

How To Control Legal Costs In Commercial Real Estate Transactions

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Real Estate

I write about commercial real estate negotiations, deals and legal issues.





Certain elements of any commercial real estate transaction will tend to drive up the legal fees.
 RANJAN SAMARAKONE

Commercial real estate clients regularly complain about legal bills, both because they think the hourly rate is too high and they say the work took too many hours. It's a compelling demonstration of the incredible power of multiplication.

To save money, clients can put certain types of work out to bid and then hire the lowest bidder. That often doesn't end well. Instead, a client might prefer to hire the best counsel for the job regardless of hourly rate, then try to manage the legal time and the bill. Here are a dozen suggestions.

Make Your Business Deal First. Agree on the business deal before involving counsel. That usually means creating a nonbinding term sheet to cover the important bases: economic terms and anything else (not totally "standard") that is important enough that if the deal didn't include it, you wouldn't do the deal.

Often, the best time to involve counsel is when the basic economic terms have been resolved but the term sheet isn't final. That's when counsel can help identify issues that, if left to the definitive documents, will run up legal fees that could have been prevented by covering them in the term sheet. Before that, the major legal issue consists of making sure the term sheet doesn't bind anyone.

Gating Issues. For any major issue in a deal, resist the urge to postpone it to later in the process. It won't get easier to resolve. You just increase the risk of wasted legal fees. For example, in ground leases for development projects, the two largest and most common issues of this type are future rent adjustments and the required guaranty or credit support to assure the developer will complete and pay for the project. You should resolve those issues before any legal work begins.

In a mortgage loan, define the actual words of the nonrecourse carveouts before the lender starts any other legal work. Don't just refer to "the standard carveouts." Standard is in the eye of the beholder.

Organize Information. Any transaction usually begins with information on its history, context, and previous documents. If that information dribbles in over time, the attorneys will spend more time organizing and tracking it – and figuring out what they've already seen and thought about and what they still need – than actually understanding it and figuring out what to do as a result. So try to provide all relevant information once, in an organized way.

Keep It Simple. If you can keep your deal simple, do it. Complexity means more legal work and more risk of mistakes. Try to stay away from deal elements that tend to get complicated, such as profit participations, rights of first offer or first refusal, special provisions for weird hypothetical eventualities, deal structures that are designed to echo or replicate other deal elements, multiple interacting waterfalls, complex exceptions and alternatives, creative new ways to do things that everyone else has always done a certain way, and so on. That's particularly true for deal elements that will probably never activate and never have much practical or economic value.

Timing. Try not to have emergencies. They cost more. Conversely, try not to have unreasonably long timelines to get a deal closed. Make a reasonable schedule and stick to it.

Prevent Surprises. When selling real estate, know what you are selling so unexpected issues don't arise. Do the same investigations a buyer will. If leasing space, identify your needs, including nonobvious ones, from the start. If engaging a broker, check that you don't already have similar obligations to some other broker that you previously hired. If you have an internal approval process that isn't automatic, line up the approvals early in the process. And identify from the beginning all third parties that must be involved, including any other professional advisers and deal participants on your side.

Changes in the Deal. Try very hard not to change the deal once the parties have involved counsel, and particularly once the counsel have started on documents. Changes run up legal fees and increase the risk of mistakes and problems.

Document Girth. For most commercial real estate transactions, documents always seem to become longer and more complex over time. Consider starting over, paring the documents down to what's essential without covering every possibility at extraordinary length or covering the same issue multiple times, probably in multiple and inconsistent ways. Creating shorter documents may entail more work at the outset, but it may reduce negotiations and revisions, the main sinkhole for legal fees.

First Drafts. It may make sense to have counsel prepare and send out "reasonable" first draft documents, rather than the more typical egregiously one-sided documents. On the other hand, it often seems that any attorney who receives a substantial document, whether reasonable or not, will always have a certain volume of comments on it, so you may as well start from a more favorable starting point. This is a matter of taste, experience, cast of characters, context, and judgment.

Close Issues. In negotiating documents, try to resolve issues rather than leave them open. If you are ultimately going to compromise an issue, do it. Try to get something for it. But don't let it fester. As long as it stays open, it requires continued care and feeding in the form of legal attention and legal fees.

Watch and Listen. Pay attention to what the attorneys are doing and working on. Don't just let them go off and do what they think needs to be done. If they are overcomplicating or overthinking something, stop them. If they are doing something that doesn't seem necessary, stop them. Don't wait until you receive the bill. At that point it's harder to solve the problem.

Closing Statements. Try to have anyone except the attorneys prepare closing statements, i.e., financial calculations for a closing. The attorneys aren't very good at it. They're more expensive than almost anyone else who might do it. And if they're working on a closing statement, then legal work isn't getting done.

Ride One Horse. If you stick to the same counsel for similar deals, that counsel will learn how you structure your transactions, what you care about, what you don't care about, how your business works, who handles what within your team, and how you like to resolve issues. That's an education process. It takes time and multiple deals.

A continued flow of similar deals to the same counsel will produce efficiency, less need for long phone calls to discuss issues, and ultimately a good argument for some discount on the hourly rate. But that's another discussion.

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