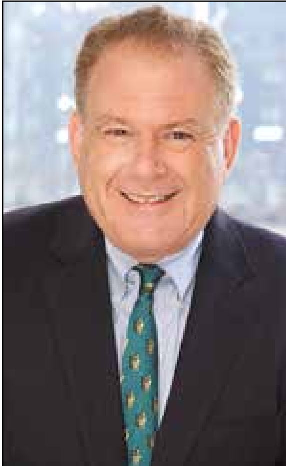
How Lender's Counsel Reviews a Lease



In 2014, **Joshua Stein**, the sole principal of Joshua Stein PLLC, was recognized by ***Who's Who Legal*** as the first attorney in the list of the "most highly regarded" commercial real estate attorneys in the Americas. In 2011 through 2013, he was recognized by ***Super Lawyers*** magazine as one of the top ten attorneys in the New York City region, across all practice areas. ***Chambers USA*** regularly identifies him as one of the leading real estate attorneys in New York—the only one in that group who does not practice in a large firm. He is one of the most prolific writers about commercial real estate law and practice in the United States. An earlier version of this article appeared as a chapter in ***Lender's Guide to Structuring and Closing Commercial Mortgage Loans,*** written by Joshua Stein but now out of print. Electronic copies may be ordered from www.joshuastein.com. Another version of this article appeared as a chapter in the New York State Bar Association's two-volume treatise on Commercial Leasing, edited by Joshua Stein. Please forward to the author any comments, improvements, suggestions or corrections. Copyright © 2014 Joshua Stein, www.joshuastein.com. All rights reserved.

Joshua Stein

I. WHY MORTGAGE LENDERS CARE ABOUT LEASES

Leases in place provide a major source of value for commercial real estate. The rent pays the owner's debt service and more. For those reasons, a mortgage lender wants to understand the space leases that affect—and are a crucial part of—the proposed real estate collateral.

When a mortgage lender begins to prepare for a commercial mortgage loan closing, the lender will often ask its counsel to review some or all of the leases. That review will focus on a handful of concerns driven by the lender's basic assumptions and desires about the leases. Those concerns are:

- Confirmation of Income. Do the leases support and substantiate the rent roll that the lender reviewed in estimating the value and cash flow of the mortgaged property? Does the rent roll accurately describe the tenants' obligations to contribute to the property's operating expenses and real estate taxes?

- Constancy of Cash Flow. Does anything in the leases create a risk, or at least an atypical risk, of any interruption of cash flow to the borrower and hence loan payments?

- Continuation of Leases. Will the leases probably stay in place, so the value the lender saw in them will likely continue over the life of the loan and even after a possible foreclosure?

- Concerns of a Landlord. Recognizing that any mortgage lender is a landlord-in-waiting (or a possible seller of the property to a future investor), do the leases contain anything that a typical landlord would find unacceptable? Do they impose on the landlord any unusual, unmeasurable, unexpected, or burdensome obligations?

Beyond those questions, a lender will also assess the likelihood that the income stream from a lease will vanish as the result of the tenant's default or financial distress—an underwriting risk inherent in any commercial real property that arises outside the terms of the leases themselves, and that probably leads to more loan defaults than anything the leases or the loan documents do or do not say. The likelihood of tenant default represents a credit analysis and part of the lender's "business" underwriting of the loan. A lender will typically not rely on counsel to assess these "business" issues.

The level of lease review that a lender will require for any particular loan will depend on the circumstances. As with most other issues that arise in commercial mortgage loan closings, much depends on the ratio between the loan amount and the value of the mortgaged property. A lower loan-to-value ratio makes it easier for a lender to make a business judgment and cut any number of corners, including the degree of scrutiny the lender applies to leases. If, on the other hand, a transaction is "stressed" from the beginning because of a high loan-to-value ratio, the lender and its counsel must approach leases—and everything else—that much more carefully.

As an equally fundamental question, the lender must decide and advise counsel whether the lender plans to rely on the particular leases presently in place, or whether the lender looks to present and future rental income of the building generally—the rental value of the space whether occupied by today's tenants or by any potential future replacement tenants.

Commercial mortgage lenders usually care much more about actual rental income from leases in place than about hypothetical future rental income. In a frothy market, though, when lenders fight to "get deals," they may place more weight on hypothetical future rents from hypothetical future tenants. That type of underwriting often drives a lending boom, often followed by a foreclosure boom. These things can change from day to day, from lender to lender, and from transaction to transaction.

Although any lender recognizes that today's leases will all eventually expire and today's tenants may all simply default or move out, a lender will also know that any effort to replace those tenants will take time and cost money, and even then may not replace the cash flow in place. If a property has significant short-term risk related to scheduled lease expirations and the need to find new tenants, a lender will regard the project as being not entirely stabilized, and will reassess the risk of the deal, perhaps restructuring the loan accordingly.

