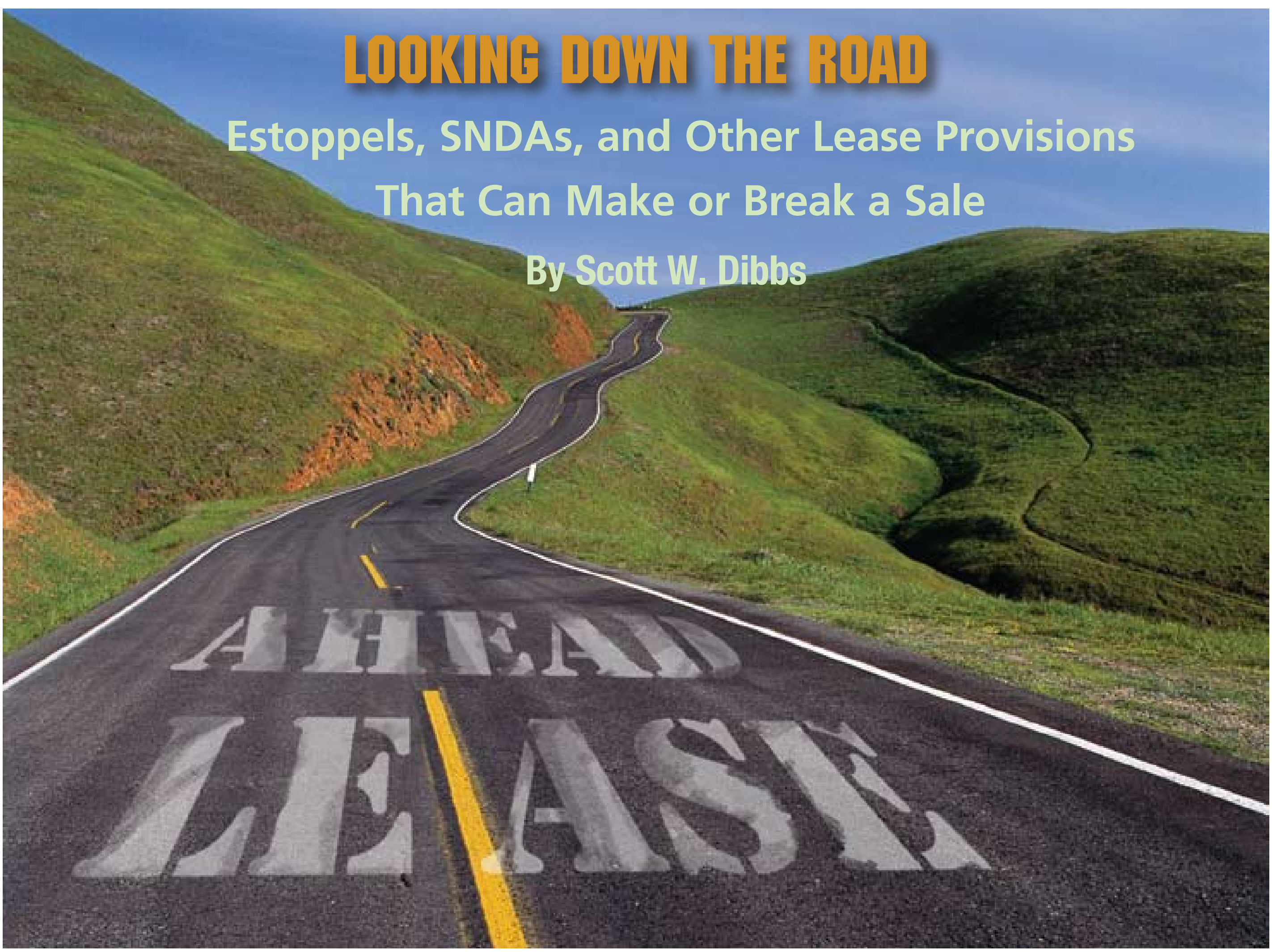
LOOKING DOWN THE ROAD

Estoppels, SNDAs, and Other Lease Provisions That Can Make or Break a Sale

By Scott W. Dibbs



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All commercial rental properties, whether retail shopping centers, industrial parks, or multi-tenant office buildings, will eventually be sold. To maximize sales prices, owners seek to keep their projects filled with credit tenants paying the highest possible rentals; yet many owners fail to recognize how important a properly drafted lease can be when the time comes to sell a project.

