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#TipTuesday

FIVE REASONS A SELLER SHOULD CONSIDER CONDUCTING THEIR OWN DUE DILIGENCE BEFORE A PROPERTY SALE

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March 7, 2023

Myth: "You only need to conduct due diligence when you're **purchasing** a property."

Fact: There are many reasons why a **seller** of a commercial, industrial, or multi-family property might consider conducting their own due diligence when selling their property.

Here are five:

Reason # 1: Risk Management

Once a potential buyer starts their due diligence at a seller's property, the clock has started and the "cat may be out of the bag" before the seller has a chance to control it. A seller might then not have the luxury of dealing with any identified concerns in the time, manner, and budget they prefer.

A buyer's identified concerns could include environmental impact, deteriorated or damaged building utility and structural conditions, financial obligations such as tax liens or delinquent payments, and unsatisfied compliance and legal requirements, amongst others.

By conducting their own due diligence *before* the buyer does, a seller is more likely to identify what needs to be fixed, remedied, or addressed at *their* discretion, and with sufficient time to most effectively handle those concerns from *their* perspective, i.e., the seller can determine and control the cards they've been dealt before the buyer even comes to the table.

Even if some of a buyer's likely concerns are unable to be addressed before the property goes to sale, a seller can prepare for the transaction wisely, and maintain the upper hand when they are more knowledgeable about their property and what the estimation of remediation costs or liabilities might be.

Reason #2: Minimize Transaction Delays, Hurdles, and Last-Minute Surprises

Last minute revelations identified by a buyer during their due diligence can delay a property transaction at best, and obliterate a deal at worst. These discoveries of the buyer can come at any time during the process, and sometimes after much time, energy, and resources have been spent by all parties including both the buyers and sellers, and their respective counsels, brokers, and consultants.

Has the seller gathered all the required documents a buyer is likely to ask for during their due diligence? Such preparation may include the establishment of a "data room" with all the property's previous engineering reports; due diligence documents from when the seller originally purchased the property; former chain-of-title reports; surveys, plans, and figures; insurance documents; maintenance logs; and regulatory correspondence, etc.

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Does the seller have pre-knowledge of what the buyer is likely to find during their due diligence? A seller can avoid, or at least minimize, much consternation, aggravation, and transaction delays (as well as needless spent time and money) by attempting to identify those "last minute surprises" long before a buyer does, and addressing them as early and efficaciously as possible (see Reason #1 above).

Reason #3: Disclosure Requirements

In days of old, a seller might have been able to exclusively rely on the old adage, "caveat emptor", more colloquially known as "buyer beware". After all, if the buyer doesn't conduct sufficient due diligence of their own, surely, they themselves are responsible for whatever they end up buying, right?

Not necessarily.

As was shown in Strawn v. Canuso (1995) amongst other legal cases, sellers have a duty to disclose the existence of site conditions, as well as off-site conditions, if those conditions are (1) unknown to the buyers, (2) known or should have been known to the seller and/or its broker, and (3) based on reasonable foreseeability, might materially affect the value or the desirability of the property involved in the transaction.

If a seller conceals and/or fails to disclose a latent defect that is not readily observable and could have a material effect on the buyer's decision about the transaction – such as increased liability or cost to the buyer – the seller could potentially be in breach of their obligations and may be liable for fraud, damages (such as legal fees and court costs), or even rescission of the property transaction itself.

By conducting their own due diligence early enough prior to the sale, a seller can more conveniently and thoroughly identify and gather the required disclosures about their property and present them to a potential buyer – if necessary, using a pre-prepared Non-Disclosure Agreement (NDA) – in good faith and with sufficient transparency, thereby more capably meeting their obligations as a seller.

Of course, every case is different – with specific buyers, sellers, property types, and locations – but prudent due diligence actions and preparation on the part of the seller that encourages a fair business dealing is generally always a good idea. As is true for the entire real estate transaction process, it is recommended that both buyers and sellers consult with their real estate and other appropriate counsel each step of the way.

Reason #4: The New Jersey Industrial Site Recovery Act (ISRA)

The New Jersey Industrial Site Recovery Act (ISRA) is a unique, state-specific environmental law that requires the "remediation" (i.e., completion of specific assessment and remedial processes) of certain business operations prior to their sale, transfer, or cessation (colloquially known as "triggering events").

