

A Buyer's Guide to Purchasing Commercial Real Estate: Top 10 Due Diligence Questions Before Signing A Contract

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A good portion of my practice involves representing buyers in commercial and residential transactions. Part of this representation involves advising my clients on due diligence matters pertaining to the property. Most of us know investigation of various real property matters is critical before purchasing commercial real estate. Do you also know your due diligence of the property should begin before you sign a contract to purchase? Due diligence is critical in your negotiations prior to signing a contract.

Because a lot of my clients come to me after they have signed a contract, I have decided to write about the importance of due diligence before and after a contract is signed to purchase commercial property. This month's article discusses a buyer's due diligence before signing a contract to purchase. Next month I will discuss a buyer's due diligence after the contract has been signed but prior to closing and taking title to the property.

The reason a buyer must perform due diligence is to ensure he or she is aware of all material facts concerning the investment property and should begin before a contract to purchase is signed. The extent and scope of any due diligence differs with each property and the goal of the buyer. Is the buyer going to be the end user or is she going to expect a return on her investment via an income stream from rentals? Will the property be held long term or short term by the buyer? Is a business being purchased in conjunction with the real property?

Prior to signing a contract to purchase the commercial property, the buyer should obtain answers to some initial questions, including but not limited to the following:

1. What is the real property being purchased? You need to know the legal description, street address and parcel identification or strap number. You should also obtain the size of the building and ascertain any fixtures that will be removed from the building prior to closing.
2. Are there any development rights or obligations pertaining to the property?
3. What is the physical condition of the property? You can ascertain this initially by either personally performing a visual inspection of the property (if you are qualified and knowledgeable with such matters) or requesting an inspector to perform a site visit with you to point out any obvious concerns with the property. This is useful information when you are negotiating with the seller prior to signing a contract to purchase.

4. Is the current land use and zoning consistent with your plans for the property? It is important to remember that you cannot rely on the previous use of the property as being permitted in the future. Many times clients will say to me that they are certain they can use the property as they intend because their use is the same as the prior use. This is not always the case because zoning and land use regulations change with time. Therefore, it is possible the prior occupant's use was grandfathered as a permitted use. Do not assume the previous use will be permitted in the future.
5. Are improvements, changes or major renovations required to the property to be suitable for your intended use and what are the costs of these items?
6. Does the property comply with Americans with Disabilities Act or is it exempt?
7. Do you have sufficient parking?
8. Are there any apparent encroachments or access issues with property based upon your visual inspection of the property?
9. Are there any open permits?
10. Are there any title concerns based upon an initial review of the official records website in the County where the property is located? I often perform an initial search of the public records for my client so I can advise them of such things as mortgages against the property, whether the mortgage amounts exceed the purchase price, if there are other recorded liens against the property and if there is pending litigation (for example, a foreclosure lawsuit).

Bottom Line:

Obtaining answers to these types of questions will assist you in negotiating a contract with the seller, as you will be able to identify some areas of concern that need to be further investigated or resolved.

The parties may elect to enter into a letter of intent to allow the buyer to perform his or her initial due diligence as discussed above with seller's agreement to not enter into a binding contract with another buyer during said initial due diligence period. Keep in mind, however, that letters of intent can be drafted as either binding or non-binding. However, even if the letter of intent is drafted to be non-binding, it may include an obligation by both parties to negotiate the contract in good faith and with fair dealing.