These days, a buyer of commercial property will require that a seller satisfy a number of technical requirements and demands as conditions to a sale, such as obtaining estoppel certificates and subordination, nondisturbance, and attornment agreements (SNDAs) from project tenants. How the lease addresses estoppels and SNDAs, as well as other lease provisions, can have a big effect, positive or negative, on a sale. In fact, many of these lease provisions can serve not only to facilitate a smooth sale process but also to increase (or at least preserve) the property's value and, therefore, the sales price. This article discusses the issues relating to these lease provisions from the respective viewpoints of the interested parties—seller, buyer, tenant, and lender—and attempts to provide practical solutions to some of these issues.

Scott W. Dibbs is a shareholder in the Tampa, Florida, firm of Hill Ward Henderson and vice-chair of the Office Leasing Committee.

Buyer's and Lender's Concerns

To understand how to draft leases to maximize the potential for a successful sale, it is important to understand a buyer's two primary concerns in evaluating the leases in a sale transaction: lease economics and potential liabilities. As you might expect, these buyer concerns are also the primary concerns of the lenders that finance property acquisitions.

A buyer's first concern in understanding and evaluating the economic value and risks inherent in the leases on the property being acquired is whether any of the leases provide a tenant with a right of first refusal or option to purchase the leased property. The buyer will also want to determine whether any provisions in the leases endanger the rent payment stream for the full lease term. Consequently, most buyers will focus on the lease provisions relating to the lease term, the base rent and operating expenses, insurance requirements, maintenance and repair obligations, condemnation, casualty damage, and any rights of early termination or rent setoff. A prudent buyer will also conduct a thorough lease review to confirm that the provisions of each lease are consistent with those of the other leases and that all leases work together without potential ambiguities and problems. For example, the buyer should review all lease provisions that purport to limit the rights of other tenants and confirm that they are not being violated. Buyers are also concerned with understanding and minimizing their potential liabilities on acquisition of the property. For all of these reasons, in drafting its leases, a landlord should pay careful attention not only to the rights of other tenants and early termination rights but also to lease provisions relating to service interruptions, landlord defaults, tenant remedies, and casualty and condemnation provisions, all of which create potential liabilities for a purchaser on its assumption of the leases.

Lease reviews alone, however, will not provide most buyers with the comfort they seek, and most buyers will need assurances from the tenants themselves to evaluate properly the tenant leases being acquired.

Estoppel Certificates

Estoppel certificates are the most common method used by buyers to obtain the necessary assurances about the terms of the tenant leases. A buyer will typically insist on obtaining from each tenant (or, at least, each major tenant) an estoppel certificate stating not only the term of the lease, the base rent, the date through which the rent has been paid, and the security deposit, but also some or all of the following assurances:

- the lease is in effect, with no amendments other than those listed, and there are no oral or other side agreements;
- there are no defaults, events, or circumstances that, with notice or expiration of time to cure, would lead to a default on the part of either the landlord or the tenant;
- all of the landlord's and tenant's construction and other obligations have been fully performed, all construction has been accepted, and all tenant improvement allowance amounts have been paid;
- the number and length of extension terms, if any, are as stated in the estoppel certificate;
- the charges (other than the rent) payable by the tenant are in the amounts specifically set forth or described in the certificate;
- the tenant has paid no rent or other charges more than one month in advance;
- the tenant has no right to deduct or offset any amounts from the rent;
- whether a security deposit has been paid and, if so, the amount of the deposit;
- there are no outstanding concessions, rent abatements, or rent rebates due the tenant;
- the tenant has no defenses to the enforcement of the lease;
- the tenant is not subleasing any part of its space, and its rights have not been assigned (including assignment to a leasehold mortgagee);
- the tenant has received no notices of default from the landlord and has given the landlord no notices of default;
- the tenant has previously made no claims against the landlord;
- the tenant has no right of first refusal or option to purchase the premises or right of first refusal, right of first offer, or other expansion rights for any other premises; and
- the tenant's use of the premises has not involved the generation, storage, treatment, disposal, or release of hazardous substances, and the tenant is in compliance with all environmental and other laws.

Given the number of interested parties involved—seller, buyer, tenant, and lender—and their varying respective interests, negotiating tenant estoppel certificates can be difficult and can complicate and even delay the closing process. A better practice is to negotiate a lease provision listing the matters to which the tenant must certify on request or even attach a form estoppel certificate as an exhibit to the lease. Although a buyer and its lender may attempt to insist on using their own estoppel form, a set of certifications approved in advance by a tenant that takes buyer and lender concerns into account will often be acceptable to potential buyers and their lenders.

