Open Permits Can Open Up Issues for Property Owners

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Permits are often an overlooked component of real estate transactions. So-called "open" permits can cause headaches for owners who are selling or financing their property. While title searches disclose encumbrances such as liens, mortgages, easements and restrictions, they do not disclose open permits, which must be independently searched at the local government.

When an owner obtains a permit to perform work on their property, the permit issued for that work is "open." Typically the work is completed, an inspection is performed by the local building department and the permit is then "closed" by the local government. If this process is not followed, a permit search will disclose it.

There are several reasons why a permit may not be closed. An owner may obtain a permit, but not start or complete the work. Perhaps the work is completed, but the owner never asked the building department to perform an inspection. Perhaps an inspection is done, but deficiencies are noted that the owner does not correct, or that the owner does correct but fails to have reinspected.

An additional issue is that permits typically have expiration dates. Some local governments treat expired permits differently. Some may require the owner to reactivate and amend them to complete the work, while others may require the issuance of a new permit for the work, whereupon the open but expired permit for that same work is closed. Both scenarios usually require the payment of a fee. The owner can then arrange for completion of the work (if not already done) and a final inspection can be made so that the permit can be closed.

Failure to properly close a permit can be deemed a building code violation by the local government, and can result in the imposition of a fine, although this does not occur very often. The local government can also withhold new permits if the owner has open permits on the same property. Recently, an attorney known to the authors was contacted by a client owning a very large shopping center, because the county government began rejecting all permit applications related to the shopping center. After contacting the county, this attorney learned that new permits were

being denied due to the existence of over 200 open permits relating to work done at the property, mostly for tenants, some dating back 20 years. The attorney and his client now face the arduous task of closing the permits, each having the potential to present any number of issues. It may be difficult to ascertain whether the work was ever commenced and/or completed. The tenant may no longer occupy the space. The suite number may have changed, or the property may have been drastically remodeled, changing the dimensions of the leased spaces. While certificates of occupancy are evidence that certain work has been completed, these are not issued for many types of work, such as signage, kiosks, HVAC and electrical work.

Furthermore, in the event that building codes have changed during the period between the issuance date of the permit and the completion date of the work, or between the completion date and the date of inspection, the work may not pass inspection if it is not in compliance with the current building codes. If an owner waits months or years before scheduling the inspection to close a permit, and the building codes have changed, the owner may be forced to redo the work in accordance with the current building codes before the work may be inspected and the permit is closed. The situation can be further complicated if the contractor who did the initial work is out of business, or has already been paid and therefore has no incentive to come back and do any more work without additional compensation.

It is not unusual for sophisticated purchasers and lenders to require that all open permits be closed as a condition to their acquisition or financing of property, and this practice is becoming more common. If open permits are discovered late in the closing process, the owner may not have enough time to address them. If no permit searches are conducted by the purchaser before closing, the purchaser may have to address them at its own expense after the closing if it is seeking new permits or obtaining financing later. Another attorney known by the author recently encountered a situation in which an open permit was discovered the day before the client was to close on the refinancing of a property. Moreover, the original loan on the property was to reach maturity on the closing day. Had the open permit required the postponement of the closing, the property owner would have faced a serious predicament. Fortunately, the attorney was able to resolve the issue and the closing proceeded as scheduled.

To avoid these problems, owners should be diligent about closing out permits after the work is done. If the work is not done, the local government should be notified so that the permit can be closed on that account. Before selling a property, the owner should have a permit search performed so that it will have ample time to close any open permits. Purchasers should always require, as part of the purchase contract, that an open permit search be performed, specifying who bears the cost, and that the owner satisfactorily close all open permits before the closing date under the contract, without any liens attaching to the property on account of any additional work.

An example of the importance of the foregoing advice recently occurred in connection with the sale of a property in central Florida. The purchase and sale contract for the transaction stipulated that the buyer, at its discretion, could search for open permits, and could object to any open permits discovered as part of the buyer's due diligence. The buyer informed its counsel that the buyer would handle that part of the due diligence, but the buyer failed to perform the permit search during the due diligence period. The open permit was discovered when the buyer's lender arranged for a search, but by that time the due diligence period had expired, and the buyer was forced to proceed to closing. The buyer in this case was stuck with the open permit and was forced to bear the cost of closing it afterwards. Additionally, the buyer had to convince its lender to allow that to be done as a post-closing obligation without requiring the escrow of loan proceeds to cover it, although in this case the buyer's principal, who was a guarantor of certain "bad boy" carveouts under the loan, was required to also guaranty the closure of the open permit within the period stipulated by the lender. Had the contract been drafted differently, or had the buyer properly searched for and objected to the open permit during the due diligence period, the seller could have been obligated to close the permit as a condition to consummating the sale. Depending on the nature of the work, that obligation could have delayed closing, or even been cause for the

buyer to terminate the contract.

Even owners that do not anticipate selling or financing their property in the immediate future can benefit from obtaining a permit search and closing any open permit, since postponement can only result in increased expenses. If you are an owner, or an attorney representing an owner, of improved property that is the subject of multiple permits each year (such as an apartment project, shopping center or office building), you may wish to consider arranging for an annual open permit search just to keep on top of this potential problem and ensure that open permits are closed in a timely manner.