The more important any particular lease is, the more carefully lender's counsel needs to review it. Anchor leases in a retail property or large office leases in particular will often require more careful review. First,

those leases will often contribute a large share of the borrower's cash flow. Second, the tenants under those leases will have negotiated more heavily and the terms may have become more heavily tailored or tenant-friendly and correspondingly unfriendly to landlords and their lenders. Particularly in retail projects, major tenants may have imposed their own forms of lease, rather than negotiated from the landlord's form.

On the other hand, to the extent that existing leases are below market, in default, or about to expire, or to the extent that the existing tenants are not creditworthy and hence are likely to vanish, the lender may care more about hypothetical future rental value (on the assumption the space will soon need to be leased to new tenants) than about the details of the existing leases. In such cases, the lender may require only a minimal (if any) review of the terms of the leases—perhaps merely checking for lease terms that are so bizarre and undesirable that they would, on their own, cause substantial concern for any lender or landlord, even if they will probably go away soon enough.

A lender's instructions to its counsel on lease review will also vary depending on whether the lender believes in the borrower's competence in negotiating leases and operating the property or in analyzing an existing property being acquired, and sharing the results. In the rare case where the lender obtains meaningful representations and warranties on the leases, backed by credit beyond the borrowing entity, the lender might decide to ease up on its own lease review.

This article describes the items that a lender will usually want its counsel to consider in any lease review project. Because of the wide variety of issues any lease will address, many of which will make a difference under some circumstance or another (or the lease wouldn't need to cover them), one can easily find items to add to this list. More generally, anyone who thinks about it carefully can expand any lease review project, almost without limit, if a lender decides it wants to be as exhaustive as possible.

Nevertheless, the discussion in this article should cover the major "hot buttons" for a typical commercial mortgage lender in most transactions. Different lenders may, however, have different expectations for lease reviews in different transactions. Any lender's expectations will be completely different—and this list will be inadequate—for any "credit tenant lease," bondable lease, synthetic lease, or ground lease.

This article begins by describing, in Section II, some questions that counsel should answer before starting a lease review project, to define its scope and exactly what the lender wants its counsel to deliver.

Once counsel starts the lease review process, that process might identify problems and issues in the leases. Section III briefly discusses some common solutions to those problems and issues, and how the problem resolution process ties to the loan closing process more generally.

Section IV offers an overview of the basic general and financial questions that counsel should try to answer in any lease review, or questions whose answers counsel should confirm against the rent roll that the borrower provided. The latter approach will usually save time and cost less.

Section V then turns to a broader group of issues of a less directly economic nature—issues where a lender's concerns are about the same as those of any other potential owner of the mortgaged property, and therefore the lender's and the borrower's interests are fairly well aligned, except that a borrower will usually have a greater appetite for risk even on these issues. A careful lender may want its lease review process to cover these issues as well.

Finally, Section VI examines some issues that a lender will care about, but where a landlord (borrower) will probably have no direct interest. These issues relate to protecting the lender's interests, without particularly helping the landlord, when the lender does not (yet) own the mortgaged property.

Although this article addresses lease review in the context of a mortgage loan closing, many of the same issues arise when an investor considers acquiring the same property. Thus, the same issues also arise when a landlord and its counsel negotiate new leases, thinking ahead to a future mortgage loan and ultimate sale.

II. SOME PRELIMINARY QUESTIONS: DEFINING THE LEASE REVIEW

When lender's counsel begins to think about the existing leases in a building that will secure a new mortgage loan, he or she should ask some preliminary questions to help define the job to be done, even before anyone reads the first word of any lease.

A. What Lease?

Landlords and tenants often amend leases. If amended more than three or four times, they readily become a confusing mess because of sloppiness and imprecision in drafting. Some amendments won't look like amendments. Instead, they'll take the form of letter agreements that, for example, confirmed the exercise of an option and added some space, perhaps adjusting the rent for that space. Sometimes landlords and tenants amend leases in other strange ways, such as through estoppel certificates.

It usually makes sense to read the most recent amendment first, then go backwards in time. The more recent amendments will often amend and restate the most important financial terms. In an extreme case, counsel may want the borrower to agree to try to amend and restate the entire lease after the loan has closed, to mitigate the risk of issues, inconsistencies, and uncertainty (which will produce issues and concerns if the lender ever tries to sell or securitize the loan) resulting from the messiness and complexity of the lease documents.

As the first step in any lease review, lender's counsel should try to confirm that the borrower has provided not only the lease, but also every amendment that affects it. Any lease review should indicate exactly which amendments counsel received. This is true even if the lender has requested only the most minimal and abbreviated lease review.

