

**“Anatomy of a Commercial Real Estate Purchase Agreement”<sup>1</sup>**  
Commercial Real Estate: Negotiating and Drafting 5 Key Contracts  
March 8, 2023

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## **Introduction**

This presentation centers around a commercial purchase agreement form intended for general applicability, which is attached. This presentation is meant to provide an overview of the fundamentals involved in purchasing commercial property. General thoughts on drafting purchase agreements are presented first. Highlights, some suggested practice pointers, and details concerning less self-explanatory provisions of the agreement are then discussed.

## **General Thoughts**

- a. Don’t trust a form purchase agreement too much. Begin the drafting process by talking with your client about what they are trying to accomplish with the transaction, then customize the form based on those goals. It’s a good idea to brainstorm a checklist of deal points you think will be important to your client. Then, review those after going through the form to make sure those points are included.

For example: Is the deal for vacant property? If so, you don’t need to include provisions to inspect the physical condition of improvements, though you may want to have an environmental inspection, Phase I, and so forth done. Is the deal for a retail center? If so, reviewing the leases and estoppel letters will be of particular importance. If you are sure certain provisions in a form are irrelevant, you should delete them, but it’s a good idea to insert a placeholder like “[DELETED PROVISION],” or something similar, so any cross-referencing in your agreement isn’t adversely affected. This is commonly done.

- b. Familiarize yourself with the property. A picture is worth a thousand words, and a property visit is worth a lot more than that. The aerial photos of parcels of real estate that are available online through county GIS systems are an incredible resource, and a great way to learn about the subject property. You will see access, parking availability, potential boundary line issues; even the pivot points on a central pivot irrigation system. Additionally, it has been our experience that you will always learn something significant about a parcel of real property when you visit it. The more you know about the subject property, the better your issue-spotting process will be.
- c. Be pragmatic, and reasonable. You are drafting the agreement because your client wants to buy or sell the property. So, it is best to start with a balanced, fair draft agreement, not

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<sup>1</sup> The presenters wish to thank Timothy J. Kuntz, LeVander Gillen & Miller, PA, for his invaluable contributions to the drafting of the attached Purchase Agreement form.

a lopsided one that could result in expensive and futile negotiations. Your goal is not to “win” on deal points in an adversarial process, but to document the deal your client wants to do on a timely and efficient basis.

That being said, you still need to inform your client’s decision making process. They are hiring you for your expertise and objective judgment. If you spot problems, make sure to let your client know about them, warts and all, so they can make the best decision possible.

Also, keep in mind that the commercial real estate bar is such that you will probably be dealing with the other attorney again. For that reason, and many others, being cordial and professional is always a good idea. The primary effect of unnecessary provocation and bombast is an increase in your client’s fees.

## **Section 1: Definitions**

### Subsections 1.2, 1.3: Buyer and Seller.

The purpose is simple: Identify the buyer and seller. However, you will want to make sure you have the correct buyer and seller name. It’s a good idea to obtain a deed or, in the case of registered Torrens property, a Certificate of Title from a title company or online resource such as [www.orbitinfo.com](http://www.orbitinfo.com) or Record EASE to make sure you have this right. Clients can be mistaken as to the actual ownership of property they ask you to draft an agreement for – and this can be true even when you represent the buyer.

It’s also good to check the Secretary of State’s website to make sure you have the right entity name, and to confirm the entity is in good standing. If the entity in question has been administratively dissolved -- which often happens with single purpose entities that own real property -- it should be reinstated. *See* Minn. Stat. §322C.0706 for the process.

**Tip:** Talk to a buyer client about how they want to structure ownership. They may wish to set up a single purpose entity to be the owner; most often, this will be a limited liability company. There are tax implications involved in this decision, and unless you are well qualified to give tax advice, be very careful not to give it; instead, refer those decisions to the client’s tax advisor. If they don’t already have one they work with, they should find one.

### Subsection 1.4: Real Property.

Again the purpose is simple: Identify the property being sold pursuant to the agreement.

Of course, you must identify the real property. Exhibit A states a legal description. You can’t close on a transaction without one, of course, and its best to have one to base a purchase agreement on. The legal description available on a county tax assessor’s website is, especially if a metes and bounds description, generally not detailed enough to use. Its best to obtain the most recent vesting deed to confirm the legal description.

**Tip:** Assuming the deed you use is legible, and particularly if you are using a metes and bounds description, you would be wise to cut and paste the legal from a PDF version of the legal description into your document. You don't want to create an error by incorrectly copying a lengthy legal description.

