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# Commercial Lease Due Diligence in Real Estate Acquisitions: Key Issues and Best Practices

Buildout Obligations, Termination Rights, Purchase Options, Co-Tenancy, Rental Terms

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TUESDAY, MARCH 23, 2021

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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Today's faculty features:

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Malinda R. Steeb, Associate, **Troutman Pepper**, Pittsburgh, PA

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# Commercial Lease Diligence in Real Estate Acquisitions: Key Issues and Best Practices

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## Commercial Lease Due Diligence in Real Estate Acquisitions

- **Rent**
  - Base rent
  - Percentage rent
    - Breakpoint
    - Definition of gross sales
  - Rent abatements
- **Taxes and Operating Expenses**
  - NNN vs. gross
  - Base year
  - Operating expense exclusions
  - Operating expense caps

## Commercial Lease Due Diligence in Real Estate Acquisitions

- **Purchase and Sale Agreement (PSA) representations**
  - Lease documents
  - Lease defaults
  - Rent Roll for the Property
  - Security Deposits/Letters of Credit
  - Brokerage Commissions
  - Tenant Improvements/Allowances
- **Estoppels to be delivered pursuant to PSA**
  - Estoppels from all or majority of tenants/required estoppels from major or large rsf tenants
  - Estoppels should be consistent with the Rent Roll and the Leases
  - No outstanding Landlord obligations or rent credits
  - Standard for “clean” estoppels
  - Estoppel form (Lender, if applicable, or Tenant form)

## Commercial Lease Due Diligence in Real Estate Acquisitions

- **Estoppels**
  - Confirming lease and tenant facts
  - Addressing inconsistencies
  - Best Practices for resolving issues
    - Start early
    - Both parties (and Lender, if applicable) approve estoppel before sent to Tenant
    - Quick turns



## Sample Language – Lease Representations and Warranties

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“A true, correct and complete copy of the rent roll listing the name and premises of each Tenant under the Leases is attached hereto as Exhibit 9.1.10 (the “Rent Roll”).”

“True, correct and complete copies of all Leases shall be delivered to, or made available via an electronic data room accessible by, Purchaser within two (2) days after Effective Date. The Leases are the only leases currently affecting or relating to the Property; the Leases are in full force and effect; to Seller’s knowledge the Tenants under the Leases are not in default under the Leases beyond any applicable grace, notice and/or cure periods; and except as provided in Exhibit 9.1.11 (the “Outstanding Tenant Inducements/Leasing Commissions”) there are no outstanding Tenant Inducement Costs or Leasing Commissions (as those terms are defined in Section 11.2 below) due with respect to the current terms of the Leases. As of the date hereof, the Leases are valid and subsisting and in full force and effect, have not been amended, modified or supplemented other than as indicated thereon. Seller has received no written notice of default or breach on the part of the landlord under any of the Leases which remains uncured by the landlord and all repairs, alterations and other obligations required to be performed by the landlord under the Leases have been fully performed and paid for by Seller. No Tenant is entitled to any purchase option, concessions, allowances, set-off, rebates or refunds or has prepaid any rents or other charges for more than the current month. There are currently no security deposits required under, or being held pursuant to the Leases except as set forth on the Rent Roll.”

## Commercial Lease Due Diligence in Real Estate Acquisitions

- **Tenant improvements**
  - Landlord or Tenant to perform
  - Turnkey vs. Allowance
  - Substantial Completion and Commencement Date
  - Outstanding construction obligations of Landlord and/or unpaid Allowance amounts should be reflected in estoppels
  - How to handle in PSA
- **Use restrictions and non-competes**
  - Are tenants complying with use restrictions?
  - Will planned development comply with use restrictions?
  - Exclusive Uses in place
  - Prohibited Use restrictions in place
  - Radius restrictions in place

## Commercial Lease Due Diligence in Real Estate Acquisitions

- **Renewal/expansion/contraction options**
  - Should be reflected in estoppels
  - Have tenants been properly notified of options (if entitled to notice)?
  - Have tenants properly waived or elected any options?
  - Will expansion or contraction options interfere with planned development?
  - Are renewal or expansion rights inconsistent among tenants?

