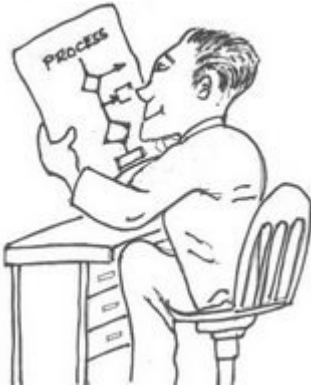


Be Cautious of a Due Diligence Clause!



By Brian Madigan LL.B.

A clause that is silently creeping into the real estate industry is the due diligence clause. Basically, it provides an opportunity for the purchaser to walk away from a deal for any reason, including the fact that the purchaser has now had second thoughts. It's not that common in Ontario but it is in certain other jurisdictions. It's fine for the purchaser, but no help at all to the vendor.

This type of open-ended walk-away clause is quite common in many commercial transactions. Rather than having 20 or more conditions, one simple straightforward, no strings attached condition will do.

It needs to be short in duration, yet sufficient in time to permit what needs to be done. Thirty to sixty days may be fine. Ninety days is often too long. Since it virtually amounts to nothing more than an option to purchase, some vendors will want the purchaser to pay for that option. In this case, an option price or non-refundable deposit clause might be used.

This type of clause often goes with the sale of a complex business. Here, the purchaser really needs to know a fair amount about the company before he can confirm the purchase. The vendor will agree to such a clause if he can be sure that the purchaser is a serious buyer and has a good track record of going through with deals.

As for the real estate industry, the use of this type of clause is less common. The reason is simple, there's less uncertainty with real estate.

So, if you are a vendor and your property is overpriced, you haven't had any offers, and you are not under any financial pressure, then why not accept such a clause?

On the other hand, if your property is well-priced and you are just coming into the peak selling season for your type of property, why tie it up for 21 days?

So, what would be some reasonable conditions:

- Financing, allow the purchaser one week to obtain financing
- Inspection, allow the purchaser one week to have a home inspector examine the building

These are two reasonable conditions and they are of short duration. In commercial transactions, there may be some other conditions that are quite reasonable as well:

- Zoning, allow the purchaser 30 days to determine the feasibility of a zoning change
- Building, allow the purchaser 30 days to determine the feasibility of construction

For rural or vacation properties, it may be quite reasonable to permit:

- Water usage, 30 days to determine if the water is of sufficient quality and quantity
- Septic system, 30 days to determine whether it works and is adequate

In these cases, the conditions all relate specifically to the particular property at hand. It may seem that if we had a transaction in which all six conditions applied that the purchaser could just about walk away for any reason. This may be somewhat true. However, the issue of buyer's remorse does not enter the picture. And, what happens if the purchaser simply finds another (but better) property in the meantime. The vendor will be out of luck.

So, be cautious before agreeing that an open-ended walk-away clause be part of your agreement.

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