

Purchase and Sale Agreements and Leases: A Framework for Review and Analysis

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Purchase and Sale Agreements

Overview

- Legal Concepts
- Framework for Review and Analysis of Purchase and Sale Agreements
- Risk Management

Law Applicable to Purchase and Sale Agreements

- Statute of Frauds
- Priority Statutes
- Contract Law

Statute of Frauds

Deals with the relationship between the parties who are entering into an agreement.

Statute of Frauds

NCGS 22-2

“All contracts to sell or convey any lands...and all leases...for leasing land for the purpose of digging for gold or other minerals, or for mining generally, of whatever duration; and all other leases and other contracts for leasing lands exceeding in duration three years from the making thereof, shall be *void unless* said contract, or some memorandum or note thereof, be put **in writing and signed by the party to be charged therewith...”**

Statute of Frauds

- 3 Important Elements
 - Contract
 - for sale of land
 - Must be In writing

Statute of Frauds

This statute deals with the relationship between the parties who are entering into an agreement with each other.

Priority

*Priority is a concept that focuses on the relationship of the parties to a transaction, such as a buyer and seller, or landlord and tenant, relative to the interests of *third parties**

Priority Statutes Purchase and Sale Transactions

- NCGS 47-18
 - Purchase and sale transactions
 - Leases
- NCGS 47-119
 - Authorizes recording of memo of option to purchase
- NCGS 47-119.1
 - Authorizes recording of memo of contract

Priority Statute
NCGS Section 47-18(a)

“No (i) conveyance of land, or (ii) contract to convey, or (iii) option to convey...shall be **valid** to pass any property interest as **against lien creditors or purchasers** for a valuable consideration from the donor, bargainer or lesser but from the **time of registration** thereof...”

Priority Statutes
NCGS Section 47-18(a)

3 Important Elements

Conveyance, contract, or option

Validity against Third Parties

Time of Registration

Priority Statute
NCGS Section 47-119

Option Agreements
authorizes recording of memo of option

Priority Statutes
NCGS Section 47-119.1

Purchase Agreements
Authorizes recording memo of purchase
agreement

Priority Statutes

Protects a party's rights in real estate relative to third parties

Contract Law

Some statutes, but Common Law primarily regulates commercial purchase agreements

Remainder of this presentation will focus on practical contract concepts rather than specific laws.

Framework for Purchase and Sale Agreements

- Parties
- Property
- Purchase Price
- Mechanics for Closing
 - What is delivered
 - Prorations
- Timeline for Purchase
 - Deliveries
 - Due Diligence
 - Rezoning

Framework for Purchase and Sale Agreements

- Time Line (continued)
 - Design and Permitting
 - Closing
- Representations
- Warranties
- Covenants
- Conditions
- Remedies
- Casualty/Condemnation

Framework for Purchase and Sale Agreement

- Miscellaneous Provisions
- Exhibits including form transfer documents

Framework for Purchase and Sale Agreement

- Representation
- Warranty
- Covenant
- Condition

Framework for Purchase and Sale Agreement

- Representation
 - statement of fact as of a given time

Example:

As of the Effective Date of this Agreement, Seller is a limited liability company in existence under the laws of the State of North Carolina.

Framework for Purchase and Sale Agreement

- Warranty
 - An agreement that a factual circumstance will remain the same for some period of time

Example:

- Seller shall remain a limited liability company in existence at all times through closing.

Framework for Purchase and Sale Agreement

- Covenant

- An agreement to take some action or not take some action

Example:

Seller shall not enter into any new agreements affecting the property prior to closing.

Framework for Purchase and Sale Agreement

- Condition

- An event the occurrence of which is a requirement for something else

– Example:

- Tenants occupying a minimum of 95% of the space in the shopping center must have delivered estoppel letters prior to closing.

Framework for Purchase and Sale Agreements

- Covenants v. Conditions

Something I can do

v.

Something that someone else who is not a party to the transaction has to do

Framework for Purchase and Sale Agreements

Use Covenants and Conditions to separate

– That which I control

v.

– That which I don't control

Framework for Purchase and Sale Agreements

Covenants v. Conditions--Examples

Agreement not to enter to a lease

v.

Agreement to obtain an estoppel letter from a
tenant

Framework for Purchase and Sale Agreements

Covenants v. Conditions--Examples

Agreement to demolish my building

v.

Agreement to obtain an access easement from a
neighbor

Framework for Purchase and Sale Agreements

Covenants v. Conditions—Examples

Agreement to restrict your own land

v.