You'll also want to identify certain other items, such as leases and contracts being assigned, permits, licenses and trade names, and personal property which are party of the sale; so you'll want to carefully discuss Exhibits B, C and D with your client, and with the opposing party. The more detail you can supply early on here, the better.

#### Subsection 1.5: Permitted Encumbrances.

Permitted encumbrances are items which adversely affect title, but which your client can live with and will accept. Drainage and utility easements, rights of way, and power line easements are examples. Permitted encumbrances can also be "take it or leave it" propositions, that is, things your client doesn't like but which can't be removed or cured.

**Note:** Certain title issues are virtually always accepted and thus are permitted encumbrances, e.g., building and zoning laws, ordinances, and state and federal regulations.

**Tip:** Make very sure you comply with the deadlines for making title objections which are referenced in Section 10, so you don't create an issue for your client with an encumbrance they can't live with but may be stuck with. Even when such problems can be resolved later – not a given - you'll probably have to give up a bargaining chip in the process.

#### Subsection 1.10: Due Diligence Date.

Due diligence is of primary importance to a buyer: It's how you learn about the property, and how you assess the risks inherent in the transaction. Missing something important – say, an environmental issue, or a significant structural problem with a building – can be a very expensive mistake. It's important to track this deadline; you don't want to miss it. It's also important when drafting the agreement to allow enough time for the due diligence process. And it's important to get the due diligence process started right away after the agreement is signed.

From the seller's side, it's important that the due diligence time period be reasonable, and not excessive. Otherwise, you have what comes close to being an option to buy the property, without the payment of typical option fees. Buyers do sometimes seek to simply tie property up for as long as they can. Also when representing a seller, consider making the earnest money non-refundable when the due diligence period expires.

#### Subsection 1.16: Conditions Precedent to Closing by Buyer.

The purpose of this section is to list the types of due diligence that the buyer will be entitled to conduct.

The Accuracy of Representations, Performance, Absence of Litigation and Approval of Documents conditions essentially mean that no issues have cropped up between the date of the signing of the Agreement and the closing date.

Acceptance of Marketable Title, Easement Approval Contingency, and Encroachment Approval Contingency conditions generally mean that the buyer shall have accepted and approved the status of title of the property, or waived any objections to title issues, by the Due Diligence Date.

The Environmental/Physical Condition Approval Contingency provides that before the Due Diligence Date, the buyer shall have inspected the real property and determined the environmental and physical condition is acceptable.

The SNDA and Estoppel Certificate Contingencies provide the buyer with the opportunity to ascertain the status of the leases affecting the property. The SNDA requires tenants to subordinate their interests to buyer's lender, and the estoppel certificate requires tenants to give the buyer lease information upon which it has a right to rely. The seller will want to allow sufficient lead time to get these documents from its tenants.

The Governmental/Zoning Approval Contingency gives the buyer the opportunity to confirm it will be able to get the government permissions it wants (e.g., plat approvals, rezoning) before proceeding with the sale, and the Suitability Approval Contingency provide buyer with a general "out" if there are other issues affecting the property.

#### Subsection 1.17: Consideration.

The purpose here is to state the price that buyer is paying to buy the property, and how it is to be paid – including the amount of up-front earnest money.

Usually, the consideration is going to be paid in cash, but at times part of the price being paid can be something else, such as real property.

**Tip:** If real property is going to be part of the purchase price, it must be valued on a reasonable basis so that it can be included in the overall consideration for the purpose of calculating deed tax.

#### Subsection 1.18: Seller's Warranties.

Always keep in mind that having the right to sue a seller at some point post-closing, either on a breach of warranty claim or for a failure to disclose, is far less desirable than learning of an issue through thorough due diligence – if possible. Even a complete victory in such litigation, which is rare, comes at the end of a long period of stress, expense, business interruption, and so on.

So, it can be argued that the primary purpose of this section is to find out what the seller knows about the property, during the very earliest phase of the purchase, the purchase agreement negotiation. That can inform the due diligence process. For example: If Seller discloses that there is a “farm dump” on the subject property, the buyer will want to alert their environmental engineer as to its presence so it can be inspected.

From the seller’s perspective, to avoid the stress and expense of litigation referenced above, its wise to make thoughtful and fulsome disclosures here and list any exceptions from the warranties when the agreement is being negotiated.

#### Subsections 1.18(h), 1.20, 1.21, 1.22, 1.23, and 1.24: Environmental Issues.

These sections include the environmental warranty, and the definitions of the terms used in the warranty. There is a very complex statutory framework governing environmental matters, so the statutory references are exhaustive and detailed.