Amendments will tend to address important issues. Any lease review must fully reflect them.

B. Missing Documents

If documents appear to be missing (which usually happens, particularly as a result of disguised amendments as mentioned above), request copies from the borrower (or notify the lender client) immediately. As a common example, if the lease gives the tenant options that the borrower treats as having been exercised, ask for some written confirmation of the exercise—at least the notice of exercise and ideally a letter agreement confirming the exercise and whatever economic adjustments it produced. Absent such documentation, the borrower can usually eliminate any uncertainty through an estoppel certificate, but one needs to identify the requirement early in the closing process, while the estoppel certificates are being prepared.

C. What Deliverable?

A lender should decide early in the process exactly what form of "lease review" the lender wants its counsel to deliver for the particular transaction. At one extreme, the lender may want formal "abstracts" of each lease, a summary of the business terms and of any special "lender issues" the lease might create. Such abstracts often take more time than they justify, creating billing issues and delays. Summaries or charts, even handwritten, may suffice.

Lenders that desire to control costs instead often request an extremely abbreviated memorandum that summarizes only "bullet points" of concern on the leases, not a complete abstract of every lease. Such a memorandum can be informal and need not use complete sentences.

Sometimes, the right "deliverable" consists of nothing at all, beyond a confirmation that the leases reviewed seemed generally consistent with the rent roll, and that nothing jumped out as troublesome. In such a case, lender's counsel should think about what happens if counsel's confirmation turns out to be wrong. Did counsel clearly indicate the scope of the lease review conducted? If so, is that enough to protect the counsel from blame or even liability? Should counsel advise the lender of the risks of conducting a less-than-complete lease review?

In any event, the subject of "deliverables" represents a subject that the lender and its counsel should resolve before the lease review begins and, in any case, before counsel responds to any request for an estimate of legal fees or timing for the closing. Large and open-ended lease review projects can cause billing problems, surprises, and delays. Changing the scope of the project once it has started will only make it worse.

Here are some more thoughts on techniques to control the lease review process:

- Existing Abstracts. If the borrower has already prepared abstracts of the leases, the lender may be willing to rely on them, particularly if competent counsel prepared them and lender's counsel can randomly spot-check them. But did the borrower sign any further lease amendments after preparing the abstracts?

- Shared Abstracts. Borrower and lender can engage a single law firm or due diligence contractor to prepare lease abstracts, taking into account the directions of both borrower and lender. Borrower's counsel

may be willing to address its "due diligence" memos and lease reviews to the lender as well, although any such additional "reliance" will often create its own issues. When borrower's counsel learns that someone else may "rely on" its work product, the exercise sometimes attracts the same scrutiny as issuance of an opinion of counsel, whereas until that point it was just a routine due diligence process.

- Marked Copies. A borrower might have, or easily be able to prepare, copies of its leases marked to show changes from its standard form of lease. Those marked copies would let lender's counsel focus on deviations from the standard form rather than potentially considering every paragraph of every lease. Occasionally, property owners prepare their execution leases in the ordinary course in a way that highlights deviations from the standard form, just as a marked copy of the lease might.

- Compromise on Presentation. Instead of requiring beautifully word-processed abstracts, the lender might settle for lease review forms, filled in by hand and not thereafter edited or reformatted.

III. DEALING WITH PROBLEMS

The lease review process exists to identify any problems or issues that might exist in the leases. Once a lender or its counsel identifies those issues, some may occasionally (rarely) rise to a level high enough that they would lead the lender not to close the transaction. Others may lead the lender to establish reserves, special covenants, or other measures to resolve or mitigate whatever risks the lease review process identifies. In other words, the lease review process does not occur in a vacuum. It represents part of the process of structuring and closing the larger transaction, and even defining some of its economic terms. For that reason, a lender and its counsel should keep these points in mind in any lease review process:

- Problems and Exceptions. Although the lease review process must in part confirm that the leases support the rent roll, the lender and its counsel should try to focus on exceptions and problems, and report them and act on them when found.

- Assumptions. Don't assume that the leases are "right." To the contrary, assume they hide mistakes and surprises, or at least might do so. That's the whole purpose of the exercise.

- Early Identification. Try to identify any problems as early as possible in the process. They may require lease amendments or other cooperation by the tenant, all of which will take time and may drive the closing documentation. Because the importance of any problem will usually multiply for a larger or more important lease, start reviewing those leases first.

