# Fundamentals of Purchasing Real Estate

*This worksheet is designed to provide a brief overview of the process for purchasing real estate and to help organizations make an informed evaluation of a property's suitability to meet their needs.*

Once your agency has determined its program goals, facilities needs and financial means, you are ready to begin the process of identifying suitable real estate. It is critical for your organization's Board and staff to clearly define and agree on what target areas, neighborhoods and other geographic requirements will meet your organization's needs for the long term (*see Worksheet #1: "Assessing Your Organization's Program and Facilities Needs"* and *Worksheet #7: "Approaching a Real Estate Project"*). Well before acquiring property or starting construction, you will incur costs for inspections, legal professionals and earnest money. Remember to set aside cash from your operating budget or special grants funds to help pay for these costs.

**Identify and Visit Available Properties**

Once you have defined your property criteria (*e.g., target area, size of building, special features*), you can begin a search for your new facility. The property search and identification can be completed by a designated staff person, a project manager (*if you have one secured at this point—see Worksheet #9: "Selecting a Project Manager"*) or a real estate broker. Base the decision to hire a broker on the amount of time staff has to dedicate to a property search. For a fee, which is paid for by the seller of the property, a good broker can save time by narrowing the field to your pre-set criteria. Whether you have hired a broker or are accessing available listings yourself, a property's initial suitability can be determined from the information typically contained on a standard Real Estate Listing Sheet. Your broker or the broker representing the properties for sale can provide you with such listings, which include the following information:

- Address
- Lot Dimensions
- Building Dimensions (Gross Square Footage)
- Room Dimensions (Net Square Footage or Usable Space)
- Selling Price (Total and Cost per Square Foot)
- *Zoning Restrictions:* Zoning is established by local government and designates a building's type and how it may be used, such as residential, commercial and industrial. Determine what classification of use your agency falls into and which zoning designations allow this type of activity. To make this determination, you can contact your local zoning office, reference the local zoning ordinance, or work with a zoning attorney.
- *Taxes:* In addition to the most recent tax information, inquire when the last tax assessment was made and if there are any special assessments regarding roads, streets, sewers, electrical or other public works improvements.
- *Utility Costs:* Recent data on previous expenditures for water, gas and electricity.

If several buildings meet your criteria from the listing sheet, visit potential sites for further investigation.

**Choosing the Best Properties and Entering into a Purchase Agreement**

When you have identified a property and determined that it meets initial suitability requirements, you will need to learn more about the condition of the property. Additional research and/or tests usually require access to the property. The seller will typically require you to enter into a purchase agreement before you have access to the building to perform the tests. You should hire an attorney to draft and review your purchase agreement. A purchase agreement, usually secured with earnest money, expresses your interest in purchasing a property, subject to the information you gather during the due diligence period. Earnest money is credited against the final purchase price if the transaction occurs, or is refunded to the purchaser if the deal falls through, or is kept by the seller if the purchaser defaults under the terms of the purchase agreement.

Your earnest money deposit should not exceed 10% of the purchase price; you should offer enough of an earnest money deposit to let the seller know you are serious but keep it affordable for your organization. The earnest money deposit is often less than 10%.

Sometimes a “letter of intent to purchase,” which expresses your interest in purchasing, can establish the terms for the contract; price, due diligence period and closing date are usually spelled out in such letters of intent. Letters of intent are not contracts, but let the seller know that you are interested in the property when you don’t have time to wait for your attorney to draft a purchase agreement.

Purchase agreements are created with contingency clauses to allow for time to obtain additional information or perform due diligence. Negotiate at least a 30-day due diligence period; 60 to 90 days is preferable, and 120 days is ideal. Due diligence usually includes building inspections (including roof, structural and systems review), a zoning and parking requirement review, building code review, environmental assessments, and an appraisal. The information gathered during the due diligence period will enable you to make a more informed decision about the property. While the costs of these inspections can add up, the information they reveal can often result in tremendous savings in the long run. Pay special attention to:

*Layout Suitability:* An architect or space planner should look at the current configuration of a building to make an assessment of how easy or difficult it will be to renovate to meet your organization’s space needs. Common problems are: load-bearing walls that are not easily moved; plumbing and HVAC (Heating Venting and Air Conditioning) piping that are not easily modified; and stair, door and hallway configurations that are not readily ADA (Americans with Disabilities Act) accessible.

