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CRE-approved contracts: Off-record matters & special districts

This is the 10th in a series of articles that come from some years of experience using the Colorado Real Estate Commission-approved contracts for purchase and sale of real estate for commercial real estate transactions. Previous articles addressed the buyer, the seller, the property, water rights, ordering the title commitment, owner's extended coverage and title objections. This article addresses off-record matters and special districts.

The contract requires the seller to disclose to the buyer "all easements, liens (including, without limitation, governmental improvements approved but not yet installed) or other title matters (including, without limitation, rights of first refusal and options) not shown by the public records, of which seller has actual knowledge." These are defined in the contract as "off-record matters." **Trap:** A seller should consider whether it wants to take responsibility for disclosing these matters or, instead, make the off-record matters provisions apply only to matters the buyer brings to the seller's attention. The courts have not imposed as strict an obligation for sellers to disclose defects and other unfavorable matters in commercial contracts as it has in residential contracts. See, e.g., *In re the Estate of Gattis*; *Gattis v. McNutt*, 2013 COA 145. Leaving these items for the buyer to discover is more consistent with "caveat emptor," which a seller of commercial property generally prefers.

The steps envisioned in the contract for the buyer's review of off-record matters include 1) the seller's delivery of true copies of all existing surveys in seller's possession and disclosure of off-record matters by the off-record title deadline selected by the parties; 2) the buyer inspecting the property "to investigate if any third party has right in the property not shown by the public records" by the off-record title deadline; 3) the buyer making any objections it



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wants to make in a notice of title objection or terminating the contract by delivering buyer's notice to terminate by the off-record title objection deadline; 4) if the buyer makes one or more off-record matters objections in a notice of title objection per §8.4, the seller either satisfying the buyer as to those off-record matters objections, or not; and 5) if the seller does not satisfy the buyer as to any off-record matters objections made in a notice of title objection, the buyer either withdrawing those objections or letting the contract automatically terminate by the title resolution deadline (§8.4.1).

Trap: The seller has no obligation to address an objection to an off-record matter objected to by the buyer. If the seller does not address the objection to the buyer's satisfaction, the buyer may withdraw the objection by the title resolution deadline or let the contract terminate. This procedure is the same as for record title. The same "tips" and "traps" discussed in the previous articles in this series about title review and title objections apply to off-record matters.

Section 8.3 of the contract is a provision similar to the one for record title objections and addresses any off-record matter that is received by the buyer after the off-record title deadline. Again, the buyer has until the earlier of closing or 10 days after the off-record matter is received by the buyer to object to the matter in a notice of title objection or to terminate the contract by a buyer's notice to terminate. If the seller does not address the matter to the buyer's satisfaction by the earlier of closing or 10 days after the off-record matter

is received by the buyer, the buyer may withdraw the objection on or before the earlier of those two deadlines or let the contract terminate.

Tip: Before objecting to an off-record matter, a buyer needs to think through what its response will be if the seller elects not to address the matter.

A totally different basis for terminating the contract by the off-record title objection deadline relates to special taxing districts. Special districts, of which there are thousands in Colorado, are quasi-governmental entities with the power to tax, charge fees for services and (the power to) condemn property. They include districts that own, operate or provide schools, libraries, water service, sanitary and storm sewers, roads, parks, recreation facilities and a long list of other improvements and services. Section 8.5 of the contract allows the buyer to terminate the contract "based on any unsatisfactory effect" of the property being located within one. What makes a special district unsatisfactory is "in the buyer's sole subjective discretion." Thus, the basis for termination does not need to be reasonable, but it does need to be made in good faith under Section 29. **Trap:** Since almost every property in Colorado is located within at least one special taxing district (e.g., a school district), §8.5 provides the buyer an "easy out" of the contract until the off-record title objection deadline.

The all caps disclosure about special districts contained in §8.5 was imposed by C.R.S. § 38-35.7-101, after many property owners were badly stung financially by imploding special taxing districts during the real estate crash in the 1980s. During that time many special districts that provided vital services, such as water and sewer service, were loaded with debt that needed to be serviced by less than the expected number of taxpayers. In order to maintain those services, property owners within those districts had to pay exorbitant taxes to the districts. In addition to the dis-

closure provision, in order to protect property owners from similar fates in the future, the state Legislature passed a bill to limit the amount of taxes a special district could levy for debt service.

Most special districts are long standing and completely financially sound. Some, however, are not. Special districts in newer communities that are still under the developer's control should be looked at especially carefully to determine what limits, if any, have been placed on the district's power to impose taxes and charge service fees. The financial stability of these newer districts often depends on how fast the development is built out and lots or houses are purchased; the slower the development, the less stable the district. The 2008 real estate crash, like the one in the 1980s, destabilized many of these districts and some have not fully recovered. **Tip:** Conducting due diligence on special taxing districts is important.

Trap: Doing due diligence on a special taxing district is not easy. The information a buyer wants most is the financial information needed to determine whether services might not be provided or taxes, fees or charges the buyer must pay the district might become exorbitant. The Colorado Division of Local Government in the Department of Local Affairs can provide some information on districts, but their financial information is spotty and not always current. The division's website (www.colorado.gov/pacific/dola/special-districts-0) is a good place to start, however. **Tip:** If the property is located within a special taxing district, require the seller to provide to the buyer current financial information, and all other information the buyer reasonably requests, regarding the district. The seller might also have difficulty obtaining the information but, nonetheless, the seller or the seller's broker is usually the best source for information about the districts in which the property is located.▲