- Remedies. Any analysis of a problem in a lease is not complete without taking a look at the rights and remedies the lease creates if an issue ever arises. For example, a lease might grant a tenant an "exclusive" right to sell a particular type of product in its space. But the lease may also say that if landlord violates the "exclusive," the tenant can only claim a nominal and meaningless credit against rent—with no right to terminate the lease. The limited nature of the tenant's remedy would probably make any lender less con-

cerned about the "exclusive" clause. More generally, whenever any problem shows up in a lease, lender's counsel should also focus on the parties' rights and remedies in the context of that particular problem.

- Sounding the Alarm. To the extent that a lease review discloses discrepancies or concerns, counsel should note and report them to the client, quickly, in a way that brings them to the appropriate people's attention. Don't mention them as footnotes or textual discussion buried in a voluminous report about the leases as a whole, most of no particular concern to the lender. Merely writing a little note somewhere, which someone else will have to notice, read, and think about, doesn't necessarily do the job of calling attention to the problem. Don't assume anyone will actually read or think about whatever report you write.

In general, if lender's counsel discovers a problem with a lease, the lender will usually have only five choices, some of which may lead to changes in the loan documentation:

- Do Nothing. In most cases, the lender will decide to live with the problem and whatever risk it creates. If the risk later "hits," whoever reviewed the lease will simply need to show that he or she identified the problem and disclosed it.

- No Loan. Decline to make the loan. Although lenders occasionally do choose this option, it can damage relationships and sometimes conceivably lead to liability, or more often just threats of liability, if the documentation to date (application, term sheet, or commitment letter) does not give the lender adequate escapes. Lenders also sometimes use the possibility of not closing the loan as a mechanism to encourage borrowers to go solve the problem some other way—essentially a game of chicken between borrower and lender.

- Mitigating the Risk. Figure out a way to mitigate the problem and whatever risk it creates. For example, the lender might establish a reserve or tailor additional documents to give the lender additional controls or protections tailored to the circumstances.

- Borrower Quick Fix. In rare cases, the borrower will be able to "fix" the problem before closing. When this option is available, it will usually be the lender's first choice. This could, for example, involve a lease amendment or waiver, or adding a paragraph to the estoppel certificate to be signed by the tenant. A tenant may and may not cooperate, though.

- Borrower Slow Fix. The borrower might conceivably be able to solve the problem after closing. In these cases, the loan documents will need to define the borrower's obligations. If the "fix" will require cooperation from third parties, as it usually will, the parties need to recognize that those third parties might not cooperate. Therefore, they need to deal with backup measures, instituted either at closing or if the borrower has not fixed the problem after a certain time.

To the extent that the lender and the borrower agree on measures to solve a problem in a lease, the lender will also usually want to satisfy itself that those measures will work not only for today's loan closing, but also for any future loan closing with some other lender that might later refinance this lender. Today's lender

cares about future lenders because today's lender wants to make sure the borrower can later refinance the loan. Otherwise, this lender may find itself "stuck holding the bag."

On the other hand, each possible future lender may have its own agenda and own concerns. Something that one lender cared about a lot, another lender may disregard. And tomorrow's lender may care about issues that today's lender never even considered. Still, the universe of concerns of a future lender seems relatively limited and predictable, and today's lender will want to consider them.

If a lease lacks some provision that today's lender regards as important, the borrower might suggest a mechanism that gets past the problem for today's closing but will not necessarily help for the next closing, the one that will refinance today's loan. For example, the tenant might issue a letter to the current lender that solves the problem, but the letter might not also benefit the next lender. In that case, although today's lender can go ahead, it may also look ahead and be concerned about a future refinancing, and insist that the borrower develop a longer-term solution to the problem, perhaps in this case as simple as having the letter addressed to the borrower and its present and future lenders.

Once lender's counsel identifies a problem and lender decides borrower will need to solve it, the lender will need to fit that requirement into the larger closing. It will become part of the closing checklist. Lender and lender's counsel should track it and make sure it gets done and doesn't fall between the cracks.

IV. GENERAL AND FINANCIAL QUESTIONS

This Section IV offers a more specific checklist of the basic points that typically matter when counsel reviews any lease to confirm its basic financial terms. In each case, lender's counsel should check these points against the rent roll. To the extent that any it does not match the rent roll, lender's counsel should mention the inconsistency in the lease summary—whether it is "good" inconsistency (the facts are better than the rent roll suggests) or "bad" inconsistency (the opposite). Either type of inconsistency may affect the lender's decision process or even the ultimate business terms of the loan. At a minimum, "good" inconsistency may raise doubts about the reliability of the rent roll and the borrower's management.

