Structuring a Buyer's Competitive Advantage

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Expert Commentary

For the better part of this decade, sellers of real estate enjoyed a "rabid auction" environment and, as a result (given the competition between buyers vying for the "win" and multiple backup offers), the seller's selection of the winning bid was almost always based on price alone.

It should come as no surprise to anyone that we are no longer in a "Seller's Market." Given the deterioration of the general economic climate in the United States and the crisis in the financial markets, very few transactions are occurring outside of "distressed" situations. Where a seller is under duress, the likelihood and speed with which a particular buyer can close the sale can be more important factors than price in crafting a winning bid. Based on our recent experience, buyers that have the ability to close without a financing contingency and expedite other contingencies (i.e., due diligence) have been selected over bidders offering a higher purchase price.

Eliminating or Limiting Financing Contingencies
The ability to consummate an all-cash deal is the strongest position for a buyer in today's market. However, there are options other than all cash that will provide the buyer with the ability to close without a financing contingency. For example, a buyer might obtain a line of credit or a loan commitment in the amount of the purchase price from its lender prior to the execution of the purchase and sale agreement. Alternatively, when a buyer can't orchestrate the removal of the financing contingency before entering into the purchase agreement, it may structure an accelerated financing contingency period to provide the best alternative to the seller on the issue.

Evidence of Cash Available
On a related front, a larger than normal upfront earnest money deposit might further comfort the seller that the buyer has the financial wherewithal to close the transaction. This is particularly true if the due diligence contingency period is dramatically shortened and the deposit becomes non-refundable to the buyer upon satisfaction of such contingency.

Expediting Due Diligence Contingency Periods
The major components of due diligence review with respect to commercial real property include a title report, survey, Phase I environmental report, property condition report and lease abstracts. As recently as one year ago it was nearly impossible to have a due diligence contingency period that was shorter than one month given the frenetic deal activity in the commercial real estate market. In contrast, with a focused strategy it is now possible to significantly shorten the due diligence contingency to as short as 10 days or two weeks, depending on the size, complexity and other particular qualities of the asset in question.

We suggest the following simple, yet effective strategy for buyers desiring the shortest possible due diligence contingency period (thereby creating a competitive advantage for its bid):

First, create a team of sophisticated professionals steeped in the commercial real estate market, including transactional attorneys and brokers. The long-term relationships that counsel and brokers have with the key vendors necessary to complete due diligence components (e.g., physical inspections, environmental analysis, operational issue review, etc.) will ensure a smooth and timely process.

Second, the longer lead-time items, such as title, survey and lease review, should be coordinated and commenced concurrently with or before the buyer's submittal of its offer (listing brokers are frequently populating diligence databases with key property documentation to enable potential buyers to commence their review on an expedited basis). Although this strategy requires a buyer to incur additional expenditures before its bid is secured, the ability to quickly satisfy contingencies has become a key component to a buyer’s ability to win a bid. The knowledge that a particular buyer is already making an "investment" can itself sway the seller in its bid selection.

Recently, one of our clients followed the model outlined above with great success, achieving a winning bid and closing with a 10 percent discount to the seller’s asking price, below several competing bids. This particular client committed to a 30-day all-cash closing, following an expedited due diligence period of only 10 days. With our assistance, key due diligence vendors were mobilized before the submittal of the offer to seller and were on-site conducting inspections immediately following seller's acceptance of that offer. By commencing such work while the definitive purchase documentation was being finalized, the buyer completed its diligence (title and survey review, major lease abstracts, receipt of a Phase I environmental report and a property condition report) and was able to waive all contingencies within five days after the signing of the purchase and sale agreement. The seller confirmed that the buyer's aggressive diligence commitment, together with the absence of any financing contingency, were the keys to its selection.

In the coming months, as a greater number of distressed commercial real property assets come to the market, we can expect to see buyers utilizing variations of such a strategy to successfully acquire properties at prices lower than otherwise available.

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