A Checklist for Buying Real Property

Expert Advice
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No one buys a car without researching it — looking up facts from the maker, reading reviews, test driving, etc. In other words, a car buyer does his or her due diligence before making a purchase. The same concept applies for real estate, only on a much larger scale because of the high price of real estate and complicated issues.

The question that I often get is what due diligence a buyer needs to do. The question is complicated by the expense of due diligence activities, with routine examinations like surveys, environmental inspections and title insurance costing thousands of dollars each.

Some types of due diligence are also very time-consuming, such as determining if the property is affected by federally protected wetlands or endangered species. The time constraints of the deal may make some due diligence impossible to complete.

The key to effective due diligence is making a list and categorizing each option as critical, ideal or aspirational.

The critical items on the list are those that cannot be skipped without a substantial risk of a fatal flaw going undiscovered.

The ideal items are those that could be skipped if time and budget do not allow them but are still extremely important. Leaving ideal items undone creates significant project risks that may or may not be tolerable.

The aspirational items are not necessarily critical but can provide valuable information that a buyer should want to know before proceeding with closing.

Some types of due diligence might be ideal for one project but critical for another, depending on a range of factors, including the buyer's risk tolerance and the unique nature of the property. For example, a wetland delineation, which is the procedure for identifying federally protected wetlands, might be merely ideal on an urban property with a history of development but might be critical on a greenfield development near a creek.

There are a few types of due diligence that stand out as almost always belonging on the critical list, with the big three being: 1) title review (and title insurance), 2) survey and 3) environmental inspection, i.e., a Phase I.

Failure to perform any one of these can present enormous risks, such as not discovering third-party rights to use the land (like a neighbor's easement to use the property as a driveway), missing a fatal restrictive covenant (like a restaurant development saddled with an alcohol sales prohibition) or missing an environmental issue that might cost tens of thousands of dollars to remediate.

The ideal list could include any number of items, depending on the nature of the land and the buyer's plans. There is also a fine line between what constitutes critical and ideal, with strong arguments possible for any of these items belonging on the critical list instead.

Common ideal items may include: 1) completing any necessary rezoning, 2) obtaining permits for the development of protected wetlands, 3) obtaining approval of plans for the development of flood plains and flood ways, 4) verifying that no endangered species are negatively affected, 5) verifying that no protected cultural resources are negatively affected and 6) obtaining any off-site easements that may be necessary, such as access easements or temporary construction easements.

Finally, the aspirational list is the most variable. Depending on the time and resources available, a buyer may decide to undertake all or none of these before closing. Possible aspirational items include: 1) substantially completing full engineering and/or architectural designs, 2) negotiating a construction contract or 3) obtaining all governmental approvals. All of these are very important but might be acceptable risks to some buyers.

These lists notably omit securing financing for the project. Financing is often a sine qua non that kills the entire project if not properly addressed and, therefore, belongs in its own category. Certainly, no one should purchase real estate without knowing that the money is in place.

Failing to make a due diligence checklist is perhaps the worst mistake you can make when buying real estate. Whether you classify any particular type of due diligence as critical, ideal or aspirational is less important than going through tbe process of thinking about what you should know before buying and figuring out how you are going to go about learning it. You should never invest your money in real estate without knowing what you are buying, and due diligence is there to help you find out what you don't know but really need to know. ■

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