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Legal Lines

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Threshold Considerations: The Lease Back and Possession Prior to Closing

The playing field between Buyers and Sellers in the Bay Area real estate market is inching towards a state of equilibrium. Higher interest rates appear to be cooling Buyer activity in the historically red hot market and the proliferation of three- and five-year adjustable rate mortgages which are set to expire in the near term are placing additional financial pressures on recent home owners. Consequently, Buyers no longer feel compelled to waive all contingencies when making offers. Instead, Buyers exercise their new found negotiating strength by adding provisions for Seller lease back (where the Seller actually pays rent to the Buyer to retain possession post close of escrow for a fixed term) or alternatively for Seller surrender of possession to Buyer prior to close of escrow. Although deviations from the orthodox surrender of possession upon close of escrow may facilitate formation of the purchase contract, the potential ramifications in the event of subsequent breach of contract can be quite problematic.

The Lease Back

Several cities in the Bay Area are subject to residential rent control protections. Cities like San Francisco, Oakland, and Berkeley have exercised their police powers to develop legal frameworks limiting a residential property owner's ability to evict tenants and restricting the amount by which the owner can increase the rent. As such, any contract which purports to

- create a tenancy,
- grant possession of a residential unit, and/or
- require payment of rent or services for the right to occupy the premises

opens the door to potential landlord-tenant claims. Within the context of a Real Estate Purchase Agreement, Buyers and Sellers occasionally negotiate a Seller Lease Back which allows the Seller to retain possession of the premises even after title transfers to the Buyer.

What happens when Seller's new accommodations are not ready and Seller fails to vacate the premises upon expiration of the contemplated lease back term? The selling agent gets a very unhappy client and lawyers get called in to recover possession for the Buyer. The legal procedures available for recovery of possession are largely predetermined by the language employed in the Purchase Contract. A simple one-liner in the Purchase Contract stating that Seller will rent back the premises at

a set price from Buyer for one month from close of escrow will open up the floodgates of landlord-tenant law.

Local rent ordinances typically include expansive definitions of landlord, tenant, rental unit and rent which may bestow upon the breaching Seller rent control protections including just-cause limitations on the new owner's right to recover possession. Under such circumstances, the Buyer may have to serve a thirty-day notice of eviction and comply with owner move-in residency requirements to recover possession from the breaching Seller. Unfortunately, if all of the funds were released from escrow upon transfer of title, then the breaching Seller has ample capital to drag out the legal proceedings. Recovery in unlawful detainer eviction proceedings could easily take three months or more. If the parties signed a mandatory arbitration provision in the Purchase Agreement which does not expressly exclude unlawful detainer actions, the Seller could demand arbitration in order to delay Buyer's recovery even longer.

Possession Prior to Closing

The flip side to a Seller Lease Back is a provision allowing a Buyer to take possession of the premises prior to close of escrow. What happens if the Buyer breaches the Purchase Agreement? The listing agent gets a very unhappy client and lawyers get called in to recover possession for the Seller. If the Buyer tendered payments for the right to occupy the premises separate and apart from the purchase price, an argument can be made that the Buyer is entitled to rent control protections. However, the more likely scenario is that the Buyer will claim a right to possession not as a tenant, but as an owner. By so doing, the Buyer may prevent the Seller from recovering possession of the premises in a summary unlawful detainer proceeding. Instead, Seller will be forced to resort to filing an ejectment action in order to recover possession from the breaching Buyer. Unlike an unlawful detainer proceeding, an ejectment action can easily take a year to wind its way through the courts. Meanwhile, Seller is receiving no rent, and no purchase money. Furthermore, Seller must continue paying the mortgage, insurance and taxes on the property to protect Seller's credit and must pay legal counsel to recover possession and quiet title to the property.

Keeping Hearth and Home

If either party insists on tendering possession on a date other than upon transfer of title, then set up an appointment for your client to meet with an experienced Bay Area real estate attorney *prior* to ratifying the purchase contract. Stipulated Judgments, Escrow Hold Backs, License Agreements, creative Rent Provisions and Fee Waivers are all transactional tools available to legal counsel which may dramatically reduce the risks associated with breach of a Purchase Contract. Avoid the temptation of taking transactional shortcuts or risk taking the long way home.

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