Environmental issues present a need to work with a competent environmental engineer, who can prepare a Phase I report, and provide additional advice as environmental issues arise.

#### **Section 4: Pro-Rations**

The purpose of this section is to provide for a division of negotiable costs between the buyer and seller. This section will be used by the title company to create the settlement statement for closing.

#### **Section 5: Operation of the Property Prior to Closing**

This section governs the operation of the subject property during the “executory period,” i.e., the period between the effective date of the purchase agreement and the closing date. This is an important provision as this can be a long period of time.

The goal here is typically to maintain the status quo. The buyer does not want problems to crop up with the property while it is doing its due diligence and getting its finances in order. Events which detrimentally affect the value of the property can blow up a deal, sometimes because of the effect of such events on the willingness of the buyer’s lender to move forward.

#### **Section 6: Access to, and Inspection Of, the Real Property**

This provision is critical to the buyer. Without it, you don’t have a clear right to go on to the property to conduct inspections, testing, and due diligence.

This provision is also of great importance to the seller. If there is to be entry onto the property for purposes of inspection, the seller needs to be protected from claims for

payment filed by buyer's contractors, and indemnified from harm resulting from the inspections.

**Tip:** If you are representing a seller, don't let the buyer enter onto the property for inspections, testing, etc. before they sign the purchase agreement. Without the indemnification and attorney's fees provisions included here, it will be more difficult to seek a remedy for your client if they suffer a loss due to the inspection.

### **Section 7: Governmental Zoning Approvals**

This provision gives the buyer the express right to apply for governmental approvals, which would include matters such as rezoning and platting applications, and provides for cooperation by the seller, who as the owner of the property would have to authorize such applications.

### **Section 8: Environmental Assessment**

This provision gives the buyer the right to obtain a Phase I environmental assessment of the property, which is an overview of the environmental status of the property. It also gives the buyer the right to seek additional on-site testing which may be called for in the Phase I, including a Phase II report.

Environmental testing, which can trigger reporting requirements, can make sellers of property uncomfortable. This provision gives the buyer the right to conduct such testing.

### **Section 10: Title**

This section governs due diligence as to the title of the property. The three components of title evidence to be evaluated are the commitment produced by the title insurance underwriter (whom buyer will typically select), the survey, and UCC searches. Payment for the cost of a survey is negotiable; sellers will, at times, simply refuse to pay this expense. A buyer of commercial property should obtain a survey regardless.

Again, you will want to pay particular attention to the deadlines, such as the deadline to make title objections. It's a good idea to have a closing checklist prepared early on in the purchase and sale process, tracking all of the applicable deadlines.

If there is a title defect which is learned of through this process and the seller is unable or unwilling to timely cure it, the buyer can be faced with a hard choice of whether to proceed. It can be hard to walk away at this point, after a significant investment has already been made in a subject property.

### **Section 12: Warranties**

The purpose of this section is to state that the warranties made by the respective parties are material, continuing, and survive closing, but for a limited time, and that said warranties

shall expire 24 months after the closing date. The parties pledge to indemnify each other for any breach of the warranties, including as to attorney's fees.

### **Section 13: Conditions Precedent**

This section lists what must occur for both buyer and seller to be obligated to move ahead and close the property. Both the Conditions Precedent To Closing By Seller, as defined in Subsection 1.15, and the Conditions Precedent To Closing By Buyer, as defined in Subsection 1.16, must be satisfied or waived; otherwise, either buyer or seller can cancel the agreement by written notice to the other party.

For both buyer and seller, these conditions include the Accuracy of Representations, Performance of all agreements and conditions, the Absence of Litigation pertaining to the subject transaction, and the Approval of Documents. Additional conditions are in place, to protect the buyer, e.g., the Environmental/Physical Condition Approval Contingency, the Governmental/Zoning Approval Contingency, the Easement Approval Contingency, the title review process, Encroachment Approval Contingency, the SNDA Contingency, the Estoppel Certificate Contingency, and the Document Review Contingency.

**Tip:** If one cancels the agreement and the other party does not agree to sign a termination of the purchase agreement, a statutory cancellation must be done. *See* Minn. Stat. § 559.21.

### **Section 15: Assignability of Interest**

Contract rights are generally assignable “except where the assignment is (1) prohibited by statute; (2) prohibited by contract; (3) or where the contract involves a matter of personal trust or confidence.” *Travertine Corp. v. Lexington-Silverwood*, 683 N.W.2d 267, 270 (Minn. 2004). Thus, it is appropriate to limit the assignability of the buyer and seller's interests in a purchase agreement.

