

REAL ESTATE & TITLE INSURANCE

Drafting Land Purchase Agreements for Developers

The purchase of vacant land for future development raises special contractual considerations

By Allen P. Fineberg

Contracts for the purchase of vacant land for future development present special issues. Representing a real estate developer requires an appreciation of practical business constraints that influence the structure of the transaction, which must be reflected in the agreement's terms.

Identifying the Property

Surveys. Although the identification of the subject property is basic to any real estate contract, larger tracts in undeveloped areas often have not been surveyed recently. The contract should provide that the buyer may require the seller to convey the property using the legal description based on buyer's survey, rather than the description in the prior deed. However, the contract should provide that the survey will be certified to the seller also. This will

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also be important if the purchase price is based on the area of the property, in which case the parties will agree to rely on the area determined by buyer's survey.

Excluded parcels. When the property includes the seller's residence (e.g., sale of a farm), the seller often will want to exclude the residential parcel from the sale, which will typically require subdivision from the remainder of the property. However, the buyer cannot be certain that its other approvals will be obtained (or perfected) by the time set for closing, which may also depend on the buyer's financing. Although the parties could agree to apply separately for minor subdivision approval, that option may not always be possible (or desirable). Therefore, the contract should also give buyer the right to require seller to convey the entire parcel, subject to buyer's obligation to re-convey the excluded parcel when the subdivision is perfected. Usually this obligation is secured by a mortgage on the excluded parcel, and the deposit in escrow of a deed for the excluded parcel. Seller's attorney may also request that buyer grant seller a license to use the excluded parcel pending re-conveyance, which should also require the seller to pay all property taxes, utilities, insurance, etc.

Purchase Price

Due to the buyer's approvals con-

tingency (as discussed below) the contract term will usually be over a year, and the seller will often want interim payments to compensate for keeping the property off the market pending the buyer's satisfaction of such contingency, and a price escalation provision for the anticipated increase in value during the term. Apart from the amount and timing of such payments, key issues for negotiation include:

- To what extent payments are refundable in the event of contract termination; e.g., for failure to satisfy a contingency, title defects or condemnation.
- Whether payments are credited against the purchase price. Payment to extend a contingency period might not be credited against the price, since it would essentially be a price escalation payment.
- The granting of security (such as a mortgage or personal guaranty) for the refund of the payments, such as in the case of seller's default. Seller may insist upon the deposit of a mortgage discharge in escrow to be recorded in the event of termination of the agreement due to buyer's default.

Due Diligence Period

During the due diligence period, when the buyer can investigate the property's condition and suitability for buyer's proposed development, the buyer should be concerned about a

number of issues, such as cost management, the basics for termination and the scope of its investigations.

To control costs, the buyer will want to conduct certain investigations sequentially rather than simultaneously, and also will want to have sufficient time for further investigations when preliminary due diligence so indicates. An investigation period of 60 to 90 days is fairly common.

The decision to proceed with the purchase and development of the property is based on many variables. The buyer should resist limitations either on its discretion or on the basis for termination (e.g., buyer can only terminate if, in its reasonable judgment, the property cannot be developed for a [narrowly defined] project). A developer does not want to risk a deposit dispute, especially after incurring significant due diligence expenses.

Finally, the buyer will want to have maximum flexibility to conduct investigations, including invasive testing for environmental studies, and evaluation of ground water levels and suitability of soils. However, buyer's investigations will typically be subject to:

- Providing prior notice of entry to seller.
- Allowing the seller to be present during invasive testing.
- Providing liability insurance naming the seller as an additional insured.
- Agreeing to indemnify the seller for liability resulting from the buyer's activities.
- Requiring the seller to give or make available to the buyer materials relevant to the buyer's due diligence investigations and/or its proposed development, including a title report, survey, wetlands letter of interpretation, previous approvals or development plans, environmental reports, etc. The due diligence period should be extended if seller fails to timely deliver these materials.

Buyer should be able to enter the property throughout the contract term (not just during due diligence), since this will be required in connection with the engineering and approvals process.

Buyer may also want a limited right of cancellation in the event that an envi-

ronmental condition is discovered after due diligence ends. This is usually a subject of intense negotiation, since the seller understandably wants to limit the buyer's right of termination after the due diligence period expires. Solutions to protect the interests of both parties can include allocating remediation costs to obligate both parties to share such costs up to a specified amount before triggering a right of cancellation.

