

How To Prevent Real Estate Problems in Non-Real Estate Transactions

Joshua Stein

Real estate and non-real estate lawyers may have different starting points for the transaction. But it is crucial that they agree on the goals.

IN SOME TRANSACTIONS, real estate represents just another category of asset—part of a larger pool of assets being held, sold, financed, mortgaged, or otherwise dealt with by a company that is not in the real estate business.

Here, real estate attorneys and paralegals need to work closely with their non-real estate

colleagues to bring about a single combined closing of a single combined real estate and non-real estate transaction. Sometimes the best possible outcome for the real estate side of the deal will be that it does not delay the closing. As long as that doesn't happen, neither the clients nor the other attorneys care much about the real estate or how the real estate attorneys handle it.

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This article offers some advice to help achieve that goal. Much of this advice is relevant more to the non-real estate lawyer than to the likely reader of this work, but it is included here because it may be helpful in running and planning the real estate side of one of these hybrid transactions.

HANDLING THE REAL ESTATE • Real estate attorneys must coordinate their efforts with their non-real estate colleagues toward a single goal: making sure the real estate pieces of a transaction integrate seamlessly with the transaction as a whole.

Real Estate Takes Time

In scheduling a transaction, assume that to handle the real estate work in a proper, traditional, and (relatively) economical way, depending on the transaction, will require anywhere from three weeks to a month. This clock begins ticking, though, only when the client has provided a full list of properties and authorization to start work. If surveys are required, add two weeks.

Quicker turnaround can almost always be achieved, but it usually increases total time billed and total cost. These estimates are usually out the window if the property involves any of the following:

- Railroad land;
- Waterfront;
- Mineral or timber rights;
- Large or complex property not recently acquired or refinanced;
- Wetlands; or
- Purchases out of bankruptcy or other distress situations.

Tell the Real Estate Team What Is Going On—Early

As early as possible in the life of the deal, if it will involve real estate, whoever is running the

deal should go over it with a member of the real estate department to discuss how real estate fits in and how best to handle, document, and staff the real estate work. Do this as early as possible, before the client signs anything, commits to a closing date, or receives any estimates of costs or timing.

Set Up Direct Communications

If real estate is a significant part of the deal, try to set up direct communications, early in the deal, between the right person in the client's organization and the attorneys and paralegals who will handle the real estate. This can help give the client the best and most timely possible service, minimize communications problems and delays, and assure that the client understands any real estate risks.

Likewise, try to set up direct communications, as early as possible, between the attorneys and paralegals at the firm working on the real estate and those representing other parties. Try to include the real estate team in the players' lists as early as possible.

Figure Out What Real Property Is Affected

In any transaction involving real estate, the major startup and timing problem (*i.e.*, cause of delay and avoidable expense) consists of understanding what properties will be involved and getting the necessary underlying documentation.

As soon as it becomes apparent that a deal will involve real estate, try to obtain a current site list, including any site numbering scheme that may exist, for both operating and (often forgotten) nonoperating real property involved—all of it. The company might not always be able to provide this list quickly, so try to give as much lead time as possible.

If you will be responsible for title review or preparing any recordable documents, try to get

legible legal descriptions and existing title policies, commitments, reports, surveys and so on—all as early as possible.

Site lists and legal descriptions should, to save time and money, be provided electronically if available; however, this is not yet customary. A high-quality typed original that can be scanned is almost as good.

If the client wants to manage costs by treating properties differently depending on relative importance, usually based on value or use, that information also needs to be communicated at the beginning of the transaction, along with any special instructions about what is and what is not included.

Meshing the Real Estate with the Rest of the Transaction

You will want the real estate side of the deal to mesh appropriately with the non-real estate side. That means you need to review or edit the non-real estate documents to check references to real estate documents, issues, and closing procedures. Some common problems:

- *Reasonableness.* Corporate documents often give the borrower more flexibility than real estate documents, because of differing fundamental premises about the value of the borrower's credit and business judgment versus the ability and need to rely on a so-called hard asset. Make the documents consistent. If necessary, include a "conflicts" clause.
- *Defaults.* The defaults, cure periods, and remedies between the larger transaction and the real estate side of the transaction should coincide. This works both ways. If a problem arises with the real estate, at some point it may need to become a default for the larger transaction.

