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San Diego Daily Transcript

## Law Journal

# Strategies For A Changing Economy: Real Property Purchases In A Sloppy Market

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San Diego Daily Transcript

December 10, 2001

The softening real estate market presents opportunities for capable investors. But from a transactional standpoint, these purchases can often get sloppy: the properties are distressed, and so are the sellers; tenants are weak and their payment records are deteriorating; maintenance is being deferred; and, records and documentation pertaining to the properties are in a shambles. In addition, there may be a fundamental, but not obvious, reason the property is experiencing difficulties, which has caused the seller to lose heart.

When purchasing a property that is dumped onto the market, investors need to recognize these circumstances and beware. Uncooperative sellers, incomplete paperwork, and the existence of undisclosed problems can be countered, at least in part, by the following "ounces of prevention".

Make sure the purchase agreement and the related paperwork is signed and initialed. This may seem obvious, but it is often overlooked. Does the seller need more than one signature in order to enter a binding purchase and sale agreement? Often, trusts have two trustees, and both signatures may be necessary to make the contract valid. Corporations may need two signatures--the president's and the secretary's should be sufficient. Has the seller signed any disclosure statements, or were those statements tendered unsigned? Did the seller initial all changes to the contract (usually not)? And finally, did the liquidated damages clause get initialed? In a down market, where the purchase price may, by the time of closing, be above market, the liquidated damages will provide a welcome cap to the seller's damages in the event the buyer for some reason cannot or chooses not to perform.

Insist on a sufficient escrow period. Purchases take time. Even if you think you can hurry, your lender may have other ideas. And there is no guarantee that your due diligence process will go smoothly: What if your inspector needs to reschedule his visit? What if your lender finds something in your credit background that she thinks needs explaining?

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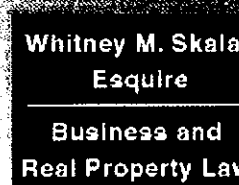
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Engineers, architects, and other professionals can be extremely busy, and you are ill-advised to take their availability for granted. For a substantial commercial property purchase, 60 days is an extremely short escrow period; 120 days is much more comfortable and realistic.

Insist on a right to extend. This is the fallback for buyers who could not negotiate a sufficient escrow period. Too many buyers assume that the seller will be reasonable and agree to an extension, especially in a down market. But what if the seller has discovered a reason not to sell, such as adverse tax consequences of a sale? The buyer needs the protection of a contract right. Also, the buyer needs to understand the difference between extension pass-throughs (which typically are credited against the purchase price), and extension fees (which typically are over-and-above the purchase price).

Get those due diligence reports reissued in the new buyer's name. Distressed properties may have been in and out of escrow already, so some of the due diligence may already have been performed. A stack of soils, contractor, and environmental reports that are tendered at the opening of escrow can appear to be a boon to the deal. Putting aside for a moment whether these reports ought to be relied upon at all (do these firms have any conflicts of interest? Were the reports within the firm's fields of specialization? Are the reports outdated?) if the reports are not addressed to the buyer, then the buyer probably has no right to sue on them if they prove to be wrong. The solution is to call the author and, usually for a minimal or no cost, get the report updated and re-addressed.

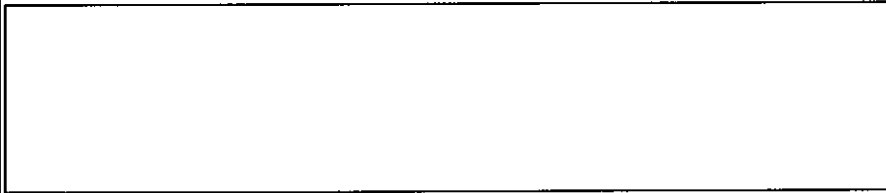
Befriend your title officer. The buyer needs to pay close attention to title issues. Remember, even the transactional team for the Ballpark District was surprised by the discovery that the East Village streets were owned by private parties, and even the NTC redevelopment team was surprised by the assertion from certain heirs of the original donors that a restriction in the gifting deed prohibits the redevelopment plan. Do not let the seller choose the title company. The buyer needs a first rate title company whose allegiances are solely to the buyer. A good survey, addressed to the buyer, and appropriate title insurance endorsements can be the cheapest and best way of flagging potential title issues. Spend time digging into the particulars of any assessment districts and other bonds against the property: The assessment authority of an agency can lie latent for some time, and then seemingly out of the blue, an obligation of several thousands of dollars a year can spring into existence. In researching bonds, do not be satisfied with the statement of the seller or even a low-level government staff member about the status of bonds-keep pushing until you are certain you have spoken with an authority on the bonds.

Nonconforming uses are everywhere. If the existing use or improvements are valid, nonconforming uses or structures, then the buyer may be able to carry on the existing business in its present state. But what if the buyer intends to add another structure, such as a canopy in the back lot? Existing structures that are inside set-backs, ADA noncompliance, and even an out-dated use can frustrate the long-range plans of the buyer. These issues can be discovered and, perhaps, resolved, by using quality professionals early in the due diligence process.

Tenant estoppel certificates can guard against leasing surprises. Obtaining tenant estoppel certificates is always prudent practice, but even more so where the buyer suspects that the seller's records may be incomplete. The estoppel certificates typically reference the lease, and

recite that there are no other lease documents or rights not reflected in the identified lease. If there are amendments (or, correspondence that amounts to a de facto amendment) that are not raised by the tenant in the estoppel certificate, then that tenant may be unable to later claim that the amendment is effective against the new owner.

The existing opportunities require that buyers look out for themselves more so than in the past. Savvy techniques can preserve the benefits of an advantageous purchase.



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