Because it is common - due to liability concerns and tax considerations - to own commercial property in a separate entity, there will often be a provision allowing for an assignment of the seller's interest to such an entity.

Since buyer and seller are relying on the other to meet obligations provided for in the Agreement, at times even after cancellation or closing, it's a good idea to have the assignor remain liable for such obligations regardless of the assignment.

### **Section 16: Costs**

This section provides for a division of certain closing costs to be paid by each party. The divisions shown here are typical. Seller pays deed tax and the cost of proving up good title (i.e., providing a title commitment). Buyer pays the title insurance premium. Closing costs are typically divided in half, though this is negotiable. Each side pays its own attorney's fees.

## **Section 18: Broker's Commission**

As drafted here, this section states that there have been no real estate brokers involved in the transaction. If a broker is involved, there should be a representation concerning the identity of the broker and who is responsible for payment of their commission.

There is also an indemnification provision protecting the indemnified party if the representations contained in this provision turn out to be inaccurate.

## **Section 20: Termination; Remedies**

This section provides for the means and effects of termination of the Agreement. The means are a written notice of default, which provides an opportunity to cure (unless the non-defaulting party waives the default). Note, however, that the party giving the notice must still comply with Minn. Stat. § 559.21, which mandates the manner of service of the notice, among other things. Note also that Minn. Stat § 559.217, which applies only to cancellation of residential property purchase agreements, is outside the scope of this discussion.

The effect of termination is that the agreement has ended. Thus, one cannot then bring a claim for default, or resulting damages (there is a narrow exception for provisions in the Agreement which specifically provide that they survive termination of the Agreement). This means that if a party has suffered significant damages resulting from a default under the contract, and wishes to bring claims for them, one should not terminate the agreement.

One could also include a provision in the Agreement limiting remedies in case of default; for example, retention of earnest money as liquidated damages could serve as seller's sole remedy in case of default.

## **Section 21: Miscellaneous**

### Subsection 21.3: Notices.

This section governs the means by which the parties will give each other notices pursuant to the Agreement, including title objections, notices of default / cancellation, and so on.

**Tip:** This is a matter of personal preference, but the experience of the authors is that the allowing for notice to be given electronically, and effective on the day of transmission, is a good idea. You could be dealing with tight timeframes as it is. Having to give notice by mail several days before the notice will become effective could add a lot of unnecessary risk and stress.

### Subsection 21.7: Survival.



Survival clauses are negotiable. This one provides that the parties' respective terms, conditions, covenants, agreements, representations and warranties all survive the closing, but expire and terminate 24 months after closing.

That is a compromised lessening of the statutory statute of limitations for contract claims of six years. Minn. Stat. § 541.05, subd. 1. (Which states, "[e]xcept where the Uniform Commercial Code otherwise prescribes, the following actions shall be commenced within six years: (1) upon a contract or other obligation, express or implied, as to which no other limitation is expressly prescribed . . .")

#### Subsection 21.9 Attorney's Fees.

This is a provision allowing the prevailing party in a dispute to recover its attorney's fees; note; that this is one of the agreements that will survive termination of the Agreement. The provision is mandatory but, as is typical, is limited to *reasonable* attorney's fees ("the losing Party will pay to the prevailing party all reasonable expenses incurred by the prevailing Party, including costs and reasonable attorneys' fees.").

#### **Section 22: Lease Extension Contingency**

This is not an example of a form provision, but rather is an example of a provision that is particular or special to the transaction in question. Here, the provision provides for a contingency concerning the extension of leases with certain tenants.

Such provisions are included in purchase agreements fairly frequently. They are drafted separately from the other provisions of the Agreement, and therefore typically function independently, including their own provisions for remedies and so forth, as cross referencing to other sections of the Agreement will be cumbersome.

#### **Conclusion**

Remember that while forms are helpful, they should be viewed as a starting point. No form will spot all the issues that you as counsel for a buyer or seller will need to address. For that reason, it's best to draft a checklist of important issues to deal with even before you start adapting a form for use on a particular transaction.

Finally, of course, note that **the attached form is not a substitute for the competent legal advice that an attorney will provide to a client based on the individual nature of the property and the transaction involved.** This is consistent with the long-standing Minnesota rule of law that each parcel of land is unique. *In re Kreger*, 296 B.R. 202, 209 (Bankr. D. Minn. 2003), *aff'd*, 307 B.R. 106 (B.A.P. 8th Cir. 2004) (stating, "[1]and has consistently been treated as unique under Minnesota law.")

Please feel free to contact us with any questions you may have regarding these materials. Thank you.