Delineating in advance the matters to which the tenant will certify is also important to tenants because buyer and lender estoppel forms often go well beyond the fundamental purposes of the estoppel and can lead to problems if not reviewed carefully. As a general matter, tenants can and should object to any statements in an estoppel that are readily ascertainable through a review of the lease, other than basic business terms such as the rent, the security deposit, and the term. From a tenant's standpoint, the estoppel certificate should not be a substitute for a buyer or lender doing its own due diligence and reviewing the lease. For example, buyers and lenders often include a certification as to whether the tenant has certain rights and options, such as renewal or expansion options, rights of first offer or refusal, or termination rights. The presence or absence of these options and rights can be easily determined by reviewing the lease, so tenants may try either to strike these types of certifications or to except from the certification any options or termination rights that are expressly provided for in the lease.

In addition, because of the potential for confusion and conflict between an estoppel certificate and the lease to which it relates, the tenant may want to include a statement that, in the event of a conflict between the estoppel certificate and the lease, the lease provision will control. A tenant with bargaining power may also try to include a statement protecting it against liability in the event of a good faith mistake or inaccuracy in the certificate, arguing that it should not assume liability in a transaction to which it is not a party and from which it receives no benefit. This type of language, however, may not be acceptable to a buyer or lender that is relying on the statements in the certificate to make its buying or lending decision. In fact, owners, buyers, and lenders may want language specifically putting tenants on the hook for liability for misstatements, although few sophisticated tenants will agree to incur an express indemnification obligation.

As a further limit to exposure relating to estoppels, a tenant should also qualify certain factual certifications (for the existence of defaults, rights of offset, and claims against the landlord, for example) as only to its actual, then-current knowledge, and without duty of investigation. Most buyers and lenders will agree to these types of knowledge qualifiers because they do not really expect the tenant to certify matters that have not yet been discovered. The buyer's legitimate concerns should be satisfied by an actual knowledge certification for these types of claims and defaults, coupled with absolute certifications—with no qualifiers—for the rent, the term, and the fact that the lease document attached to or otherwise identified in the certification is the entire agreement and has not been assigned by the tenant. A tenant (particularly a larger corporate or institutional tenant) also may seek to limit its certification to the knowledge of certain identified individuals such as the tenant's property manager or director of leasing. This type of additional limitation often is acceptable to a buyer or lender, as long as the tenant also certifies that the identified individuals are the persons within the tenant's organization who have direct knowledge of such issues.

The time required to obtain an estoppel certificate can be critical to a sale. The buyer typically wants the estoppel certificate to be dated very close to the sale date, and the purchase agreement may even obligate the seller to provide estoppel certificates dated no fewer than five or 10 days before the closing.

There is a downside to waiting too long to get the estoppels, however. The buyer will need an opportunity to review the estoppels and seek a remedy if any estoppel is not in accordance with its expectations. Sellers will rather give the buyer a specified period to conduct its due diligence than to allow the buyer to terminate as late as the scheduled closing date. Moreover, the seller will not want to be liable to a buyer if one of the estoppels deviates slightly from the rent roll. Consequently, the estoppels should be obtained early enough to permit the buyer to object to any matters contained in the estoppel and, if the buyer's objections are not satisfactorily addressed, renegotiate business terms or even refuse to go forward with the sale.

Recognizing these timing issues, a landlord should draft its leases to require the tenant to provide an estoppel in as short a time frame as the landlord can negotiate, but no more than 10 days after request. Some larger tenants will insist on longer periods, arguing that their internal procedures will not permit a faster response. Especially in the case in which a landlord permits a tenant to have 15, 20, or 30 days to deliver an estoppel certificate, the landlord will need to confirm that the estoppel delivery requirements in its purchase agreement are achievable in light of the estoppel requirements in its tenant leases.

But, even if the landlord has successfully negotiated for short turnaround times for tenant estoppels in its leases, the landlord could have problems if the tenant does not in fact comply with the lease provisions. These problems include potentially losing the sale or even incurring liability to the buyer. Therefore, a landlord/seller needs meaningful and immediate remedies to compel a tenant to deliver its estoppel certificate in a timely manner. Typically, the lease's basic default provisions will not provide an adequate solution for a couple of reasons. First, the landlord will probably not have time to give a default notice and wait for the nonmonetary default cure period to elapse before exercising its remedies. Second, putting the tenant in default for failure to deliver an estoppel when required is not a practical solution, because typically it is critical to the sale that all tenant leases are in good standing at closing.