## Commercial Lease Due Diligence in Real Estate Acquisitions

- **Early termination rights**
  - Should be reflected in estoppels
  - What are the deadlines for notice of termination and effective date of termination?
  - Impact on financing
  - One-time right or continuing right
  - Termination fee
    - Is the fee a set amount or must it be calculated at the time of termination?
    - Should be reflected in estoppel

## Commercial Lease Due Diligence in Real Estate Acquisitions

- **Purchase options and rights of first refusal**
  - Should be reflected in estoppels
  - Have options been properly noticed and waived?
  - Does right survive sale?
  - Impact on financing
  - What are economic terms and timing?
  - Is pending transaction consistent with offer waived by tenant?

## Commercial Lease Due Diligence in Real Estate Acquisitions

- **Continuous operation – “Go Dark” provisions**
  - Do tenants have a right to “Go Dark”?
    - Impact on other tenants
  - Landlord right to recapture
  - Co-tenancy provisions
  - Any violations of co-tenancy requirements
  - Reduced rents triggered by co-tenancy defaults
- **Parking requirements**
  - Layout
  - Number
  - Protected (No Building/No Change) areas
  - Spots designated for certain tenants
  - Impact on planned development

## Commercial Lease Due Diligence in Real Estate Acquisitions

- **Casualty and Condemnation**
  - Landlord or Tenant to insure improvements
  - Landlord or Tenant to restore
  - Tenant required to restore its own improvements
  - Timing of restoration
    - Landlord Work
    - Tenant Work
  - Abatement of rent
  - Lease termination rights
    - Loss of premises
    - Loss of protected areas
  - Application of insurance and condemnation proceeds

## Commercial Lease Due Diligence in Real Estate Acquisitions

- **Assignment, Subletting and Subordination**
  - Assignment and subletting
    - Any tenant consent required for Landlord to assign/sublet in connection with sale/purchase?
      - Government tenants or major/anchor tenants
  - Standards for approval
    - State specific standards
  - Does Landlord's lender have consent rights?
  - Subordination, non-disturbance and attornment agreements
    - Lender or Tenant form
    - Tenant right to demand SNDA
    - Lender condition to financing
    - Timing to obtain
    - Best practice to deliver SNDA form to tenants with estoppel form



# Key Lease Provisions

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## Commercial Lease Due Diligence in Real Estate Acquisitions

- **Letters of Credit, Security Deposits and Lease Guaranties**
  - Letters of Credit
  - Security Deposits
  - Guaranties
    - Guarantor
      - Persons or entities
      - Tenants by the entirety
      - Financials
      - “Good Guy” guaranty
      - Burn off

# BONUS SLIDES

# Sample Estoppel Certificate

The undersigned ("Tenant") is a party to a lease dated \_\_\_\_\_ between \_\_\_\_\_, as landlord (the "Landlord"), and Tenant, as tenant, for certain space (the "Premises") located in that certain building commonly known as \_\_\_\_\_ (the "Lease").

Landlord, as the owner of the property of which the Premises is a part (the "Property"), intends to sell the Property to \_\_\_\_\_ ("Purchaser") who, as a condition of the purchase of the Property, has required this Estoppel Certificate.

At the request of the Landlord and Purchaser, Tenant certifies as follows:

1. Attached hereto is a true, correct and complete copy of the Lease and all amendments thereto. The Lease is the sole agreement between Landlord and Tenant relating to Tenant's occupancy of the Premises. The Lease is in full force and effect.

2. The term of the Lease commenced on \_\_\_\_\_ and expires on \_\_\_\_\_. Tenant has no right to extend the term of the Lease except as follows: \_\_\_\_\_.

3. The fixed monthly rent presently payable under the Lease is \$ \_\_\_\_\_. The fixed monthly rent payable under the terms of the Lease has been paid through \_\_\_\_\_. The monthly amount currently payable by Tenant under the Lease on account of operating expenses and taxes is \$ \_\_\_\_\_.

