

ABCs Of Closing Commercial Real Estate Acquisitions

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"A-B-C. A-Always. B-Be. C-Closing. Always be closing!"

It's the popular expression from the '92 cult classic, *Glengarry Glen Ross*. Set in New York City, a group of struggling real estate salesmen must close their deals or risk losing their jobs. The company sends an overly-aggressive motivational speaker to deliver a provocative message to the group to spur them to close (or perish). However, in the world of commercial real estate, oftentimes, it's not the salesmen, brokers or business people that close the deal — that responsibility is shouldered by the lawyers. For those less-experienced lawyers reading, don't panic. Duly noted, *Closing 101* is not a course taught in law school. This article has you in mind and lays out essential closing techniques every real estate acquisitions lawyer should know.



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A. Identify Closing Requirements

The Transaction. First and foremost, to be effective at closing, you must know the ins-and-outs of the deal. The conditions and other requirements to close are contractual obligations. Read the transaction documents, read them again and again. Understand the properties, the parties and their interplay. Will the order of steps at closing be important for tax or other reasons? Will a joint venture need to close before the closing of a financing, which financing must close before the closing of a property acquisition and which property acquisition must close before the closing of a ground lease? Clearly, the transaction may seem confusing to some, but it can't be to you. Is time of the essence to close? If so, failure to close within the time stated in the contract constitutes breach — period. Only a closer that fully understands the rules of the game can be trusted with the ball in the ninth inning.

The Closing Checklist. The closing checklist is your roadmap to closing. If you fall asleep at the wheel or shift into cruise control, closing items may fall through the cracks. The closing checklist is a list of every document, action and other item required to close. At a minimum, it should include responsible parties, timeline of completion and status for each closing item. It's better to be over-inclusive. The order of the closing checklist should be tailored to the transaction. If the transaction is particularly steps driven, order each closing item by transaction step. If the transaction involves many subtransactions, order each closing item by subtransaction. The parties should discuss and update the closing checklist on a

continual and frequent basis from the beginning of the transaction until closing (initially weekly, then as closing approaches, twice a week, and when it is imminent, daily). The objective of checklist discussions should be to confirm that the closing items are being progressed by the responsible parties for completion at closing. If kept complete, organized and current, the closing checklist will make the most complex commercial real estate acquisition seem like a walk in Central Park.

Funding Requirements and Cut-Offs. Determine funding requirements and cut-offs early; when it comes to funding at closing, failure is not an option. Timing of funding, method of funding, destination of funds, amount of funds and funding disbursements are questions that need answers as early as possible. Timing, method and destination are identifiable by the transaction documents. Typically, (1) timing is the day of closing, which can be a preset date or a date following the occurrence of certain events, (2) method is either by wire transfer of immediately available federal funds or by certified or bank check and (3) destination is designated by the seller or escrow agent a few days prior to closing. It's that simple.

Amount and disbursements are also identifiable by the transaction documents, but often not so simple. Amount is usually subject to adjustments for operating expenses and income of the property. Disbursements are only identifiable once one has allocated responsibility for the associated closing cost. The parties should prepare and finalize as early as possible both (1) a proration statement for amount of funds and (2) a closing statement for funding disbursements. The proration statement should detail the agreed calculation of the adjustments and include per diem amounts for the operating expenses and income being prorated. The closing statement should detail the flow of funds at closing and include amount to be funded (from the proration statement), amounts to be disbursed to the recipients and wire transfer instructions for the disbursements. At closing, real estate lawyers can't claim to be legal-wise dollar-foolish. Determining funding requirements and cut-offs early must be made a priority. Particularly at closing, funding will be considered the most important closing item.

B. Mobilize Closing Work Streams

Advance Arrangements. Stay on the offensive by making closing arrangements in advance. Closing commercial real estate acquisitions requires a well-coordinated effort. It is incumbent on the lawyers to make certain that no detail, big or small, is overlooked. Check availability of signatories. Check availability of decision makers. Ensure necessary bank accounts are set up. Ensure wire transfer instructions for funding are delivered and funding is prepared and ready. Ensure necessary internal and third-party approvals are obtained (e.g., shareholders, members, partners, boards, lenders, landlords, major tenants and counterparties to significant contracts). If you're always playing defense, you're only ensuring potential issues at closing and scoring zero points with your client.

