10 Things You Need to Know About Due Diligence in Complex Commercial Real Estate Transactions

Client Alert

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Due diligence is the backbone of any successful commercial real estate transaction. While every deal is unique – driven by the specific asset class and the speed of negotiations – a structured approach to uncovering and managing risk protects all parties and ensures long-term operational success.

Here are 10 essential takeaways for buyers, sellers, and stakeholders navigating the due diligence process.

#1 The Three Core Components of Due Diligence

In an ideal transaction, due diligence follows a logical progression:

- Reviewing contract provisions, representations, and warranties
- Analyzing leases, financial records, reports, and operating histories
- Conducting physical property evaluations and environmental assessments

#2 Sellers Benefit Greatly from "Pre-Disposition" Due Diligence

Sellers who proactively assemble, organize, and review their own due diligence materials (including title, survey, environmental reports, and property condition assessments) before going to market can:

- Avoid late-stage surprises that delay closings or yield purchase price reductions
- Tell a complete, reassuring story about past issues that have successfully been remediated
- Facilitate a smoother underwriting process if the buyer utilizes Representation and Warranty Insurance (RWI)

#3 Buyers Should Address the Following Key Areas

To confirm a property's economic viability, future development potential, and legal compliance, a buyer's due diligence must evaluate:

- Title and Survey: Uncovering easements, restrictions, or boundary issues
- Zoning and Land Use: Confirming allowable uses (particularly for planned redevelopment) and identifying non-conforming structures
- Environmental: Securing Phase I/preliminary assessment reports to limit future liabilities and establish innocent landowner status
- Existing Tenancies: Analyzing rent, lease terms, options, defaults, and tenant financial strength
- Financing: Ensuring the asset meets lender underwriting standards
- Landlord and Tenant Due Diligence: Reviewing historical management practices and future tenant requirements
- Property Condition: Inspecting roofs, structural integrity, mechanical systems, ADA compliance, and any existing environmental engineering controls
- Insurability and Taxes: Evaluating insurance costs/exclusions and ongoing tax appeals

#4 Third-Party Contact Restrictions Can Cripple Due Diligence

Sellers frequently try to limit a buyer's right to contact third parties (such as local zoning officials, environmental agencies, prospective lenders, insurers, and tenants). Buyers should aggressively push back on these restrictions because:

- Environmental consultants legally require public record reviews for Phase I reports
- Redevelopment plans often require early discussions with local municipal officials
- Financing, insurance underwriting, and tenant interviews are fundamental to assessing the investment

#5 Access Rights and Insurance Require Careful Coordination

Invasive inspections (like environmental core sampling or roof testing) create tension between buyers and sellers. Sellers should protect themselves by:

- Requiring advance notice, insurance certificates, waivers of subrogation, and lien-free performance
- Ensuring proper contractual privity so that the seller is explicitly named as an additional insured on the buyer’s consultants' policies (via direct access agreements or third-party beneficiary provisions)

#6 "AS IS" Clauses and Non-Reliance Provisions Carry Heavy Weight

Sellers rely heavily on "AS IS," non-reliance, and merger clauses to shield themselves from post-closing liability.

- For these clauses to be enforceable, courts look at the sophistication of the parties, whether the agreement was freely negotiated at arm's length, and whether the buyer conducted an independent inspection

- The Golden Rule: Contractual disclaimers *cannot* protect a seller who engages in actual fraud or intentional concealment
- The Open Question: How does a seller insulate themselves from liability to subsequent property owners?

#7 Disclosure Limitations vs. Transparency

Sellers often want to provide only the most recent "clean" inspection report, withholding historical reports about past property defects that were subsequently repaired. If a buyer uncovers an old issue post-closing, they can often make a credible legal argument that disclosing that history would have prompted deeper diligence. Transparency regarding past issues – paired with proof of resolution – is frequently the safer path.

#8 The Doctrine of "Sandbagging" Depends on Buyer Awareness

"Sandbagging" occurs when a buyer closes on a transaction knowing that a seller's representation or warranty is untrue, intending to sue for breach afterward. Generally, if a buyer has actual knowledge that a representation is false prior to closing, courts may rule that the buyer did not rely on it, thereby barring a subsequent fraud claim. However, mere doubts or questioning (short of definitive knowledge) typically will not relieve a seller of liability under an express warranty.

#9 RWI is Transforming Deals

RWI is an increasingly popular risk-allocation tool in commercial real estate.

- Buyer-side policies allow buyers to file claims directly with an insurer for breaches of seller representations, bridging gaps where sellers insist on narrow "knowledge qualifiers" or "AS IS" sales
- RWI provides a clean exit for sellers (reducing the need for escrows or post-closing holdbacks)

#10 Confidentiality Must Be Balanced with Legal Realities

Sellers will naturally demand strict confidentiality regarding shared property data. However, these non-disclosure obligations must always be carefully balanced against a party's ethical responsibilities and legal obligations to disclose material facts to prospective buyers, investors, and lenders.

Please contact the author of this Client Alert with questions or to discuss your specific business circumstances.

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