Leases frequently will provide that, if the tenant does not timely complete and return an estoppel certificate, the landlord may execute the certificate as the tenant's attorney-in-fact. Some leases also provide that, if the estoppel certificate is not produced when required, the tenant will be deemed to have certified all of the matters set out in the requested certificate. Few buyers or lenders, however, will be satisfied with an estoppel certificate executed by the seller on behalf of its tenant (especially a significant tenant), and even fewer will be satisfied with an unsigned estoppel certificate that is deemed to be accurate. Although some buyers may agree in the purchase agreement to accept, in lieu of a tenant estoppel certificate, the seller's certificate on the status of the lease, many sellers will not want to have this continuing liability for a position that may be taken by a tenant after the sale contrary to the seller's certificate. If a buyer does accept the seller's certificate, the buyer may require a substantial holdback of purchase proceeds for a period of time until it is comfortable that seller's certifications are accurate.

One solution that often proves effective is a lease provision requiring the tenant to pay a significant per diem monetary penalty if the tenant does not return an estoppel certificate on time. Another option, which is much less likely to be acceptable to a tenant with bargaining power, is an acknowledgment in the lease that a failure to return the certificate on time will cause the landlord to incur significant damages and that the tenant will be liable for all losses and damages incurred by the landlord by reason of the tenant's failure, including loss of the sale. In either case, the risk of a monetary penalty or significant damages should motivate most tenants to be timely in reviewing and returning requested estoppel certificates—particularly if these risks are highlighted by the landlord when it sends the estoppel certificate to the tenant. A sophisticated tenant might argue for a second notice and cure period before any such penalties would apply and might opt for two shorter time periods (an initial five-day notice followed by a second five-day notice, for example), rather than one longer period, to avoid an administrative snafu that could lead to significant liability for the tenant.

Lender Concerns

As noted above, a buyer's lender has all the concerns of the buyer about the terms of the leases and the certainty of the rent payment streams. Consequently, an estoppel certificate from the tenant in favor of the lender may be necessary to confirm the lease terms and that the tenant has no immediate right to terminate the lease, to set off amounts from rent, or to seek damages against the landlord.

In addition to these concerns, because acquisition lenders typically require that their mortgages be first-priority encumbrances, all tenant leases will need to be subordinated to these mortgages. A subordination of a lease means that, if there is a default under a mortgage, the lender will have the right to foreclose on the property and sell it free of all junior encumbrances, including the lease. In today's economy, however, few lenders that extend loans on property occupied by credit tenants will actually want a foreclosure to wipe out the leases. Therefore, the lender will also want the option to keep all leases in effect despite the borrower's bankruptcy or default, to transfer the leases as part of the property assets to pay the debt, and to have the tenants pay rent and perform lease obligations in favor of any transferee.

Subordination, Nondisturbance, and Attornment Agreements (SNDAs)

An SNDA from a tenant in favor of a lender is the document that satisfies the lender's competing concerns of confirming that the lease is subordinate in priority to the mortgage and of making sure that the lease will not terminate on a foreclosure sale.

When a commercial rental property is sold and the sale is financed, the lender will require that the buyer provide it with an SNDA from each tenant (or, at least, each major tenant). The buyer frequently passes this obligation on to the seller, but, even if the seller is not the party that will solicit the SNDAs, the seller needs to be sure that the buyer can obtain the SNDAs from the tenants because the sale will not go forward unless the lender's requirements are satisfied. SNDAs are also frequently required during the term of a lease if the leased property is refinanced. To be sure that each tenant delivers SNDAs when needed, the landlord must include in its leases provisions that address the content of, and the tenant's obligation to deliver, these SNDAs.

As discussed above, from the lender's standpoint, the basic purpose of the SNDA is to have the tenant acknowledge that its lease is subordinate to the mortgage (the "subordination" portion of the SNDA) but also agree that, at the lender's option, the tenant will recognize and perform its obligations in favor of the lender if the lender forecloses and becomes the landlord under the lease (the "attornment" portion of the SNDA). The quid pro quo for tenants is an agreement from the lender that, so long as the tenant is not in default under the lease, the lender (or any successor owner in a foreclosure sale) will recognize the tenant's rights and will not terminate the tenant's lease on foreclosure (the "nondisturbance" portion of the SNDA). The practical effect of this nondisturbance agreement is that the acceptance of the lease by the transferee after a foreclosure sale (a sale that technically wipes out the subordinate encumbrances, including the lease) is mandatory rather than optional for the lender.

Most landlord lease forms contain a provision under which the tenant subordinates its rights to all current and future mortgages but also agrees that, at the lender's option, the tenant will recognize a foreclosure transferee as its landlord and perform its lease obligations in favor of the transferee for the rest of the term. Theoretically, a separate subordination and attornment agreement may not be needed when the lease includes this language. Lenders, however, generally require a separate subordination and attornment agreement that is expressly addressed to them, so most landlord lease forms require that the tenant also agree to provide a separate subordination and attornment agreement on request.

