

COVID-19 Checklist: Issues to Consider for Commercial Real Estate Purchase Contracts and Closings

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Practices

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What we've learned so far in 2020 is to expect the unexpected. Prior to February of 2020, who would have predicted the impact of a pandemic in general, let alone COVID-19 in particular, when drafting commercial real estate purchase contracts? Likewise, who would have predicted the impact of COVID-19 on due diligence, loan documents, and closings?

In the immediate aftermath of the initial impact of COVID-19 in the U.S., focus was on whether COVID-19 was within the scope of a force majeure clause or whether COVID-19 could reasonably be construed as an "Act of God." Attorneys debated whether the governmental "stay at home" Orders and other similar regulatory Orders fell within the legal impossibility and/or frustration of purpose doctrines. Since then, what lessons have we learned?

This checklist of issues is just a starting point for tips to consider in drafting commercial real estate purchase contracts, conducting due diligence, negotiating loan documents, and closing transactions. By this time next year, the list will be twice as long. And, also, by this time next year, we can expect (1) more legislation on COVID-19, including allocation of risk for losses, and (2) more cases that have litigated COVID-19 liability. Bottom line: while we await statutory and/or common law guidance, draft for the unexpected.

"Stay at home" Orders and Other Similar Regulatory Orders (such as phased-in re-openings of certain non-essential businesses)

TIP: Add a custom regulatory provision (don't rely upon force majeure or Act of God).

Pandemic/Coronavirus/COVID-19 specific provisions

TIP: Add a custom pandemic provision (don't rely upon force majeure or Act of God).

Default/Cure

TIP: Extend cure periods until a reasonable period of time following the lifting of "stay at home" Orders and other similar regulatory Orders.¹

Right to Terminate

TIP: Consider whether either party should have a right to terminate if COVID-19 delays exceed a certain length of time. And, in such an event, does the buyer receive a full refund of the earnest money deposit even if the COVID-19 issue arises after the expiration of the due diligence period?

Force Majeure

TIP: For contracts utilizing a force majeure provision, include pandemics/Coronavirus/COVID-19 and consider whether the provision should be reciprocal.

Consider whether a force majeure clause is applicable "after" knowledge of the Coronavirus/COVID-19 pandemic. Think about how often a force majeure clause is based upon something unanticipated (as opposed to Coronavirus/COVID-19 which is now a known risk).

Acts of God

TIP: Going forward, there is no reason to risk whether COVID-19 is or isn't an "Acts of God" – address pandemics/Coronavirus/COVID-19 specifically.

Time Is of the Essence

TIP: If your contract has a “time is of the essence” clause, consider a carve out for a COVID-19 delay.²

Notice/Address

TIP: Consider providing alternative notice addresses while a “stay at home” Order is in effect or while “work at home” is a common practice.

Notice/service:

TIP: Consider whether “notice” will be valid if “return receipt” or “signed receipt” is specified and such provisions are being waived (ignored?) by delivery services.

Provisions requiring governmental approvals/permits:

TIP: Provide for extensions for COVID-19 delays.

Contract conditions requiring compliance with governmental regulations that may not be achieved within normal time frames:

TIP: Customize the conditions.

Conditions precedent:

TIP: Consider adding a “business as usual” provision.³

Insurance issues:

TIP: Buyer to discuss available insurance products with buyer’s insurance agent.⁴

Forum selection:

TIP: Consider modifying provisions that are geographic dependent in light of travel restrictions.⁵

Prorations of rent and additional rent:

TIP: Consider how rent and additional rent should be adjusted between the seller and the buyer in light of:

- the inability of tenant(s) to operate during closures?
 - the inability of seller (as landlord) to provide certain amenities during closures?
 - an unusually large one-time expense (such as a closure due to a COVID-19 outbreak)?
 - additional on-going expenses related to COVID-19 (such as security, sanitization, etc.)
 - which of these additional expenses are properly within the definition of operating expenses chargeable to the tenant (s)?
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Post-closing collection of rent and additional rent:

TIP: Consider the impact of COVID-19 on post-closing collection of rent and additional rent:

-who bears the risk of non-payment of rent and additional rent?

-what changes are appropriate for the post-closing rent collection provision?

Tenant Issues for Investment Property

Is the tenant able to be open for business under applicable Orders?

TIP: Risk to be assessed by buyer during due diligence period.

What is the current financial status of the tenant in light of COVID-19?⁶

TIP: Risk to be assessed by buyer during due diligence period.

What is the landlord's ability to foreclose under emergency Orders if the tenant defaults?

Will the default be "excused" because of COVID-19?

TIP: Risk to be assessed by buyer during due diligence period.

What landlord liability issues exist as a result of COVID-19? Will the landlord be obligated to ensure compliance by the building's tenants and guests of government-mandated safety Orders (such as masks and social distancing)? Will the landlord be liable for sanitizing common areas if not specified in the lease? Will any such costs be legitimate common area costs that can be passed through to the tenant? Who bears the loss if there is a COVID-19 outbreak at the Property?

TIP: Risk to be assessed by buyer (as to buyer being the future landlord) during due diligence period.

