

A Reprint from *Tierra Grande*

Commercial Letters of Intent

By Reid C. Wilson



Commercial real estate transactions can be complicated and time-consuming. Real estate professionals looking for ways to expedite deals should become familiar with the letter of intent — a tool that can eliminate many of the speed bumps on the road between an offer and a legally executed contract.

A letter of intent (LOI) is a document outlining preliminary agreements (“understandings”) between parties in a transaction. It should *not* be a legally binding contract. Rather, it describes important business terms. These include timing, monetary terms, financing, deal contingencies, risk allocation, form of documentation and who will prepare the documentation. The parties involved would be unwilling to invest further time, energy and money in negotiating a deal if these understandings were not clearly spelled out.

Purpose of LOI

A well-drafted LOI moves a transaction toward a legally binding contract by reducing misunderstandings between the parties and binding them psychologically and morally to the deal.

LOIs can be used to determine if property not currently listed for sale is available and whether a particular price range is generally acceptable to a seller. They also make it possible for attorneys representing the parties to quickly and efficiently negotiate and draft formal, legally binding documentation by providing a written outline of the deal and detailed information about the parties involved.

The Texas Real Estate Commission, Texas Association of Realtors and the State Bar have not created LOI forms. Consequently, LOIs are typically drafted in the form of a letter between brokers or agents for the parties. The majority of the text usually is a list of paragraphs

discussing material business terms, often numbered and with headings. In some cases, an LOI is a simple outline of agreed upon terms, signed or initialed by the parties.

The format of an LOI is not critical as long as it is clear, concise, unambiguous and nonbinding. Because they are shorter and more informal than a binding contract or lease, LOIs can be drafted quickly. The length of the document depends on the complexity of the deal.

Most LOIs are drafted by the broker or agent representing the buyer in a sale transaction. Either the tenant or landlord in a leasing transaction may draft an LOI. Drafting an LOI does not constitute the unauthorized practice of law because LOIs are nonbinding.

Because attorneys are routinely left out of the drafting process, legal fees and delays can be avoided. However, complex LOIs are sometimes drafted by attorneys.

LOIs may be effective in any commercial transaction but may not be appropriate if the subject matter is overly complex or legalistic. In such cases, the parties should skip the LOI and proceed directly to drafting a legally binding contract.

Brokers and agents should not draft a legally binding LOI or advise a client to execute a binding LOI. If a binding agreement is desired, the client should be advised to consult an attorney or proceed directly to drafting a contract. A seller or landlord may negotiate several LOIs simultaneously but should not execute duplicate LOIs.

Because LOIs are nonbinding, who signs them is not important. Typically, an LOI is signed by either the principal or the principal’s broker or agent.

Either party to a nonbinding LOI may terminate negotiations at any time,

without reason, except when binding provisions such as the agreement to negotiate in good faith during a specified period (see next section) are included. Except in unusual circumstances in which the parties' conduct is inconsistent with the nonbinding character of the LOI, there are no legal ramifications for failing to comply with a nonbinding LOI. Relations with other parties in the transaction will likely deteriorate, however, and termination may also affect a broker's or agent's reputation in the commercial real estate community.

LOI Content

A poorly written LOI, particularly one with ambiguous terms or lack of clear, nonbinding language, may actually impede a transaction or cause the parties to waste time on a transaction that has little chance of closing. A well-drafted LOI should include the following elements.

Title. The LOI should be titled "non-binding letter of intent" or "letter of intent." Avoid "letter of understanding" or "letter of agreement." Other titles sometimes used are "term sheet" or "transaction outline."

Nonbinding character. The LOI should include a provision stating specifically that the document is not legally binding, preferably in capitalized, underlined or bold text. This provision should be located immediately above the signature lines. Ambiguous language such as "subject to legal documentation"

or "subject to attorney approval" should not be used. Such language may result in a binding agreement.

Separation of binding and nonbinding provisions. Any legally binding provision included in a nonbinding LOI, such as an agreement to take the property off the market, should be placed in a separate section of the document to make it clear that it is an independent, legally binding obligation. Courts evaluate the intent of the parties when determining whether a provision is legally binding, so clarity is essential.

"No shop" provisions. The seller or landlord might agree not to seek other buyers or tenants for the designated property while the parties negotiate a binding contract. This provision should be in effect for the same term as was set for negotiating in good faith (if applicable). A provision to remove the property from the market or to prohibit specific types of marketing might be included.

Details of legal documentation. The LOI may state:

- whose attorney will draft the legal

documentation,

- when the first draft will be completed,
- to whom it will be distributed,
- the form of the contract or lease to be used (TREC or TAR, for example) and
- the goal or deadline for completion of negotiations or signing of the binding document.

Distribution list or cast of characters.

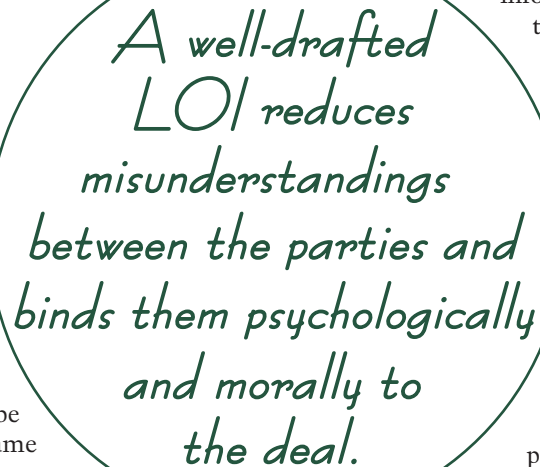
A list of parties involved in the transaction and pertinent

information about the parties may be included in the final LOI. Company names, individual contacts, mail and street addresses, phone numbers, fax numbers and e-mail addresses are generally provided.

Used appropriately, LOIs can make commercial real estate transactions

smoother for real estate professionals and their clients. 📌

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