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Negotiating For Certainty In Uncertain Times: Covid-19 Considerations In Real Estate Purchase And Sale Agreements

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Commercial real estate transactions have suffered a sharp decline during the COVID-19 pandemic. According to real estate data provider Real Capital Analytics (as cited to *The Real Deal*^[1]), commercial real estate deal volume totaled \$11 billion in April 2020, a 71 percent year-over-year drop as compared to April 2019. Similarly, the number of commercial real estate deals fell 61% between March and April of 2020.^[2] With meaningful recovery not expected until 2021 even under the most optimistic of predictions and with varying recovery timelines predicted for different asset classes, commercial real estate deals will need to happen in an environment of economic uncertainty. Therefore, it will be critically important to create certainty wherever possible in negotiating purchase and sale agreements (“PSAs”). This article is intended to provide guidance to both sellers and buyers on drafting PSAs in order to achieve a greater degree of certainty during these uncertain times.

DEFINING DISEASE EVENT AS A TRIGGER FOR RIGHTS AND OBLIGATIONS

The unique circumstances presented by COVID-19 have presented numerous challenges to closing real estate transactions over the past few months. For example, parties were unable to record deeds, mortgages and other closing documents except in jurisdictions where recording offices were set up for e-recording; shelter-in-place orders prohibited potential buyers from traveling to conduct on-site due diligence; notarization of documents was made challenging in jurisdictions with shelter-in-place orders absent authorization for remote notarization; complying with seemingly innocuous covenants such as to continue operating “in the ordinary course of business” became all but impossible; and the requirement for representations to remain true at closing became extremely challenging to achieve or even verify. PSAs drafted without COVID-19 considerations in mind left buyers and sellers in uncharted waters when these challenges arose.

To avoid these kinds of issues which can easily derail a transaction, buyers and sellers should address the many challenges and uncertainties brought on by the COVID-19 pandemic when negotiating PSAs. The starting point will be developing a definition of “Disease Event” that is broad enough to include both the current outbreak of COVID-19 and a mutation or re-naming of the COVID-19 virus or even a new virus.^[3] A number of the considerations outlined in this article reference the “Disease Event” concept.

DUE DILIGENCE

COVID-19 has resulted in many unforeseen shelter-in-place orders, property closures for deep cleanings, travel restrictions and governmental office closures, rendering physical property due diligence challenging. While restrictions had been lifting, in recent weeks we have seen the re-imposition of some of these orders in states that have been hard-hit by the pandemic, and we may see more in the future. Buyers will want to negotiate for the ability to extend the due diligence period in the event they are unable to complete their on-site due diligence for such reasons so that they are not prematurely faced with the decision of having to abandon the deal or lose their earnest money deposit. In accommodating such requests, sellers will want to:

- Precisely define the limited circumstances in which such extension right may be exercised (e.g., property closures to comply with legal requirements or to perform deep cleanings, governmental office closures and travel restrictions, in each case that actually affect the property or the buyer);

- Expressly provide that failure to provide access to the property for such reasons does not constitute a default on the part of the seller; and
- Create an outside date beyond which the due diligence period cannot be further extended. Sellers may also wish to require an additional deposit in exchange for the right to extend the due diligence period.

TITLE MATTERS

Title companies have started to add COVID-19-related exceptions^[4] into their title policies and request broad gap indemnities^[5] from sellers due to uncertainty over whether deeds, mortgages and similar documents can be recorded at closing. In some cases, title companies are also requiring buyers to provide an affidavit acknowledging potential delays in recording. In this connection:

- In jurisdictions where records cannot be searched electronically and/or e-recording is not available, sellers should attempt to provide in the PSA that any Disease Event related title exceptions added by title companies constitute permitted exceptions, as failure to do so may present an exit opportunity for buyers.
- Sellers should negotiate with the title company early on to ensure that (i) any Disease Event related title exceptions are deleted in jurisdictions where records can be searched electronically and e-recording is available and (ii) any expanded Disease Event related indemnity is required only in cases where e-recording is not possible. Where gap indemnities are necessary, sellers should attempt to limit the “gap” period to the extent possible and carve out, at a minimum, title defects arising during the gap period as a result of the actions or inactions of the buyer. The agreed upon form of indemnity should also be attached to the PSA, for the protection of both the buyer and the seller.
- Buyers in any jurisdiction should negotiate with the title company early on to obtain a waiver of any buyer affidavit requirement.
- Buyers obtaining acquisition financing should coordinate all title matters, closing mechanics and other material issues with the lender before making any commitments vis-à-vis the seller. In particular, buyers should confirm that the lender is willing to close on a gap basis in jurisdictions that do not permit e-recordings (some lenders have taken the position that they will not close unless the mortgage can actually be recorded) and accept e-notarization or remote notarization to the extent permitted by local law.