Going forward, all these same issues need to be addressed in drafting commercial leases, including whether the obligation to pay rent and additional rent remain due and payable notwithstanding forcemajeure events in general and COVID-19 in particular.

Due Diligence Topics

Will seller be able to produce the required seller deliverables on time?

TIP: Provide for extensions for COVID-19 delays.

Will buyer be able to conduct due diligence inspections within the deadline provided?

TIP: Provide for extensions for COVID-19 delays.

Title work:

(1) initial search: Is the applicable Register of Deeds, Tax Office and Clerk of Court open to the public for the title update?

Is there any lag in documents being recorded (either in person or online)?

Is there any local Registry issue impacting reliability of online records?

TIP: Provide for extensions for COVID-19 delays.⁷

Title work:

(2) impact on filings:

What is the impact of various court Orders extending filing deadlines?

What if a lien can't be filed on time (especially if it is apparent recent work was completed)?

What if a lis pendens with a Complaint can't be filed before a (known) disputed closing?

What about the expiration of the ten-year statute of limitations on a judgment that would otherwise have expired? Is it tolled for the period of time when a lawsuit can't be filed to extend the judgment lien?

TIP: Discuss with your client and your title insurance company.

Due diligence inspections:

Will the buyer's vendors be available?

Will the buyer's vendors be willing to physically go onto the Property?

Will the seller let the buyer's vendors onto the Property (and if so, under what conditions)?

Seller may only want buyer to do a video inspection, but this may not be acceptable to the buyer. What if something is discovered after closing that was not discovered because due diligence was by video inspection?

What if there is an active COVID-19 outbreak on the Property during the due diligence period?

What if, after due diligence but before closing, the building itself is closed due to a COVID-19 Order?

TIP: Provide for extensions for COVID-19 delays. Add provisions for buyer's vendors to comply with applicable safety rules (mask, social distancing, etc.). Does the contract contemplate various scenarios involved with video inspections?

Will buyer be able to process a re-zoning application, etc. within the deadlines set in the contract?

TIP: Provide for extensions for COVID-19 delays by governmental agencies.

Will buyer be able to negotiate applicable economic incentives without extraordinary delays by the governmental approval process? How are public hearings going to take place?

TIP: Provide for extensions for COVID-19 delays by governmental agencies.

What has been the impact of COVID-19 on the fair market value ("FMV") of the Property?

TIP: Going forward, buyers are on notice of the issue and can best be protected during the due diligence period.

What will be the impact on buyer's ability to get the anticipated financing and what new loan conditions will be imposed by the lender?

TIP: Discuss with lender.

What will be the impact of COVID-19 on buyer's ability to access common area (such as within an office park, a shopping center, etc.).

TIP: Risk to be assessed by buyer during due diligence period. Consider extension of closing until common areas have re-opened or consider buyer's right to terminate.

What will be the impact of the closing deadline if, during the due diligence period, there is a diagnosis of COVID-19 that impacts the use of the Property?

TIP: Risk to be assessed by buyer during due diligence period. Consider obligating seller to sanitize the building/common areas at seller's expense prior to closing.

Construction topics:

Which party bears the risk for changes in costs and inability to obtain labor and/or materials?

What if a contractor/subcontractor cannot get necessary access?

TIP: Construction contracts typically have heavily negotiated forcemajeure provisions; however, additional COVID-19 risks should be addressed.

Loan document topics:⁸

What if the lender cannot complete its typical audit of a property?

TIP: The lender may require a certificate from borrower.⁹

What COVID-19 terms will the lender customize in its standard loan documents to address borrower's COVID-19 concerns, such as:

-financial covenants?

-material adverse change?

-lender “deemed insecure”?

-other terms?

TIP: Negotiate a custom addendum to address deal-specific COVID-19 concerns.

What COVID-19 terms will the lender customize in its standard documents to address borrower’s COVID-19 concerns with respect to borrower’s tenants, such as:

-continuity of operations in light of “stay at home” Orders and Orders designating phased-in re-openings of certain businesses?

-tenant financial conditions?

-waiver of lender consent to amendment to leases by landlord to help tenant stay afloat during pandemic?

-other terms?

TIP: Negotiate a custom addendum to address deal-specific COVID-19 concerns.

Closing Topics

Will all commercial closings be by escrow?

TIP: Plan on an escrow closing with emergency video notarization if necessary. Address any COVID-19 issues in closing escrow letter.

What are the notary issues?

TIP: See NCGS 10B-3, 10B-10 and 10B-25 for temporary “emergency video notarization” procedures (originally set to expire by August 1, 2020 and now extended through March 1, 2021). Be sure to consider whether an out of state party has emergency video notarization available in that party’s home state. NCGS 47-2 (honoring “sister state” notary provisions) should continue to apply to lawful out of state notaries. Verify any notary concerns with buyer’s lender and title insurance company.

Title work: updating title and recording:

TIP: Provide for extension for COVID-19 delays and possibly a right to terminate.¹⁰

Is the applicable Register of Deeds, Tax Office and Clerk of Court open to the public for the title update?

Is there any lag in documents being recorded (either in person or online)?

