

United States

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1. Introduction

Acquisition of real estate in the United States is governed largely by the laws and practices of the state in which the property is located. While the common law establishing rights and obligations pertaining to real property ownership and to contracts for the purchase and sale of real property is generally the same from state to state, and in all cases except Louisiana based on English common law, the precedents established by case law in an individual state, the statutes passed by that state's legislature and the rules and regulations promulgated by state and local regulatory agencies do differ. US real property owners are also subject to both federal and state tax laws.

Custom and practice also vary from state to state in the manner in which a real estate transaction is handled and the parties who are likely to be involved. Residential and commercial transactions in the same state are also often handled differently. This chapter will describe in general terms how acquisition of real estate is handled in the United States and the fundamentals that a potential purchaser should keep in mind. It will not attempt, except in very general terms, to describe differences in state laws or procedures. An investor in US real estate should always consult with counsel and other advisors in the state where the property proposed to be purchased is located. The chapter also assumes that the non-resident investor is purchasing fee title to the property, either as an individual or by forming an entity to acquire title, and is not acquiring an interest in a REIT, partnership or joint venture, or other investment entity formed by third parties for the purpose of investing in US real estate.

The typical stages of a real estate acquisition include: identification of a property meeting the investment objectives of the purchaser (property type, location, price range and potential for income generation and appreciation); negotiation of the terms of purchase acceptable to buyer and seller; due diligence with respect to title, physical condition, existing tenancies, development potential, availability of financing for purchase or future development, etc; and closing. Properties for sale are commonly listed with a licensed real estate broker, who represents the seller, but who can also represent a prospective purchaser under a dual agency agreement. The prospective purchaser may have a separate real estate broker, who enters into an agreement with the selling broker to share the real estate commission the seller has agreed to pay or who, by agreement with the buyer, may be separately compensated by the buyer. Due diligence, as further explained below, may involve engagement by

the buyer of a contractor or inspector to evaluate the physical condition of the property and its compliance with legal requirements, an appraiser, a surveyor, an environmental consultant, a tax advisor and legal counsel. Closings in some states are handled by title companies or independent escrow agents and in other states by attorneys who function both as the escrow agent and as a legal advisor to either buyer or seller. It is important that a non-resident purchasing real estate in the United States obtain the advice of both a tax specialist, either a tax accountant or tax lawyer, and a real estate lawyer versed in the tax and reporting requirements applicable to US non-residents.

2. **Terms of purchase**

Once a potential property has been identified, the terms of purchase are often negotiated in a two-step process, first the negotiation and acceptance of a non-binding letter of intent and then a binding purchase and sale agreement. This is often the preferred method when dealing with commercial properties. The letter of intent typically sets forth the agreed price, the amount of any deposit, the length of the due diligence period during which the deposit may be refunded if the buyer elects not to proceed with the transaction, the outside closing date, the allocation of closing costs and whether the purchase is to be 'as is', or subject to customary representations and warranties. Certain provisions, such as confidentiality or the seller's agreement not to have discussions with other potential purchasers for a stated period of time, are binding on both parties, but otherwise the letter of intent, by its express terms, does not create an enforceable contract of purchase and sale.

In other cases, the initial offer to purchase is presented to the seller in the form of a purchase agreement, which the seller may accept, reject or further negotiate the terms. This approach is often used in the case of residential purchases and often relies on the use of standardised printed form contracts which have been developed by the state's association of realtors. While use of a standardised form, particularly in residential transactions, can expedite the offer and acceptance process and may make the seller feel more comfortable, the form should always be reviewed carefully and changes or additions made by addendum, as may be desired or required by the buyer.

The purchase agreement generally addresses: the purchase price; the amount of any deposit and, if applicable, increases in the deposit at the end of due diligence; the period for and the kinds of due diligence to be conducted; other conditions precedent to the buyer's obligation to close the transaction; any representations and warranties being given by the seller; the timing and mechanics for closing, including proration of income and expenses attributable to operation of the property and allocation of closing costs; provisions pertaining to seller's obligations to maintain the property during the contract period; provisions relating to damage or destruction that may occur during the contract period; and other miscellaneous provisions.

