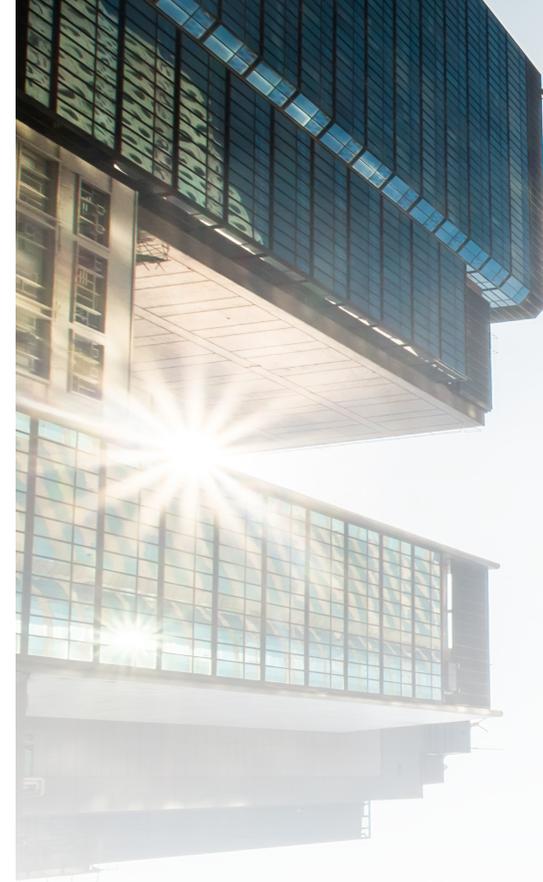


Navigating Closing Contingencies in Commercial Real Estate Transactions

BY DON G. MARTIN, ESQ.

Closing contingencies: sellers battle to eliminate them and buyers dig in hard to require them. The negotiation of conditions on obligations to close between buyer and seller is a necessary part of every real estate transaction. When properly documented, a road map to a successful closing can be achieved. When not properly addressed, the transaction can be destined to failure.

Several years ago an attorney asked me if I had any advice that might help him close more transactions. He showed me some of the typical purchase contracts he used, and one thing was clear: his documents consistently failed to adequately address closing contingencies. As a result, he often found the parties at odds when complications and questions arose. He further thought that by avoiding the issues and not putting them in the purchase agreement, he had a better chance of locking the parties involved into the deal, rather than blowing it up during the negotiation. However, in spite of his intentions, he was creating ambiguity and the possibility for dispute of matters that were not adequately addressed in advance. I convinced him that if he included provisions relating to several common contingencies, the odds of reaching a successful closing would increase. This article addresses several common closing contingencies in Nevada commercial real estate transactions.



Title and Survey Contingency

One of the most important contingencies for a buyer is the title and survey contingency. All buyers should require the review and approval of title. Title review can be an extensive task and often requires that the reviewing attorney have significant expertise. I occasionally see attorneys reviewing only the title commitment or report and not the underlying documents. I have often heard “the title looks clean,” and then had to disappoint someone by bringing up restrictive covenants buried in a set of CC&RS. This step of title review is critical.

From a seller’s perspective, a buyer should be limited to a certain window of time in which to review the title and survey matters. Typical transactions provide the buyer with 10 to 20 days in which to review title; this period is followed by a shorter period of review by the seller. If the seller does not agree to remove title contingencies, the buyer is typically afforded the opportunity to either terminate the transaction or proceed, subject to the title matters. A seller can try to limit a buyer’s right to object to a title item, if and only if, the matter materially impairs the property or the



buyer's intended use of it. Alternatively, buyer's satisfaction should be held to a standard of reasonableness. I have found that the most successful agreements allow a buyer full review of all matters, with enough time to review, object and terminate for any reason. Given that most transactions provide for a due diligence review period, wherein the buyer can terminate for any reason whatsoever anyway, the title review period can work in conjunction with such diligence review. The key, however, will be to have the agreed-upon title items cured or removed prior to the closing.

Zoning and Land Use Contingency

The planned use of the property by a buyer is critical in determining the extent of any zoning and land use contingency. If the buyer intends to use the property for the same purpose as did the seller, there are often few concerns. However, when the buyer desires a change in use, whether it be a completely different use or just a modification or expansion of the current use, care must be taken to address concerns. Particular issues arise when the property is subject to special use permits, variances or restrictive covenants that run with the land. In most instances, a land use expert should be consulted to ensure the buyer obtains the property for its desired use. I have seen many instances in which a buyer fails to adequately require a land use and zoning contingency, only to find that the property will not fulfill the intended purpose and use desired by the buyer. In such situations, when discovered prior to closing, a buyer is faced with either walking away from a deposit, or going ahead with the closing and trying to salvage the situation.

