The Flip Made Easy (or Easier)—Part 1

Preparing Your Shopping Center Leases and Operation for Sale

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All shopping centers will be sold eventually. When a sale is not actually on the horizon, most owners do not consider the steps that they can take to make a sale easier when this inevitable time comes. Of course, owners try to enhance the value of their centers by keeping them fully leased to credit tenants at the highest possible rentals. However, a buyer today requires that the seller satisfy a number of technical requirements and demands as conditions for a sale. An owner can make the process much easier, faster and more certain by keeping these in mind as it negotiates leases and operates its shopping center. This two-part article will discuss these considerations from both the buyer and seller's perspectives.

The Leases Should Anticipate a Buyer's Requirements

The lease provisions that are the most important in a sale are its estoppel certificate and its subordination, non-disturbance and attornment agreement ("SNDA") requirements. Other lease provisions can also be structured to be helpful in a sale.

Estoppel Certificates

Today, shopping center buyers wish to obtain from each tenant a 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 assuring the buyer of the following:

1. The lease is in effect, with no amendments other than those listed;
2. There are no defaults or events or circumstances that, with notice or time to cure, would lead to a default on the part of either the landlord or the tenant;
3. All of the landlord's and tenant's construction and other obligations have been fully performed, and all construction has been accepted;
4. There are only the number of extension terms stated in the estoppel certificate and each of these terms is for a specified period;
5. The charges other than the rent payable under the lease are in specified amounts set out in the certificate, and the tenant has paid the rent no more than one month in advance;
6. The tenant has no right to deduct amounts from the rent that it is paying;
7. There are no outstanding concessions, rent abatements or rent rebates due to the tenant, and no construction allowance remains to be paid;
8. The tenant has no defenses to the enforcement of the lease;
9. The tenant is not subleasing any part of its space, and its rights have not been assigned;
10. The tenant has received no notices of default from the landlord and has given the landlord no notices of default;
11. The tenant has previously made no claims against the landlord; and
12. The tenant has no right of first refusal or option to purchase the premises.

Few buyers or lenders will be satisfied with obtaining an estoppel certificate executed by the seller on behalf of its tenant, rather than on its own behalf, and even fewer will be satisfied with an unsigned estoppel certificate that is deemed to be accurate.

Some buyers go further and require that the tenants certify that the use of their space has not involved the generation, storage, treatment, disposal or release of hazardous substances, and that their space is in compliance with all environmental and other laws. In the future, as new issues arise in shopping center ownership and leasing, buyers are likely to ask tenants to certify to additional and more complex matters.

The buyer's lender usually wishes to obtain its own estoppel certificate from each tenant. Frequently, after the initial estoppel certificates have been obtained from the tenants, the buyer's lender comes forward with a request for another estoppel certificate that covers the same areas covered in the buyer's estoppel certificate. This lender document often includes agreements that are more properly included in an SNDA, including an agreement by the landlord to notify the lender of any defaults, and to give the lender both additional time to cure these defaults and a waiver of claims against the lender for defaults by the landlord.

Purchase agreements frequently provide that if the tenant will not certify to each of the required facts, the seller must do so on behalf of the tenant. If the seller certifies inaccurately that its tenant has no claims against it (a matter usually known only to the tenant), then the seller will be liable to the buyer for those claims. Sellers that do not wish to assume this liability should be sure that each lease contains a detailed listing of the matters to which the tenant will certify upon request as well as an agreement by the tenant to certify to all other matters requested. However, many tenants prefer a specific listing of the certification requirements and object to an obligation to certify to unspecified matters in the future.

Most tenants will ask that its certification as to facts, such as the existence of defaults, rights of offset and claims against the landlord, be made only to the best of its knowledge and without investigation. Reasonable buyers and lenders will agree to this type of certification since a tenant should not be expected to certify to matters that have not yet been discovered. The buyer's legitimate concern about obtaining a confirmation of the lease terms and assurance that there are no known outstanding claims will be satisfied by a certification of the claims and defaults that are then known to the tenant.

The time required to obtain estoppel certificates can be crucial to a sale. Buyers like their estoppel certificates to be dated as close as possible to the sale date but obtained in time to permit the buyer to refuse to go forward with the sale if the matters certified are not satisfactory to the buyer. The lease provisions requiring that the tenant provide an estoppel certificate on request should, therefore, require the tenant to produce this estoppel certificate within as short a period as possible. In many deals, the seller may need to have the estoppel certificates provided within ten days after request (particularly the estoppel certificate in favor of the lender, which is often requested a few days before closing), although most large tenants will ask for a longer period.

