FUNDAMENTAL CONSIDERATIONS IN A REAL ESTATE TRANSACTION

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I. **Foundational elements to understanding the transaction**:

A. **Parties to the transaction**: Knowing the parties and their primary and secondary motivations informs the attorney and enhances the attorney's negotiating skill.

1. **Seller** – Possible motivations
   a. Profit
   b. Distress sale
   c. Partnership disruptions/disputes
   d. Diversification
   e. REO (real estate owned/foreclosed)

2. **Buyer** – Possible motivations
   a. Planned development
   b. Investment opportunity (short term/long term)
   c. 1031 exchange (purchasing target property)
   d. Protection of neighboring property

3. **Existing lender** – not really a "party" but may be providing underlying motivation for Seller to sell. For example, if the loan has been on the books for a long period, the existing lender may be forcing a sale because of its desire not to renew the loan

4. **Acquisition/construction lender** – Also not a party, from the seller's perspective, but very much "a part" of the transaction because the lender's requirements will often time dictate the flexibility of the buyer.

   a. If the lender requires additional equity because of deferred maintenance issues, the buyer will be motivated to seek a price reduction rather than come up with additional cash.

   b. The lender may require a threshold of estoppel certificates and SNDA's (Subordination, Non-Disturbance and Attornment Agreements), either in number, square footage

or from certain key tenants, failing which it will refuse to fund.

c. The lender may be unhappy with vacant space and require lease guaranties, in the form of a master lease or other escrow.

d. A host of other due diligence issues could affect a lender's willingness to fund, including, without limitation, zoning issues, environmental concerns and restrictive covenants or other title matters. It is entirely possible that the lender and buyer have identical issues and concerns, or that the lender is more risk averse than the buyer.

5. **Brokers** are specifically not parties to the transaction but can facilitate (and sometimes impede) a transaction. The broker's need to know all details of the transaction must be weighed against the broker's actions and reputation (as being truly a client representative, looking after the client's best interest, or as being motivated solely by commission).

6. **Tenants**, in existing developments, especially those involving "key tenants" (those that are credit-worthy and lease a substantial amount of space or substantial square footage).

a. **Estoppels** (and **SNDA's**, if applicable) will be required as a condition to closing; disgruntled tenants can use this as an opportunity to seek redress for existing landlord failures or defaults.

B. **Property type**: Each type of property has unique requirements.

1. **Retail** properties may be complicated not only by key tenants, but by out-parcel, or large lot owners, with interconnected easements and maintenance/operating agreements. Escrows for pass-through expenses have to be considered. Exclusive use covenants, co-tenancy ("going dark") clauses and signage rights might be confusing. Existing lease brokerage agreements may require payments on renewals or expansions not contemplated by the purchaser.

2. **Office** buildings usually involve a large number of tenants, some of which may be key tenants. If the lease form does not contain automatic subordination and attornment language, SNDA's can become crucial. Expansion options and rights of first refusal might be complicated. Lease brokerage agreements also come into play.

3. **Industrial** properties are similar to retail, but usually less complicated in terms of easements and tenant requirements (i.e. no co-tenancy or exclusive use clauses). There are usually fewer tenants, but that means that each tenant becomes more important to the transaction.

4. In **multifamily** property deals, the rent roll is crucial in determining value. There will be no estoppel or SNDA requirements. Self-storage facilities have unique rent proration provisions.

5. **Vacant** or "raw" land might be viewed as the most simple of transactions, especially if the property has never been developed. Leasing is non-existent. Evidence of governmental compliance is also not required, except as might concern environmental, wetlands or flood concerns.

6. Purchase of a **leasehold interest** is unique. Ground lease estates are purchasable interests of real property, and special attention must be paid to the landlord under the ground lease, and a landlord estoppel is an absolute requirement. Lenders will have special requirements regarding notice and cure rights under the ground lease. A well drafted ground lease has commonly sought mortgagee protections.

    a. These protections are notice and cure rights, the right to assign the tenant's interest following a foreclosure, anti-merger language (so the fee and leasehold interest do not merge), and savings clauses in the event the ground lease is inadvertently terminated.