A key term of any purchase agreement is whether and the extent to which the seller is making representations and warranties about the property and to what extent the buyer is being asked to rely solely upon its own inspections and investigations in assessing possible risks associated with a particular property. There is no standardised meaning for what may constitute an 'as is/with all faults'

purchase. In all cases, the seller should be willing to make representations and warranties pertaining to its authority to sell the property, having obtained all consents required for the sale and not being the subject of a bankruptcy proceeding or otherwise insolvent. Beyond that, representations may be negotiated with respect to: title to and encumbrances against the property (although title insurance provides better protection for the buyer than the seller's representations); physical and environmental condition of the property; compliance of the property with applicable laws; including environmental laws; status of leases and tenancies, including whether either landlord or tenant are in default of any lease obligations; absence of any litigation or administrative proceedings involving or threatened against the seller pertaining to the property; absence of pending or threatened condemnation proceedings; accuracy of financial and operating statements pertaining to the property; and any additional matters of concern with respect to the specific property. Many sellers will agree to give representations only about matters which are within the seller's knowledge, but unlikely to be learned in the course of either a physical inspection or examination of public records. The seller will otherwise want the buyer to satisfy itself about the property. Sellers do have an obligation at law to disclose any condition of which they are aware that, if known to the buyer, would have a material adverse affect on the buyer's decision to acquire the property. Sellers will also often want to limit the period during which the representations and warranties remain in effect (often for a period of six months to one year following the closing) and/or the amount or kinds of damages that may be claimed in the event a breach of any such warranty is discovered after closing.

Purchase agreements also generally set forth conditions which must be satisfied in order for the closing to occur. If any of the express conditions to the buyer's obligation to close are not satisfied, the buyer is usually entitled to a return of its deposit. If all conditions are satisfied or waived by the party for which benefit they existed and the buyer fails to close, the buyer is subject to damages for breach of the purchase agreement. Often the deposit is viewed as liquidated damages and may be retained in its entirety in the event of a buyer's failure to close as required by the terms of the purchase agreement. A state may, by statute, limit the amount of liquidated damages which may be collected in the event of a buyer breach in a residential transaction; in other cases and in other states, the amount must simply be a reasonable estimation of the damages the seller would suffer. In California, for example, the amount of liquidated damages in connection with the purchase of residences is capped at 3% of the purchase price; for commercial transactions, there is no statutory cap. Conditions precedent for the benefit of the buyer may include: willingness of a title insurance company to issue title insurance to the buyer subject only to the exceptions to title agreed to by the parties; satisfaction of buyer's due diligence condition within a stated period of time; buyer's confirmation that it will be able to obtain any financing required for the acquisition; the truth and accuracy of seller's representations on the closing date; delivery of tenant estoppels confirming that the leases are in full force and effect, that there are no lease terms not reflected in the lease and any amendments provided to the buyer and that neither tenant nor landlord is in default of any of its lease obligations; and other matters of concern to the buyer.

3. Due diligence

As noted above, regardless of any representations and warranties being made by the seller (or seller's broker) about the property, the buyer will want to confirm independently, to the extent it can, that the property is as presented. That includes the state of title to the property, compliance with zoning laws, building codes, environmental and other laws applicable to the property, physical condition of the property and what, if any, repairs are likely to be required immediately or in the near term, status of leases etc. It also includes, for a foreign purchaser, an understanding of the laws applicable to non-resident owners of US real property, reporting requirements and tax implications of the manner in which title to the acquired property is held. The buyer's broker (or investment advisor) can be very helpful in arranging inspections of the property by qualified professionals and otherwise recommending local advisors.

Review of title involves both confirmation that record title is held by the seller and approval of all title restrictions applicable to the property and parties, such as easement holders, who have an interest in the property. All such restrictions or interests which have been recorded in the public records and which will be binding on future owners can be determined by a review of a title report prepared by the title company. Depending on the state, the title report may take the form of a preliminary report (which simply lists the record owner, the legal description of the property and any exceptions to title recorded against the property), or a title commitment (which also sets forth the conditions which must be satisfied for the title company to issue a policy in the form of the commitment). Exceptions to title include any outstanding real property taxes and the date to which taxes have been paid, any assessments against the property which are not included within the real property taxes, easements, recorded restrictions on use (often referred to as CC&R's – covenants, conditions and restrictions), mortgages evidencing indebtedness secured by the property, mechanics or materialmen's liens for work done or materials provided to the property and not paid for, tax liens, judgment liens, leases or licences granted to third parties where a memorandum of the lease or licence has been recorded and, in some cases, agreements with local government agencies setting forth conditions pertaining to future development of the property.

Title insurance, issued by a nationally or regionally recognised title insurance company, assures the buyer that valid, marketable title has been transferred into the buyer's name (ie, that the seller had valid title and took all actions, including obtaining any required consents, necessary to transfer that title to the buyer for the agreed consideration), which title is subject only to those matters or agreements which are expressly listed in the title policy. The insurance, usually in the amount of the purchase price, insures title as of the time of transfer. It does not insure against any title claims arising out of events occurring after recordation of the deed. The title policies issued by title insurance companies differ from state to state, but are generally based on standards developed by the American Land Title Association. Residential policies typically insure only against matters that have been recorded in the official land records. Commercial policies may be similarly limited or, for payment of an additional premium, will also insure against matters such as

encroachments shown on a current survey of the property, uses of the property that are not recorded rights but can be observed by physical inspection of the property (such as occupancy rights) and mechanics liens which have not yet been recorded but may arise in connection with current or recently completed work at the property. In addition, the buyer may request additional affirmative coverages in the form of endorsements, such as those insuring against any outstanding violation of CC&R's affecting the property or against the forced removal of improvements which encroach onto a neighbouring property or an easement or insuring that the property is a separate tax parcel or that the property is zoned for its current use.

