

Modernizing real estate purchase agreements for 2023 and beyond

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The evolving economy, climate change and health concerns are forcing real estate buyers and sellers to adapt their standard purchase agreements for a changing world. Agreements may now need: specific provisions to address more intense weather events; general force majeure provisions for entirely unanticipated events; and tweaks to standard provisions to better address the impacts of rising interest rates.

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Following are a few strategic updates that buyers and sellers can make to both commercial and residential purchase agreements to help them set expectations and respond quickly to novel situations.

Casualty provisions

Cities across the globe are experiencing more intense and less predictable weather events due to climate change. As a result, casualty provisions, which were often an afterthought in most purchase agreements, are far more likely to be used in the coming years.

Buyers should consider adding a detailed casualty provision that specifies the following:

- how to define a casualty event's severity to determine whether it justifies optional termination;
- the timing of any right to terminate;
- how repairs will be made or insurance proceeds will be assigned in the event that the closing proceeds.

In order to determine the severity of the casualty event, the agreement might reference the extent to which the property is damaged by dollar value or percentage. It could also reference the length of time it might take to place the property back into service.

Typically, the buyer has the right to terminate after a significant casualty event, which is consistent with the seller's standard

representation that the property will not materially change between due diligence and closing. However, the buyer should be obligated to notify the seller of termination within a reasonable time after the damages and anticipated repair schedule have been determined, for example, within 10 days of the casualty.

If the buyer elects to proceed with the closing instead of terminating, the seller should either make repairs prior to closing or assign its insurance proceeds (or the right to collect them) to the buyer. In that case, the seller will want the buyer to assume any obligations to tenants with respect to repairing their spaces.

Where specific weather events are expected, such as during a fire or hurricane season, the buyer and seller should add provisions specifically describing how the parties will address closing delays due to these events. For example, they might specify that either party may delay the closing if they are unable to perform the final walk through, bind insurance, send wires or appear at the closing agent's office. The closing will occur a specified number of days after all of these requirements are met, or if they can't be met within a reasonable specified time, then either party could terminate.

Force majeure

Most purchase agreements already provide that, if a "force majeure" event outside of the parties' control prevents them from performing, then the time to perform is extended until the event ends. It is important to maintain this general provision in order to account for wholly unexpected events.

In addition, the parties should add a specific listing of applicable events (such as government-imposed closure orders) and state whether an extended event would justify termination. The agreement should specify that the casualty provision applies over the general force majeure provision if there is a conflict.

Rising interest rates and a changing market

As interest rates rise and buyers need to lock-in their rates, closing deadlines are becoming extremely important. Therefore, it is imperative that the purchase agreement holds the seller to the closing timeline, and the attorney should develop the closing timeline based on the lender's requirements.

If the buyer needs to close quickly to keep a low rate, the buyer could negotiate a short due diligence period with an optional

extension period (with or without a fee). This would allow the buyer to decide later to forgo the rate and do additional diligence if something significant, such as hazardous substances, comes up during the short review period. Sellers should be more willing to accept these types of provisions as the market transitions in buyers' favor.

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In light of increasing difficulties in obtaining favorable financing, the financing contingency in the purchase agreement should be as specific as possible. The purchase agreement might provide, for example, that the buyer can terminate unless it is able to obtain a loan for a specific amount, term and maximum rate. The buyer will want the right to terminate to continue through closing if the loan falls through for any reason that is not the buyer's fault. The seller should require specific evidence of efforts to secure financing.

If financing becomes a roadblock to the transaction, buyers should consider requesting seller financing or acquiring the property "subject to" the seller's existing mortgage. In that case, the purchase agreement should detail the loan terms or the "subject to" terms, including mortgagee approval if required by the mortgage.

As the economy begins to slow, the risk of declining property values and potential tenant defaults means buyers must fully exercise their due diligence rights. Purchase agreements typically allow the buyer to inspect all of the tenants' leases, obtain tenant estoppels and review a rent roll and income/expense statements during due diligence. Buyers should also add a provision stating that it is a condition to closing that there will be no material change to these items prior to closing. This will allow the buyer to terminate in the event of a material change. The parties should specify what constitutes a "material" change.

Conclusion

As our world changes, buyers and sellers must continually update their purchase agreements to have a clear roadmap to respond to new situations. Continuous and proactive review and revision of real estate agreements may provide an edge to get ahead in this fast-paced industry.

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