II. Tying up the Land: Letters of Intent and Purchase Contracts

A. Letters of Intent – **Purposes**:

1. Gives comfort to parties seeking to make a deal

2. Sets forth basic business terms from which a formal agreement can drafted

B. Letters of Intent – **Customary Inclusions**:

1. Identify property, purchaser and seller

2. Specify purchase price, payment terms and earnest money

3. Specify time periods for closing and for inspection period, if any

4. Identify brokers and payment of commission
   a. Regardless of contract language, the real party paying the commission is the purchaser because the commission is factored into the purchase price

5. Set forth the costs for which each party is responsible. Georgia practice is to have the seller pay for the Georgia Real Estate Transfer Tax ($1.00 per $1,000 of consideration), costs of satisfying any title exceptions required to be cured pursuant to the contract, and other costs incurred by the seller. Purchaser generally pays title, survey and other costs incurred by the purchaser.

C. Letters of Intent – **Other Possible Inclusions**:

1. Impose a responsibility of cooperation on the seller to deliver all due diligence materials such as title, survey, development plans, environmental reports and other tests and analyses. May include prior years operating statements.

2. Include other desirable contingencies, such as development permit contingency or annexation into adjoining municipality contingency

3. Require the seller not to market the property or take any back-up offers during contract period.

4. Confidentiality provisions which require that the purchaser and seller not reveal information discovered regarding the property during due diligence.

   a. If there is detrimental information, the purchaser could poison the market by revealing the information to other potential purchasers, thereby limiting the number of available and willing purchasers and thereby causing a reduction in the market price of the property.

5. Any particular contract terms that might be relevant, such as requiring that the sale be “as is” or requiring certain specific representations, such as the presence of utilities at the property.

D. Letters of Intent: **Mandatory Inclusion**:

1. Need a statement that the letter of intent is "non-binding" or could be result in an incomplete agreement that is binding and enforceable.

    a. The statute of frauds requires that all real estate contracts be in writing, and a letter of intent, even though incomplete, is a written agreement that could be enforced.

2. The form and substance of these "non-binding" sections can vary but should contain at least as follows:

> "It is understood that this letter is merely a description of certain basic terms of a proposed transaction and not a legally binding agreement, and is subject to Purchaser and Seller negotiating and executing a formal Agreement. From and after the date of execution of this letter of intent, Purchaser and Seller shall use their best efforts to enter into a mutually acceptable formal Agreement and shall direct their attorneys to prepare the Agreement, provided that until such Agreement is signed by both Purchaser and Seller, either Purchaser or Seller may withdraw from negotiations by written notice to either other without any liability."

3. Might also include language prior negotiations are incorporated and merged in the letter of intent, and that any reliance, estoppel, commitment, or other legal argument is justified or enforceable. Also possible to include a "merger" clause stating that the entire understanding of the parties regarding the subject matter is contained within the letter of intent which supersedes all prior and contemporaneous agreements and understandings related thereto.

4. The parties may nonetheless require that certain covenants in the letter of intent be binding, such as confidentiality provisions, which protect the proprietary nature of material that the seller may furnish regarding the property and its business operations.

II. **Purchase Contract – Completing the Acquisition Requirements**:

A. **Purchase Contract Essentials Not covered by the Letter of Intent**

1. Establishing escrow for earnest money and absolving escrow agent from liability

2. Describing the property with specificity together with any necessary appurtenances

3. Title and survey section setting forth time periods for objections and defining the seller's obligation to cure title objections

4. Describe the closing process, including documents to be executed and delivered, prorations, and other deliveries at closing

5. Establishing an inspection right, and containing an indemnity by the purchaser for damages arising from the inspection of the property

6. Additional covenants of the seller regarding on-going property operations, such as leasing rights or leasing criteria, compliance with existing loan documents, maintaining the property and property insurance, and restricting further encumbrances

7. Casualty and condemnation provisions

8. Default provisions

9. Assignment rights, if any

10. Representations and warranties or "as is" limitations

11. Service contract provisions – which ones will be assumed and which ones will be terminated

12. Completion of any offsite or onsite infrastructure

13. Brokerage disclosures and indemnities

14. 1031 like-kind exchange provisions

15. Miscellaneous but crucial provisions:

    a. Time is of the essence
    b. Severability clause
    c. Merger clause
    d. No amendment or modification clause
    e. Georgia law provision
    f. Multiple counterparts
    g. Establishing "effective date" or other key dates