4. Tenant has no existing defenses, offsets, claims or credits against rent payable under the Lease or against the enforcement of the Lease by Landlord.

To Tenant's knowledge, neither Landlord nor Tenant is in default under the terms of the Lease.

6. Tenant has no option or right to purchase the Property or any part thereof.

7. All tenant improvement work required to be completed by Landlord has been completed by Landlord in accordance with the Lease and accepted by Tenant. Landlord has paid in full any and all tenant improvements allowances payable to Tenant under the Lease.

8. Tenant has no option or right of first refusal to lease additional space except as follows: \_\_\_\_\_.

10. Tenant has not assigned the Lease nor sublet any portion of the Premises.

11. The security deposit held by Landlord under the Lease is \$ \_\_\_\_\_.

This Estoppel Certificate may be relied upon by Landlord, Purchaser, Purchaser's lender and their respective successors and assigns.

\_\_\_\_\_  
By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

Date: \_\_\_\_\_, 20\_\_

# Sample Estoppel Certificate (Simple)

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To: \_\_\_\_\_, its successors and assigns ("Lender")

Re: Lease (the "Lease") dated \_\_\_\_\_ between the landlord named in the Lease, as landlord ("Lessor"), and \_\_\_\_\_ as tenant ("Lessee") of certain real property, having an address of \_\_\_\_\_ (the "Property").

Lessee hereby certifies the following representations with respect to the Lease are accurate and complete as of the date hereof with the understanding that Lender will rely upon the representations in connection with a loan to borrower under Lender's loan documents (the "Loan") and accepting an assignment of the Lessor's interest in the Lease as additional security for making the Loan:

1. The following are the pertinent terms of the Lease:

Property/Suite Address: \_\_\_\_\_

a. Current Monthly Base Rent: \$ \_\_\_\_\_

b. Commencement Date: \_\_\_\_\_

c. Termination Date: \_\_\_\_\_

d. Lease Square Feet: \_\_\_\_\_ sf

2. Neither Lessee nor Lessor is in default under the Lease. The Lease is in full force and effect and has not been supplemented or amended, nor has any portion of the Property leased by Lessee been sublet, except: None.

IN WITNESS WHEREOF, this certificate has been duly executed and delivered by the authorized officers of the undersigned as of \_\_\_\_\_, 20\_\_.

LESSEE:

By \_\_\_\_\_  
Name:  
Title:

## Sample Language – Estoppel Provision

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“Seller shall prepare and submit to each Tenant under the Leases an estoppel certificate, in the form of Exhibit 9.5.A attached hereto or, if a form of estoppel certificate is described in or attached to a particular Lease, then in such form (each, an “Acceptable Estoppel Certificate”). Purchaser’s obligation to close title hereunder is conditioned upon Tenants leasing at least eighty percent (80%) of the leased square footage of the Property (which must include all Tenants leasing more than 15,000 rentable square feet) (collectively, the “Estoppel Tenants”) delivering to Purchaser Acceptable Estoppel Certificates. Seller may elect to deliver to Purchaser at Closing an executed estoppel certificate from Seller in the form of Exhibit 9.5.B attached hereto (the “Seller Estoppel”) for Tenants leasing up to five percent (5%) of the leased square footage of the Property (provided that no Seller Estoppels shall be allowed for Tenants leasing more than 10,000 rentable square feet of the Property), and any such Seller Estoppel shall constitute an Acceptable Estoppel Certificate from such Estoppel Tenant(s); provided, however, that, if any Tenant for which a Seller Estoppel was provided later delivers an executed Acceptable Estoppel Certificate (whether it is before or after the Closing), such Acceptable Estoppel Certificate shall supersede and replace the Seller Estoppel delivered by Seller (and this sentence shall survive Closing). The failure of Seller to obtain Acceptable Estoppel Certificates from the Estoppel Tenants on or before the scheduled Closing Date shall not be deemed a default by Seller, it being agreed that the sole remedy of Purchaser in the event Seller does not so obtain an Acceptable Estoppel Certificate from the Estoppel Tenants shall be as set forth in Section 14.1. Purchaser shall have the right, but not the obligation, and in Purchaser’s sole and absolute discretion, to waive the requirement that Seller furnish Acceptable Estoppel Certificates in accordance with the provisions of this Section 9.5.”

