



Q&A: real estate sale and purchase in USA (New York)

USA | May 13 2022

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Sale and purchase

Due diligence

Are there any particular due diligence considerations for real estate sale contracts concluded in your state?

Buyers obtain a title search to confirm ownership and limitations and encumbrances on the seller's interest. In the title review process, a buyer or its counsel obtains a survey showing the property boundaries and some physical conditions. This helps the buyer confirm, among other things, that it is acquiring the property it intends to acquire. The title search and survey culminate in a policy of title insurance confirming the buyer's ownership interest and recorded limitations on that ownership.

Some cities, particularly New York City, have agencies that inspect real estate. Any inspector can, if so inclined, typically find some violation of some municipal code—if nothing else, a failure to post a newly mandated warning sign. Those violations are then entered in registries outside the recording system. They can be difficult to remove, even once the underlying violations have been fixed. Similar data banks offer information on governmental permits, licenses, approvals, and certificates of occupancy, which may limit what owners can do on their property. A buyer of real property will typically obtain searches of these registries.

Physical and environmental conditions of the real property require investigation by third-party professionals. Some environmental restrictions and agreements will not be disclosed by the recording system. Finding them requires inquiries to government agencies. Buyers of older buildings will want to look into the existence of lead paint and asbestos, both of which can be expensive to remove.

Any buyer will review all leases, including their remaining duration, options to expand or renew, identity and creditworthiness of tenants and guarantors, and lease amendments. In addition to checking the rent revenue, the buyer will watch for burdensome terms, such as abatement or offset rights, options to purchase, rights of first refusal or offer, termination rights, obligations to pay future brokerage commissions, and construction obligations. At closing, the buyer will typically require the seller to deliver certificates from most or all commercial tenants to confirm the status of their leases.

A buyer will want to know that an existing building complies with zoning and other restrictions. If the buyer intends to develop a new building or repurpose or redevelop an old one, zoning will play a major role, especially for larger projects. If nearby properties contain less square footage than zoning would allow, a developer might be able to acquire that unused development potential for a new development.

A buyer will also consider building codes, historical landmark restrictions, available incentives and tax abatements, and the conditions attached to them. Abatements and incentives often require the investor to file with, and sometimes obtain approval from, a government agency before initiating the transaction. As a result of New York's unpredictable and high real estate taxes as well as marketplace expectations, most new developments need tax abatements and incentives to make economic sense.

In the city, Local Law 11 requires the owner of any building taller than six stories to inspect its exterior every five years to make sure nothing might fall off and injure or kill pedestrians. These inspections require installation of sidewalk bridges and sometimes scaffolding, all at substantial cost. A buyer will want to know when the building had its last Local Law 11 inspection and what the inspectors found. A buyer will also want to know whether the leases in the building allow the owner to pass through to tenants any costs of complying with Local Law 11 and other expensive city laws.

A property may be subject to service agreements, such as elevator maintenance contracts. These agreements occasionally present challenges to buyers. For example, if a building's elevator is obsolete and the elevator company can refuse to maintain it after closing, then the elevator service contract could become a significant issue.

Older rental apartment buildings in New York City and some other municipalities may be subject to rent regulation, often full of surprises and in many cases economically lethal. It requires extensive due diligence, including detailed review of historical documentation, sometimes going back decades.

The real estate tax assessor will eventually learn how much the buyer paid for the property, and may increase the real estate tax assessment accordingly. That would increase real estate taxes. The buyer will also want to understand any tax abatements in place. These will burn off over time and eventually expire, so the property will revert to full real estate taxes. Any buyer's financial model will need to consider all such built-in future tax increases.

New York City laws require buyers of some larger properties to offer employment to certain existing building employees. The requirement does not apply to a unionized building. Any buyer of a unionized building, especially a hotel, must consider the resulting cost burdens. A union contract often travels with the property, much like a prior mortgage not repaid, whether the buyer wants it or not.

Bankruptcy proceedings or other litigation could also complicate the transaction. A careful buyer will look into those seller matters too.

Contracts

Are sale contracts in your state subject to any formal or substantive requirements?