A. Tenant

In their zeal to uncover hidden issues or problems in a lease, anyone reviewing a lease should not lose sight of a dumb basic issue that should jump out from any lease for anyone who pays attention: Exactly what party signed the lease as tenant? If the lender assumes the tenant is a creditworthy chain or other large company, is that creditworthy entity in fact the tenant? Or is the tenant some less creditworthy affiliate with a confusingly similar name? Discrepancies and differences in the tenant's name may not jump out of the page, but catching them may represent the most important issue—as well as the easiest issue to explain and the easiest one to miss—in any lease review project. Although courts sometimes look beyond confusingly similar names and find a parent company liable under a lease that a subsidiary signed, no lender wants to rely on any such result. No counsel wants to miss that issue.

B. Space

The lease should identify the address of the building and the leased premises within the building. Uncertainty can lead to disputes if, for example, some area is "burdensome" to maintain or repair, and neither landlord nor tenant really wants responsibility for it. Larger premises are not always better premises for a tenant. Sometimes the lease will need to identify the size of the leased premises, though by no means always. Any lease review should indicate whether the tenant has exercised shed rights or expansion rights and should note the existence of any unexercised rights. Do any unresolved issues exist on the consequences of a tenant's exercise of such rights?

C. Term

When does the lease expire and what extension options does it give the tenant? Flag the existence of any expired lease or informal month-to-month extensions, as these potentially impair reliability of income. Does the file suggest any ambiguity, uncertainty, or dispute about whether a tenant in fact exercised an option and, if so, how that affected the rent, the tenant's other obligations under the lease, or the expiration date? To the extent that the tenant has renewal options, must the tenant make its decision far enough in advance so that if the tenant doesn't want to renew, the landlord (or the lender or other owner of the property after foreclosure) still has enough time to re-rent the premises without risk of an interruption in rent?

D. Rent

Check the tenant's main rent obligations, which will typically consist of some combination of these: (a) fixed or base rent, payable based on a schedule (almost always monthly) in the lease; plus (b) escalations, whereby the tenant contributes to (i.e., protects the landlord and lender from increases in) real estate taxes, operating expenses, or other expenses of the building; or sometimes (c) percentage rent, a percentage of the tenant's gross sales.

Sometimes leases will allow the tenant to claim credits against some of these rent obligations. For example, if the lease requires the tenant to pay real estate taxes, the lease may allow the tenant to credit those payments against percentage rent above a certain level. Those "credit" rights may not appear in the percentage rent section of the lease. The lease reviewer will need to watch for them elsewhere, often at the very end just before the signatures or in an amendment.

Particularly for leases that the landlord signed relatively recently, the lease reviewer will want to look for any uncertainty about the "base amounts" that define the tenant's obligation to contribute to real estate taxes or operating expenses. If these base amounts have not yet been determined or finalized, the tenant may later be able to reduce its escalation rent by asserting a higher base amount than whatever the parties assumed. If any lease raises this concern, counsel may simply want to note it for discussion. There may be ways to deal with it, or it may simply amount to a risk that the lender will need to understand and accept.

E. Security Deposit

How much of a security deposit did the tenant provide? Watch out particularly for any form of security deposit other than cash, such as a letter of credit. If these security deposits are substantial, the lender may want to hold—or at least control—them, particularly if the lender requires a lockbox or other cash-management measures for the mortgaged property. The measures to allow a lender to take control of unusual security deposits may require attention early in the closing process, particularly to the extent that they may require cooperation from third parties, starting with the tenant but also often including a bank or other financial institution.

At a minimum, counsel may want to suggest that the lender confirm the landlord still has the security deposit. If the security deposit arrangements take the form of something other than cash, the lender will also want to know that they still exist and, for example, that any letter of credit has not expired.

F. Construction Obligations

If the building is still under construction, or if the lease for some other reason was signed only recently, it may still obligate the landlord or tenant to complete or pay for certain construction to prepare the space for the tenant's business. Any such obligations will typically concern a lender, because they introduce construction-related risks that should not arise for a stabilized building. Lender's counsel will typically want to answer at least these questions:

- Landlord's Obligations. What construction must the landlord still perform, whether on the premises, in the common areas, or elsewhere, even potentially off site? Does the lease clearly define these obligations? Does the file suggest any sign of disputes, delays, or uncertainty about the landlord's completion of its work?

- Remedies for Late Delivery. If the landlord does not finish its construction on time, what can the tenant do? Can the tenant claim a rent credit? Can the tenant terminate the lease? May the tenant perform the work itself and offset rent?

- Monetary Obligations. If the landlord has agreed to make a cash contribution to the tenant's construction work, how much is that contribution and what conditions must the tenant meet in order to receive it? The lender will also want to understand how the landlord plans to fund the contribution and assure it will be available when required. Often, the loan will include a line item to fund these landlord obligations. In those cases, the lender and its counsel will want comfort that the lease requirements and the loan availability match up.