Agreement to obtain release of a use restriction a third party holds on your land

Framework for Purchase and Sale Agreements

Why does it matter?

– Consequences of each

Breach

v.

Failure of a Condition

Framework for Purchase and Sale Agreements

Control the Consequences

- Failure of a condition—Status Quo
- Breach -- Default -- Remedies
 - Limit downside exposure by capping damages
 - Limit downside exposure before and after closing

Risk Management

- Understand the business *of the deal*
- Analyze the business deal for additional issues
- Manage the risks of the business deal with the purchase agreement

Risk Management

Understand the Business of the Deal

Understand the Business Deal

LOI is half of the story

Risk Management

Understand the Business of the Deal

Understand the Client's Business Model

Example:

Shovel Ready Client

Risk Management

Understand the Business of the Deal

Understand the Client's Risk Tolerance

Example:

The novice developer

Risk Management

Analyze the Deal

- Missing details
- Missed issues
- Economic Motivation

Risk Management

Analyze the Deal

- Missing details
example, 1031 deadlines

Risk Management

Analyze the Deal

- Missed issues
 - Real Estate—Access and Use
 - Development – Infrastructure and Entitlements
 - Third Party Agreements—Due diligence and Existence

Risk Management

Analyze the Deal

- Economic Motivation
 - Timing of performance
 - Escrow Agreements

Risk Management

Two Examples:

- Development Transactions
- Existing Income Property

Risk Management

Development Transactions

- Entitlements
- Infrastructure
- Third Party Agreements

Risk Management

Development Transactions—Entitlements

- Zoning
- Design and Plan Approval
- Permits

Risk Management:

All should be conditions to closing.

Risk Management

Development Transactions—Infrastructure

- Roads
- Utilities
- Storm water
- Parking

Risk Management:

Requirements for closing **or** post closing performance secured with escrow funds—may be conditions or covenants.

Risk Management

Development Transactions—Third Party Agreements

- Access rights
- Use Restrictions or Rights
- Storm water
- Utility Easements
- Appearance
- Signage
- Cost Sharing

Risk Management:

Pre-closing written agreements recorded at or before closing—may be conditions or covenants.

Risk Management

Existing Income Property

- Lease Analysis
- Third Party Agreements

Risk Management

Existing Income Property—Lease Analysis

- Review Leases
- Verify Lease with Tenant
- Verify Franchise Agreements with Franchisor
- Verify financial performance of Tenant

Risk Management:

Review and verify with estoppels, which should be conditions to closing.

Risk Management

Existing Income Property—Third Party Agreements

- Verify that important rights for use of property have been memorialized and recorded
- Verify
 - All approvals obtained
 - All sums paid under third party agreements
 - No defaults

Risk Management:

Review and verify with estoppels, which should be conditions to closing.

Risk Management

Manage risks with the Purchase Agreement, but understand the risks being managed and the tools available for management.

Leases

A Closer Look

Why a closer look at Leases?

Because,

Leases drive the revenue dollars which drive value in a real estate transaction.

Overview

- Legal Concepts
- Framework for Review and Analysis of Leases
- Risk Management

Law Applicable to Leases

- Statute of Frauds
(Similar to purchase and sale)
- Priority Statutes
(Similar to purchase and sale)
- Lease Law

Statute of Frauds

Deals with the relationship between the parties who are entering into an agreement.

Statute of Frauds

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Statute of Frauds

- 3 Important Elements
 - Leases for land
 - Greater than 3 Years
 - Must be In writing

Statute of Frauds

This statute deals with the relationship between the parties who are entering into an agreement with each other.

Priority

*Priority is a concept that focuses on the relationship of the parties to a transaction, such as a buyer and seller, or landlord and tenant, relative to the interests of *third parties**

Priority Statute

NCGS Section 47-18(a)

“No...**lease of land** for more than **three years** shall be ***valid*** to pass any property interest as ***against lien creditors or purchasers*** for a valuable consideration from the...lesser but from the **time of registration** thereof...”

Priority Statute NCGS Section 47-18(a)

4 Important Elements

Lease of Land

Greater than 3 years

Validity against Third Parties

Time of Registration

Priority Statute NCGS Section 47-18(a)

This statute protects a contracting party from the interests of other people who are contracting with the same person as the contracting party.

Example: Landlord and Tenant from Tenant perspective.

Lease Law

- NCGS Chapter 42 primarily regulates residential real estate transactions
- Common Law primarily regulates commercial leases

Remainder of this presentation will focus on practical lease concepts rather than specific laws.