B. **Details on essential provisions**

1. **Earnest money and escrows**: Some contracts require relatively little earnest money on execution and a more substantial amount upon expiration of the inspection period. Since earnest money is generally refundable until the expiration of the inspection period,

initially the purpose of earnest money is limited to demonstrating the ability and sincerity of the purchaser rather than establishing an incentive to prevent default. After the inspection period, the earnest money should be sufficient enough to motivate the purchaser not to default.

a. The contract should provide that the failure of the purchaser to timely deliver any of the required earnest money is grounds for the seller to terminate. Case law has held that there is independent consideration for the purchase and sale agreement even if the earnest money is not deposited.

b. Any additional deposits which are intended as earnest money should be defined as such, and the definition of earnest money should specifically encompass those other deposits, by reference to sections or paragraph numbers of the contract. Earnest money can also be in the form of letters of credit.

c. The escrow agent should not be a stakeholder in the transaction. Brokers, title companies and attorneys typically serve as escrow agents. Their liability should be restricted to liability resulting from willful acts or gross negligence. Interpleader language should also be included (potentially with the right to deduct the costs of interpleader from the escrowed funds).

2. **The property description** must be specific. Attachment of a survey or legal description is best practice. Other possible references include tax maps, street addresses, or other drawings. Case law holds that if there is no "key" from which to determine the property description, the contract will fail.

a. In the context of a property to be carved out of a larger tract, it is problematic, but common practice, to be unable to specify the exact legal description until the survey is complete. The seller may want to control the survey process in such a case, or at a minimum, have consent rights thereto.

b. Often legal descriptions drawn from surveys differ from the vesting legal description, but it is unfair to have the seller warrant a new survey legal. Common practice is to require a (limited) warranty deed to the vesting legal, and a

quitclaim deed to the survey legal, thereby updating the public records.

3. **Parties to the contract**: The seller should be the party holding vested title, and the purchaser should be specific, without references to "its successor and assigns" although common practice is for real estate companies to which assign the contract to a specifically created new entity at closing.

4. **Purchase price and payment terms**: Describe the purchase price in words and numbers. Typically, payment is cash, cashier's check, or funds wired in the federal reserve electronic funds transmission system. Federally wired funds are the best practice because the funds are readily available upon receipt. Contrary to popular belief, bank checks and cashier's checks are not instantly available and need to clear, sometimes overnight and sometime over a longer period. The payment section should specify that the escrow agent shall release the earnest money to the seller and the purchase price will be credited in the amount thereof. The section also may provide that payment is subject to prorations and adjustments as provided in other parts of the purchase contract.

    a. If payment is not "all cash" but includes a purchase money note and security deed, the form and content of the note and security deed need to be either attached, or language should be included that they will be on certain standard forms (such as a recognized bank form) or that the seller and purchaser will negotiate the forms during the inspection period. In either case, essential terms should be included, such as payment terms, notice and cure rights, release (i.e. for roads, common areas and parcels) provisions and non-recourse provisions.

5. **Title and survey sections**: Defines parameters of valid objections and the seller's cure obligations. Objections may be limited to those title exceptions which are not "insurable" at standard rates by a national title company. However, there are distinctions between title that is "insurable" and that is "good and marketable." Sellers often attach a list of those exceptions which are already known, and thereby exclude them as valid objections. The rationale is that the purchaser can review the pre-existing exceptions during the inspection period and terminate the agreement if needed.

    a. The time periods for objecting and for the seller to respond affirmatively or negatively thereto should be specified. The purchaser's rights to cure, terminate or waive those

objections should also be specified (by time period as well, from the seller's perspective).

b. The seller should nonetheless be obligated to cure certain monetary liens. The extent of this obligation is negotiated. The seller may want to limit its obligation to those liens known to the seller, such as security deeds which it expressly executed, assumed or took subject to or to a maximum dollar amount (i.e. $25,000). The purchaser may want to include other monetary liens and judgments. A compromise may include a monetary limit on unknown liens. Prior years taxes should generally be a seller obligation. Taxes due as a result of a reassessment of prior years (or other "roll-back" taxes) should be a seller obligation, but this may be negotiated.

c. The purchaser should retain the right to use portions of the purchase price to pay-off those monetary liens that the seller is obligated to cure. Otherwise, the purchaser may be left with an action of specific performance, the timing of which can frustrate the transaction.