In Nevada, particular attention must be paid to gaming uses. Land use and zoning for gaming properties can be restricted on several fronts. Additionally, properties that have grandfathered gaming licenses can be

problematic to address. In all instances, the buyer should require that, as a condition to closing, the property be zoned and permitted for the buyer's intended use, and that all privileged licenses can be obtained. A seller should try to include language that requires the buyer to timely apply for and diligently pursue all necessary governmental and regulatory approvals for the operation of the business on the property. Typical language might read as follows:

“As a condition to Buyer's obligations to close, Buyer shall have secured the necessary and required permits, licenses and land use approvals to operate the Property as Gaming business (“Land Use Approvals”). Without limiting the foregoing, as of the Closing Date, Buyer shall have obtained all necessary licenses and permits from the Nevada State Gaming Control Board, the Nevada Gaming Commission, the City of Las Vegas, Nevada, Clark County, Nevada, and any other governmental agency or entity with jurisdiction over the Business and Property required for the ownership and operation of the Business on the Property, including, without limitation, the sale of alcoholic beverages or, as applicable, for the transfer of Seller's existing liquor licenses, if permitted by applicable Laws, and to participate in the gaming revenues of the

Business (collectively, “Gaming Approvals”). Buyer shall commence its applications for all Land Use Approvals and Gaming Approvals within ten (10) days of the Effective Date. Buyer shall diligently pursue the applications, and shall reasonably inform Seller of Buyer's progress and the status of such applications.”

Environmental Conditions Contingency

Pursuant to an environmental conditions contingency, a buyer's obligation to close arises only if the buyer is satisfied that the property is not environmentally impaired. Sellers should try to restrict a buyer's right to terminate for failure of the property's clean bill of health. For example, an “impairment” might exist only if the cost to remediate or remove the environmental condition exceeds \$25,000. Anything less and the buyer must still proceed to closing. In such instances, it is not unusual for the buyer to receive a credit against the purchase price in the amount of the “minor” impairment.

Both buyers and sellers must pay careful attention to the language in the environmental conditions, as environmental liability for contamination arises regardless of the timing of the occurrence or event that caused the impairment. Additionally,

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sellers should require that buyers promptly engage the third-party services of environmental engineers and commence the Phase I Assessment. Environmental assessments can take significant time to prepare and review, especially if a Phase II assessment becomes necessary. These inspections can also be costly and the allocation of such cost is often negotiated.

Sample language addressing an environmental condition may look like this:

“Within ten (10) days following the Opening of Escrow, Seller shall deliver to Buyer, at Seller’s sole cost and expense, any existing Phase I environmental assessment report on the Property. Buyer may, at its sole cost and expense, obtain a current Phase I environmental assessment of the Property and also conduct any other environmental studies and/or assessments of the Property as it deems appropriate.

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Prior to expiration of the Review Period, Buyer shall be provided a copy of the Environmental Site Assessment prepared for Seller with respect to the land included within the Property. As a condition to Buyer’s obligations hereunder, on the Closing Date, there will be no Environmental Conditions affecting the Property other than those that may have been disclosed to Seller by Buyer during the Due Diligence Period and/or described in any Phase I Report received by Buyer.” In addition to the foregoing

examples, a typical commercial real estate transaction will include conditions to Buyer’s obligations for obtaining:

1. Adequate financing for the purchase;
2. Tenant estoppel certificates;
3. Approvals for construction of any improvements;
4. Third-party consents, including in respect to any tenants on the property;
5. Subordination agreements from any tenants;
6. Tax abatements or financial incentives; and
7. Insurance coverage (including title insurance).

As can be seen from the above list, the contingencies can be quite extensive. If unaddressed, significant arguments prior to closing can occur and the transaction can fall apart – often leading to litigation of the contract and the parties’ obligations thereunder. As a result, it is highly recommended that attempts be made to address as many of the contingency concerns as possible while negotiating the purchase agreement, and to leave nothing to chance. Finally, it is important to remember that every transaction is unique; not all conditions and templates apply to every transaction. Careful negotiation and drafting of the conditions to close in a purchase agreement provide the framework necessary for a successful transaction. **NL**

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