In particular, governmental approvals and filing requirements should not be ignored. Check the filing requirements for transfer or recording taxes, whether state or municipal. If the transaction involves significant personal property, application of state sales taxes may be required. Advance filing or preclearance requirements may also be applicable — some states require filings and preclearance if the seller is selling its only asset in the state. If the transaction involves an operating business, filings could apply under Hart-Scott-Rodino. If the transaction involves foreign investment, the transaction may need to be reported to the U.S. Department of Commerce. Residential properties may be subject to unique requirements like obtaining new registration certificates, certificates of occupancy and similar "sign offs" and first refusal rights in favor of a government authority. Other governmental approvals may apply, for example, (1) under governmental agency regulations if the property is used for gambling, liquor sales or storage of hazardous activities, (2) under bulk sales statutes if the transaction includes the sale of a

business including significant personal property and (3) under state securities laws if the transaction includes the sale of cooperative or condominium apartments. Run these to ground because Uncle Sam is watching. Failure to satisfy closing items requiring long lead time can be avoided by making closing arrangements sufficiently in advance. By failing to prepare, you are preparing to fail.

Third-Parties. Common misconception: third-parties are fully engaged in your deal. They aren't. Third-parties are rarely as familiar with or interested in the transaction as you might think — you need to keep them informed. In any real estate transaction there are a number of third-party closing deliverables (e.g., title insurance, lender consent, opinions and estoppels). If practicable, encourage third-parties to deliver their documents in escrow in advance. Review their escrow instructions. Confirm that any conditions to release can be satisfied as early as possible and without their further participation or be sure to arrange for that participation. Confirm that the escrow instructions are straight forward and easy to understand to avoid disputes as to whether escrow was in fact broken. Failing to keep third-parties informed will likely result in delays at closing — as you near closing, be in the habit of regularly reminding third-parties of timing and what you need from them at closing. Persistence is critical. Don't be afraid to pester.

Executing into Escrow. Signature pages seem simple: get the parties to sign their John Hancock on the line which is dotted. If only it was that simple. In the heat of closing, signature pages tend to go missing or forgotten or turn up incorrectly executed. Formats for signatures of corporate entities are changed. Signatories disappear. Ideally, you would finalize all closing documents and have them executed in escrow in advance of closing, so that at closing parties can focus entirely on the mechanical process of getting the deal closed and, of course, planning the closing dinner. But fast paced and heavily negotiated transactions typically require changes to the closing documents until the so-called "fat lady sings." For this reason, it's common practice to gather executed signature pages in advance of closing and in advance of the documents being finalized. Changes can continue to be made to the documents while the executed signature pages are being held in escrow, until released by the parties when the documents are finalized. Contracts can be executed by each party signing a duplicate original and exchanging the counterparts by person, courier or electronic transmission, but be mindful that certain instruments such as promissory notes and stock certificates should not be exchanged electronically or executed more than once. This method has support under law. If you prepare broken-out signature page packets for each signatory early and review them with a critical eye before being delivered for execution, this part of closing will be as it should be: simple.

Funding into Escrow. Funding into escrow early on the day of closing, or even the business day prior to closing, will alleviate pressure to timely satisfy payment cut-offs. Most closings are like a series of scripted acts; there is an order to funding which must be followed. Closings are typically conducted through an escrow agent. The funds and documents are deposited with the escrow agent. When the conditions to closing have been satisfied and title is cleared, the deposited documents are released, recorded and delivered and the funds released in the order required. Funding early is a reasonably safe approach. The escrow agent will likely be a recognized and well capitalized title company. Additionally, the parties and the escrow agent will enter into a formal escrow agreement prior to depositing funds and documents, establishing a contractual obligation to safeguard the funds (as there is often no statutory obligation). But some buyers resist funding into escrow earlier than absolutely necessary. Such resistance is not completely without merit: (1) there can often be a cost to funding early, if for instance the money is borrowed or the funds earn a return from the date advanced; (2) well capitalized or not, buyers dislike losing control of their funds; (3) other than in some jurisdictions, regulatory oversight for escrow agents is minimal; and (4) the escrow agreement will likely provide that the escrow agent's duties are purely ministerial in nature, that the escrow agent is not subject to liability unless resulting

from its willful misconduct or gross negligence and that the escrow agent is permitted to hold and retain the funds or deposit the funds in an appropriate court of law if it receives conflicting or inconsistent demands or a dispute arises between the parties. If your buyer can get past these concerns, fund early. Thrill-seekers may enjoy the “edge of your seat” feeling as the clock winds down on funding, but this scripted act is better suited for Broadway.