CONTINGENT PURCHASE PRICE CONSIDERATION

Many deals have fallen apart or been put on hold due to the economic uncertainty stemming from the COVID-19 pandemic. Specifically, many market players have cited uncertainty regarding long-term value of real estate assets as one of the primary impediments to getting deals done (with the degree of uncertainty varying by asset class), with buyers expecting much steeper discounts to pre-COVID values than sellers are willing to provide at this time.

One mechanism that has been receiving increased attention as a means to consummate deals is the implementation of a contingent purchase price consideration. Specifically, the PSA would provide for a base purchase price that would be paid by the buyer at closing (one which the buyer would be comfortable paying during current times). The PSA would also require that at closing the buyer would deposit additional funds in escrow and all or a portion of those funds would be paid out to the seller upon (i) the occurrence of certain macro events that the parties agree would justify a higher price (e.g., GDP growth, COVID-19 vaccine being released to the public, etc.) (a “Macro Event”) or (ii) the property satisfying certain performance metrics (such as a base level of net operating income) (“Property Related Metric”), each by a certain date (the period between closing and such agreed upon date, the “contingency period”). Any contingent funds not paid to the seller by the agreed upon date would be returned to the buyer. The contingent portion of the purchase price would serve to mitigate the risk that a buyer takes on in buying a real estate asset in uncertain economic times. For example, contingent consideration based on net operating income could in effect guarantee a base level of

net operating income during the contingency period. The contingent consideration can also serve to bridge the gap between the buyer's and seller's assessment of the value of the property.

In drafting a contingent consideration provision, the following should be addressed:

- The parties should agree on an outside date by which the Macro Event or Property Related Metric must be achieved (or not) in order for all or a portion of the contingent funds to be paid to the seller (or returned to the buyer). The outside date may be calibrated to the expected period of recovery of the applicable real estate sector (e.g., hotel or multi-family residential), or may be determined taking into account the parties' best assessments of when a specific Macro Event will (or will not) occur.
- Sellers may wish to require the buyer to abide by certain operating covenants at the property during the contingency period so as to ensure efficient operation of the property and therefore, greater chance of achieving any Property Related Metric.
- Buyers will want to ensure that such operating covenants allow for modifications due to Disease Event related closures of the property and related matters affecting the operation of the property, as well as more traditional *force majeure* events. Buyers may be less willing to entertain operating covenants the longer the contingency period is, as the operating covenants may limit the buyer's flexibility to operate the property.
- The parties should narrowly and specifically define the Macro Events and Property Related Metrics by reference to objective criteria to eliminate any ambiguity.

CLOSING DATE EXTENSION

Given the potential for unforeseen governmental office closures and interruptions in delivery services, the parties may wish to provide for the right to extend the closing date for Disease Event related reasons. In drafting such a provision, the following should be considered:

- The circumstances warranting a closing date extension should be narrowly defined (e.g., closure of recording office, interruption in delivery services, interruption of banking services) and adapted for each specific deal. For example, while the closure of overnight courier and postal services may warrant extension in one circumstance, the same may not be the case where all of the signatories are located within driving distance of the escrow officer.
- There should be an outside date beyond which the closing date cannot be further extended and the PSA should specify whether the deposit is returned to the buyer.
- Sellers should specify that the delay in closing will not operate to require delivery of updated estoppels or other diligence materials. Buyers obtaining acquisition financing should ensure that the same concepts are mirrored in its loan documents.

REPRESENTATIONS AND WARRANTIES

Given the constantly changing circumstances during the COVID-19 pandemic, it is very important that sellers review each representation carefully, as certain representations may take on new meaning in the context of a Disease Event. For example, a knowledge-based representation stating that there are no hazardous materials at the property may be breached if the term "hazardous materials" is defined to include bacteria, pathogens and viruses. Similarly, a straightforward representation regarding the absence of a taking may take on new meaning depending on whether "regulatory takings", such as those caused by mandatory closures, are included in the PSA definition of a condemnation. Sellers should ensure that such takings are excluded from the definition of condemnation.

Leasing representations may be harder to confirm, given the rapidly changing circumstances, so the parties may wish to specify a cut-off time (e.g., one or two business days prior to the execution of the PSA and closing, as applicable) as of which the leasing representations are required to be true. Also, sellers may want

to propose a categorical exclusion of changes in representations related to a Disease Event, although this will likely encounter strong resistance from buyers.

In order to achieve some clarity on liability resulting from breaches of representations and warranties, the parties should consider negotiating an objective “materiality” standard (e.g., the change in the representation results in a loss of more than a certain dollar amount or a decrease in expected net operating income by more than a certain percentage) in order to limit a buyer’s ability to walk away from the deal due to changes in circumstances related to a Disease Event.