Contracts for the sale of interests in real estate and leases for more than a year must be in writing. These documents are typically signed through an emailed exchange of scanned signature pages. Outside of real estate, contracts nowadays are often signed using a third-party online service. Those in the New York real estate world, however, generally believe that creative new ways of doing business will simply lead to creative new problems. Contracts and leases need to identify the real estate, the parties, and sufficient business terms so that if a court needs to enforce the document, it can understand what the parties intended.

Obligations and liabilities

What are the seller's disclosure obligations and other liabilities, and what are the consequences of breach?

New York law requires no particular disclosures in commercial purchase and sale transactions. Buyers will, however, typically demand, and sellers will typically provide, some limited representations and warranties. First, the seller will provide assurances about its ability to enter into the transaction; the buyer will reciprocate. Second, the seller will provide assurances about the property, typically limited to full disclosure of specified categories of material information, known to the seller, that the buyer could not obtain through third-party due diligence or inspection.

A seller's breach of a representation or warranty would, under general contract law, entitle the buyer to recover contract damages, i.e., the amount of value lost because the seller's assurance was inaccurate. In commercial transactions, however, sellers contractually limit their liability in several ways. Total claims cannot exceed a low percentage, typically 5 per cent or less, of the purchase price. Claims must be made within a short time, rarely more than a year after closing. If a buyer succeeds with a claim, any victory will probably be pyrrhic, as the seller is most likely a single-purpose entity with no other assets. Buyers sometimes request an escrow or holdback to respond to claims. Market conditions typically allow a seller to laugh at that suggestion. The very limited customary remedies for misrepresentation force the buyer to rely primarily on its own due diligence while giving the seller minor incentives to disclose what it knows.

If a significant breach of representation or warranty becomes apparent before closing, the buyer may have the right to refuse to close, terminate the transaction (with the seller occasionally agreeing to reimburse costs, probably up to a cap), or close with a price adjustment. This all depends on market conditions and commercial negotiations.

Beyond representations and warranties, a typical purchase and sale contract requires the seller to deliver good title, subject only to certain exceptions and, between contract and closing, operate the property in a way that will not produce unpleasant surprises.

Contracts and the law both require the seller to pay New York state and city transfer taxes, typically totalling 3.275 per cent for substantial transactions. If the seller fails to pay, then the state and city will try to collect these taxes from the buyer. The buyer must police the seller.

Are there any other obligations on the buyer, aside from paying the purchase price?

At signing, the buyer will deposit in escrow, typically with a title insurance company, somewhere between 1 per cent (for very large transactions) and 10 per cent (for very small ones) of the contract purchase price. If the buyer defaults, the seller will normally keep this deposit and have no other claims.

A buyer will typically conduct inspections. If preliminary environmental research (a so-called Phase I assessment) discloses possible issues, the buyer may want to conduct on-site testing. In that case, the seller will require the buyer to maintain certain insurance, clean up any new messes, and repair any damage.

A purchase and sale contract will also often require the buyer to maintain confidentiality by not speaking to tenants or other third parties about the property before the closing.

Though contracts do not require title insurance, buyers universally obtain it. In New York, buyers pay for their title insurance, which costs around 0.3 per cent of the purchase price.

Special considerations

Are there any other special considerations for real estate sale and purchase transactions in your state?

Most purchase and sale contracts, even in a seller's market, give the buyer a 30-day or longer due diligence period, essentially a free option so the buyer can check out the property and, more importantly, line up its capital. At the end of that time, the buyer must give notice if it wants to proceed or terminate the sale. A careful buyer will want to be able to give that notice by email, although email notices are not otherwise common in New York real estate transactions. If the buyer decides to proceed after due diligence, the contract often requires an additional deposit.

The basic material terms of a purchase and sale transaction can be written on one side of a small cocktail napkin. Much of the remainder of any purchase and sale contract generates complex negotiations over hypothetical eventualities whose average expected magnitude is often less than the legal fees incurred. A risk-tolerant buyer might instruct its counsel to limit its efforts accordingly. Conversely, a worried offshore buyer may direct its counsel to maximize protection for the buyer.

As one very important and entirely counterintuitive state-specific contract issue, if a mortgage encumbers the property, the buyer should ask the seller to agree to have the lender assign the existing mortgage to the buyer's lender. Such an assignment can help the buyer save significant mortgage recording tax.

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