Strong (or represented) tenants will argue that their leases should not be subordinate to a mortgage unless the mortgagee simultaneously agrees in writing that no foreclosure or other exercise of remedies under the mortgage will disturb the tenant's possession of the leased property and that, if there is a sale or other transfer under the mortgage, the transferee will accept the lease and the tenant. A nondisturbance agreement is particularly important if the leased premises are essential for or unique to the tenant's business operations or if the tenant has spent significant amounts of money constructing improvements in the premises. Some landlords may resist this type of mandatory nondisturbance provision (especially for smaller leases in multi-tenant projects), arguing that it could limit the ability to procure financing. It has become increasingly more customary, however, for lenders to agree to give nondisturbances in commercial leases. It should also be noted that, in many states, recording a nondisturbance agreement will be necessary to assure the tenant that its subordinate lease will not be terminated in the event of a foreclosure sale.

Although the three basic purposes of the SNDA (subordination, nondisturbance, and attornment) may seem simple, the document effectuating these purposes is often the source of a great deal of negotiation and can often complicate and prolong the sales process. The seller and buyer, after all, have less control than they would like to have over an agreement between two third parties—the tenant and the lender. Also, national and conduit lenders today are not satisfied with a simple subordination and attornment document. In their form SNDAs, these lenders also expect tenants to certify all of the facts generally included in an estoppel certificate and to agree to provisions that protect the lender or the person that purchases the property in the foreclosure sale from the consequences of the original landlord's defaults as borrower. These lender-protective provisions frequently include the following:

- Before a transfer to a lender or purchaser at foreclosure,
  - —the tenant will not modify or cancel the lease, or surrender the premises to the original landlord, without the lender's consent;
  - —the tenant will not make any rent or other payments more than one month in advance;
  - —the tenant will give the lender notice of all landlord defaults and will not terminate the lease or exercise abatement or rent setoff rights until it has first given the lender time to cure the default, and if the default cannot be cured unless the lender takes possession of the leased space, the tenant will not terminate the lease while the lender is trying to obtain possession through foreclosure proceedings; and
  - —the tenant will pay its rent directly to the lender if the lender demands this payment.
- After the leased premises are transferred to a lender or a purchaser in a foreclosure,
  - —if the original landlord has breached the lease or owes the tenant any money, the tenant will not require the lender or other foreclosure successor to cure this breach or pay this money;
  - —if the tenant has the right to offset or deduct amounts from its rent by reason of events that occurred before the transfer to the lender or other successor landlord, it will not assert this offset or deduction after the transfer;
  - —the lender or other successor landlord will not be obligated to return the tenant's security deposit unless the original landlord has turned the deposit over to the lender; and
  - —the lender or other successor landlord will not be required to repair casualty or condemnation damage unless it has received sufficient funds from the insurer or condemning authority, and even if it receives these funds, it will not be required to apply these funds to the restoration if its mortgage permits application of these proceeds to the outstanding loan amount.

Tenants may face serious concerns and issues when lenders attempt to go beyond the basic lender purposes of the SNDA (the basic subordination and attornment agreements) and use the document as an opportunity to obtain assurances, protections, and tenant concessions in favor of the lenders and successor owners that were not otherwise contemplated in the original lease. As a notable example, most modern lender SNDA forms include an agreement by the tenant not to proceed against the person that acquires the property in a mortgage foreclosure for any default by the prior landlord. This type of provision typically prohibits the tenant from seeking redress from the new owner or from deducting cure amounts from the rent and could leave the tenant with an action only against its original landlord, which is probably insolvent. Although a tenant is likely to be forced to give up the right to proceed against a lender or successor owner for money owed by the original landlord, a sophisticated tenant will require each new owner to assume the landlord's obligations under its lease that are to be performed after the date on which the new owner acquires ownership. If the tenant's bargaining power is strong, it will also require the new owner/landlord to cure any property conditions that are not in compliance with the lease.

Some SNDAs include an express waiver by the tenant of any obligation on the part of the successor landlord to perform construction or pay tenant allowances. Even in the absence of this express waiver, tenants should be wary of this issue because the general disclaimer of the successor owner's responsibility for defaults of the prior owner may include this waiver by implication. A lack of recourse against a successor owner can present some very immediate problems for a tenant whose improvements have not been completed by the original landlord or who has spent its own money on construction in reliance on the prior owner's agreement to reimburse the tenant through payment of an improvement allowance. The tenant could effectively be left without a remedy because the landlord is now out of the picture, and the lender is not obligated to complete the work or pay the tenant allowance. If the landlord was to have constructed the improvements, a solution for the tenant is to provide for a well-defined right of "self-help" in the lease to finish the improvements in the event the landlord fails to do so, coupled with a right to deduct the amounts spent by tenant from the rents due under the lease. If a construction allowance is not paid, the tenant may insist on the right to deduct this unpaid allowance amount from the rent, with interest.

