.
- Review *operating agreements* (typical for shopping centers but sometimes found in multi-owner integrated office or mixed-use projects). List any obligations or problems regarding assignment or notice.
- Review *parking contracts* for assignment, termination, or notice provisions (including contracts with independent operators providing landlord with spaces for employees of landlord or tenants).
- Review *all other service agreements and equipment leases* for assignment, termination, or notice provisions.
- Determine whether *insurance policies* require any action at time of sale, such as cancellation notice.
- Inventory *personal property* and *intangible property* (e.g., property name) and prepare schedule showing what is to be included in, or excluded from, sale.
- Inventory *real and personal property tax bills*; schedule same, indicating any pending tax certiorari proceedings or refunds.

- Determine *status of utilities* and note action needed to be taken at closing time (e.g., notice to cancel service, proration at closing, including likelihood of re-proration's being required, or perhaps some other procedure).
- Determine assignability of any *building systems or equipment warranties or guaranties*.
- Without necessarily engaging an independent engineer, *inspect the property*, putting yourself insofar as possible in the shoes of the buyer's consulting engineer. Consider taking care of some or all indicated repairs and replacements before going to market.

#### **Existing Financing**

- Review documents for any *prepayment penalties, due-on-sale or assignability provisions, notice obligations*, etc.

#### **Title, Survey and Other Matters**

- *Review existing title insurance policy, endorsements and updates* and determine whether insurer is still in business. (If not, consider trying to look up your contact at the defunct company if he is still in the business.) *Order update*, including copies of any referenced documents, *and compare to existing policy*.
- *Review latest existing survey* and determine whether surveyor is still in business.
- Determine *local customs* regarding prorations, party required to pay for title, survey and transfer taxes and any other points that should be specified in the marketing brochure and should not be allowed to become the subject of wrangling at the closing. A seller's lawyer, if located in an area other than the property's location, normally doesn't hire local counsel, but may have to do so on this point. Best bet: Ask your lawyer to call a law school classmate who practices where the property is; this is likely to result in the information you need in return for the price of lunch for two.
- Estimate *transfer taxes*, by whatever name they are called locally, and consider structuring the transaction to minimize their impact (especially on you).

- *Order violation search* and take any necessary curative action. Get your hands on the *certificate of occupancy*, review it for any wrinkles and then guard it with your life until the closing. Determine *zoning* status and compliance of property. Be sure to state the exact zoning classification and what is permitted by that classification in the marketing brochure; I've never been sure exactly why, but you know from your own experience as a buyer how much potential purchasers love this!
- Schedule and assess all pending *claims and lawsuits*. Figure out how you are going to make the investigation underlying the buyer's lawyer's virtually inevitable demand for a representation regarding threatened claims. If you can't figure out how to do this, then figure out how you're going to resist that demand.
- Review any existing *environmental reports*. If there aren't any, or even if there are and they are not fairly recent, consider ordering a Phase I Report, but (except in exceptional circumstances), only if the environmental inspector is willing to allow a buyer to rely on the Report.
- "*Corporate*" Matters: Determine entity status, good standing, and condition of the entity's organic and other official records. Check what approvals (shareholders, partners, etc.) you need and, above all, make sure that the people who have to sign will be there to sign – or, if they won't, make sure that someone who *will* be there is appointed as one or more additional signatories. Remember that some of the world's greatest real estate lawyers don't know the first thing about the law of corporations, partnerships, limited liability companies, etc., and are prone to making the most awful hash of the "corporate" work. So be sure that there is a qualified corporate lawyer on board; he/she may well also be your real estate lawyer, but be candid in inquiring about his/her "corporate" qualifications. He/she doesn't have to be The Great M&A Maven; he/she just needs to understand how corporate law and practice work and what a glorious thing it is when it's thought through in advance of marketing; implemented in a reasonable period of time before the closing; and done right the first time.

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Neither my law firm nor I will claim that the foregoing checklist is complete or that all of its items are applicable in all circumstances. We do hope that it will be a helpful start for you and your lawyer. Among other things, it's probably not a bad start for deciding which tasks will be best performed by the real estate professional, the lawyer, the paralegal, the property's managing agent, and others who may be available. If anyone has any suggestions, as to additions or clarifications, I'd be delighted to hear them. You will find my e-mail address below.<sup>REI</sup>

#### ABOUT OUR FEATURED COLUMNIST

**Edwin "Brick" Howe, Jr., CRE**, is a lawyer practicing for 36 years in a range of areas, including real estate, shopping center, business, partnership and international law, taxation and litigation strategy and tactics. His law practice is currently conducted principally out of Ticonderoga, NY, which is also the base of his consulting firm, The Roseville Company LLC. In addition, he is senior counsel (by telecommunication and, when required, by airliner) to Howe & Addington LLP, the New York City law firm he founded in 1970. ■■■■■ ■■■■■