

**REAL PROPERTY LEASING ISSUES
IN THE PURCHASE AND SALE OF A BUSINESS
Tim Dudley, Rhoades McKee**

I. **Introduction.** Almost every business transaction involves leasing. The selling entity, for example, might lease its location from a land holding company with common ownership. In that case, the leasing issues might be fairly straightforward if the buying entity is not also purchasing the real property. In that case, the seller and related party will terminate the related-party lease at closing and the land holding company will enter into a mutually agreed-upon arm's length lease with the buying entity.

Or the business transaction might include purchasing both an operating entity and the real property where there are also third-party leases that need to be vetted and assigned, with appropriate tenant estoppels and SNDAs.

For purposes of this discussion, we will focus on the common situation where the seller leases its operating location from an unrelated third party and the buyer is purchasing only the assets or equity of the operating entity and not any real property.

II. **Actions/Documents needed.**

A. **Stock Deal.**

1. Review the Lease for potential concerns. The purchase agreement should require delivery from Seller of a true, accurate and complete copy of the Lease and all amendments/modifications; and should include a contingency if the Lease is unacceptable or the Seller can't obtain the necessary landlord consent.
2. Pay particular attention to the assignment/subleasing section. A stock sale may be considered an assignment that requires landlord consent. If it does, obtain landlord consent in a written document.
3. The Buyer will want a Landlord Estoppel Certificate (and representations and warranties from the Seller in the purchase agreement)
 - a. The contents of the Landlord Estoppel Certificate will depend on the terms of Lease, but generally will provide:
 - i. Attached are true, complete and correct copies of all documents which constitute the Lease. The Lease is the only agreement between Landlord and Tenant relating to the subject matter thereof.
 - ii. The Lease is unmodified and is in full force and effect in accordance with its terms.

- iii. There are no Landlord defaults and Landlord has no knowledge of Tenant defaults.
- iv. Amount of current rent.
- v. A representation that rent has been paid through the date of the certificate and that no rent or other amount has been paid more than a month in advance.
- vi. No additional rent is currently due or owing.
- vii. Confirmation of security deposit amount or lack thereof.
- viii. Confirmation of term and renewal options.
- ix. A representation that the lease has not been assigned or sublet.
- x. A representation that there are no lease guaranties.
- xi. Representations regarding the condition of the leased premises.

B. Asset Deal. Same as above AND:

- 1. Assignment and Assumption of Lease (can contain landlord consent).
Issues:
 - a. Seller will want to be released from liability under the lease going forward.
 - b. Rent/Additional Rent proration.
 - c. Representations and warranties from Seller/Assignor.
 - d. Indemnification from Seller/Assignor for obligations/liabilities arising from facts and circumstances occurring before the date of the assignment and from breach of representations and warranties. From Buyer/Assignee for obligations/liabilities arising from facts and circumstances occurring after the date of the assignment.
- 2. Phase I Environmental Site Assessment, potentially Phase II Environmental Site Assessment and Baseline Environmental Assessment/Due Care Plan:

