

Alert

Real Estate Considerations for Effect of COVID-19 on Purchase and Sale Agreements

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The sudden and widespread outbreak of COVID-19 both domestically and abroad has significantly impacted all contracts and, in particular, buyers and sellers alike in their course of dealing with counterparties under real estate purchase and sale agreements (“PSAs”). Additional perspectives and new complexities have arisen as a result of COVID-19 and are significantly impacting the way we are negotiating PSAs in today’s environment. This *Alert* focuses on material contract provisions in PSAs from a buyer’s and seller’s perspective in light of the current climate and in anticipation of the evolving landscape surrounding these issues in the weeks to come.

Due Diligence Period. Typically, PSAs provide a period of time after the execution, and prior to a deposit “going hard” (i.e., the deposit becoming non-refundable) for buyers to conduct due diligence and determine whether, as a result of its findings, it will allow the deposit to go hard and proceed with closing the transaction (“Due Diligence Period”). During the normal course of a Due Diligence Period, buyers will often engage third parties to perform any relevant due diligence it deems appropriate under the circumstances (such due diligence investigation often includes, but is not limited to, a Phase I environmental site assessment (and, if applicable and permitted under the applicable PSA, a Phase II), an appraisal, a title search and land survey of the Property, a zoning report and a physical site inspection of the property). In addition, buyers will typically request and, if available, sellers will deliver historical financials of the property subject to the terms of the PSA to aid buyers in their underwriting of the asset as well as assist in coordinating with tenants and other relevant third parties to obtain tenant estoppel certificates and any consents or approvals necessary to transfer the property.

The expiration of the Due Diligence Period is a critical juncture in the life of any PSA as the buyer is typically faced with the decision to either terminate the PSA or elect for the deposit to “go hard” and proceed to closing the transaction contemplated by the PSA.

While this is all standard operating procedure during a typical Due Diligence Period, COVID-19 has presented new challenges to parties looking to account for the unavailability of services, delayed response times and rapid changes in criteria that impact property valuation. Buyers are suddenly faced with tremendous uncertainty surrounding the availability of capital sources, third-party consultants, the impacts of domestic and international travel restrictions, delays in obtaining necessary approvals, the issuance of title policies and recording of documents caused by the closure of governmental agencies. Likewise, Sellers are faced with a new reality that it may be difficult, if not impossible, for buyers to conduct the necessary due diligence during the negotiated Due Diligence Period and grapple with market risks which impact the viability of a model based on pro forma operating income. In light of these, amongst numerous other concerns, parties to a PSA should consider the following:

- *Due Diligence Period.* Given the delays caused by COVID-19 and the unpredictability of the coming months, buyers and sellers alike should strive to negotiate a timeline that is market from a transactional perspective but also realistic under the circumstances to ensure that each party has sufficient time to conduct its bargained for due diligence in accordance with the PSA.
 - From a buyer's perspective, one might consider seeking automatic rights to extend the Due Diligence Period that may be unilaterally exercisable by the buyer. Including a provision in your PSA that permits a Due Diligence Period to be extended can aid a prospective buyer in preserving the deal the parties bargained for under the PSA without the need for further negotiation or formally documented extensions and/or additional deposits.
 - From a seller's perspective, the focus needs to be around certainty of execution. Upon expiration of a negotiated Due Diligence Period, a seller might consider permitted extensions only for those items which a buyer was not reasonably able to diligence during the Due Diligence Period. In addition, a seller should consider requiring an increase in the size of the deposit in exchange for allowing a buyer more time to complete its due diligence investigation.
- *Representations, Warranties & Covenants.* Another material component of PSAs are representations and warranties ("R&Ws"). R&Ws are provided at the time a PSA is executed and then reconfirmed by each party prior to the consummation of the transaction as of the closing date. The PSA also includes covenants made by other parties with respect to the underlying property. In today's environment, buyers and sellers alike should consider how the R&Ws and covenants under their PSA may be implicated.
 - *Compliance with Laws.* Government officials are debating new legislation on a daily basis in an effort to slow the COVID-19 virus and, aside from any regulations that have been passed into law, the CDC is constantly releasing recommendations for maintaining the safety of the population including mandatory closures of "nonessential" business and requirements that those which remain in operation. Sellers should consider this when negotiating applicable R&Ws in PSAs and anticipate how the underlying assets in a PSA may be implicated by any such change.
 - *No Defaults.* Typically, Sellers will be required to represent that they are not either in default or aware of any default under any leases or other agreements impacting the property. Sellers should consider these provisions in their PSAs to ensure they are not in making misrepresentations with respect to such R&Ws and contemplate any unintended defaults as a result of COVID-19. Likewise, Buyers should be realistic about this uncertainty and consider whether any leniency should be granted in these provisions. Buyers may also want to consider additional notice requirements in their PSAs for any changes to these provisions and a requirement that updates be provided on a real-time, rolling basis.
 - *Operating Covenants.* PSAs often require the seller to covenant that it will operate the property in the ordinary course during the contract period. Sellers should take care to adjust this covenant so that vacancies caused by COVID-19 do not trigger a seller default or perhaps, trigger a renegotiation right between the parties if any such event occurs. To the extent any applicable operating covenant in a PSA is violated, buyers should

provide recourse in the form of a renegotiation right and/or unilateral termination right and, at a minimum, require the seller to provide prompt updates on a real-time, rolling basis.