6. **A place of closing** should be specified, such as the office of the purchaser's attorney, at a set time and date. Escrow closings are becoming particularly in favor, with title companies acting as escrow agents not only for money but also with conveyance documents. This is sometimes referred to as a "New York style" closing. A contract without an outside closing date may be void or voidable.

a. Deliveries at closing include the vesting deed (generally limited warranty deeds), bill of sale, assignment of leases and service contracts (with indemnities), assignment of general intangibles, title affidavit, evidence of authority, FIRPTA and Georgia residency affidavits, brokers' lien waivers and closing statement.

b. Prorated items should include taxes, items of income and expense (including utilities, which are sometimes "read" at closing), and rent (with credit or separate delivery for security and other deposits). If tenants of the property pay any of these items, extra care must be taken to cover any items that may have been pre-paid by tenants, or which will be paid after closing. If there are delinquent tenants, the seller may want to retain the right to collect rent arrearages. The purchaser often will agree to give the seller any rent it

receives in excess of currently due amounts and allow the seller to attempt to obtain payment from the tenant, short, however, of any legal action.

i. If tenants escrow for CAM or other pass-throughs, there must be an accounting for these times as well. For example, if a tenant pays for taxes in advance, and the closing date occurs before the tax bill is due and paid, then the purchaser should have the advantage of the escrow. In such a case, proration of taxes should also be adjusted.

ii. In self-storage, most tenants pay by credit card or automatic debit to their checking accounts, and the custom is to prorate based on percentages – i.e. prorate based on anticipated receipts rather than actual receipts. Seller may get a percentage of past-due rents because they may be customarily paid late.

7. **The inspection right** includes the right of access to the property, with the purchaser indemnifying the seller against loss and damage that may result therefrom. The indemnity should specifically survive the expiration or termination of the purchase contract. Sometimes the seller requires that it be named in the purchaser's general liability insurance policy. The seller may also request prior notice of any entry onto the property, and restrict invasive testing. Environmental testing may be limited to a "Phase I" test without further consent because of reporting requirements if hazardous substances are actually found at the property.

a. While general practice has evolved so that the inspection right is often essentially a "free look," sometimes inspection is limited to specific property and development matters. Independent consideration should be established for the inspection right so that the purchase contract is not void or voidable for lack of mutuality. This independent consideration is often a small portion of the earnest money ($100) being delivered to the seller on termination within the inspection period, rather than all of the earnest money being returned to the purchaser.

8. **Additional property** covenants are important. Most important is protecting the current status of title and leasing of the property, so that the seller does not impose new matters or obligations on the property which could impede or adversely affect the purchaser's

intentions. These matters might be new mortgages, or amendments which cross-collateralize or cross-default the property with other properties, new leases, property covenants and restrictions. A seller may want to retain the right to alter title or leasing during the inspection period, with purchaser's consent, not to be unreasonably withheld, but after the inspection period, the purchaser should have the benefit of its bargain and be able to withhold its consent.

a. Multifamily contracts will usually allow leasing in the ordinary course of business, based on either "prudent" standards, or on established rent rates for different floor plans (i.e. no less than specified rents for 1, 2 or 3 bedroom units) with terms no longer than 1 year or thereabouts.

   i. Sometimes residential leases have termination clauses if the project is sold or if there is redevelopment.

