

Real e-State™

An electronic newsletter for real estate professionals ©2004

From the desk of The Real e-ditor

In the past couple of years, how often have you said, or has someone said to you: "It's not easy to make a deal anymore"? The Summer is a time for "due diligence" on a lot of real estate deals. This issue of *Real e-State* focuses on the so-called due diligence process. But why has this process become so time consuming, expensive and complicated in recent years? Why are willing buyers and sellers drawing lines in the sand over how long property inspections should take, and what inspections should be allowed? Why do buyers and sellers often have such disparate views of what property is worth or what an appropriate cap-rate is on investment property?

I have a couple of theories. First, the impact of environmental law on real estate transactions has had an incalculable effect on the real estate transaction process. An entire environmental consulting industry was spawned, has evolved and matured just in the twenty years since I graduated law school.

More recently, the way many real estate deals are financed has changed dramatically too. The quest to obtain the longest term and the lowest possible (of the impossibly low) interest rates has resulted in more and more transactions being financed by Wall Street "conduit" lenders. These deep pocket lenders package portfolios of real estate loans on Wall Street, and sell mortgage backed securities to investors, who want a slice of the stability that real estate can offer their battered investment portfolios. This new source of cheap money, however, has not been without its dark side. These lenders, while liberal with their economic terms, are ultra-conservative with their risk. The lender's due diligence requirements often far exceed the depth of a prudent purchaser's typical investigations. Escrows are established for virtually every possible expense, from future tenant improvement and leasing commissions, to capital maintenance and replacement reserves, and beyond. Many Wall Street lender requirements have begun to permeate more traditional lending sources, complicating even bank loan financing transactions in ways not imagined, just five years ago.

Finally, there is a great cloud of uncertainty hanging over the industry. How far and how fast will interest rates rise? Will buyers keep their equity on the sidelines as interest rates rise? Where and when will terrorism next strike, and how will the economy be affected? How will we pay for the war in and reconstruction of Iraq? When will Washington get serious about "fixing" social security? Are tax increases inevitable? What if John Kerry is elected President in November? With so much to think about, no wonder making real estate deals is tougher these days.



Steven D. Sallen
Shareholder

ASSURING TIMELY LOAN FUNDING

BY: KASTURI BAGCHI

So, the ink is still drying on your loan interest rate lock application. Time is now your enemy; you need to navigate through the maze of loan requirements to close before the interest rate lock expires. To win this race against time, here are some tips to get through the due diligence items efficiently.

If you have not already done so during the negotiation of the loan application, ask the lender for a copy of its closing requirements and

checklist. Without knowing the lender's exact requirements, you may spend a lot of time, and money, pursuing the incorrect or incomplete due diligence and cause a delay in loan closing.

Once you have a copy of the lender's requirements in hand, go through it thoroughly and determine which items have a long lead time and which do not. There are four primary areas of due diligence that require long lead times for completion.

See **LOAN Page 2**

TIMING YOUR INSPECTIONS

BY: DANIELLE SPEHAR

You are negotiating a Letter of Intent or a Purchase Agreement to buy a parcel of vacant land for resale or development or an existing building for your client's use or investment. You want to provide enough time to complete inspections of the property before earnest money becomes non-refundable. But, the Seller wants to give as little time as possible for inspections to avoid "time off the market." How much time do you really need to complete inspections? Can simultaneous scheduling of the various due diligence inspections reduce the total time required?

Title Work: The Pur-

chase Agreement should always require the Seller to provide a current commitment for an owner's policy of title insurance and legible copies of all documents of record within a brief period of time. Generally speaking, there is no cost for obtaining a commitment and, as the Purchaser has no real ability to correct defects in title, you will want to know if any insurmountable title problems exist before expending substantial sums on due diligence inspections. Unless the property has a complicated title history, a commitment should be available within seven to ten days.

See **AUDIT Page 3**

28400 Northwestern Highway
Third Floor, Essex Centre

Phone: 248-827-1861

Thirteenth Annual Tax Symposium

Maddin Hauser will host its thirteenth annual Tax Symposium, at the Novi Sheraton on Saturday, October 16th, 2004, from 8 a.m. until 12 p.m.

Charles M. Lax, who is organizing the event, was recently selected by the Internal Revenue Service to join the Advisory Committee on Tax Exempt and Government Entities (ACT). Mr. Lax is a shareholder with Maddin, Hauser, where he also serves as chairman of the firm's Employee Benefits Group.

The Tax Symposium will include individual presentations on legal techniques of interest to Tax professionals.

If you are interested in attending our Tax Symposium or would like more information, please contact Charles M. Lax at 248-827-1877.

LOAN (CONTINUED FROM PAGE 1)

First, the lender's requirements should identify what third party reports need to be ordered. In addition to appraisals, environmental reports, title insurance commitments, surveys, insurance certificates and zoning letters, you may also be required to provide an engineering report or a soil test (geotechnical) report if new construction is involved.

Second, the lender's requirements will indicate which loan documents require the signatures of third parties. Let's say you or your client are refinancing a shopping center or office building. Procuring subordination agreements and tenant estoppel certificates from each tenant can take a long time. In the construction loan context, the lender may request contractors, architects, and/or engineers to consent to the assignment of their project documents to the lender in the event of default. You should ask the lender to draft such third party documents as soon as possible so that they can get circulated early in the process.

Third, submission to the lender of the organizational documents of the borrowing entity may require immediate attention. If the borrowing entity has not yet been formed, you need to determine the entity structure and prepare and file the necessary organizational and governing documents. Sometimes, existing entities will have lapsed, causing a mad last minute scramble to re-qualify the entity to conduct business. Obtain certified state filings early to flush out any problems.