In order to obtain coverage against matters which may be shown on a survey, the buyer will need to obtain a survey meeting the requirements established for ALTA/ASCM surveys, which are prepared by licensed surveyors. Survey matters, such as plotting the legal description of the property, showing the location of all easements and any encroachments and establishing whether or not the improvements meet all setback, height and similar governmental requirements, are important where the buyer is acquiring land for future development. Surveys are also typically required by lenders making a loan secured by any commercial property.

An environmental assessment report, prepared by an environmental consultant, is generally obtained in connection with commercial transactions and will be required by the lender if the acquisition is being financed with a loan secured by the real property. The environmental assessment report, often referred to as a Phase I, will address prior and present uses of the property, whether any of those uses involved the actual or potential storage or use of hazardous materials, as defined by federal and state law, and whether the records of state and local government agencies regulating the use and clean-up of hazardous materials evidence the presence or former presence of underground or above-ground storage tanks for petroleum-based fuels or other hazardous substances, any remediated or unremediated spills, discharges or underground migration of hazardous materials affecting the property and, if contamination or possible contaminants have been noted, whether the applicable government agency has determined that the contamination issue has been satisfactorily resolved. If contamination or possible contamination is found to exist, a Phase II may be ordered, which would involve the taking of soil or groundwater samples to determine if any hazardous materials contamination in quantities sufficient to require any further action is or is not present.

Due diligence in all cases, whether acquiring residential or commercial real estate, should include physical inspection of the property for possible violations of local building codes and other applicable ordinances and conditions which require immediate repair or are likely to require repair in the near term. Focus typically is on such items as termite infestations and dry rot, roof condition, heating and air conditioning systems, electrical systems, foundations and, in commercial buildings, compliance with disability access, fire code and other local governmental requirements. These investigations are typically conducted by contractors and others in the building trades. This aspect of the due diligence should also include a review of the records of the local building department and, in the case of commercial buildings, the local fire and planning departments to determine if there are any outstanding code violations

for which notice to correct has been given, whether appropriate building and other permits were issued for prior improvements to the property and those permits have been closed by a final inspection and sign-off by the applicable government department and that a certificate of occupancy has been issued and is in force.

4. Closing

The closing of the transaction (in its simplest terms, the exchange of cash for a deed to the property) can take place in a number of ways, generally involving an escrow in which a neutral third party receives the cash and the deed and then disburses the cash to the seller, after paying lienholders and closing costs, and records the deed in the official records of the county where the property is located as soon as all the conditions to closing have been satisfied or waived by the parties. As noted above, the attorney for one of the parties may act as the escrow agent and may also act as the agent for the title company issuing the title insurance. In other cases, the escrow agent is either an independent escrow agent or an escrow officer employed by the title company. Customary practices for real estate closings do vary from state to state, so consulting a local professional to determine how closings are typically handled in the jurisdiction where the property is located is important.

The form of deed used to transfer title to real property also differs from state to state. A deed may be: a general warranty deed, in which the seller warrants title to the property against any and all claims; a special warranty deed (in some states called a grant deed), in which the seller warrants only that the seller has not conveyed away any interest in the property and that the property is free from encumbrances created by or attributable to the seller; or a quitclaim deed, which is a conveyance of whatever interest the seller may have, if any, and contains no warranties of title. A general or special warranty deed may state on its face that the conveyance is subject to all covenants, conditions, restrictions, easements and other matters of record or may itemise those recorded documents which the buyer has agreed to take title subject to. The signatures on all deeds, mortgages and other documents which are to be recorded in the official records of the local county must be notarised by a notary public licensed by the state in which the document is executed or by a US consular officer if being executed outside the United States. That means the signatory must sign the document in the presence of a notary public or consular official and prove to that person that he is the person signing the document by providing a valid driver's licence or passport. The notary will also enter a fingerprint of the signatory in the record required to be kept by the notary. In countries which subscribe to the Hague Apostille Convention, the procedures set forth in that convention for authentication of public documents may be substituted. Actual delivery of the deed, whether or not recorded, constitutes the required act of conveyance of title to the property. Recordation in the official records of the county where the property is located, however, provides record notice to the world that title is held by the party listed on the deed.

Closing is generally conditioned upon: the escrow agent having received from the buyer and holding immediately available funds in the amount of the purchase price and the buyer's share of closing costs; the title company having confirmed that it will issue the title policy in the form and with the endorsements requested by