Increasing Buyer Leverage In The 'Sign-And-Go-Hard' Era

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Sign-and-go-hard transactions have become the new normal in the feverish real estate market of recent years. While standard purchase agreements typically contain a diligence period during which the buyer may terminate the transaction and recover its deposit, "sign-and-go-hard" transactions require that the buyer commit its deposit upon execution of a purchase agreement, without the opportunity to reclaim such investment if it discovers an undesirable condition during the course of its diligence.

Such transactions give sellers the upper hand at the competitive bid and letter of intent stage, and can result in a windfall if an objectionable discovery motivates the buyer to terminate the transaction, or if the buyer is unable to timely secure financing.

This article will explore steps buyers can take to increase their leverage, protect their deposits and attain the time and opportunity to line up their financing, notwithstanding this seller-sided market trend.

Early Access Agreements

The most straightforward way to replicate the standard diligence period is to enter into an access agreement promptly following the execution of an LOI, allowing the buyer to access property and diligence materials while negotiating the purchase agreement. Access agreements advance transactions while the parties finalize deal terms, and are typically negotiated in a fraction of the time it takes to finalize a purchase agreement. Buyers who make the most of their access agreements, however, will necessarily incur legal and diligence costs before they have a contractual right to purchase the property, and may lose that investment if the transaction does not go forward.

Purchase Agreement Provisions

Insure Against Risk Through Seller Representations

During purchase agreement negotiations, buyers can negotiate robust seller representations to insure against the risk they would typically investigate during the diligence period. A seller representation is a certification regarding the condition of the property or the status of seller's ownership, which, if discovered to be false, allows the buyer to terminate the purchase agreement and recover its deposit (notwithstanding the sign-and-go-hard nature of the transaction), or sue the seller and recover damages if the transaction closed prior to such discovery.

In addition to standard representations regarding authority and bankruptcy, sign-and-go-hard buyers should negotiate representations which address key diligence-related concerns, pertaining to: (1) the legal compliance of the property and existing uses thereon, (2) the environmental condition of the property, (3) the status of existing or pending litigation against the seller or the property, (4) if applicable, the status of entitlements and conditional use permits, and (5) if there are leases, the seller's compliance with its obligations as the landlord thereunder, the absence of outstanding leasing costs (including costs associated with landlord work, tenant improvement allowances and free rent) and the absence of any tenant defaults.

Although the buyer will not have had the opportunity to investigate the property before delivering its deposit, the seller representation acts as warranties that certain conditions and obligations have been satisfied — the inaccuracy of which allows the buyer to recover the deposit, and may even permit the buyer to seek reimbursement for other diligence and legal costs.

Carve Out Title and Survey From the Diligence Period

Purchase agreements typically incorporate the review of title and survey into the stated diligence period, and require that buyers notify the seller of any title and survey objections before diligence expires and the deposit "goes hard" (i.e., becomes nonrefundable). In the absence of a diligence period, buyers may be successful in negotiating a limited title and survey review period, with the right to receive a refund of the deposit if the buyer discovers a problematic title condition which the seller refuses to cure.

While title and survey matters do not encompass all relevant diligence inquiries (they do not provide any information regarding environmental matters, physical condition, zoning, entitlements and other issues relevant to the buyer's investigation of the property), buyers must review title and survey to evaluate any recorded restrictions on use or rights of third parties which will affect their future ownership.

Discovering that a third party has a recorded right to purchase the property, that an easement runs through the middle of a building or that a meaningful part of the property encroaches on neighboring land can make the property significantly less valuable or the acquisition riskier, and even a limited review period can provide substantial protections to the buyer.

Expanded Conditions Precedent

While sign-and-go-hard buyers don't have a timeframe in which they can recover their deposits without reason, they can still negotiate certain circumstances under which they are entitled to terminate the purchase agreement and recover their deposits. Typically, these circumstances include the occurrence of a casualty or condemnation, a seller default and perhaps most importantly, the failure of a condition precedent.

Conditions precedent are circumstances which either the buyer or seller has stated must occur prior to a specified time, or the benefiting party may terminate the purchase agreement. If the nonoccurrence of any event would devalue the property from the buyer's perspective, a sign-and-go-hard buyer should require that such event occur as a condition precedent to the closing.

Tailored closing conditions are necessarily deal-specific, but might include that the seller has received an estoppel certificate from all tenants (for leased properties) certifying to material information about the leases, that the buyer has obtained certain licenses or entitlements in connection with an intended development, that the seller has executed a lease with a particular tenant, or that the seller has received final sign-offs that no further remediation will be required on a contaminated property. Buyers should also generally require, as a condition precedent to their obligation to close, that the title company be committed to issuing a title policy in a form approved by the buyer.

Closing Extension Options

Sign-and-go-hard buyers who require the cooperation of third parties prior to closing a transaction, including lenders, capital partners and governmental agencies, should negotiate the right to extend the closing date. Extension options should be negotiated upfront, since waiting until the buyer needs additional time gives the seller leverage to demand an extension fee or other consideration in exchange. Note that in any event, it is not uncommon to require that the buyer deliver an additional deposit in connection with a closing extension to show the buyer's further commitment to the deal, but such deposit should be applicable to the purchase price at closing, and should not be a "fee."

Conclusion

Provided market conditions remain strong, Buyers can expect to continue encountering sign-and-go-hard transactions throughout the balance of this real estate cycle. However, buyers need not shy away from competitive bids or sought-after deals due to the absence of a diligence period, and can increase transactional leverage by entering into an access agreement to investigate the property prior to delivering the deposit, insuring against risk by negotiating robust seller representations, demanding a title and survey review period, negotiating expanded conditions precedent and bargaining for closing extension options.

Although the foregoing recommendations provide a general framework for negotiating sign-and-go-hard transactions, the specifics of each transaction should be evaluated individually in consultation with legal counsel.

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