If the tenant does not return an estoppel certificate when required by the lease, the seller needs the right to exercise immediate remedies against the tenant to compel it to complete and sign the certificate. It will not want to give a default notice and wait for the cure period to elapse before exercising its remedies. Leases frequently will provide that if the tenant does not complete and return an estoppel certificate when it is required to do so, the landlord may execute it as the tenant's attorney in fact. Some also provide that if this estoppel certificate is not produced when required, the tenant will be deemed to have certified to all of the matters set out in the requested certificate. Few buyers or lenders will be satisfied with obtaining an estoppel certificate executed by the seller on behalf of its tenant, rather than on its own behalf, and even fewer will be satisfied with an unsigned estoppel certificate that is deemed to be accurate. One solution is to provide for a *per diem* monetary penalty sufficient to generate attention if the certificate is not returned on time. Another would be to include an acknowledgment by the tenant that a failure to return the certificate on time will cause the landlord to incur serious 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. The risk of these damages should motivate most tenants to be timely in reviewing and returning requested estoppel certificates.

SNDAs

When a shopping center is sold, the seller must obtain from each tenant not only an estoppel certificate, but also the SNDA, which is required by its buyer's lender. This is important to the seller because unless the buyer's lender is satisfied, the sale cannot close.

Years ago, lenders asked only that the tenant agree that its lease would be subordinate to the lender's mortgage or deed of trust (the "subordination" portion of the SNDA) and that it would pay its rent to the mortgagee or any other party acquiring the property in a foreclosure sale (the "attornment" portion of the SNDA). In return, the tenant asked for assurance that neither the lender nor any other party acquiring the premises in a foreclosure sale would take the position that the foreclosure sale terminated its lease; in other words, the tenant's possession would not be disturbed by the mortgage or its enforcement (the "non-disturbance" portion of the SNDA). Most lease forms require the tenant to sign only this simple SNDA document.

National and conduit lenders today are not satisfied with a simple subordination and attornment. In their form SNDAs , they also want each tenant to certify to all of the facts customarily found in an estoppel certificate and to agree to provisions that protect the lender or the party that purchases the property in the foreclosure sale from the consequences of the original landlord-borrower's defaults. These provisions frequently include the following:

(i) prior to a transfer to a lender or purchaser at foreclosure,

(a) the tenant will not modify the lease, cancel it or surrender the premises to the original landlord without the lender's consent;
(b) the tenant will not make any rent or other payments more than one month in advance;
(c) the tenant will give the lender notice of all landlord defaults and

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will not terminate the lease because of the default 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

(d) the tenant will pay its rent directly to the lender if the lender demands this payment; and

(ii) After the leased premises are transferred to a lender or a purchaser in a foreclosure,

(a) 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;

(b) 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;

(c) 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

(d) the lender or other successor landlord will not be required to repair casualty or condemnation damage unless the lender has received sufficient funds from the insurer or expropriating authority, and even if the lender receives these funds, it will not be required to apply these funds to the restoration if its mortgage permits it instead to apply them to the outstanding loan amount.

Some lenders also ask that the tenant agree that if the lease terminates by reason of the landlord's bankruptcy or default, then at the lender's request, the tenant will enter into a new lease with the lender. A lender might also ask that the leases be modified to include the tenant agreements set out above in the body of each lease.

Most of the agreements set out above greatly limit tenant rights. They force the tenant to proceed against its original landlord, which is probably insolvent, for pre-foreclosure defaults and preclude the tenant from seeking redress from the new owner or deducting cure amounts from the rent. To avoid going through a lengthy process in which its tenants either negotiate these provisions at the owner's expense or refuse to agree to them at all, the owner should include each of these provisions in its leases and obligate its tenants to agree to these provisions if requested by a prospective lender.

A sophisticated tenant will negotiate these provisions as part of its lease negotiations. For example, a sophisticated tenant is likely to give up the right to proceed against a lender or other new owner for money owned by the original landlord. However, it 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, and to complete all construction and cure all repair defaults existing at that time, even though this construction was to have been performed or these defects were to have been remedied by the original landlord.

At the very least, the owner should require its tenants to agree from time to time on request to certain basic itemized SNDA provisions, as well as "all other matters that may be requested by a prospective lender." The lease should also require the tenant to agree to any lease modifications requested by a lender, although a wary tenant will ask for a provision requiring it to agree only to modifications requested by institutional lenders that do not impose additional obligations on the tenant or diminish its rights.

If the tenant is an anchor tenant or other large national tenant that has demanded an SNDA from the lender holding the mortgage at the time of lease execution, the lease's SNDA provisions can be simplified considerably. In that case, the tenant and the lender are likely to have negotiated a mutually acceptable form of SNDA before the commencement of the lease. The owner can then attach this form of SNDA to the lease and require its tenant to sign an SNDA in this general form in favor of any other lender in the future. This may not satisfy all lenders, but the fact that it was accepted by a prior lender can be very persuasive.

The conclusion of this article will discuss how shopping center leases should consider the seller's concerns. ■

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