- *Survival Periods.* PSAs often provide that R&Ws survive closing for a specified period of time (“Survival Period”). A Survival Period is intended to protect the parties to a PSA in the event either party discovers a misrepresentation made in an R&W after closing. With the heightened level of uncertainty in the financial markets and global, socio-economic conditions, buyers should seek to negotiate for longer survival periods. In contrast, sellers should seek to maintain the same general market positions on survival periods in PSAs.
- *Conditions to Closing.* Purchase and sale agreements often provide for condition precedents that must be satisfied by either party prior to consummating the transaction. In the event such party fails to satisfy a condition precedent to closing, the other party may terminate the agreement and retain the deposit.
 - *Title Policies.* A standard condition precedent to any buyer’s obligation to consummate a transaction under a PSA is the commitment of a national title company to issue a satisfactory title insurance policy to the buyer subject only to payment of premiums, recording fees and other related charges and the recordation of all conveyance documents/necessary lien releases. This condition is directly implicated by COVID-19 as many county court houses and recording offices are closing on a rolling basis and as such, recordation of lien releases and conveyance documents is not available in many jurisdictions. Many national title companies are taking the position that they will not close or insure any transactions involving property in areas where they are unable to record required lien releases and/or applicable conveyance documents. As such, from a buyer’s perspective, PSAs should expressly provide that any condition precedent to consummating a transaction under a PSA will not be satisfied (or deemed satisfied) if, a title company is unable to record the necessary documents and issue the title insurance policy in the form agreed to at closing. In contrast, sellers consider workable alternatives to this issue including, automatic extensions of the closing date and/or possibilities to close in escrow. Sellers may also consider providing title companies and buyers with reasonable assurance and/or indemnities in an effort to cause them to consummate the transactions under the PSA notwithstanding an inability to satisfy this condition.
 - *Material Adverse Changes.* Buyers often seek to include a provision in their PSAs which state that the buyer’s obligation to close is conditioned upon the absence of a material adverse change in the property or seller generally measured from the expiration of the Due Diligence Period to the closing date. While these provisions are typically heavily negotiated, buyers and sellers alike should pay additional attention to these provisions in the coming months. From a buyer’s perspective, buyers should try to expand any such condition to include the adverse effects caused by COVID-19 and also include adverse changes to the financial and/or real estate markets generally. In contrast, sellers should seek to narrow this definition to changes to the physical condition of the property and

should seek to expressly carve out any changes to general market conditions due to COVID-19.¹

- *Tenant Estoppels.* Tenant estoppel certificates are a valuable tool utilized by buyers to gain information about the state of affairs at a property and performance by the applicable tenant and Seller, as landlord, of its obligations under the respective lease. Delivery of tenant estoppel certificates is typically a condition precedent to consummating any transaction contemplated by a PSA and, more often than not, the parties to a PSA negotiate thresholds for delivery from all tenants as well as solutions in the event the required estoppels are not delivered. In light of COVID-19 impacts on properties and businesses, buyers should consider whether the information delivered in an estoppel continues to accurately reflect the situation on the ground. As such, buyers should consider increasing threshold requirements for estoppel deliveries, removing seller solutions for failure to deliver and requirements to bring down and/or recertify information contained in tenant estoppel certificates by the seller and applicable tenants.
- *Financing Contingencies.* Whether a transaction will include a financing contingency is a business point that is typically negotiated in a letter-of-intent. A financing contingency in a PSA stipulates that the buyer's obligation to consummate the transaction contemplated by the PSA is contingent upon its ability to obtain financing for the acquisition of the Property. Buyers should strongly consider the use of these provisions in the months ahead to provide additional protection.

The impact and destruction of COVID-19 is an ever-changing landscape, but in the current climate one thing is certain — you should expect the unexpected and plan accordingly. As such, it is essential that parties privy to any PSA negotiations not only consider but anticipate these additional risks and the evolving constraints posed by COVID-19 and take reasonable steps to mitigate any exposure they may have under a PSA as a result.

Authored by [Zak Rosenbaum](#), [Michael K. Berman](#) and [Michele E. Williams](#).

If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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New York | Washington DC | London
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¹ See "Deal Terms — Assessing Material Adverse Change Clauses and Other Deal Certainty Considerations Under and After COVID-19," *SRZ Alert*, March 16, 2020, available [here](#).