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A facility with such a business operation is known as an "industrial establishment", a defined term in the ISRA rule that describes those businesses regulated under the Act. What defines an *industrial establishment* may not necessarily be intuitive; one needs to check whether the property operations are (or were, in some cases) listed under one of the applicable North American Industry Classification System (NAICS) numbers (based on the nature of the business operations).

In addition to having a listed NAICS number, the business must have operated in New Jersey on or after December 31, 1983, and business operations must involve the storage or handling of certain types and quantities of hazardous substances and petroleum products (this can include petroleum storage tanks).

Any person who owns an *industrial establishment,* owns the real property of an *industrial establishment* , or is the operator of the *industrial establishment* **must** comply with ISRA. In other words, even a property owner who leases their facility to an ISRA-subject tenant is responsible themselves, in addition to the tenant, to comply with these requirements should they apply.

Complying with the ISRA requirements can take time, money, and resources, and is something a prospective owner or operator of an *industrial establishment* should consider long before any triggering event occurs. Failing to consider such ISRA requirements can result in potential fines and liabilities for the obligated parties, and delays in the transaction process.

Reason #5: Market Effectively and Maximize Your Asset

How well does a typical seller know their own property and the surrounding properties? How can a seller see their property through the eyes of a potential buyer? How should a seller value their property?

The worth of a parcel of real estate can be contingent, in part, on the amount of liability and potential benefits associated with that property.

When planning to retire a business or real estate asset, a seller should identify how to effectively market and maximize the asset in order to realize a greater return on investment. What is a buyer going to find when they perform their due diligence, and how can a seller mitigate any identified concerns?

By conducting their own due diligence before a sale is contemplated, a seller can not only identify and minimize the number of liabilities associated with their property, but can also examine out how best to market the property to its strengths and, in this way, the asset can be valued correctly and maximally, resulting in a quicker and more profitable sale.

Bonus Reason: Ready Your Team

"Measure twice, cut once" – you've only got one chance to make a good first impression with a buyer so, in advance of a potential transaction, a seller should assemble for themselves a good team of trusted and experienced advisors.

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To quote Proverbs, "a wise person accepts advice" (12:15) and "without a strategy, a people will fail; victory comes with much counsel" (11:14). A seller can strengthen their negotiating position by planning ahead, and surrounding themselves with wise advocates who can help guide the seller to maximize their results and limit their liability.

As famously advised by Benjamin Franklin, *an ounce of prevention is worth a pound of cure,* and *by failing to prepare, you are preparing to fail.*

Conclusion

Conducting real estate and facility due diligence is not only necessary when purchasing a property, but can also be extremely valuable, and sometimes necessary, when *selling* it or ceasing operations.

There are numerous reasons a property or business owner might consider conducting such pre-transactional due diligence including risk management, minimization of transactional delays and surprises, legal disclosure requirements, regulatory requirements such as the Industrial Site Recovery Act (in New Jersey), effective marketing of the property and maximization of the asset, and wise strategic planning and preparation.

As is true for both buyers and sellers of real estate, the amount and type of due diligence will vary depending on the nature, history, size, and location of the property or facility; the particular client and their objectives; and the time and resources available to conduct the due diligence.

It is recommended that a seller seek out and work with advisors whom they trust and who have experience with similar transactions, properties, locations, clients, and due diligence scopes of work. The earlier such due diligence is considered, the better. If you're not sure if such due diligence is appropriate for you, don't hesitate to reach out to the experienced members of your team and ask.

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Chemmie provides his clients with expert real estate due diligence services by evaluating current and past property uses and conditions, and identifying potential risks, liabilities, and constraints associated with the property's current and potential future uses. Chemmie is also a NJ-Licensed Real Estate Salesperson, and is the Due Diligence and Development Consultant at Wolf Commercial Real Estate.

Chemmie holds a B.S. in Environmental Science, a M.S. in Environmental Management & Water Resources. and is currently completing a Master of Business Administration degree with a Real Estate concentration. Chemmie is an active member of the ASTM Committee E50 on Environmental Assessment, Risk Management, and Corrective Action, and participates in several ASTM Task Groups including the E1527 Phase I Task Group where he was the final editor of the E1527-21 Phase I ESA standard, and is also an ASTM-certified instructor.

Chemmie has written numerous articles regarding environmental due diligence, and has been published and cited in several industry and trade journals.

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