UNDERSTANDING THE PROS AND CONS OF A LETTER OF INTENT IN CRE TRANSACTIONS

In the realm of commercial real estate transactions, a Letter of Intent (LOI) serves a preliminary document outlining the key terms and conditions of a potential deal. It is a non-binding agreement that precedes the formal contract, providing a framework for negotation and due diligence. This white paper aims to clarify the advantages and disadvantages of utilitizing an LOI in commercial real estate transactions while outlining the essential/basic elements that should be included in such documents.

ADVANTAGES OF A LETTER OF INTENT

- **Clarity and Initial Agreement:**

The LOI serves as a roadmap, clearly outlining the fundamental terms and conditions agreed upon by both parties. It sets the tone negoations, ensuring that both parties are aligned in their understanding of the deal's basic structure.

- **Efficiency in Negotiation:**

By outlining the key terms early in the process, the LOI streamlines negotations, reducing the likelihood of misunderstandings or disputes arising during the contract stages of the transaction. This efficiency can save time and resources for all involved parties. Since this is a simple non-binding letter, it typically does not have to be drafted by an attorney, saving both time and cost.

- **Establishment of Good Faith:**

The act of drafting and exchanging an LOI demonstartes a commitment to the negotation process and signals good faith between the parties involved. It lays the groundwork for a collaborative and constructive relationship moving forward.

- **Framework for Due Diligence, Cost, Financing, Earnest Money, and Escrow Agent(s):**

While non-binding, an LOI provides a framework for conducting due diligence, and the items provided by the parties. In addition, it establishes guidelines for the parties in relation to gathering the necessary information to asses the feasibility, financing, settlement cost, and risks associated with the transaction.

DISADVANTAGES OF A LETTER OF INTENT

- **Risk of Premature Commitment:**

Despite its non-binding nature, parties may feel pressure to adhere to the terms outlined in the LOI once it is signed. This can lead to a premature commitment to the deal, potentially overlooking critical issues such as passing on additional offers when the binding purchase and sale contract have not been agreed to and/or executed.

- **Ambiguity and Interpretation:**

The language used in an LOI may be subject to interpretation, leading to ambiguity regarding the parties' intentions. This ambiguity can result in disagreements or disputes during the contract negotiation process, undermining the effectiveness of the document. It is imperative that the LOI is clear in what it states in relation to the desires of the client.

- **Cost and Resource Allocation:**

Drafting and negotating an LOI requires time, effort, and resources from both parties involved. In some cases, these costs may outweigh the benefits, particularly if the transaction ultimately fails to materialize. Occasionally, we will find that the client's attorneys chose to negotiate the non-binding letter of intent as if it were the binding contract. It is importnatn to remember the contet and impact of the document.

ESSENTIAL ELEMENTS OF A LETTER OF INTENT (not to be considered an exhaustive list)

- **Identification of Parties:**
Clearly identify the parties involved in this transaction, including their legal names and contact information.

- **Description of Property:**
Provide a detailed description of the property or properties under consideration, including any relevant specifications or features.

- **Terms of Purchase or Lease:**
Outline the proposed terms of the purchase or lease agreement, including price, payment terms, earnest money, financing, and any conditions and precedent.

- **Due Diligence Period:**
Specify the duration and scope of the due diligence period, during which the parties will conduct investigations and assessments related to the transaction.

- **Closing Period:**
Specify the duration of the closing period, typically expressed in calendar days after the expiration of the due diligence period. Equally important is outlining the responsible parties for the closing expenses. Items such as Escrow Fees, Title Policy, Endorsements Coverage, Recording, and Survey Cost.

- **Tax Deferred Exchange:**
It is becoming common place for the Buyers and Sellers to utilize 1031 Tax Deferred Exchanges. If this is the case, there needs to be notification and mutual agreement to the action that will need to be completed for this to occur.

- **Documentation:**
It is advisable to outline during the LOI stage exactly who is to prepare the Purchase and Sale Agreement, or the Lease as the case may be.

- **Advisor's Fee:**
Clarify and establish the relationship between the broker(s) and the Seller and Buyer as well as who is paying the fee. Typically, this section would also include directions as to how and when the fees are to be paid.

In conclusion, while a Letter of Intent can be a valuable tool in commercial real estate transactions, it is essential to carefully consider its advantages and disadvantages before proceeding. By understanding the potential benefits and pitfalls of using an LOI and incorporating essential elements into the document, parties can effectively navigate the negotiations process and lay the groundwork for a successful transaction.

SVN®
HOLMAN PARTNERS

Will Holman
SVN | Holman Partners
www.svnholman.com
O: 636.628.2111
will.holman@svn.com