- Tenant's Remaining Work. How much work does the lease say the tenant will perform? Is there anything about the work that makes it appear uncertain or difficult? Must the landlord participate in the tenant's work in ways that may become expensive or complicated? And, again, does anything in the file suggest disputes or problems have arisen about that work?

V. LANDLORD'S LEASE ISSUES

Beyond the basic economic issues listed above, a lease raises a wide range of issues about the relationship between landlord and tenant—every possible event or circumstance that can occur in a potentially complicated piece of real estate over a long period. For most of those issues, the lender's concerns largely match the landlord's. A lender will, however, often worry more than the borrower—particularly about any issue that might interfere with the reliability of cash flow—based on the lender's more "downside" orientation.

A borrower may, for example, be willing to tolerate some small risk of an impairment of rental income if that is the price of "getting the lease" or if the borrower regards the risk as immaterial "in the grand scheme of things." In making that decision, the borrower has probably identified both the "downside" and the "upside" in the project as a whole, and accepts the former as the price of the latter. A lender attaches less weight to the possible "upside" and cares more about preventing the "downside." Hence it will weigh risks differently than might a borrower. A lender will care about small risks that a borrower might ignore. A borrower, innately more optimistic, will also be more likely than a lender to believe that it can control or mitigate any risk that the lease creates, whereas the lender may see only risk.

Because a routine space lease can potentially deal with hundreds of issues, the range of possible concerns to a lender is almost limitless. A lender could, if it wished, have its counsel review any lease—or selected leases in a building—with the same level of detail and concern as if the lender were a potential landlord of the building, or negotiating or approving the lease in the first instance. This approach is unusual and highly inefficient.

Instead, a lender will typically assume that most of the nonfundamental terms of an existing lease are commercially tolerable, because: (a) the lender isn't really the landlord; (b) the lender's loan-to-value ratio gives the lender a cushion to tolerate some imperfections in the leases, except potentially substantial direct threats to reliability of cash flow; (c) such imperfections will probably not lead the lender to walk from the deal, so they are not worth the time they would take to find; (d) the lender has some confidence in the borrower's ability to negotiate and manage leases—a process that is fairly well-defined and manageable by most borrowers if they have any experience or competence; and (e) a full review of every term of every lease makes no practical or economic sense.

These lease issues are those that any lender will probably place at the top of its list of issues. Most are not directly, but are instead indirectly, economic because they affect possible interruption or loss of income, the lender's primary concern. Others affect a range of lender concerns not necessarily tied to loss of income.

A. Casualty and Condemnation

A lender will want to assure that if the building burns down or a government acquires it for public use (however defined), the lender understands how that loss will affect rental income and the continuation of the leases in the building. The lender does not necessarily expect tenants to continue paying rent if they

can't occupy their spaces. A lease that imposes such a requirement may create more problems than it solves. Here is a short summary of the lender's agenda in this area, when considering a routine space lease:

- Rent Abatement. Understand and summarize, very briefly, when and how the lease allows the tenant to abate rent after a casualty or condemnation. Typically, a lender will accept reasonable rights to abate rent in proportion to the tenant's inability to use its premises. A lender will even usually tolerate provisions that allow a tenant to terminate its lease if the unusability continues for a certain period. A lender's tolerance for these provisions will be greater in small leases than in large leases. The lender also wants to confirm that the provisions allowing the tenant to abate rent and terminate the lease make sense and dovetail with the borrower's actual insurance coverage and the insurance requirements in the loan documents. This may require coordination with the borrower's insurance broker and the lender's insurance advisers, plus tailoring of the insurance provisions for the loan. If lender's advisors identify a disconnect between tenants' abatement rights and borrower's insurance program, the lender will want the borrower to adjust its insurance program—both for the closing and in the loan document requirements for future insurance. Here, as so often happens, the due diligence process and what it uncovers can drive changes in the loan documents.

- Where's the Cash? If a loss occurs, the lender will not want the tenant to take any of the insurance or condemnation money that would otherwise go to the lender—which would make these unavailable to repay the loan or restore—or to require the borrower to apply those funds in a manner inconsistent with the loan documents. A lender will therefore want to understand exactly what the lease, particularly a large lease, requires along these lines, and identify any inconsistencies or issues. Strong tenants will often insist on resolving any inconsistencies between their lease and the loan documents in favor of the former, though it's rare for a space tenant to claim any significant amount from casualty or condemnation proceeds. A lender will want to know that the lease allows landlord to use insurance or condemnation proceeds to restore, with any excess going to landlord and its lender, all under reasonable and typical terms and conditions that the lender can accept. As long as those terms and conditions are generally reasonable, a lender will probably not want its counsel to spend the time to confirm that they match perfectly the requirements of the loan documents.