Of course, any right on the part of a tenant to stop paying all or a portion of the rent by reason of a prior owner's default may be problematic for a lender because any such right diminishes the value of the lender's collateral and is the practical equivalent of a lender obligation to pay the amounts. If a lender agrees to setoff rights, it should require that these rights be limited to specific landlord obligations (for example, a specifically negotiated buildout or allowance obligation) and should require the tenant to give generous notice and cure rights before the tenant is entitled to exercise its self-help rights. Often these setoff rights are also capped at some percentage of the rent payable by the tenant to preserve at least a portion of the normal rent stream under the lease.

Many lenders simply refuse to allow setoff rights for tenants because of the concerns noted above. In this case, the tenant may be satisfied with a right to terminate the lease if the landlord's improvements are not completed within specified time periods. More problematic is the case in which the tenant is making the improvements and is to receive payment of a large tenant allowance from the landlord. In this case, the tenant is effectively lending money to the landlord by fronting the construction costs, and the lender will not want the payment of this debt to be superior in priority to the payment of the debt to the lender. Resolving this issue in a manner acceptable to the tenant and lender will generally require a more creative solution, such as a guaranty of completion by the principal of the landlord, a letter of credit, or some other security for the performance of this payment obligation, all of which could also be coupled with frequent disbursements of the tenant improvement allowance to minimize the tenant's exposure.

Other typical form SNDA provisions also have the effect of amending material lease provisions. One such provision is the grant to the lender of notice and cure rights that extend beyond those given to the landlord in the lease. To avoid having to give too many duplicate notices, a tenant may want to limit the default notices it must give to the lender to notices of those landlord defaults that could give rise to tenant termination, self-help, setoff, or abatement rights. In addition, a tenant may try to avoid giving a lender an open-ended cure period for landlord defaults that the lender claims it can cure only if it obtains possession of the leased space. The landlord's loan documents generally give the lender the right to cure landlord lease defaults, and if the lease already requires a tenant to accept cure or performance by the landlord's lender, a tenant can reasonably ask why the lender should have to obtain possession of the premises to cure the landlord default.

Most SNDAs also provide that no amendment or modification of the lease will be binding on the lender or a successor owner unless approved in advance by the lender. Although the tenant may object to this provision on the ground that it should be able to enter into an agreement with its landlord without third-party approval, the tenant is not likely to win this argument. At the very least, however, tenant should exclude from this approval requirement any amendment that arises out of the exercise of any tenant rights under the lease (for example, an amendment memorializing tenant's expansion into new space under a right or option in the lease) and, if possible, any amendment that does not materially and adversely affect the amount of the rent or the landlord's rights or tenant's obligations under the lease.

Many of the potential problems discussed in this section can be avoided by negotiating an acceptable SNDA form as part of the original lease negotiations. This will, in most cases, not entail additional expense or effort on the part of a landlord because a mortgage is often in place when the lease is executed, and a sophisticated tenant will require that an existing lender provide an SNDA anyway. This negotiated SNDA form can then be attached to the lease, the tenant will be obligated to sign a similar form whenever the property is sold or otherwise refinanced, and the landlord will have a negotiated form to give to future lenders. Of course, the landlord should be sure that the form is, in fact, commercially reasonable and satisfies normal lender requirements. The benefit to the tenant of an agreed-on SNDA form is that it will have leverage in the future to refuse to sign any SNDA form that does not adequately satisfy its concerns and protect its interests. If a prior lender signed or signed off on the SNDA form at the time of lease execution, the tenant has a much better argument to make to the landlord and future lenders that the agreed-on form is commercially reasonable and should be acceptable to the lenders.

As with estoppel certificates, the timing for obtaining SNDAs can be critical to the seller and the buyer in a sale transaction. The discussion above relating to estoppel timing issues, as well as the potential solutions to address these issues, applies equally to these SNDA timing issues.

Other Lease Provisions

Beyond the estoppel and SNDA requirements, a number of other lease provisions could have a significant effect on a sale transaction, both in terms of process and sales price.