Framework for Lease Analysis

- Determine what type of lease you are reviewing
- Review each provision within the context of the type of lease you are reviewing
- Evaluate the lease relative to the tenant

A Framework for Analysis Types of Leases

- Related Party v. Third Party
- Single Tenant v. Multi-Tenant
- Gross Lease v. Net Lease
- Space Lease v. Ground Lease
- Existing Space v. Build/Improve to Suit

Related Party Leases

Landlord and Tenant have a substantial identity
of interest whether directly or indirectly

Third Party Lease

If the Lease is with a third party (i.e., not a related party), then further categorize.

Single Tenant v. Multi-Tenant

Single Tenant Property—there is only one tenant on the land.

- This is simpler than a Multi-Tenant property because there is no concern for how the rights of multiple tenants are intertwined

Single Tenant v. Multi-Tenant

- Multi-Tenant Property
 - there is still only one tenant under each lease, but there are multiple tenants within the property of which the demised premises is a part.
 - It is important to determine how each tenant's rights intertwine with the rights of other tenants.

Gross v. Net

- Gross Lease

Under this type of lease, the rental rate includes all sums that will be due to the Landlord.

 - Economically
 - Risk on Landlord in inflationary market
 - Bet by both Tenant and Landlord as to operations cost

Gross v. Net

- Net Lease—tenant will pay a base rent plus pass through for the entire cost of operations, maintenance and repair items including without limitations, taxes, insurance and utilities and if the property is a multi-tenant property, then also common area maintenance charges.
 - Economically
 - Analogous to bond
 - Risk on Tenant for operations costs

Gross v. Net

- A continuum
 - Subject to negotiation
 - Subject to market conditions
- Rarely see Pure Gross or Pure Net leases

Space Lease v. Ground Lease

- Space Lease—Tenant is leasing a space within a building owned by the Landlord.
- Ground Lease—Tenant is leasing the land with rights analogous to those of an owner to use the land.

Ground Lease

- BEWARE
 - Landlord's like to retain rights that are not beneficial to the Tenant
 - Obtaining financing can be difficult and costly for Tenant
 - Because of length of term, rent v. cost structure is important

These transactions can be complicated and costly on the front end and throughout the lease term

Existing Space v. Build/Improve to Suit

- Existing Space

lease for existing space where nominal upfit is involved and the upfit is the responsibility of the tenant

Existing Space v. Build/Improve to Suit

- Build/Improve to Suit

Lease where there will be a substantial upfit of the premises

- The work may be performed by either the Landlord or Tenant, but usually it will be some combination

This is a construction project wrapped in a lease

Existing Space v. Build/Improve to Suit

- Build/Improve to Suit
 - Important Issues
 - Performance Dates
 - Allocation of Responsibility between Landlord and Tenant
 - Plan and Spec Review and Approval Rights
 - Contractor Lien Rights
 - Possession Delivery Dates
 - Rent Commencement Date

Framework for Lease Analysis

- Determine what kind of lease you have
- It may fall into more than one category
 - Multi-tenant Property
 - Net Lease
 - Build to Suit

Framework for Lease Analysis

- Analyze Specific Provisions

Framework for Lease Analysis Specific Provisions

- Economic Terms
- Termination Rights
- Option Rights

Framework for Lease Analysis Specific Provisions

- Economic Terms
 - Base Rent
 - Pass Throughs
 - Taxes
 - Insurance
 - Utilities
 - CAM
 - Upfit Costs
 - Maintenance, Repair and Replacement
 - Guaranties
 - Assignment Rights – effect on liability of assigning tenant

Framework for Lease Analysis Specific Provisions

- Termination Rights
 - Default
 - Casualty
 - Condemnation
 - Co-Tenancy—shopping center example
 - Continuous Operation—ground lease example
 - Kick Out Clauses

Framework for Lease Analysis Specific Provisions

- Option Rights
 - Option to Expand
 - Option to Relocate
 - Option to Extend
 - Option to Purchase

Risk Management - Leases Tools to Manage Risks

- Estoppels
 - Landlord
 - Tenant
 - Franchisor
- Historical Financial Performance of tenant & franchisor
- Financial Statements of tenant – creditworthiness
- Market study of competitors of Tenant

Risk Management - Leases

How to Manage Risks

- Review Leases in Detail
- *Put the Risks in perspective Relative to your Transaction*
- Use Estoppels and Due Diligence to Manage the Risks

Summary

- Manage risks with the Purchase Agreement, but understand the risks being managed and the tools available for management
- Leases drive the revenue dollars which drive value in a real estate transaction.
- Carefully evaluate Leases for economic terms and non-economic terms