In addition, buyers and sellers may wish to consider obtaining representation and warranty insurance (“R&W Insurance”). R&W Insurance may benefit buyers in several ways. For example, buyers may be able to purchase R&W Insurance to cover losses in amounts greater, and for periods longer, than the typical liability caps and survival periods that sellers may be willing to accept. This may be especially true in distressed sales. In competitive bidding situations, R&W Insurance may enable buyers to submit more attractive bids as R&W Insurance would reduce the need for a seller hold-back while still providing protection to the buyer. R&W Insurance can also provide a means of recovery when pursuing remedies against sellers is uncertain (for example, because the sellers are insolvent or in foreign jurisdictions). R&W Insurance can also provide a faster and more certain exit for sellers, with fewer contingent liabilities.

OPERATING COVENANTS

In general, sellers should avoid covenants to operate in the “ordinary course of business” given the unpredictability of property operations during shelter-in-place and similar orders. Sellers should also seek express authority to take such measures as may be necessary to comply with legal requirements and CDC guidelines, including in the case of some real estate assets the right to shut down operations. Buyers should seek the right to be at least notified of (or to consent to) any such measures that would have a material adverse impact on the property post-closing. Defining “material adverse impact” using an objective standard (as discussed above in the context of the “materiality” standard for representations and warranties) would also provide additional certainty. If a property closure is necessitated, buyers may wish to specify minimum maintenance and security standards to ensure that the property condition remains the same.

LEASING COVENANTS

Given the financial distress currently being experienced by businesses in certain sectors such as retail, sellers of property with third-party leases may require flexibility to grant rent relief to tenants. If buyers are willing to accommodate, the parties may wish to consider specifying that:

- Buyer approval will only be required for rent relief provided to certain major tenants and/or if the deferral is for more than a certain number of months.
- As a condition to providing rent relief (i) tenants must provide supporting evidence for the need for rent relief, (ii) relief of CAM expense payments must be approved, (iii) a payment date for deferred rent must be agreed upon, and (iv) any deferred rent will accrue interest.

OTHER CONSIDERATIONS

Finally, the parties should create certainty in the following areas:

- Notices: Parties should clarify that notices may be delivered by email without a follow-up hard copy. If the parties require hard copies, steps should be taken to confirm that mail can actually be received at the specified street addresses during shelter-in-place orders.
- Dispute Resolution: Parties may wish to specify an alternative dispute resolution mechanism that does not rely on courts, which may be closed during outbreaks. Even after courts reopen, the backlog created by the

closure may make it difficult for parties to obtain relief for non-emergency matters in a timely manner. A private arbitration provider would likely be able to respond more quickly to claims and also provide more flexibility in resolving disputes.

- **Closing Mechanics:** Parties should expressly provide that (i) signatures to closing documents (other than originals required for recording) may be delivered by PDF or DocuSign (or other system of electronic signature); (ii) parties intend to be bound by electronic signatures; and (iii) parties consent to remote and e-notarizations to the extent permitted by applicable law.

Please visit Goodwin's [Coronavirus Knowledge Center](#), where firm lawyers from across the globe are issuing new guidance and insights to help clients fully understand and assess the ramifications of COVID-19 and navigate the potential effects of the outbreak on their businesses.

^[1] Jerome Dineen, *TRD Insights: Commercial Deal Volume Plummeted 71% in April*, The Real Deal (Jul. 9, 2020, 5:58 PM), <https://therealdeal.com/2020/05/22/trd-insights-commercial-deal-volume-plummeted-71-in-april/>.

^[2] *Id.*

^[3] “**Disease Event**” may be defined as follows: “a public health emergency due to an infectious disease outbreak (as declared by the Secretary of the Department of Health and Human Services of the United States of America or a state or local Governmental Authority) that results in a moratorium, directive, order, initiative, guidance or law, rule or regulation of any Governmental Authority and that directly results in (i) mandatory closure of the Property, (ii) mandatory shelter-in-place orders or travel restrictions preventing travel to the Property by Buyer, Seller or their respective representatives, or (iii) closure of applicable government offices in the county in which the Property is located without an alternative means of accessing necessary governmental records (including through electronic searches).”

^[4] The following is an example of an exception taken by a title company: “Any defect, lien, encumbrance, adverse claim, or other matter created by or arising out of the inaccessibility of the City of [***] and/or the County of [***], State of [***], including, but not limited to (i) an inability to search the Public Records after the effective date of the commitment, or (ii) any delay in recordation of the Deed in the Public Records.”

^[5] A “gap indemnity” is an indemnity requested by a title insurance company from either a borrower or a seller to minimize its risk during the so-called “gap” period between the closing of a real estate transaction and the actual recording of the instrument. Typically, the borrower or seller indemnifies the title company for matters of record first appearing during such “gap” period.

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