9. **Casualty provisions** help to shift the risk of loss of the property pursuant to negotiated parameters. On a tear-down, or vacant land, the purchaser has no compelling interest in having a termination right if there is a casualty. However, with improved property, damage to improvements impacts cash-flow and the purchaser justifiably has reason to be concerned. Negotiated thresholds seem to revolve around "major" and "minor" damage, perhaps keyed to a dollar amount, or sometimes to tenant lease terminations resulting from a casualty. If the seller fails to maintain its insurance, the purchaser may be harmed, which is why maintenance of insurance is often a separate covenant. Upon the occurrence of a major casualty, the purchaser generally has the right to either take the insurance proceeds and close, or to walk from the transaction. A minor casualty would not invoke a termination right. Sometimes, the closing may be delayed to allow time for the seller to repair the damage (major or minor). Deductibles under insurance policies are sometimes negotiated as being payable by the seller to the purchaser, but unless they are unusually large, the purchaser cannot justifiably request payment because it would have a similar deductible under its own insurance policy were it the owner of the property.

   a. The "major-minor" distinction may be tied to a dollar amount, percentage of damaged property or tenant termination rights.

10. **Condemnation** is also sometimes phrased in terms of major or minor takings, but the emphasis is on the impact on the property operations, or on the purchaser's intended development of the property. *De minimus* takings, such as for road widenings, should not give rise to a termination right, unless access is also restricted.

11. **Default provisions** are generally restricted as follows: The seller receives the earnest money as liquidated damages upon the purchaser's default, and the purchaser has the right to terminate and receive a return of the earnest money upon the seller's default, or the right to specific performance. Specific performance is sometimes an illusory remedy, especially if the seller is unable to convey the property to the purchaser, as when the seller has delivered title to another party for more profit. For this reason, and others, the purchaser may demand the right to seek and obtain damages, generally restricted to actual, out-of-pocket, damages or to a liquidated amount in such event. A provision allowing attorney's fees to the prevailing party is advisable.

    a. Sometimes default provisions will contain specific reference to remedies under separate indemnity clauses, which are distinct and separate from general remedies on default.

12. **Assignment rights**: Contracts with payment in cash are under Georgia law assignable, so without an assignment provision, the purchaser will have an assignment right. This allows the purchaser to "market" the property under contract and make a profit on the "flip." The seller generally wants to restrict that right because a flip means that the seller has left money on the table. Even if assignments are restricted, the purchaser could purchase the property and immediately sell the property to its target purchaser, suffering only the transfer tax and additional transaction closing costs. The best practice is to restrict assignments to those companies controlled by or under common control with the purchaser.

    a. Contracts having a cash purchase price are generally assignable under law, unless the contract otherwise provides.

13. **Representations and Warranties**: There has been a trend over recent years to make many sales "as is, where is." This reverses a more civil time when a fair market purchaser was entitled to basic representations and warranties. An "as is" sale was limited to those that were REO (foreclosures) property or discounted sales.

When paying fair market value, insisting on basic representations and warranties is fair and reasonable. If nothing else, the seller can limit them to "best knowledge" or "actual knowledge" or some other reasonable qualifier. The purchaser is entitled to know what the seller knows about the property. The representations and warranties are often reaffirmed at closing, and if there is a material change, the purchaser may have termination rights. If the change is due to a breach of a seller covenant, the purchaser should have the right to damages. The seller may argue that reaffirmation in effect extends the inspection period, and the seller may be correct in this assertion. Types of representations and warranties involve the following:

a. Status of title
b. Compliance with governmental and insurance requirements
c. Environmental and underground storage tank matters (including trash or waste sometimes leftover from the construction period).
d. Boundary line disputes
e. Litigation concerning the property
f. Condemnation issues
g. Leasing and rent roll issues

    i. The rent roll representation should certify that the rent roll is true, complete and correct, states all known defaults, set forth rent, commissions, and deposits associated with the lease, any tenant inducements, allowances or free rents, and the status of any tenant improvements.

i. Certain property types might have unique requirements: apartment deals may contain representations regarding lead paint or asbestos.
j. Utility availability (stubbed to site, available in right of way or adjacent property pursuant to appurtenant easements)
k. Zoning status and compliance
l. Operating statements for prior years
m. Property taxes and pending assessments, if any
n. Condition of improvements and mechanical systems on the property

There should be a requirement for reaffirmation of the representations at closing and if there is a material change, the purchaser may have remedies, including termination or possibly the right to obtains damages (actual out-of-pocket expenses or

more) if the seller has taken affirmative action which breaches a warranty.