*Condition of Property:* Inspections of the major components of the building should be performed by qualified professionals.

*Structural:* Look for potentially expensive flaws in the structural integrity of the building. These are typically indicated by bowing, sagging or rotting structural elements. Other common indications of problems are cracks in concrete, evidence of termites, drainage problems, and eroded masonry mortar joints.

*Electrical:* Assess whether the current electrical power is sufficient for the proposed work and if it is installed in compliance with current local building codes.

*Mechanical:* A general inspection of the age and condition of the plumbing, heating and air conditioning systems should be performed.

*Roofing:* Determine the type, age and condition of the roof and drainage system and review applicable warranties.

*Environmental Audit:* A Phase I audit conducted by a professional environmental inspector consists of a preliminary site analysis, including examination of public records and surrounding properties, to determine if there is evidence of hazardous waste, underground storage tanks and possible leaks. Lenders are concerned that the security for their loan may be at risk if the property is found to contain hazardous substances. Since lenders could potentially own the property through foreclosure, they will generally require extensive documentation on environmental concerns and how they have been addressed.

**Establish a Budget**

Once you have obtained considerable additional information on the selected property, your findings need to be factored into the decision of whether to move ahead with the purchase agreement. Often, the due diligence period inspections reveal significant costs that should be incorporated into the purchase price negotiations. You may decide to abandon a property after inspections reveal too many cost-prohibitive problems. Don’t be discouraged: it’s better to keep looking for the right property than to sink money into a building that’s not right for your organization.

Have your architect, project manager or estimator provide you with a probable estimation of costs for the renovation of the property, including the results from the due diligence inspections. This is another cost item that you will incur before you ultimately decide to purchase the property, although you may be able to secure pro bono architectural or other professional services for the estimating expense.

Establish a development budget based on the probable opinion of cost that your architect, project manager or estimator has provided you, and add other soft costs to the budget to get a better of understanding of the project's total costs (*see Worksheet #8: "Creating a Project Development Budget"*).

**Secure Financing Commitment**

During your due diligence, you will need to secure a mortgage commitment. Lenders will want to see a development budget, as well as your agency's financial statements and an operating budget showing how their loan would be repaid. Lenders will also want to see your other committed sources of funds for the project.

Lenders typically require the following items before a closing on a purchase can occur. It is critical to secure professional assistance in reviewing these requirements, for they often contain critical information that can significantly delay, complicate or prevent a deal from moving forward.

*Appraisal:* This is a written analysis of the estimated value of real estate prepared by a licensed appraiser. If obtaining a loan, most lenders will require an appraisal to determine the value of their loan. An appraisal will also determine whether you are paying too much for the property. For a preliminary informal evaluation of a building's value, research recent sales of comparable properties.

*Survey:* An ALTA (American Land Title Association) survey is the industry standard. The survey is a drawing of the precise legal boundaries of the real estate (land and lot lines), the location of improvements, easements, rights of way, and encroachments. Title insurance companies and lenders generally require a recent survey; the seller usually provides this.

*Restrictive Covenants:* These are private agreements that limit the use and occupancy of real estate. For example, the purpose of the structure being built, architectural requirements, setbacks, size of structure and aesthetics may be governed by a restrictive covenant. Contact the Recorder of Deeds in your county to learn whether any restrictive covenants have been recorded in connection with your property.

*Condition of Title:* A Title Report is a search of public records of all recorded interests in and/or encumbrances on the property. You should hire a real estate attorney during the review process to investigate any unforeseen encumbrances on the conveyance of title.

*Easements:* This means a right or privilege one party has to the use of another's land for a special purpose consistent with the general use of the land. Easements are commonly given to telephone and electric companies to erect poles and run lines on the property, as well as gas and water companies to lay pipes or run lines on the property. Other easements can be given to people to drive or walk across someone else's land. Contact the Recorder of Deeds to find out what easements exist on the property. They are usually included on the survey.

**Closing**

If you still want to buy the building after performing the inspections and revising the budget, then schedule a closing.

If you haven't done so already, hire an attorney (or secure pro bono legal services) to coordinate the closing for your purchase of the building. Your attorney should make sure that all outstanding issues (e.g., condition of title, tax liens) regarding the property are resolved before you take ownership.

Once you have closed on the building you will begin to incur holding costs (insurance, property taxes, security, board-up if vacant, etc.). It is critical to keep the development process moving in order to minimize holding costs and other expenses associated with delays.