- Restoration Procedures. If the lease does require the landlord to restore, the lender will want to confirm that nothing in those restoration procedures will create risks or concerns for the lender. As an extreme example, if the lease requires the landlord to restore but provides that a noncreditworthy (or potentially noncreditworthy) tenant will hold the restoration funds while the process goes forward, a lender would regard such a provision as troublesome. A lender will also want to satisfy itself that if the landlord actually does restore in a prompt manner, the tenant will remain in place under the lease, and the deadline to restore is not unrealistically short.

B. Go Dark

If the lease covers retail space, particularly in a building with other retail tenancies or in a mixed-use project, the lender will want to confirm that—at a minimum—the lease requires the tenant to open for business by a certain date. The lender will then ideally want to ensure that the tenant must continue to operate after

opening. This issue will matter particularly for large anchor stores, which typically pay a lower rent based on the assumption that by being open for business they will attract customers for the benefit of everyone else at the property.

If the lease allows one of these major tenants to close up its operations at whim, this undercuts the assumption that drove the economics of the lease and the property. Although the lease would require the anchor tenant to continue to pay rent after closing, major chain stores have been known to do exactly this (and gladly!) when they open a new location across the street and want to prevent a competitor from opening at their former location. Any such closure by an anchor tenant can imperil the viability of other tenants and hence, ultimately, viability of the entire property. Courts will occasionally infer an "implied" covenant of continuous operation, but no lender wants to rely on that possibility. Lenders and their counsel will, and should, therefore usually assume that unless a lease obligates the tenant to operate, the tenant can shut down at any time, a possibility that will and should raise concern for the lender.

If a retail lease does not contain a covenant to operate, then counsel should flag that omission as an issue. But a lender will typically not be concerned about reasonable exclusions from the covenant to operate, such as temporary closures to take inventory, construct alterations, or the like—as long as the exceptions are not so broad that they consume the rule.

Although tenants will sometimes agree to remain open and continue operating without qualification, most tenants refuse to incur such open-ended obligations, arguing that if it no longer makes business sense to remain open they should not be obligated to do so.

As a common compromise, major tenants often agree that if they shut down for a certain period, the landlord can terminate the lease and take back the vacant space. The details and mechanics of these landlord termination rights will vary widely from project to project, but a lender will care a lot about them, particularly for anchor tenants or if the lender considers termination likely. Some examples:

- Landlord's Kickout Payment. If the landlord must pay the tenant when terminating the lease (e.g., "reimbursement" of the tenant's fixturization costs), just how much will the landlord need to pay? Usually the lease will set up a formula, often not entirely clear. At a minimum, the lender may want to try to analyze how much the landlord would actually need to pay. The lender may want to go a step further, and obtain specific comfort from the tenant about the measure of the payment. As an example, these payments often take into account the tenant's unamortized balance of its leasehold improvements. The lender may want the tenant to confirm in an estoppel certificate just how much the tenant spent on leasehold improvements, and how the tenant is amortizing that investment. That calculus represents an example of how the lease review process may drive the closing requirements, in this case through an estoppel certificate.

- Funding. If the tenant "goes dark" and the landlord decides to terminate the lease and make a termination payment, how will the landlord fund that payment? The lender will realize that if the borrower ever needs to make that payment and then find a replacement tenant, the borrower will probably try to persuade the lender to advance the necessary funds, which the lender may or may not want to do. For that reason, if

the lender cares about the issue and sees a reasonable likelihood that it might arise, based on its assessment of the anchor tenant's future at this location, the lender might want to establish a reserve or an additional line item in the loan to assure a funding source.

- Tenant's Kickout Payment. Conversely (and less likely for "go dark" terminations of anchor leases), if the tenant must pay the landlord for any such termination, where does that money go and what will the landlord use it for? The landlord will probably incur costs to re-tenant the space. As a general question, whether or not the tenant must pay for the termination, how will the landlord cover its re-tenanting costs without coming to the lender looking for more money? And how will the landlord make up for lost rent while the borrower finds a replacement tenant? Usually a lender will agree to apply the termination payment to cover all these costs, provided they are bona fide and reasonable. But what if the costs exceed the termination payment? Who covers the shortfall?

- Timing. Does the timing of the termination right give the landlord a reasonable time to find a replacement tenant before the old tenant goes away?