Real Estate Representations, Warranties, and Covenants

If the "deal documents" adequately cover

real estate issues, consider cutting back the real estate documents so they merely create whatever interests in real estate the parties want to create, along with appropriate real estate-specific remedies for default. If the parties have negotiated their "business deal" as part of the overall deal documents, they don't want to have to negotiate that same deal again in the real estate documents.

Focus on New Entities Early

If newly created entities will hold the real estate, the real estate attorneys and paralegals need the names of those entities as early as possible. Figure out who will form those entities and make sure it happens quickly.

Choose Local Counsel Carefully and Early

It does not necessarily expedite the deal to use the same local counsel as the other party(ies). Early in the deal think about the potential benefits, including potential savings, from hiring separate local counsel. If it makes sense, do it as early as possible.

Think About Environmental Review

Whenever a transaction involves real estate other than office leases, think about environmental due diligence right at the beginning. This usually requires extra lead time plus environmental expertise. Early action will often save money.

Consider Taking Shortcuts

Many non-real estate attorneys and many clients increasingly ask why real estate is so complex and costs so much to deal with, and whether there are easier and cheaper ways to handle it.

There are. All involve some incremental risk, which the client needs to understand. That discussion should take place as early as possible in

the life of the deal. It depends in part on the role of real estate in the transaction. Is the real estate a "throw-in," just an extra piece of collateral or extra asset that doesn't carry much value? Or is it an essential piece of the transaction?

You need to ask those questions and then memorialize the answers.

Beware of Leases

Much of commercial and industrial real estate in America is held under long-term leases. Real estate attorneys who represent lenders and purchasers ordinarily regard leases as cumbersome, fragile, and unreliable estates. Until convinced otherwise, don't assume leases have long-term value or reliability.

Therefore, real estate work for leaseholds is sometimes very quick and easy because the client assigns them zero value so they don't really matter. More often, leases are difficult, time-consuming, and expensive, because they are important but difficult assets and can require landlord cooperation. Whenever any discussions with a landlord are required, they tend to be agonizing and slow. Start early.

Consider Whether To Do Random Sampling

Due diligence on multisite transactions can often be streamlined by examining only a ran-

dom selection of sites—not all sites. With a properly chosen sample, or samples of various subgroups, one can achieve a surprisingly high comfort level by checking relatively few sites. A client concerned about saving money and willing to bear some incremental risk may want to consider this option.

By keeping in mind the guidelines suggested above, real estate attorneys and non-real estate attorneys can successfully work together on large transactions without having the real estate closing process cause problems, delays, or crises. All it takes is early communications, sensitivity to the real estate side of the deal, and a team approach from day one.

Understand the Importance of the Real Estate

If the transaction isn't fundamentally driven by real estate, determine just how much the real estate part of it matters. What is the significance and relative value of real estate in the larger picture? How much scrutiny of the real estate is required? If due diligence were to reveal that all the real estate had zero value and was actually owned by the Vatican rather than by the borrower, would the transaction still close on the same terms? The answer to this question will affect a great deal of what a real estate lawyer should do when working on a non-real estate-transaction.

PRACTICE CHECKLIST FOR
How To Prevent Real Estate Problems in Non-Real Estate Transactions

When real estate is part of a larger pool of assets in a transaction, real estate attorneys and paralegals need to work closely with their non-real estate colleagues to bring about a single combined closing of a single combined real estate and non-real estate transaction.

- To help achieve that goal, recognize that:
 - Real estate takes time, so make all aware of how much time is needed, particularly with unusual types of real estate;
 - See to it that the real estate team knows what is going on—early;
 - Set up direct communications between the real estate team and the client;
 - Figure out what property is affected;
 - Get legible legal descriptions—electronically if possible;
 - Check the transaction documents and their references to real estate documents;
 - Try to minimize the real estate documentation while making sure the underlying deal documents adequately cover real estate issues;
 - If newly created entities will hold the real estate, get their names as early as possible;
 - Choose local counsel early;
 - Whenever real estate is involved, consider environmental due diligence early;
 - Ask the client if it is willing to risk taking “short cuts” on the real estate (but explain the risks!), particularly if the real estate is a small part of the deal;
 - Determine whether any leases are valuable and treat them accordingly; and
 - Consider setting up a “random sampling” of multiple sites in the deal. This can often provide a cheaper alternative to a full search at minimal incremental risk to the client.