14. **Brokerage sections** should contain specifics on which parties are being represented by which broker, who is paying the commission and how it is split. Broker lien waivers and affidavits are closing requirements because of the broker lien law. Indemnities against breaches in the brokerage representations as to the brokers who are involved in the transaction must survive the closing. Finally, if the seller or the purchaser (or principals thereof) are brokers or sales persons, this matter must be disclosed.

    a. The brokers are a great source of knowledge and valuable intermediaries with the seller/purchaser. Ideally, they facilitate the transaction and act as messengers. The right intonation, dialect and emotion can make a transaction.

15. **Tenant estoppel and rent roll requirements**: Delivery of tenant estoppels is usually a requirement and condition to closing in any office or retail context. The amount of required estoppels may vary – in a large complex, the number may be limited by percentage of square footage (i.e. 85% of gross rentable area) but with major tenants being absolutely required. The estoppels should be certified to the purchaser and to the purchaser's lender. The landlord may reserve the right to certify on behalf of recalcitrant tenants. Beyond the status of the lease (rent, commencement date, security deposit, term), the purchaser may want to know about any tenant buildout allowances and brokerage commissions. Be careful to discover any rights of first refusal (lease or purchase), any purchase options, and any exclusives, all of which can be revealed in an estoppel certificate. The estoppels should match the information contained in the rent roll, which should be included in with a representation in the contract, and updated and certified by the seller at closing.

16. **Sellers may be obligated to complete infrastructure** or other improvements either prior to closing, or thereafter. Escrow arrangements, with a draw procedure and cushion on the estimated amount to complete, are advisable, with an outside completion date, failing which the purchaser would be able to complete construction, using draws, or other funds required from the seller.

III. Acquisition Due Diligence: Protecting the Client and the Lender

A. A prudent review of property includes **title and survey matters,** environmental matters, soils matters (on new development) zoning, physical inspection of improvements.

1. The title commitment or title binder should be accompanied by those endorsements that add value to title insurance, such as endorsements regarding tax parcel, access, survey and perhaps zoning (3.1). The lender may require that the arbitration and creditor's rights exceptions be removed by endorsement.

2. On construction loans, the lender will require a **pending disbursements clause**:
"Pending disbursement of the full proceeds of the loan secured by the security instrument set forth under Schedule A hereof, this policy insures only to the extent of the amount actually disbursed, but increases automatically as each disbursement is made up to the face amount of this policy."

3. There is much debate about **zoning endorsements**. The 3.1 zoning endorsement does provide some assurance that the property and improvements comply with zoning in 5 key respects:
   a. Area, width or depth of the land as a building site for the structure;
   b. Floor space area of the structure;
   c. Setback of the structure from the property lines of the land;
   d. Height of the structure; and
   e. Number of parking spaces.

   The zoning 3.0 endorsement provides assurance as to the zoning classification of the property. It is based on a zoning certification letter from the appropriate governmental authorities, which provides the same assurance. The zoning certification letter is generally a pre-closing requirement of any lender, although sometimes zoning information contained on an ALTA survey is sufficient for closing purposes. Actual compliance can be verified by architects, engineers or other inspectors trained in such matters. In Georgia, lawyers traditionally do not give zoning opinion letters.

4. Obtaining a **Phase I environmental report** is essential to qualify for the innocent landowner defense under The Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) of 1980 (42 U.S.C. 9601 (35)). The Phase I should be addressed to both the purchaser and to the lender. If the report is only addressed to the purchaser, either it can be amended, or the environmental engineer can issue a "reliance" letter allowing a third-party, such as the lender, to rely upon it. The report discloses

"recognized environmental conditions" which may warrant further investigation. This further investigation is referred to as a "Phase II" environmental report, which should be carefully tailored to test for specific possible contaminants, using defined laboratory methods. The type and extent of contamination determine the potential for liability and required remediation costs. Gasoline is a relatively easy matter to rectify, as long as it is not in the groundwater (gasoline readily evaporates). If it is in the groundwater, then it has to be extracted, and could have migrated offsite. Long-term monitoring wells will be required to validate attenuation over time.

a. Additional comfort can be derived from the Georgia Underground Storage Tank Act, which imposes liability on the operator of the gasoline facility and establishes a trust fund to assist with remediation costs.

b. Brownfield designation also limits the liability of purchasers to remediation approved at the time of designation.

