

Due Diligence On Commercial Acquisitions

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Due diligence is something that is required for the acquisition of any type of real estate asset, whether residential or commercial. What goes into due diligence varies depending on the asset class; however, it is one of the most important tasks which is handled by a buyer's legal counsel. In acquiring a commercial property, the buyer's counsel should visit various City websites (i.e. Dept. of Building's ("DOB"), ACRIS, Dept. of Finance ("DOF"), etc.) to obtain the following documents: a) certificate of occupancy for the property, b) deed, c) recorded mortgage, d) tax bill from DOF's website, e) list of violations on record; and f) restricted uses.

1. **Certificate of Occupancy:** This is imperative in determining what the current permitted use of the property is, what the zoning of the property is and if they are on par with your buyer's intended use of the property.
2. **Deed:** The deed will indicate who the legal owner(s) of the property is and also may include certain restrictions for the use/occupancy of the property. Certain multi-family buildings, for instance, may require that the property owner occupy a portion of the building as its primary residence for a fixed period of time. This is common in transactions in which the City had sold buildings to private investors at discounts in order to have them rehabbed and occupied.
3. **Recorded Mortgage(s):** You want to retrieve the recorded mortgage(s) in the event your client is obtaining a mortgage to see if you can effectuate an assignment of mortgage and save your client money on the mortgage recording tax. This tax is 2.8% of the principal sum of the mortgage. Thus this can result in a substantial savings.
4. **Tax Bill:** You want to pull up the tax bill from the DOF website to verify the taxes due on the property and its tax classification. It is important that the tax classification matches the approved use on the certificate of occupancy.
5. **Violations:** It is important to become familiar with what violations a property has and negotiate as to which party will be responsible for curing which violations and the cost for same.
6. **Restrictions:** The DOB's website will list certain restrictions for the use of a property. A common one for multi-family properties is the restriction of "Single Room Occupancy" (SRO) which is an old law from the late 19th century which is similar to rent stabilized/rent controlled tenancies.

After reviewing the City's records which are all public and available on the Internet, we need to review the following:

1. **Engineer's Inspection:** An engineer's inspection will need to be done prior to going into contract. When the market was not operating at the rapid pace that it is now, it was common to negotiate for a 2 - 4 week due diligence period in order to secure the property and go into contract and subsequently have an out in the contract should due diligence not appear satisfactory to the buyer. In this market, most sellers will not consent to this and an engineer's inspection will need to be conducted as soon as terms to a deal have been agreed upon (prior to signing a contract). Upon receipt of the engineer's report, the parties will have to negotiate as to any repairs the seller will be required to make prior to closing and the appropriate provisions will need to be inserted into the contract.
2. **Leases:** In acquiring a property with tenants (whether residential or commercial), the buyer's counsel will need to review every lease in the building and provide a summary to the buyer of the following main terms: 1) rent sums, 2) the sharing of increases in real estate taxes by the tenants, 3) expiration of the lease, 4) tenant renewal options; and 5) assignment of lease rights by the tenant and several other aspects. Additionally, the buyer's counsel should contractually require tenant estoppel certificates by the time of closing in which each tenant signs a document stating mainly that they have no claims against the landlord and that both parties are not in default under the lease. It is important to verify this as the buyer steps into the shoes of the property owner/seller at the time of closing and once the closing concludes the buyer is therefore responsible for the building and any existing or future claims. Additionally for residential leases, we review the Division of Housing and Community Renewal (DHCR) records to verify the rent (in cases of rent stabilized/controlled apartments) and inquire if there are any complaints on record with the DHCR against the landlord.

A buyer's counsel should synthesize their due diligence findings in a memorandum to the buyer. The buyer will need to be aware of the information above and additional information in order to make an educated decision on whether to proceed with a specific investment or not.

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