Termination Rights

For obvious reasons, landlords, buyers, and their lenders do not like tenant termination rights. The value of a commercial rental property is derived in large part by the rent payment stream from the leases, and each lease's rental adds to the value of the property. Therefore, any lease provisions that may end the lease or disrupt its rental stream diminishes the property's value. As a consequence, landlords who give away too many termination rights in their leases could literally pay the price down the road.

Not all termination rights are created equal, however. Some termination rights are customary and will not diminish the property's value. For example, in leases other than long-term, single-tenant net leases, the tenant will generally have the right to terminate the lease following certain fire and casualty events (typically those occurring during the last years of the lease or if the landlord cannot or does not restore within a certain amount of time) and in the event of condemnation. In these cases, the loss of the tenant (and its rent payments) can be cushioned by the landlord's rent loss insurance proceeds or the condemnation award. In addition, some tenants may be able to bargain for an early termination right after a specified number of years with sufficient notice and payment of a termination fee that minimizes the economic effect of the termination. A credit tenant of an in-line retail lease may also be able to negotiate a right to terminate the lease if its gross sales do not reach a certain level at a specified point in time (generally about halfway through the term).

Most prudent landlords, however, will avoid termination rights in other circumstances, such as service interruptions and alleged maintenance or repair issues. Only in limited circumstances involving large tenants with significant bargaining power should landlords consider termination rights in the event of landlord default (failure to maintain or repair, for example, or interruption in services). Even then, termination should not be permitted unless the default makes the premises unusable for the tenant's business, was caused by a circumstance within the landlord's reasonable control, and continues for a certain number of days after notice from tenant to landlord specifying the default (generally no shorter than the period given to the tenant to cure nonmonetary defaults).

Limitations on Landlord's Liability

When a commercial rental property is sold, a seller will not want to continue to be liable to its tenants for lease defaults by the new owner. For this reason, the lease should provide that the seller is automatically released from all liability under the lease arising after the sale, and the tenant must automatically pay its rent to and perform its lease obligations in favor of the new owner. A sophisticated tenant will provide that this release is effective only on an express assumption by the new owner of the landlord's obligations under the lease. Such a tenant will also require that after the sale, the tenant retains its right to make claims against the seller and the proceeds of the sale for defaults that occurred before the sale—particularly because most transferees will assume the landlord's obligations only from and after the date of the transfer. If the estoppel certificates are sufficiently detailed and are obtained from all tenants, the seller should know of all claimed defaults and be able to make arrangements for its post-sale liabilities.

The common lease provision stating that the landlord's liability is limited to its equity interest in the property is also helpful to a seller when the property is sold. When the property is sold, the landlord/seller no longer has an equity interest in the property and can assert that it has no further liability under the lease or, at least, no liability beyond the proceeds that it received from the sale. Tenants may want to expand the concept of "equity interest" in these provisions to add a right to proceed against any rentals or other proceeds (insurance or condemnation proceeds, for example) derived from the property. A landlord that is a special purpose entity with limited assets (in many cases, just the leased property) may not be as concerned about this issue, but one that has other assets or that is a limited or general partnership may resist such a lease provision. Also, a prospective lender may look for this clause when evaluating the lease as collateral.

Financial Information

Another lease clause that may help a landlord when it is time to sell or finance a property is a requirement that the tenant provide financial information (and, in retail leases, sales information) on the landlord's request. Buyers and their lenders need to confirm the creditworthiness of the tenants to ascertain the certainty of the rental streams that create the value of the property. For a retail property, the buyer or lender may also want to know that the sales derived from the property are good to confirm both the tenant's satisfaction with the property and the likelihood of finding a new tenant that will pay the same or more rent if the tenant defaults or becomes insolvent. The retail landlord's lease form should, therefore, require sales figures annually, even from tenants that are not paying percentage rent (although many tenants not paying percentage rents will object to these reporting requirements as overly intrusive and burdensome). As with estoppels and SNDAs, timing is important, and landlords should add lease provisions that require the tenant to provide current information quickly on request.

Tenants may reasonably request that the landlord treat any nonpublic information confidentially, although the landlord should be sure that potential buyers, lenders, and their financial and legal consultants are permitted to view the financial information. A public company tenant may also wish to include a statement that it will not be required to produce financial information if such information is available to the public at no or nominal charge.

Short Form or Memorandum of Lease

Short form leases or memoranda of lease are sometimes used to provide public record notice of a lease and certain tenant rights. Although not as common for small tenants or in multitenant projects, and not common in some states because of cost, these instruments are customary in ground lease situations (especially when a leasehold mortgage is involved) or in other situations in which the tenant has valuable rights that it wants to protect (an option or right of first refusal to purchase the premises, for example).