5. **Investigation of raw land** should include analysis of soils conditions to determine if the soils are suitable for construction. The following are some of the more paramount issues to consider when reviewing the property condition: costs associated with unusual or difficult property conditions; costs associated with unusual soil conditions or rock; slope or other easements required for construction or lateral support; utility or sewer easements which will shorten the distance to required facilities and hence reduce the cost; neighboring property which adversely impacts development plans; and topographic conditions which might necessitate unusual grading which can increase cost and increase time for construction. Geotechnical soils reports, or soils inspection reports, reveal conditions of the property which are not apparent and which can significantly impact a project. Ideal soils conditions have soils which have the proper density to permit the load factor of construction at the depth called for in the plans and specifications without the requirement of adding materials for stabilization. A soils inspection report reveals the test results and analysis of a geotechnical engineer, who takes soil samples and drill samples to determine soil characteristics at various layers of depth. Soils must be of such a condition to allow for the proper compaction and density, and retention of compaction, to support the weight and load factor of the proposed improvements. Wet soils, or those with a high moisture content, will not sustain building foundations and footings. If the ground water level is

high, either the foundation level must be raised or other measures taken so that the building slab is not adversely impacted. The presence of rock on a project site is a special concern because rock must generally be removed from site for proper construction.

6. **Analysis from Lender's Inspector**: The lender's inspector usually is a professional who has been in the construction industry as an engineer or an architect, and has the responsibility for oversight of the construction project from start to finish. The inspector is the lender's eyes and ears on the ground. He will review the initial plans and specifications in conjunction with the construction budget and provide a general opinion as to the ability of the project to be completed within budget on a line item by line item basis. The inspector begins by receiving a complete copy of the plans and specifications, and a copy of the construction contract, which should be accompanied by a budget. The inspector will also make periodic visits to the construction site and converse with the job superintendent and other contractors on the job as part of the draw request process. As each draw is requested, the inspector may be asked to insure that the project is doing well, qualitatively and quantitatively, within budget, and can be completed with remaining loan funds, and that the work which has been claimed to be finished is in fact work in place If not, an additional equity infusion may be required from the borrower. The inspector receives copies of various field tests and analysis and daily reports and logs, including geotechnical tests. A good inspector will initially review the status of project approval from the several governmental agencies which might be involved. Governmental involvement varies from locality to locality. The inspector insures that the project is being constructed in accordance with all applicable governmental codes, ordinances and regulations, and in accordance with the plans and specifications. The inspector also tries to determine the location of utility lines and drainage which is necessary for the project to operate after completion.

7. **Appraisals**: It has been said "ask for the appraisal you want and you shall receive," meaning that appraisals have a knack of uncovering the required appraised value to support loan value regardless of the circumstances. While there is some truth to the notion that appraisals often support underlying loan value requirements, it is not true that they are always on target. Banks need appraisals to comply with their internal and governmental auditing requirements. If an appraisal is delivered with a low value, the borrower will be asked to contribute more equity, either in the form of cash or other collateral, or in the form of deferred

fees contained in the loan budget to lower the actual amount of loan which may be disbursed until higher project value is attained. Appraisers generally employ three methods: The "cost" approach, the "income" approach and the "market" approach. The appraiser is generally asked to reconcile the differing values obtained using each of these methods to arrive at a truer value. The cost approach uses the anticipated costs of constructing the project as the basis for value. One problem is hidden or soft costs which can inflate the cost and not really add to value. These costs may be development fees, professional fees, or overhead and profit. The income approach uses presumed income following presumed lease-up and stabilization, and derives value based on capitalization rates ("cap rates") which institutional investors might use to estimate returns on investment if the project were purchased for cash. The market approach seeks comparable sales figures for projects in the same general vicinity and similar to the project being constructed. Appraisers have a network of information which allows them to closely derive income figures from those of similar projects.

8. **Additional Due Diligence:** Certificates of occupancy should be obtained, to the extent available. Copies of building permits are not a substitute, but are other evidence of governmental oversight. SNDA's may be required on leases by lenders, but the terms of the lease, having self-operative subordination and attornment language, can limit their necessity in a crunch.