

Environmental solutions that make your properties stand out.
THINK GREEN.
For custom-built solutions, click here.
WM WASTE MANAGEMENT



Search

facilitiesnet FacilityZone myfacilitiesnet

- ADA
- Building Automation
- Ceilings, Furniture & Walls
- Commercial Office Facilities
- Data Centers
- Design & Construction
- Doors & Hardware
- Educational Facilities
- Elevators
- Emergency Preparedness
- Energy Efficiency
- Equipment Rental & Tools
- Facilities Management
- Fire Safety
- Flooring
- Green
- Grounds Management
- Health Care Facilities
- HVAC
- IAQ
- Lighting
- Maintenance & Operations
- Material Handling
- Outsourcing
- Paints & Coatings
- Plumbing & Restrooms
- Power & Communication
- Roofing
- Security
- Software
- Windows & Exterior Walls

BUILDING OPERATING management maintenance SOLUTIONS FIND A TOPIC SALARIES JOBS & CAREER WEBCASTS & LIVE EVENTS PRODUCT RESEARCH CENTER SUPPLIER INSIGHTS

Advertisement



Share / Save

Landlords: Keep Tenants Without Putting Long-Term Building Sale And Refinancing At Risk

By Cheryl S. Prell and Lee A. Edlund



Gain access to BOM on your iPhone or BlackBerry

Vacancy rates are skyrocketing and rental rates are plummeting. Additional layoffs in virtually every sector of the economy translate directly into less tenant employees to fill spaces. Many commercial tenants are seeking to reduce or unload their leased spaces.

Landlords may conclude that desperate times call for desperate measures. Many landlords are demonstrating an increasing willingness to make compromises to keep their buildings occupied. Both business and legal concessions that landlords previously would not consider are now being granted. Nevertheless landlords should avoid taking actions that will have an adverse affect on the saleability and financability of their buildings in the future. Recognizing key lease provisions and understanding how lenders administrate their commercial real estate loans will help landlords avoid taking action that will damage future sales or financing.

Following is a list of certain important commercial lease provisions, the negotiation of which may impact future opportunities to sell or refinance a property.

1. Estoppels

The landlord should not give up the right to require the tenant to execute estoppel certificates. A prospective buyer or lender will certainly require the landlord to provide estoppel certificates from some or all of the tenants of the building.

The landlord should keep deadlines for the tenant's delivery of an estoppel certificate short so as not to delay or jeopardize the closing of a prospective sale or loan. Attaching a comprehensive form of estoppel certificate to the lease (to use as a point of reference) can expedite review and delivery when an estoppel certificate is actually needed by the landlord. But the lease should maintain flexibility to permit other reasonable provisions to be included in the estoppel certificate so that a prospective buyer's or lender's particular concerns can be addressed.

The landlord may consider making certain concessions in the estoppel provision in the lease however. For example, the landlord may agree to execute an estoppel certificate in favor of its tenant's prospective assignees or sublessees on similar terms and with similar time deadlines as those applicable to the tenant.

2. Subordination, Nondisturbance and Attornment

A lease should only allow the tenant a short window of time to deliver a subordination, nondisturbance and attornment agreement (SNDA). Preferably, the subordination and attornment of the lease should be automatic. Absent that, the lease should require the tenant to agree to be subordinate to a future loan and to attorn. It is critical that the landlord does not impair a future lender's right to have a tenant subordinate and attorn. In that regard, the landlord should avoid attaching a form of SNDA to the lease which a future lender would then be obligated to provide upon a future sale or refinance.

If the tenant is requesting that the current lender (i.e., the lender at the time of the lease negotiations) execute a nondisturbance agreement (NDA) (note that subordination will not



Learn more about our 2 HOUR GUARANTEE

Read our case study

play again >

We're GSA. We've got you covered with the Organizational Support Services you need, when you need them.

LEARN MORE

FREE E-MAIL NEWSLETTER SIGN-UP

- Weekly Articles
- Facility Webcast Alerts
- Building Products/Technology
- Monthly Digital Magazine

be necessary at the time that the lease is consummated since the loan will already be in place when the lease is executed), then notify the lender early in the lease negotiations. The landlord should only commit in the lease to use its commercially reasonable, good faith efforts to obtain a NDA since the landlord ultimately does not have any control over its lender. The tenant may want to address the consequences for the landlord's failure to deliver a NDA from its lender in the lease. If necessary to the negotiations, consider providing the tenant with a termination right in the event that the lender does not provide a NDA, but make sure that the window for tenant's election to terminate is far enough into the future to allow the landlord ample time to obtain the NDA from its lender, but soon enough that the landlord has not invested too much into the transaction before the tenant is allowed to terminate the lease.

3. Offset Rights

Lenders and prospective purchasers continue to be focused on lease provisions which enable a tenant to offset its claims for amounts owed to it by the landlord against the tenant's rent obligations. Preserving the income stream from the property is a necessity, and offset rights for a tenant's benefit should only be considered in limited circumstances and with appropriate safeguards.