Is there any local Registry issue impacting reliability of online records?

Does the inability to record by the deadline in the contract cause a breach? Does it depend upon whether there is a “time is of the essence” clause?

TIP: Discuss with your title insurance company what title insurance solutions are available, including GAP coverage.¹¹

What if a necessary party to the closing is diagnosed with COVID-19? Consider the difference between the party being in quarantine and the party being hospitalized.

TIP: Address concerns in purchase contract.¹²

The North Carolina State Bar has issued some guidance for attorneys to satisfy professional responsibilities during the pandemic. See two alerts issued April 6, 2020: (1) “Professional Responsibility in a Pandemic” and (2) “COVID-19 and Related Practice Concerns for Real Property Closings and Notarization of Documents.”

[1] In the contract provisions dealing with default and cure, consider the following provision: “If the default is inability to perform because of Coronavirus/COVID-19, the party adversely impacted shall be entitled to a reasonable period of time, beyond the [stated] cure period, to cure the default.

[2] Consider the following: “Each party agrees that time is of the essence with respect to all deadlines provided herein, provided, however, if a deadline is missed because of Coronavirus/COVID-19, the deadline shall be extended a reasonable time.”

[3] For example, as a condition precedent to closing, add: “The applicable Register of Deeds, Tax Office and/or Clerk of Court are open for business as usual with no limitations impacting the public, such as closure caused by Coronavirus/COVID-19.”

[4] Although beyond the scope of this article, there are already many cases and articles on the impact of business interruption insurance on COVID-19 losses.

[5] See *Zhang v. Paris Baguette Family, Inc.*, No. 507099/2020, 2020 WL 3060880 (N.Y. Sup. Ct. June 08, 2020), which strictly enforced a forum selection clause in a Franchise Agreement. The Court concluded “[w]hile the COVID-19 pandemic has presented challenging circumstances for litigants, the parties remain constrained by the express provisions of the Franchise Agreement to which they agreed upon.”

[6] See *In re Hitz Restaurant Group (2020 Bankr. (N.D. Ill. June 2, 2020))* (“The Court therefore rejects Creditor’s three arguments and concludes that the force majeure clause partially excuses Debtor’s obligation to pay rent for April, May, and June 2020. Nevertheless, Debtor is not off the hook entirely. Governor Pritzker’s executive order did not prohibit Debtor from performing carry-out, curbside pick-up, and delivery services...The Court therefore holds that Debtor’s obligation to pay rent is reduced in proportion to its reduced ability to generate revenue due to the executive order.”)

[7] After a traditional due diligence paragraph calling for buyer to deliver a title objection letter by a stated deadline, consider adding: “provided, however, that in the event of delay in buyer’s delivery of a title objection letter to seller by [the applicable deadline] resulting from the impact of Coronavirus/COVID-19 (such as the closure of the applicable Register of Deeds, Tax Office and/or Clerk of Court), buyer shall be entitled to deliver the title objection letter as soon

as reasonably practical after [the applicable deadline].

[8] See Frederick Klein and Skyler Anderson, “How COVID-19 Will Transform Real Estate Loan Docs: Part 1,” www.law360.com/real-estate/articles/1282801/how-covid-19-will-transform-real-estate-loan-docs-part-1

[9] Here is a recent sample provision from a Freddie Mac loan requiring a “Borrower Certification” as to the condition of the Property: “Due to the global pandemic of COVID-19, commonly referred to as the coronavirus, Lender, the Federal Home Loan Mortgage Corporati

[10] Here is a sample included in a recent sale of a commercial property: “Delay in Settlement. In the event that a government entity (such as the Register of Deeds, Tax Office, Clerk of Court, Federal Reserve System, etc.) closes its offices, suspends operations or otherwise prevents the Closing Attorney from acting as settlement agent, from timely performing any obligations required for Closing (a “Governmental Disruption”), the Closing shall be delayed until such governmental entity resumes operations sufficient to permit the Closing Attorney to conduct the Closing. If a Governmental Disruption causes a delay in Closing for more than thirty (30) days, then either party may terminate this Agreement without liability to the other (but only by notifying the other party within thirty-five (35) days following the original date of Closing), and the Earnest Money shall be returned to Buyer.”

[11] GAP closings are dependent upon a negotiated indemnity from the seller to the title insurance company. In the event of COVID-19 delays, what is a reasonable period of time for the indemnity to survive? Will the title company agree to accept a GAP indemnity for an unspecified period of days (1) after receipt by the certifying/recording attorney of the documents, and (2) after re-opening of the applicable Register of Deeds?

[12] For a case with a harsh result, see *Martorella v. Rapp*, 2020 WL 2844693 (Mass. Land Ct. June 1, 2020), in which the Court held that purchaser forfeited his earnest money deposit for breach of contract. Despite the COVID-19 pandemic, the Court showed no sympathy for the inability of a sophisticated investor to obtain the necessary financing to close (especially given the absence of a financing contingency). Even the hospitalization of the purchaser’s wife for COVID-19 during this time did not garner sympathy, as the Court pointed out the plaintiff’s wife was not a party to the purchase contract.