Don't Purchase a Lemon: Top 5 Mistakes to Avoid when Closing the Deal!

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Buying real estate is like buying a used car; if you are not careful, you can end up with a lemon. However, unlike buying that used car, purchasing a contaminated property can cost you more than just the purchase price.

Unfortunately, many people discover that their property is contaminated after closing. Pursuing legal remedies after the fact is expensive and time consuming. The remedies can be limited and may not address all potential liabilities. The best way to avoid trouble is to be proactive. Before you purchase a property you should conduct quality environmental due diligence.

These are the top five environmental mistakes purchasers make on real estate purchases:

1. Failing to negotiate the environmental terms before inking the deal

Purchasers tend to fixate on the purchase price in a real estate deal and make environmental considerations an afterthought. By not negotiating environmental terms before the parties sign, the parties may be subject to unfavourable and unintended consequences. The number one thing that purchasers dislike is a surprise.

An environmental framework for the purchase creates certainty and avoids confusion when environmental issues are identified through due diligence. Both purchasers and vendors should include specific clauses to (i) structure the environmental due diligence, and (ii) allocate the known and unknown environmental liabilities. Incorporating the proper protections up front will avoid the purchaser being left with no escape and forced to deal with someone else's mess.

2. Failing to obtain a quality Phase I Environmental Site Assessment

Environmental due diligence often starts by obtaining a Phase I Environmental Site Assessment. A quality Phase I ESA will identify current and historic on-site and off-site land uses that have potential to affect the environmental condition of the property. A Phase I ESA will also identify if intrusive investigations, such as soil and groundwater testing, are advisable or required.

Phase I ESAs are important because environmental issues are commonly caused by historic operations that are not always apparent from the existing use of a property. However, not all Phase I ESAs are alike. Purchasers should be aware of standards to which the Phase I ESA is being conducted (e.g. CSA, ASTM, O.Reg. 153/04), so they know what the Phase I ESA is designed to accomplish and, more importantly, what it may not accomplish.

3. Failing to retain a reputable environmental consultant

Retaining a reputable environmental consultant is essential to any quality due diligence. Purchasers should check the qualifications of their environmental consultant. Investing in a reputable professional engineer or geoscientist to assist in the due diligence is important, regardless of the purchase price of the property. The cost of environmental liabilities can easily exceed the purchase price, so purchasers should not cut corners by hiring the cheapest cost consultant.

4. Failing to have enough time to complete due diligence

Quality environmental due diligence cannot be rushed. Purchasers often do not leave enough time to complete due diligence and are forced to make uninformed decisions.

Due diligence should be structured to provide enough time to retain an environmental consultant, complete the Phase I ESA and assess other environmental liabilities (e.g. permits and approvals). Time should also be incorporated in the due diligence period to account for a Phase II intrusive investigation if recommended. Purchasers who buy industrial properties or commercial properties with high-risk land uses, such as gas stations and dry cleaners, should expect that a Phase II ESA will be required. Wait time for consultants and drillers is longer in the summer, and laboratory analyses take time.

Due diligence periods should be a minimum of 60-90 days. Do not put pressure on yourself or your clients to make uninformed decisions by assuming you can complete a quality due diligence within 30 days.

5. Failing to set out a thorough framework for post-closing obligations in the agreement of purchase and sale

Setting out purchaser and/or vendor's post-closing obligations is easier done before the deal closes. Parties making simplified commitments in a deal, with the hope that all the details will be worked out later will inevitably feel regret and be faced with delays and costs.

Items such as access, confidentiality, indemnities, and releases should be contemplated before the deal closes. A detailed framework should be establish that incorporates a clearly defined end point (e.g. applicable standards for clean up or filing of a Record of Site Condition), time frames, costs allocation and contingencies. For example, in-situ remediation can require multiple applications and may not achieve the desired end point within the time allotted. Ministry accepted Risk Assessments can take several years to complete and require additional field work that was not originally contemplated.

Establishing a thorough post-closing framework will help the parties maintain an amicable relationship well after the ink dries.

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