- a. Phase I must be completed prior to becoming an operator (ideally prior to signing the lease, but surely prior to taking possession or even doing any site work – control is key). If Phase I uncovers any RECs, Buyer will want sufficient time to conduct further investigation before committing to the lease. Build in sufficient time for due diligence in Purchase Agreement (this time may be significant: see Vapor Intrusion below).
 - b. Vapor intrusion. If chlorinated solvents or petroleum constituents contamination is a concern, the deal may become mired in the environmental law version of the wild west: vapor intrusion.
 - i. Rules are changing daily.
 - ii. As of mid-October, EGLE was suggesting nine quarters (!) of vapor sampling (up from four, which was already unworkable). It appears EGLE is pushing mitigation systems - hoping parties will install one rather than deal with extensive rounds of sampling and uncertain rules.
 - iii. Toluene: EGLE has recently taken the positions that a mitigation system must be installed in all instances where toluene is involved. Data shows adverse effects after only 20 minutes of exposure.
 - iv. Leasing: Landlords and Tenants each have due care obligations. If a mitigation system exists or is required, the lease must address who is responsible for what (installing, maintaining, operating, reporting) (example: backup generator)
 - v. Takeaway: If there is a vapor concern, be prepared for uncertainty, delays and additional expenses, and ensure you are working with advisers (environmental consultants and attorneys) who are immersed in the issue. Expect this issue to have a chilling effect on business transactions.
3. Subordination, Non-Disturbance and Attornment Agreement (SNDA) between Buyer/Tenant, Landlord and Landlord's lender. (Lender and/or Buyer may want). Provides that the Lease is subordinate to the Mortgage but that the Tenant's occupancy won't be disturbed in the event of a foreclosure and that the Buyer/Tenant will recognize the new property owner as the landlord under the Lease.

III. **Five (plus) most significant leasing issues.** So the Asset Purchase Agreement requires the Seller to deliver the Lease and all amendments. What are we looking for, other than rent? Generally, here are five of the most significant terms we're typically reviewing:

A. **Term/Renewals.** If the location is important, make sure there's enough time left before the term runs out!

Or negotiate an extension with the Landlord prior to the expiration of your due diligence period.

B. **Security Deposit** (asset deal). Seller: Make sure it's credited. Buyer: Make sure it's assigned.

C. **Maintenance/Repair/Replacement:** Who is responsible for the interior, HVAC, plumbing, electrical and mechanical systems, roof, roof membrane, roof systems, foundation, exterior walls, interior structural walls, interior non-structural walls, parking areas, sidewalks, drives, landscaping, drainage systems, windows, doors, plate glass, store fronts, etc.

D. **Compliance with laws / representations and warranties / use of the Premises.** Buyer/Tenant will want"

1. A representation/warranty that Landlord owns fee simple title to the property free and clear of restrictions, easements, covenants, mortgages, liens, conditions, limitations, and any other encumbrances which would materially interfere with the Tenant's intended use of the Premises;

2. A representation/warranty that all utility and mechanical systems are established, connected to the Premises and are in good working condition and repair, reasonable wear and tear excepted;

3. A representation that Landlord has not received any notice of, and has no knowledge of, existing violations on the Premises or any portion thereof of any laws, etc.

4. Makes sure that the intended use is permitted by the Lease.

E. **Environmental terms.** Buyer/Tenant will want:

1. A Landlord representation/warranty that the Premises is free from contamination and in compliance with environmental laws.

2. A Landlord obligation not to dispose of any hazardous materials at the Premises.

3. Indemnification obligations if Landlord breaches either of the above.

4. Abatement of rent if Tenant's business is interfered with as a result of presence of hazardous materials not caused by Tenant. And a right to terminate if such an interference lasts a certain period.
5. Review Tenant's obligations/indemnifications. Can Buyer/Tenant conduct its normal operations without a breach? Is Tenant's indemnification limited to costs/expenses caused only by Tenant's activities?

F. If the Lease is triple net, CAM/Operating Expenses.

What do they include?

What is excluded? Often construction costs, interest or payment on financing for the purchase of the building, depreciation/amortization, broker's leasing commissions, advertising, reimbursed costs, services provided to other tenants not provided to Tenant, markup on utilities, lease enforcement/negotiation, capital expenses, general corporate overhead, etc. are excluded.

Is there a cap on controllable expenses (everything but taxes, insurance, and (sometimes) utilities)?

Are there audit rights?

G. Default and cure / Landlord default provisions.

Does Tenant have a right to cure its defaults after notice from Landlord?

What are Tenant's remedies in case of a Landlord default? Tenant wants remedies of self-help and reimbursement, rent abatement, termination.



Tim Dudley

616.233.5272

trdudley@rhoadesmckee.com