

REAL ESTATE LAW ALERT

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Your Real Estate Purchase Contract or Option May Be Void

Alert: If you are party to a real estate purchase contract, or an option to purchase, involving property that was not subdivided as a legal parcel when the contract was signed, the contract may be unenforceable and void.

Developers and other purchasers of real property often enter into purchase options or contingent purchase agreements for property that has not yet been legally subdivided under the California Subdivision Map Act ("Map Act"). Many of these buyers now find themselves unable or unwilling to close on these transactions at contract prices that no longer make any sense in today's market. Based on an important 2007 case that I alerted some of you to last year, these buyers may have an alternative that they and their sellers are not aware of. As the real estate slowdown continues, and credit availability becomes tighter and tighter, we thought it would be good to revisit this case since some of you may be a party to such an agreement.

The case is *Black Hills Investments., Inc. v. Albertson's, Inc.* (2007) 146 Cal.App.4th 883. Black Hills contracted to purchase from Albertsons two parcels of then-unsubdivided real property in a shopping center development. A deposit of \$133,000 was paid by Black Hills, which became "absolutely non-refundable for any reason" except upon Albertson's default. The contracts contained an express condition that Albertson's obtain the necessary subdivision approvals prior to closing. Importantly, the contracts provided that this condition could be waived by Albertson's in its sole discretion. In fact, Albertson's did not waive the condition, and actually obtained all of the necessary approvals under the Map Act. Nevertheless, on the day before the scheduled closing, Black Hills informed Albertson's that it was not going to close and demanded its deposit back. Albertson's refused, and Black Hills sued.

A California appeals court ruled in favor of Black Hills. The court held that the contracts failed to comply with the Map Act, because they involved an agreement for the sale, lease or financing of undivided California real estate that was not "expressly conditioned upon the approval and filing of a final subdivision map or parcel map" as required under the Map Act. The fact that Albertson's obligation to close was conditioned on creating the parcels in compliance with the Map Act was not enough. According to the court, Albertson's right to waive that condition meant that the condition was inadequate to meet the Map Act requirements.

Many, perhaps a majority, of purchase contracts for undivided property will fail to meet the hyper-technical requirements of the Black Hills case. The ramifications of this case are critical to understand if you are a party to such a contract.

1. ***Buyers may be in a position, even if their contingency periods have expired and their earnest money has gone hard, to refuse to close and to get their "non-refundable" deposits back.*** Because these agreements are held to be void, which effectively means that they never legally existed, it does not matter that the agreement may provide for the deposit to be non-refundable. In this time of tight credit and unsure real estate markets this could be a welcome exit strategy for some buyers. Sellers, on

the other hand, need to be aware of the situation and seek ways to amend their agreements to bring them into compliance with Map Act requirements.

2. It is not enough to validate these agreements if only one party's obligation to close under the agreement is conditioned upon compliance with the Map Act. *There needs to be a non-waivable provision that prohibits the close of escrow unless the Map Act requirements have been satisfied.* The exact language of the contract is critical, since small differences in wording can result in drastically different outcomes for the parties.

3. Often, a developer uses an option to tie up property while he or she seeks entitlements, including subdivision approval. While an option is not a binding purchase agreement until the option is exercised, it is an agreement that is binding on the seller to sell the property if the option is exercised by the buyer. If neither the exercise of the option, nor the obligation to close under the resulting purchase agreement, is expressly conditioned upon legal creation of the parcel under the Map Act, this would seem to create the same situation as presented in the *Black Hills* case. *If you hold an option on un-subdivided property, you should review your agreement and carefully consider your alternatives, which may include a claim for reimbursement of some or all of your option payments or other amounts paid to the seller.*

4. *The Map Act applies to any sale, lease or finance of real property.* If property being ground leased was not a legally subdivided parcel at the time the ground lease was executed, the lease may be void. It is unclear whether the subsequent construction of a building on the leased property will make any difference in the analysis. And any loan commitment made before the legal creation of the parcel anticipated to serve as security for the loan may also be void.

The current credit crunch is having a far ranging impact on commercial real estate around the country and here in California. As developers and other real estate investors seek to survive, it will be important to understand the legal issues, opportunities and pitfalls presented by the *Black Hills* case.

The information contained in this Real Estate Law Alert is general in nature, and does not constitute legal advice or create an attorney-client relationship. For specific questions or additional information regarding this topic, please contact:

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