Fourth, the items necessary to approve the first draw of a construction loan can be numerous and time consuming to compile. If a construction loan is pending, schedule a meeting with the lender's construction disbursement coordinator early in the process. At the meeting, obtain from the lender what the specific disbursement requirements will be. Sworn statements and lien waivers have to be obtained from third parties, and can

Decisions Delayed:

If you take too long in deciding what to do with your life, you'll find out you've done it.

George Bernard Shaw

be time consuming to round up. Also, see how quickly the construction budget can be approved as well as all of the related construction contracts.

While you are determining which due diligence items are the most time consuming, you should simultaneously confirm with the lender which vendors are acceptable in terms of completing the due diligence items. Before initiating third party work, find out who are the lender's approved surveyors, title companies, environmental consultants, and appraisers so that no time or money is wasted on a vendor whose work product will not be accepted by the lender. Once the vendors are chosen, make sure that the lender's specific requirements are forwarded right away, so that the reports comply with the lender's requirements. All too often, delays in closing are caused because the survey does not contain the correct certification or the insurance certificates are not on the proper form, or are not properly endorsed to the lender. Such gaffes can be avoided by ensuring that third party vendors have and understand the lender's exact requirements ahead of time.

A smooth due diligence process and a timely loan closing can be managed if the process steps are taken in order: first, get a copy of the lender's requirements as early as possible; second, focus on the list of requirements to determine which items will take the most time to complete and begin work on those items right away; third, confirm the structure of borrowing entity and make sure that organizational documents are in place; and fourth, make sure that only lender-approved vendors are hired to complete the due diligence items and that such vendors understand and comply with the lender's requirements. This simple process will lead to an efficient *and funded* closing, every time.

Leadership:

"There are two ways of exerting one's strength: one is pushing down, the other is pulling up."

Booker T. Washington

The Real e-State Staff:

EDITOR-IN-CHIEF:
Steven D. Sallen



CONTRIBUTING
EDITOR:
Danielle M. Spehar



CONTRIBUTING
WRITER:
Kas Bagchi



LAYOUT EDITOR:
Lawrence J. Straughen

I.T. DIRECTOR:
Randall A. Straughen

AUDIT (CONTINUED FROM PAGE 1)

Survey: Depending on the location of the property, the number of encumbrances affecting the property, and the schedule of the surveyor, a complete ALTA/ACSM survey should be available within two weeks to thirty days. Keep in mind, however, that it is rare, especially when there is a lender involved, that the initial version of a survey will not require some clarification and/or revision, increasing the time necessary for completing this part of due diligence. While it is always beneficial to obtain a copy of the Seller's existing survey of the property, it won't necessarily decrease the time

required for obtaining an updated survey unless the same surveyor is used. Note that the surveyor will not be able to complete his work until a title insurance commitment and documents of record are available.

Environmental: Environmental inspections can be one of the most time consuming and costly parts of due diligence. One of the most effective methods for limiting the time needed to complete environmental studies is to obtain copies of *all* of the Seller's existing studies of the property. The levels of investigation are loosely characterized as "phase I", "phase II", "phase III" and "BEA."

A phase I audit typically includes a site inspection, an investigation into present and past uses of the property, title searches, historical public records search, and other non-invasive means of evaluating the site. A phase I audit may require two to four weeks to complete.

Phase II audits are carried out when a Phase I audit or other information indicates the possible existence of a recognized environmental condition. A phase II audit generally includes sampling and laboratory analysis of soil, and or building materials. A typical phase II audit may require an additional two to four weeks to complete. A Baseline Environmental Assessment ("BEA") may be needed if a phase II audit of the property indicates the existence of contaminants in excess of residential state default cleanup criteria.

A phase III audit is generally considered to be some level of remedial action or subsequent Phase II investigation. When phase III activities are indicated, Purchasers may want to consider a Brownfield redevelopment plan.

Appraisal/Engineering Study: You or your lender may require an appraisal of the property to be conducted. As a general rule, anticipate that at least thirty days will be required for the completion of an appraisal and/or engineering study. These can be completed simultaneously.

UCC Lien Searches/Litigation

Searches: These inspections are often-times overlooked by buyers, sometimes leading to significant problems on a post-closing basis. UCC searches for items impacting the property at the county level will be conducted by the title company in preparing the title work. However, if any personal property (including significant building fixtures) is being acquired, UCC lien searches should also be conducted at the State level. Litigation searches should also be conducted at the county and state levels. These searches can be completed within one week. Interviews of local building department officials (including file reviews) can yield much useful information.

Zoning/Building/Health: Before obtaining status letters from the appropriate municipal zoning, building and health departments to ensure the suitability of the property for the Purchaser's intended use and the absence of any outstanding violations, the Purchaser should inquire whether the lender has any specific requirements for these items. These items can all be obtained simultaneously and generally within one week. Occasionally, a municipality will charge a fee for such letters.

Even for a property with no anticipated issues, a minimum of 30 days is required to thoroughly complete a purchaser's due diligence inspections. For more complicated transactions or those in which it is anticipated that issues will arise, additional time should be negotiated up front for completion of inspections. Plan ahead: negotiate enough time for yourself, the first time. Avoid having to ask for

more time later, after you've invested thousands of non-refundable dollars in the process. The Seller will have you over a barrel, and will know it.

Optimism:

"A pessimist sees the difficulty in every opportunity; an optimist sees the opportunity in every difficulty."

Sir Winston Churchill

More Information:

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