

Due Diligence

A Critical Step

Due diligence may be the most important step in the entire construction process, and it comes very early on, before a single shovel full of dirt has been tossed or the first hammer swung. But what exactly is due diligence as it relates to a real estate project?

due diligence *noun*
/ˌdjuː ˈdɪlɪdʒəns/

(real estate) Reasonable steps taken by a person or company to accurately determine the pros and cons of a real estate transaction, prior to entering into a binding contract to purchase

"The builder had taken every reasonable step during the due diligence period, to determine whether the property in question was in fact in a flood plane, an essential factor in determining the proposed projects viability."

Essentially, the 'due diligence period' is a legal term describing a set period of time you (the buyer) have between making an offer to purchase a lot and that offer becoming a binding commitment to buy. This is an essential period of time in which you have the ability to research the lot, as well as determine how your proposed project fits (or doesn't fit) into the local zoning regulations. If, during this time period, you determine that your project is not viable or that the lot is unsuitable you can withdraw your offer and walk away with no penalties.

Once the due diligence period expires, there is very little you can do to exit a binding contract to buy. Is your property in a flood plane? Is the house you are planning on building too tall? Is the lot located in a Historical District? These are all things you need to know. While the ideal amount of due diligence on a straightforward real estate deal is between 14 and 21 days, there can be great variance in what sellers will typically accept. Some of these factors are:

If the market is hot and people are making lots of offers, the due diligence period can be very short, sometimes with as little as three days.

If the lot is owned or held by a 'short seller' they will be in a hurry to close on the deal. Often they will propose zero due diligence. In our view, it is never acceptable to accept a zero due diligence time frame. There is simply too much on the line and too many ways one could run afoul of local ordinances, etc.

The complexity of the lot and proposed project can also affect the length of time that a seller will accept to allow for proper due diligence. Land with complex zoning designations as well as land suited for larger projects such as multiple houses or town homes requires more research time. Often the sellers are already aware of this and are amenable to extended due diligence periods.

The Essential Steps of Due Diligence

In person site visit. Walk the entire property looking for signs of buried debris. If needed, have the lot cleared of overgrowth in order to facilitate the visual inspection. Rocky outcroppings, debris that appears to 'resurface' from below the surface of the ground or large indentations in the earth should all be taken very seriously. These are giant red flags pointing to potentially costly problems. If large underground rocks or buried trash pits are suspected either order

core samples¹ or simply move on to another property.

Assess the location and condition of the trees if you are in a municipal area that emphasizes preventing tree removal over private property rights. In some areas, trees alone can make a lot 'unbuildable'. Speak to the municipal or city arborist for clarification.

Visually inspect the street and lots surrounding the property in question. Are there storm drains and or sewer lines that run through the property? Is there a creek that runs through the lot or close to it? Determine if you are in or out of the 'stream buffer'.² In the City of Atlanta, for example, a 'creek' does not have to have water in it. Often, dry creek beds that are actually no more than storm water channels can be designated as 'state waterways'. You must be extremely careful to take care in determining what is and is not a creek as well as what and where any stream buffers may be.

Order a survey. A survey will locate any and all encroachments (is the neighbor's fence or driveway over the property line by 6 inches?), utility easements (buried storm water drain owned and maintained by the local water shed), zoning and historical designations, flood plane status, exact size and location of trees on site, proximity to creeks and waterways, etc.

Once the survey has been completed, double check with the local zoning office that the zoning designation and flood plane status is accurate and up to date. Often, the tax records will have this information but these records are sometimes out of date. It is vital to double-check this with a zoning official. Take this opportunity to discuss your proposed project with the zoning official and verify it's viability for this particular neighbourhood.

Once you have this information you will be able to determine whether or not to move forward. This is perhaps one of the two most important parts of the building process (the second being building an accurate budget), it is absolutely essential to get this right. You do not want to purchase a piece of real estate only to find out later that it is unbuildable.

The Importance of Surveys

In our view, you should never move forward on the purchase of a lot without a survey in hand. The optimal solution is to have a new survey prepared by a trusted surveyor. However, this can take time and depending on how hot the market is, a good surveyor may be three to 6 weeks out before he can deliver a finished drawing. You may not have enough due diligence time for this.

If the seller has a survey, this can be used while your new survey is being ordered. If using a seller-provided survey it is important to include a stipulation to the purchase agreement that allows you out of the contract if it is later determined that there were material inaccuracies contained in that survey. Often, you can call the survey company that provided the seller's survey and they can do an update more quickly than having a new survey created.

That being said, it cannot be over stated how important it is to work with a trusted survey company. A licensed surveyor must certify their work and they have a legal liability for material errors, providing some protections against serious problems created by an inaccurate survey. There are many surveyors, some good, some bad, some terrible and some great. It is absolutely vital to use only a reputable and trustworthy company.

Lastly and perhaps most importantly: Never take a seller or a real estate agent's word that the property is free of possible encroachments or any potential issues with soil quality (large underground obstructions such as rocks or debris). While they may feel they are making accurate statements, at the end of the day you are the one that will be on the hook for your decision to purchase. We find it a good policy to trust but verify, with an emphasis on verification. Having a high quality, current survey is the

keystone of that verification, otherwise referred to as due diligence.

¹ Core samples are cylindrical sample sections taken vertically from the ground of organic and inorganic material. Core samples are often used to determine the quality of soil and whether or not there are buried obstructions or other debris in the ground.

² A stream buffer is the distance from a water way where disturbance is allowed. Stream buffers can be different distances as determined by the local and state ordinances. In the simplest terms, a 75' stream buffer means you cannot conduct any land disturbance activities (i.e., construction) closer than 75' from the waterway.