Disbursements may need to be made early due to time limitations of the wire transfer system. Banks generally use the Fedwire Funds Service, operated by the U.S. Federal Reserve, for domestic transfers, or the Clearing House Interbank Payments System, operated by the New York Clearing House Association, for international transfers. Consider the time limitations of the wire transfer system being used, as well as any specific time limitations of the transferring and receiving banks for initiating and receiving wires. Also of note, the Foreign Account Tax Compliance Act is the latest potential hold up to delivery of funds because the transferring bank, by reason of its own FATCA compliance review, may not actually transfer the funds to the receiving bank regardless of instructions to do so. Funding into escrow early will expose these issues at a time in which the parties can address them without delaying closing.

C. Establish Closing Game Plan

Closing Date and Preclosing Conference. Set a closing date and preclosing conference ASAP. Setting a closing date early will keep everyone on task. The preclosing conference is attended by the attorneys and the title closer the day or night prior to closing. It’s a dry-run of closing. At the conference, the attorneys should review and finalize all of the closing documents. The title closer will review those documents required to issue the title policy and take any documents being recorded. After the preclosing conference, the only steps remaining to close should be to release signature pages and fund.

Physical vs. Electronic Closing. The general consensus today is to close either by physical closing or electronic closing. That being said, closing electronically is the clear choice — as clear as the dichotomy between carrier pigeon and texting. At a physical closing, the parties attend a meeting, the closing documents are set out in the closing room ready for signing, the signed transaction documents are exchanged physically and parties wait for confirmation of the transfer of funds or funds are paid by certified or bank check. Practicality is the main issue — large complex closings are difficult to close like this. For electronic closings there are no travel arrangements necessary and individuals are required to be involved only as necessary. With email and web based communications and electronic file sharing, the overwhelming trend today is to close through electronic closing. Electronic closings can take place either by email or telephone. For each, there is an email sent by each party attaching the executed closing deliverables stating that they are to be held in escrow and not released until escrow is broken. If by email, the escrow agent then sends an email to the parties requesting authorization to break escrow, disburse funds and close. If by telephone, the parties then join an all hands conference call and the escrow agent conducts a roll call and requests each party’s authorization to break escrow, disburse funds and close. In either case, when authorization is given, the escrow agent then proceeds to close. Bottom line, step outside of the Stone Age, close electronically.

Closing Game Plan. Don’t wake up on game day without a plan. Visualize the closing beforehand and prepare a winning fourth quarter scheme. Procedurally, how do you imagine the day will go? Who should send the first email and initiate the closing process, then who should first respond and so forth? Someone will need to take the lead and create a game plan. It can be a short memorandum or email addressed to the parties detailing the date of closing, date of the preclosing conference, location of the physical closing room (if applicable) and instructions for accessing it, procedure for executing signature pages, contact information in case there are questions about closing and transaction steps to be taken

at closing (i.e., script out the day). Circulate the closing game plan to the parties, including the third-parties. Invite comments to the extent anyone's understanding of the events at closing are contrary to the events described in the plan. The closing game plan will keep all parties in sync and force everyone to think about closing and the potential issues that could arise before it's too late to think of solutions.

Summary

In the context of commercial real estate acquisitions, where real estate lawyers are expected to close the deal, it's not enough to "always be closing." A closing fraught with issues and delays will diminish the weeks (possibly months) of good work performed for a client and, at least for that client, lead to N-M-C. No more closings. Instead, real estate lawyers should follow the essential closing techniques laid out in this article: (1) identify all closing requirements; (2) mobilize all closing work streams; and (3) establish a closing game plan. Utilizing these techniques will foster an efficient, organized and ultimately successful closing. Closing 101 is now dismissed. So what are you waiting for? Get out there and close!

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