## Sample Language – SNDA Provision

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“Obtaining a subordination, non-disturbance, and attornment agreement ("SNDA"), from any of the Tenants under any Lease shall not be a condition to Closing nor shall be permitted except as set forth below. In the event that Purchaser desires to request an SNDA from any Tenant, Purchaser shall notify Seller in writing at least twenty (20) days prior to Closing by providing to Seller Purchaser’s lender’s form of SNDA, which form shall be prepared by Purchaser for each such Tenant with the information particular to such Tenant. Purchaser shall deliver the SNDA to each such Tenant. Seller, at no cost to Seller, agrees to reasonably cooperate with Purchaser’s efforts to obtain any requested SNDA but obtaining SNDAs shall not be a condition to Closing and the failure to obtain the SNDAs shall not be a default by Seller hereunder. In all events, Purchaser shall be responsible, at Purchaser's expense, for the preparation of, negotiation of, and collection of the SNDA from each Tenant.”

# Team



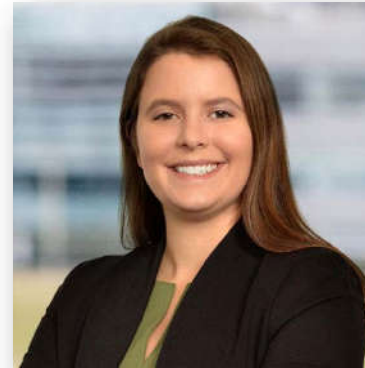
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- Concentrates her practice in real estate matters and other business transactions, including the acquisition, sale and financing of commercial real estate properties and leasing of office, retail, warehouse and industrial space, representing both landlords and tenants.
- LEED® (Leadership in Energy and Environmental Design) Accredited Professional
- Member of CREW (Commercial Real Estate Women) Philadelphia and served as past chair of Communications Committee.



## Malinda R. Steeb

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- Concentrates her practice in the acquisition, sale and leasing of office, retail, restaurant and warehouse space and commercial real estate matters in connection with corporate mergers and acquisitions.

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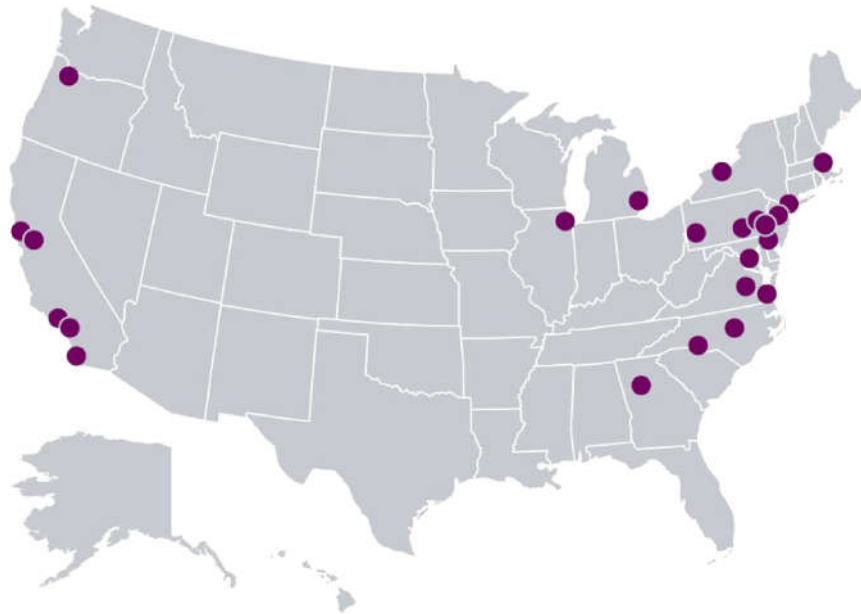
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