

# WHAT YOU DON'T KNOW ABOUT BUYER INSPECTION RIGHTS



**M**any states have legislated seller-disclosure forms and formats, but what most buyers don't realize is that most of those disclosure laws only cover single-family residential and multifamily homes. The laws do not cover true commercial real estate.

Often, buyers assume, just like in residential, that the seller is going to have to disclose every single thing they know about the property, the building's history, and even information that's detrimental. In reality, it is the Wild West out there.

"From a buyer's perspective, when it comes to commercial real estate, it's caveat emptor (let the buyer beware)," says **Soozi Jones Walker, SIOR, CCIM**, president of Commercial Executives

Real Estate Services, Las Vegas. "What you see is what you get."

In Nevada, as in many states in the West, the buyer will be given due diligence time to go and inspect the property, "but in most cases the seller makes very few warranties and representations as to condition." Walker explains. "It's almost an as-is situation, you have 45 days to do any inspection and at the end of the day, if you're satisfied with the condition, you move forward to closing. If not, possibly the seller will make some repairs — but probably won't."

Things aren't much different in other states.

"Industrial buildings in Alabama are as-is," says **Jack Key, SIOR**, principal of

J. Key Properties LLC in Vestavia Hills, Ala. "You just have to get comfortable with the product because the seller is not going to guarantee much. As a buyer you have to determine if this building is going to work for you or not. A new building might have some warranties, but for an old building, buyers are on their own to see if it works and is worth the cost to retrofit."

In Alabama you don't have contingencies, but you can get the time for inspections. "We call this a free-look, and you might get 30 days or even 60 days for any inspection, which would include roof, title, survey, Phase I environmental, etc.," explains Key.

Key also recommends spending the money to get all the pertinent studies done.



**JACK KEY,**  
SIOR



**MIKE SPEARS,**  
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As an example, Key was representing a buyer interested in a manufacturing plant where the previous tenant was a heavy industrial user. “We expected to see some environmental issues,” Key recalls, “but it turned out the problems were very significant and the seller was not truthful to us about it.”

Not only was it not very smart of the seller to not be forthcoming, but when Key asked for more scrutiny, the deal fell apart. “We told the seller we wanted some additional soil testing, which would have cost \$7,500,” Key continues. “The seller wouldn’t do it. The building still hasn’t sold.”

It should be noted, a seller should always disclose known material defects to protect all parties from future litigation.

A buyer puts a property under contract at a certain price and that price is predicated on whether the renovation is going to cost a certain amount. If the renovation costs are much higher, the buyer is either going to go back to the seller to renegotiate a discount or walk away.

“If the renovation is extensive and expensive that will impact how much a buyer can pay. I would suggest getting a contractor involved before making an offer,” says Key. “I would also suggest having an architect involved because you may have to get a code study. It pays to spend a little money to do due diligence by hiring professionals.”

Up-to-code problems come up more often than not.

**Mike Spears, SIOR, CCIM**, president of TNRG Brokerage Services in

Houston, tells of looking at an old industrial building where the wiring was so bad, even at first-glance it was obviously not up-to-code.

Sometimes, the confluence of building codes and reality are simply fantastic and fictional.

Walker tells the story of representing a buyer who was looking at what appeared to be a two-story building of block construction that had cut-ins for the second floor windows.

“We saw the windows on the upstairs and my client was saying, ‘this is wonderful, I could put my support staff up there.’”

Walker put together an offer, which was accepted, and in the negotiated inspection period, she and her client get to go inside and look around. When they wanted to see the upstairs, they couldn’t find a staircase. The current tenant used a ladder to gain access to the second floor.

“When we got an inspector in there, he pulled the county construction records and said, ‘here’s your problem, the second floor was not permitted,’” Walker recalls. “To purchase that building, close escrow and get a business license, the buyer was going to have to rip out the improvements on the second floor because it was not built to county code.”

Walker was able to renegotiate a lower sales price because, as it turned out, the building (without the second floor) wasn’t as large as it was initially represented. Instead of 15,000 square feet, it was closer to 10,000 square feet.

It pays to bring in the right people to do inspections, Walker asserts.

From buyers’ perspectives, as soon as they move to escrow on a property, they are going to hire either a licensed inspector or a contractor to inspect the building, and maybe check out the roof, to make sure there are no roof leaks, and the structure, to see if there are stress cracks or separations that have occurred. Sometimes, behind the walls, it is virtually impossible to know what is there until the property is acquired.