As one might expect, however, persons buying or lending on property do not want the property's title to be littered with recorded lease notices that encumber title. These recorded lease notices are particularly troublesome when they remain in the public records after a tenant's lease has expired or been terminated. If a landlord agrees to allow a lease notice to be recorded, the landlord would be well advised to provide in the lease that the tenant must cause all recorded lease notices to be removed of record when the lease expires or otherwise terminates. The lease may also require the tenant to be liable for any legal fees or even lost sales or financings that the landlord incurs by reason of the tenant's failure to acknowledge of record lease expiration or termination. The landlord may even want to obtain, at the time of lease execution, a signed termination of the recorded instrument to be held in escrow until expiration or termination of the lease. In this case, the lease should expressly authorize the landlord to record the termination on expiration or termination of the lease, with or without tenant's further consent (although sophisticated tenants may not agree to this). In addition, landlords should ensure that any recorded short form or memorandum of lease includes language automatically subordinating such instrument to an existing or future mortgage. Although these are not necessarily fail-safe solutions, the incorporation of one or more of them in the lease may help avoid delays and other problems in connection with a sale or financing.

Future Lender Requirements

Most lenders have other requirements beyond estoppel and SNDA requirements. To address unanticipated lender requirements in ever-changing markets, a landlord should include in its leases a broad tenant obligation to make any future lease modifications reasonably requested by a lender. This type of provision presents obvious risks for tenants, so a wary tenant should insist on language providing that it will be obligated to agree only to modifications requested by institutional lenders that do not impose additional obligations or liabilities on the tenant or diminish the tenant's rights.

Ground Lease Issues

The concerns outlined above are even more important if the seller holds its interest in the rental property as a tenant under a ground lease. Not only will the seller/tenant need to obtain estoppel certificates and SNDAs from its subtenants, but it will also need to obtain estoppel certificates and consents and agreements from its ground lease landlord before its buyer and the buyer's lender will be willing to go forward with the transaction. The buyer is paying for a secure property interest, and the lender is lending based on a transferable property interest. Therefore, the ground lease landlord must give the buyer and its lender assurance that the leasehold interest held by the ground tenant is in effect and free from defaults, that the ground lease landlord will accept the buyer as its tenant, and that the buyer's lender will have the right and ability to keep the ground lease in effect notwithstanding the default or bankruptcy of the ground tenant.

Similar to the lender SNDA requirements discussed above, the buyer's lender will insist that the ground lease landlord agree that, if the lender must foreclose to cure the tenant's defaults, the ground lease landlord will not terminate the ground lease as long as these proceedings are moving forward. The lender also will insist on written assurances that, if the ground lease is terminated by reason of the tenant's defaults or is rejected in a bankruptcy, the ground lease landlord will enter into a new ground lease with the lender or its designee on the same terms as the original ground lease, and the improvements on the property will not become the ground lease landlord's property but rather will be the property of the tenant under the new lease. A savvy ground lease landlord may require that the rent be paid by the lender in a timely fashion while the lender is curing the tenant's defaults, obtaining possession of the tenant's interest by foreclosure, or having a new lease executed. The lender will not like this provision because it requires the lender to advance additional money while the loan is in default, but many lenders will agree to this provision so long as the ground lease landlord's only remedy for the lender's failure to make a rent payment after notice is the termination of the ground lease and not a suit against the lender for the unpaid or remaining rent. Some ground lease landlords may be willing to agree to forego rent for a few months during a cure or a bankruptcy to satisfy the lender's requirement, but this type of concession by a ground lease landlord is likely only when the lease is initially executed to induce the tenant (and its lender) to develop the property.

In a ground lease transaction, it is crucial to the marketability of the ground lease interest that the ground lease landlord agree in the lease that the lease is freely transferable and that it will enter into the estoppels, consents, and other agreements that will be required by buyers and their lenders in a timely manner. Of course, these agreements should be made terms of the ground lease itself, but each buyer and lender will want to have an agreement in its name directly with the ground lease landlord, so the ground lease landlord should also be required to put these provisions in a separate agreement. Again, attaching forms that will be executed by the ground lease landlord in the future (particularly the form negotiated between the landlord and the initial tenant's lender, which will be executed when the tenant still has the leverage of agreeing to invest money in the ground lease landlord's property in the future) will avoid future disputes with and delays caused by the ground lease landlord.

Conclusion

Through careful planning and thoughtful lease drafting, owners of commercial rental properties can facilitate smooth sale transactions, while still addressing and accommodating the often contradictory interests of tenants, buyers, and lenders. ■