Approvals Contingency

• Buyer's obligation to purchase the property should be contingent upon obtaining all required approvals for its proposed development. The following factors should be considered in drafting the approvals contingency.

• It is common to request a contingency period of 18 months after due diligence, with an option to extend for at least an additional six months, or longer if rezoning is required.

• It is a point for negotiation whether the buyer would be required to pay for these extensions and whether the extensions would be in addition to the purchase price.

• A zoning change can be treated as a separate contingency to postpone any nonrefundable payments to seller until after rezoning.

• Buyer should resist a specific delineation of the approvals subject to the contingency, although it is reasonable to specifically exclude certain items, such as building permits, posting of performance guarantees and filing of final subdivision plats.

• An approval is not considered to have been obtained unless (a) it is not subject to conditions unacceptable to buyer (e.g., requiring the construction of off-site improvements in excess of those needed for the project); and (b) all appeals periods have expired and, if an appeal has been filed, the appeal has been denied or otherwise disposed of satisfactorily to the buyer.

• The approvals contingency should include obtaining easements required to develop the project, such as off-site utility easements, rights-of-way, etc.

• The contract should provide for an extension of the approvals period in

the event of the imposition of a moratorium or litigation affecting the approvals or the property. The aggregate extension should not be less than a year and at least two years would be preferable. Whether buyer must pay for this extension (and whether the payments are credited to the purchase price) is an issue for negotiation. As a compromise, the moratorium extension could be without charge (since it is outside the control of the parties), but the buyer would have to first exhaust any other extensions provided in the agreement.

Seller's Representations

The seller's representations should elicit information to augment the buyer's due diligence investigations that could affect the buyer's ability to purchase the property or proceed with its intended development. As a result, the buyer need not be overly concerned with limiting many of the representations to the seller's knowledge. However, seller's representations should be true when the contract is drafted and at closing, and the representations should survive closing for a reasonable period of time, generally one to two years. In particular, buyer should request representations to determine:

• The property's past or present agricultural use, and any farmland assessment. If the property is potentially subject to rollback taxes, the contract must allocate responsibility for this liability.

• Any environmental concerns, including current or past environmental site remediation; current or prior uses involving hazardous substances or waste; whether the property was an industrial establishment under the Industrial Site Recovery Act; and whether there are or were any underground storage tanks.

• The presence of buried debris or other items.

• Whether the property is subject to unrecorded agreements that could affect its proposed development or use.

Defaults and Remedies

Buyer's default. The buyer typically seeks to limit the seller's remedies to retaining the deposit and any other payments previously made to the seller as liquidated damages.

Seller's default. Conversely, the buyer should have the following remedies:

- The right to terminate the contract and receive a refund of all deposit monies and payments to the seller and to recover damages, at least for its actual costs incurred in connection with the proposed development of the property, including consulting, engineering and attorney's fees. Sometimes the parties will agree on a cap on the reimbursement of these expenses (which may be set in relation to the liquidated damages that the seller would receive in the event of the buyer's default).

- The right to sue for specific performance, which is buyer's only practical protection against a seller's willful default.

Notice and cure. It is advisable to provide for notice of default and opportunity to cure, although such notice would not apply to a breach of seller's representations.

Attorneys' fees. It is often advisable to provide for recovery of attorney's fees in addition to any other remedies, since the potential liability for these additional costs may serve to dissuade a seller from making a frivolous objection to buyer's exercise of a right of termination and demand for return of deposit monies.

Time of the essence. While either party may consider it appropriate to include a time of the essence provision, this could be a detriment to the buyer, who will have a number of specific deadlines in the contract. As an alternative, the contract should provide that either party may declare time of the essence upon some reasonable notice (e.g., ten days) at any time after the

deadline for performance has passed.

Memorandum of Agreement

Given the length of the contract, buyer should try to negotiate the right to record a memorandum of the agreement to provide record notice of the buyer's rights. Often, the seller will resist, so a typical solution is to provide for a discharge of the memorandum to be signed contemporaneously and held in escrow, to be recorded upon termination of the agreement for any reason other than the seller's default.

The foregoing is not intended to be an exhaustive discussion of issues that developers and counsel face in negotiating and drafting contracts for the purchase of undeveloped land. Although there are many common issues, every situation is unique and often will generate a unique solution in the course of negotiating the agreement. ■