“This is really an issue in the Las Vegas market, and in many other areas that had massive foreclosures, because the lending institutions that took back properties may be excluded from any type of disclosure and their people don’t know anything about the property,” Walker explains. “The lenders have a loan on the property, that’s all. With that being said, in many cases the buyers are trusting in the fact that it looks good – but looks can be deceiving.”

Which is why Walker recommends doing an “invasive” inspection of the property. That would include going on the roof, opening up air conditioners to make sure there are parts inside, opening up cabinets or walls where there appear to be plumbing leaks, and checking to see if there are deterioration and mold problems.

However, to do all that one needs to have that permission from the owner and nine times out of ten that means the buyer is going to be required to do two things: have a licensed party do the work; and sign an indemnity agreement. The latter indemnifies the seller against any of the buyer’s party being hurt on the property and that the buyer’s people are properly insured to do the inspection.

Normally, that all would be done after the contract is written and accepted. However, in some cases of auction and or repos, the contract won’t even give a due diligence period so that has to be negotiated in advance.

In Nevada, the buyer has the right to inspect a property, but only if it is

requested and negotiated in advance, says Walker. From a seller's perspective, it is a prudent thing to give a buyer an inspection period, even if the buyer ends up not doing the inspection, because the seller may have protected himself against possible future litigation. If required the seller could testify in court, "I gave the buyer time and access."

"I've been an expert witness in a few cases in situations like this," says Walker. "I was hired to talk about what is customary in the industry. What is customary, but not necessarily law, is to give that buyer an opportunity, after a fair offer has been negotiated, to inspect the property in a timely period. On a holiday weekend, to give somebody four days on a 10,000-square-foot, multi-tenant, industrial building isn't reasonable."

When it comes to inspections, Spears offers some common-sense advice:

- In the industrial world, some of the systems – mechanical, electrical, structural, and cranes – are often so complex that they require more than one type of inspector (as opposed to a typical residential inspection where you hire a person to look at everything). Therefore, you should hire a variety of specialists to provide accurate assessments of the various components of the facility.

- You should treat each building on a case-by-case basis to determine what should be inspected. In some cases, such as with older buildings, you might just need to assume there will be some issues and, thus, should budget for repairs, replacements, etc., that you feel will need to be made. In those cases, the willingness to proceed becomes a business decision based on the impact of the costs on the deal. For example, a 30-year old building, with the original roof still in place, is likely to require the new owner to replace it at some point in the near future (if not immediately). In that case, it might be more feasible to just budget for the replacement rather than paying someone to climb up and tell you what you already know.

- An Environmental Phase I report normally should be done. This report will take into consideration items on the site as well as other sites located nearby that might have an environmental impact (such as groundwater contamination). A typical one-stop-shop inspector is not likely to have access to this type of information and, thus, might not be qualified to provide you with a true assessment of your risk. These good reports identify such items as the previous occupants of the facility (to determine the potential risks that may cause contamination), a site inspection

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which identifies any potential signs of contamination and/or the existence of wetlands, or even items which just need to be addressed prior to closing.

- Be mindful of the qualifications of the various inspectors you choose to engage. The cheapest person is not always the best one to use. In one deal, I received a number of bids for an environmental Phase I. The client, who wanted to save money, chose the least expensive inspector and he suggested an expensive Phase II to be done due to portions of the lawn being discolored. As it turned out, the grass was discolored not because of pollution, but because boards were stored on the grass for a long period of time. When the owner moved out, he took the boards with him. The grass that was

discolored was in the shape of boards and, obviously, should not have been identified as a potential environmental concern.

Finally, lack of correct information is another problem that comes up often.

Spears represented a buyer of a building, which was listed as having 2,000 amps of power. Spear brought in inspectors who eventually discovered the structure only had 800 amps. "The existing tenant didn't use nearly that kind of power and when he bought the building, he was told it had 2,000 amps. He had no earthly idea it didn't," Spears recalls. "But, amps were important to my client and the cost to install the right amount of power would have been north of \$200,000. For the size of the deal, the added expense killed it."

Lack of information is more often than not unintended – and a real shocker.

In another deal, Spears represented a buyer for a building surrounded by considerable property. A Phase II was called because the past history of the land indicated a foundry on the site. Inspectors drilled into the ground on one side of the property and all was good. However, when they drilled elsewhere on the property they kept hitting metal. After excavating, it was discovered one of the previous users had buried a bunch of junk cars. The deal fell through as it would have cost \$100,000 to repair the site. The seller didn't even know.

Nothing takes the place of due diligence and if you don't have the expertise in-house, hire the right people for the particular information you want to ascertain. Don't get caught with a leaky roof, outdated equipment, underpowered building or cars rusting away underneath where you walk to work everyday. ■

