Strategies for a Changing Economy: Representing the Out-of-State Real Estate Client

By Whitney M. Skala, Esq.

May 16, 2002

Through the strength of your reputation, persistent marketing, or just dumb luck, you've finally landed an out-of-state client who wants to become a player in the Southern California real estate market. Let's assume they actually can find a product. Now they're on the verge of signing a purchase contract, and their lack of familiarity with California is starting to show. What matters should a real estate broker or attorney point out to an out-of-state client? Here, at least, is a starter list:

They need to either form a California entity or qualify their out-of-state entity to do business in California: An out-of-state entity that purchases California real estate will most likely have to qualify to do business in California. This step is not difficult: A corporation, for example, will have to file a form in Sacramento with the California Secretary of State. But what may be a surprise is that the out-of-state entity will not be able to file to qualify to do business in California under their existing name, if that corporate name already is in use by an existing California corporation. For the institutional investor who wishes to hold all of its projects in its corporate name, for marketing purposes, then being able to qualify in California under its existing name may be an important point.

Forming a California entity is not any more difficult than forming a similar entity in another jurisdiction, but there may be a few minor points of which the client should be made aware. For example, in California, the Franchise Tax Board imposes a gross receipts fee on LLC's. Beware--this is not a net profits tax, it is a gross receipts fee (will your client's intended project generate high gross revenues but a small net profit? They could nevertheless end up owing a fee as high as $11,000). If instead they decide to form a limited partnership, their general partner must be qualified to do business in California.

They need to understand how we close real estate transactions: We use escrow officers and title companies as key players in a closing. In some jurisdictions, attorneys are sometimes used to perform substantive title searches or to conduct closings. This is less the case in large commercial transactions, but in smaller transactions, the role of an attorney may be much greater than is our practice. In California, however, it is commonplace for attorneys to draft escrow instructions (although escrow officers seem always to re-type these instructions onto escrow company forms) and to review the preliminary report of the title company. For certain out-of-state clients, the lengthy roster of professionals involved in the closing can become confusing.

We have real estate finance laws that protect a borrower...: Our state's history of land speculation led to the enactment of the statutes that form our legal framework of protection for borrowers. Such terms as the "one-action rule" and the "security-first rule" are elements of our anti-deficiency legislation that, in a nutshell, requires lenders secured by real property collateral to respond to a borrower default by first foreclosing their real property lien and to forbear from self-help measures.

... But, as a practical matter, they require that the lender consider insisting on guarantees: So, if a lender has limited remedies strategies, then the lender is forced to consider requiring that its loan be guaranteed. California law will not enforce a guarantee by the borrower itself, so a second party, perhaps the principal shareholder or limited partner of the borrower, must be found to serve as a guarantor. An alternative to the guarantee is a letter of credit, a device that became especially popular recently to secure the payment of dot-com leases.

We have very public entitlement processes: The entitlement processes may appear familiar to the experienced out-of-state property owner, but that client may not have anticipated the level of public involvement. The local review groups can be dogged, and their determinations can amount, at least from the owner's viewpoint, to a de facto modification of applicable zoning. Are your set-backs in conformance with code? Are your intended construction heights within the guidelines? Local design review groups might ignore these points, in favor of pressing the client to reduce "mass," conform to surrounding development, and lessen their density.

We have a coast: For the buyer from out-of-state, the presence of the coast is an asset. But that owner also needs to think of the coast as presenting another reviewing jurisdiction, our California Coastal Commission. The Coastal Commission is made of state-wide appointees, and represents a state-wide agenda. The local lobbying techniques that an owner might be accustomed to won't work where the commissioners may have on their minds the preceding effect of the client's project on projects and properties far from the client's site.

And when it's time to close, we have our own procedures and our own time zone: Out-of-state clients need to be forewarned about any last minute, unique closing items. Those notary public forms that get attached to deeds of trust and other recorded documents? Our state has its own form-it's best to use it. Recording times for documents? Title companies prefer first thing in the morning. And wiring money? On this the client catches a break: Ten in the morning in New York is only seven o'clock here, so they can wire their money, and when the wire arrives, usually about an hour-and-a-half later, there may still be plenty of time to record. Final settlement of all funds is usually the following day.