



Protecting the Buyer: Structuring Post-Closing Remedies for Breach of Seller Representations — and the Special Challenge of 1031 Exchange Sellers

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In real estate transactions, buyers rely heavily on the seller's representations and warranties regarding title, leases, environmental matters, authority, litigation, and other property-related issues. Because diligence cannot uncover every potential problem before closing, the buyer's protection depends not only on the representations themselves but also on whether the buyer has meaningful post-closing remedies if those representations prove inaccurate after closing.

A recurring challenge is that many property sellers are single-purpose entities (SPEs) that distribute sale proceeds to their owners immediately after closing. If the seller retains no assets, the buyer may be left pursuing indemnity claims against an entity with no ability to pay.

For this reason, sophisticated buyers typically negotiate structural protections to preserve post-closing recourse. In practice, several approaches are commonly used.

Parent or Creditworthy Affiliate Joinder

One of the most straightforward protections is to require a parent company or financially viable affiliate to join the purchase agreement or [guaranty](#) the seller's indemnification obligations.

This is particularly important where the seller is a [single-purpose property-owning entity](#), which is often the case in institutional real estate structures. Without additional credit support, the buyer's claim may effectively become unsecured and uncollectible.

A parent guaranty can:

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- Provide recourse to a creditworthy entity
- Discourage the seller from dissolving or distributing all proceeds immediately after closing
- Increase the likelihood that disputes are resolved commercially rather than through litigation

Post-Closing Escrow Holdbacks

Another common structure is a post-closing escrow holdback, where a portion of the purchase price is held by an escrow agent during the survival period for certain representations.

This mechanism provides a readily accessible pool of funds to satisfy indemnification claims without the need to pursue the seller directly.

Typical features include:

- Escrow amounts ranging from 1%–10% of the purchase price, depending on transaction risk
- Escrow duration tied to the survival period of key representations
- Defined claim procedures allowing the buyer to assert claims prior to release

Escrows are often viewed as the most practical and efficient method of ensuring post-closing recourse.

Letters of Credit as an Alternative to Cash Escrow

Where sellers resist tying up sale proceeds, buyers sometimes accept a standby letter of credit issued by a financial institution in lieu of a cash escrow.

Under this structure:

- The seller obtains a letter of credit in favor of the buyer
- The buyer may draw upon the letter of credit upon the occurrence of specified indemnification events

This approach allows the seller to retain access to sale proceeds while still providing the buyer with reliable credit support.

However, the buyer must carefully negotiate draw mechanics, as banks typically require strict compliance with documentary conditions before honoring a draw.

Deferred Purchase Price or Setoff Rights

In some transactions, particularly where the buyer has leverage, a portion of the purchase price may be structured as deferred consideration, payable after the survival period expires.

This structure allows the buyer to offset indemnity claims directly against unpaid purchase price amounts, avoiding the need to pursue the seller or draw on escrow funds.

Special Indemnities for Known Risks

If diligence identifies specific issues—such as environmental concerns, pending tenant disputes, or tax matters—the parties may negotiate special indemnities that:

- Survive longer than standard representations
- Are backed by separate escrow or enhanced credit support

This approach isolates particular risks while keeping the overall indemnification framework manageable.

The Special Complication: 1031 Exchange Sellers

Buyers frequently encounter additional resistance to escrow holdbacks when the seller is completing a tax-deferred exchange under Section 1031 of the Internal Revenue Code.

A [1031 exchange](#) allows a seller to defer capital gains tax by reinvesting sale proceeds into “like-kind” replacement property within strict time limits. To preserve the exchange treatment, sale proceeds must be held by a qualified intermediary (QI) rather than received directly by the seller.

Because of these structural requirements, sellers in 1031 exchanges often object to post-closing escrows for several reasons.

Exchange Proceeds Must Remain with the Qualified Intermediary

Exchange rules generally require that all net sale proceeds be transferred to the [qualified intermediary](#), who then applies those funds toward the replacement property.

If a portion of the purchase price is held outside the exchange structure in a traditional escrow, the seller may argue that the escrowed funds could be treated as constructive receipt, potentially jeopardizing the exchange.

Even when escrow structures can be designed to comply with exchange rules, many sellers and intermediaries prefer to avoid any arrangements that could introduce tax risk.

Sellers Need Maximum Liquidity to Acquire Replacement Property

1031 exchanges impose strict timing requirements:

- 45 days to identify replacement property
- 180 days to close on that property

Because acquisition prices often exceed the relinquished property value, sellers typically want full access to sale proceeds to complete the replacement acquisition.

Escrow holdbacks effectively reduce the amount of capital available to fund the replacement property, which can complicate financing and closing logistics.

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Qualified Intermediaries Often Resist Escrow Complexity

Many qualified intermediaries prefer clean exchange structures without side escrows or complicated claim mechanics. Introducing escrow arrangements can require:

- Additional documentation
- Coordination among the buyer, seller, escrow agent, and intermediary
- Potential amendments to the exchange agreement

As a result, exchange participants often push for minimal post-closing obligations.

Exchange Sellers Often Expect Limited Post-Closing Exposure

In many exchange transactions—particularly with institutional or repeat sellers—the market expectation may be that:

- Representations are limited in scope, and
- Survival periods are short or terminate at closing.

This expectation can create tension when buyers seek traditional indemnification protections.

Practical Solutions in 1031 Exchange Transactions

Because of these dynamics, buyers and sellers often negotiate alternative forms of credit support that do not interfere with exchange proceeds. These may include:

- Parent or sponsor guaranties
- Letters of credit issued by banks
- Seller indemnity backed by retained assets outside the exchange entity
- Escrow structures funded with non-exchange funds

The key is structuring protection that preserves the seller's exchange treatment while still providing the buyer meaningful recourse.

Takeaway

Representations and warranties are only as valuable as the buyer's ability to enforce them after closing. Buyers should carefully evaluate who stands behind those representations and what assets will remain available if a breach occurs.

Common tools include:

- Parent or affiliate guaranties
 - Escrow holdbacks
 - Letters of credit
 - Deferred purchase price structures
 - Targeted indemnities for known risks
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Where the seller is engaged in a Section 1031 exchange, buyers should expect heightened resistance to escrow arrangements and should consider alternative forms of credit support early in negotiations.

Thoughtful structuring of these protections can ensure that post-closing remedies remain meaningful. This is the case even when the transaction involves exchange structures, SPE sellers, or rapidly distributed sale proceeds.

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