4. Operating Expense and Property Tax Pass-Through Clauses

The landlord should avoid giving concessions relating to operating expense and property tax pass-throughs which will have an economic effect on the property. Limitations on capital expenditure pass-throughs should not jeopardize the landlord's right to pass-through capital costs resulting from a change in applicable law or arising from the landlord's reasonable attempt to achieve cost savings in its operations. Any cap on the pass-through of operating expenses and any Proposition 13 protection should be sparingly granted.

5. Audit Rights

Lenders and purchasers will scrutinize any provisions in the lease that may subject them to future liability. Audit rights are fraught with problems for subsequent owners who likely will not have the books and records required to honor the landlord's obligations. Keep audit rights short — 6 months following landlord's delivery of the year-end statement, for example. Allow the tenant to audit its base year only once, early in the lease term, so that the landlord's books and records for the base year may be closed. Prohibit the tenant's use of auditors paid on a contingency fee basis. Such auditors interests conflict with accurate fact finding, compromise and settlement.

6. Termination Rights

As previously mentioned, preservation of the income stream from the property is critical. Prospective purchasers and lenders will discount the value of a lease by assuming that a tenant will exercise any express right it may have to effect an early termination of the lease. If the landlord's loan requires minimum term lengths for leases, the landlord should be wary of efforts to circumvent the loan requirements by granting of the tenant early termination rights.

7. Mid-Term Allowances

Lenders resist assuming liability for the landlord's monetary obligations under a lease. Sometimes the landlord is required to deposit improvement allowances and brokerage commissions into escrow. The requirement may be imposed by the landlord's lender, or by the tenant who demands security for the obligations in the event that the landlord's lender refuses to assume liability. Granting refurbishment allowances or other allowances that are not payable for years may burden capital by forcing the landlord to fund the money into an escrow at the beginning of the term. Where possible, consider adjusting the rent schedule rather than agreeing to come out-of-pocket during the lease term.

8. Security Deposits

A lease is valued based upon the creditworthiness of the tenant. Considering the credit of the tenant and obtaining appropriate credit enhancement is critical. Whether the lease security should be cash, a letter of credit, and/or a personal guaranty must be carefully analyzed. When accepting a letter of credit as credit enhancement, be sure to consider the creditworthiness of the issuing bank.

9. Purchase Options

Perhaps no lease provision has greater potential to kill a prospective sale than a purchase option. Furthermore, the landlord's loan may prohibit granting a tenant the right to purchase the project. If a tenant presses the issue, consider instead a provision requiring the landlord to notify the tenant if the landlord decides to market the project for sale to third parties, but avoid any commitments that could thwart a sale by landlord of the project (or the portfolio of which the project is merely a part).

10. Condemnation and Insurance Proceeds

Lenders will typically want to control the condemnation and insurance proceeds, although

4 - 4 = (anti-spam)

SITE INFO

[Advertising](#) [Policies](#)
[Contact Us](#) [Copyright Disclaimer](#)
[Email Management](#) [FM Online Tools](#)

SITE OVERVIEW

[Content Directory](#) [Site Map](#)
[RSS Feeds](#) [Topic Index](#)

lenders will usually agree that the proceeds may be used to rebuild the damaged project, subject to the reasonable terms of the mortgage.

Current Lender Practices





Lenders are feeling the heat of the current economic situation, and many (cognizant that they may become owners of the collateral) have adjusted their behavior accordingly. Landlords whose loans are approaching maturity may need to think carefully about how to best position their assets to allow for refinancing or sale. Lenders are carefully scrutinizing lease provisions, income streams, tenant credit and potential future liabilities. Some lenders are consulting with independent sources to confirm that the rental rates being proposed by landlords are consistent with the market. Some lenders also are requesting copies of reports and financial information that the landlord receives from its tenants and prospective tenants, even though the lender has no privity with such tenants.

When negotiating leases, landlords should remain aware of lender concerns and try to propose compromises in the lease negotiations that have a perceived benefit for the landlord, the landlord's lender, and the tenant. Landlords should keep in mind the issues addressed above (including, in particular, those related to SNDAs and future monetary obligations of the landlord).

Landlords should not become so distracted by the economic climate and the struggle to find or maintain tenants that they lose sight of maintaining leasing practices that will preserve the value of their assets to the greatest extent possible and will not inhibit their efforts to refinance the properties in the future. Landlords today are in a difficult position, and attracting creditworthy tenants (a category that is continuing to diminish) is understandably their top priority. However, landlords cannot afford to be shortsighted in their lease negotiations, as the ultimate goals of selling and refinancing could become seriously compromised.

Cheryl S. Prell and Lee A. Edlund are partners in the Real Estate Department of Allen Matkins Leck Gamble Mallory & Natsis LLP. Prell is resident in the firm's Century City office. Edlund is resident in the firm's San Francisco office. Both have a broad commercial real estate practice, emphasizing the areas of commercial leasing and lease workouts, property management, and acquisitions and dispositions.

Be the first of your friends to like this.

Comments

[Add a comment](#)

MORE ON THIS TOPIC

Browse articles on [Landlords](#), [Tenants](#), [Leasing](#), [Property Managers](#) on FacilitiesNet
Search for [Landlords](#), [Tenants](#), [Leasing](#), [Property Managers](#) articles on FacilityZone