- Control Over Termination. Look carefully at how the termination right actually works. Does the borrower control it to the exclusion of the lender? Would it survive a foreclosure? Could the borrower use its control over the termination right to create leverage against the lender? For example, if the termination right is a "one time only" event, the lender may fear that if the borrower and the lender are in litigation at the time the termination right arises, the borrower might—simply to gain leverage in the dispute with the lender—refuse to exercise the termination right even though it makes economic sense for the building. The lender may prefer that the termination right remain in effect indefinitely, or at least arise periodically, so that once the borrower and the lender resolve their dispute and (hypothetically) the lender owns the building, the lender will still have some reasonable opportunity to terminate the lease if the anchor tenant stays closed.

- Lender Consent Right. Conversely, if the lender does not want to terminate the lease but the landlord does, does the lease (or a separate agreement) protect the lender by saying that the termination will not be effective without the lender's consent? Does that restriction bind the tenant? If the lender fears a termination without its consent, the lender may want to tailor the nondisturbance agreement with the tenant accordingly.

- Required Activity Level. What level of activity in the space must the tenant continue to show to protect itself from termination? Will that level of activity meet the lender's expectations for the space and the project? For example, operation of two subleased flea market booths in the back corner of the space should not suffice to protect a tenant from termination.

For any retail project, issues about the tenant's obligation to operate, and the possibility of closure, will often reside near the top of any lender's list. If lender's counsel does not remember to look for these issues, they are easy to miss because the concern arises more from what the lease doesn't say than from what it does.

C. Abatement Rights

Does the lease allow the tenant to abate or offset rent? (Disregard casualty or condemnation abatements, which raise separate concerns, if any.) A tenant's rights to abate rent will often tie to the tenant's "self-help" rights—rights of the tenant to cure the landlord's defaults and offset the costs against rent. Major tenants will often negotiate these rights if the landlord fails to complete required construction or fails to deliver required services or utilities and the failure hurts tenant's business. In extreme (and rare) cases, the tenant may obtain these rights for any landlord default at all.

For a major tenant, a lender may simply have to live with abatement rights. But the lender should begin by understanding exactly what they are. At a certain point they become intolerable. At some earlier point, they may lead to tailored language and negotiations in the loan documents.

Ideally, the tenant will not be able to activate any "self-help" or abatement rights without giving the landlord and the lender plenty of notice and opportunity to correct the situation. Moreover, the tenant's self-help and abatement rights should apply to as few of the landlord's obligations as possible. For example, a lease that lets the tenant abate rent for delays in initial construction or for interference with the tenant's network control center is far more palatable than one that allows the tenant to self-help and abate whenever the landlord defaults in any way.

A practical lender may also recognize that a tenant rarely exercises any "self-help" or abatement rights, particularly if the landlord manages the property in a competent way.

D. Assignment/Subletting

If a tenant is particularly desirable, the existence and continuation of that tenant may be a substantial element in the lender's approval of the loan, both because of the tenant's creditworthiness backing part of the rent stream and (for a retail lease) because of the traffic and visibility the particular tenant can bring to the property.

In those cases, the lender may care a great deal about whether and under what circumstances the lease allows the tenant to assign or sublet. Typically, even if the lease allows assignment or subletting, a lender will live with it as long as the original tenant remains liable under the lease. On the other hand, a lender might take a harder line, saying that the possibility of an assignment or sublet creates the possibility of an unexpected change in the character and use of the property. It all depends on the circumstances. A lender will often conclude that the borrower's equity cushion provides adequate comfort so the lender doesn't have to worry too much about the risks of assignment and subletting.

Unless a lender has instructed its counsel that special circumstances exist, any lease review should probably answer at most these questions about assignment and subletting under any major lease:

- Assignment/Subletting. Does the lease let the tenant assign or sublet, and if so to what degree and within what constraints? To the extent that the lease grants the tenant flexibility, can the lender tolerate that level of flexibility and the long-term uncertainty it creates for the landlord and lender?

- Release of Liability? Does the lease contain any language that would allow the original tenant or its guarantor to be released from liability upon an assignment? Any such release from liability amounts to a "red flag" that counsel should bring to the lender's attention promptly. This issue will be important if the initial lease obligor is creditworthy, and less important or not important at all if that initial obligor has no meaningful credit.

- Recapture Rights. Does the landlord have the right to terminate the lease ("recapture" the space) if the tenant wants to initiate certain types of assignment or subletting? Does the timing work and does the lender want to be involved in these decisions and any related re-leasing decisions? (Many loan documents restrict new leases and any lease amendments. Fewer require lender approval for assignments and subleases that require the borrower's approval.)

- Change of Use. Does the lease offer any flexibility for a change of use if the tenant assigns or sublets? Does the flexibility create potential problems for the future economics and attractiveness of the property? Might the lender fear that a permitted change of use could create some intolerable situation from the lender's perspective?

E. Termination/Cancellation Rights

If a lease allows the tenant to terminate under any circumstance beyond casualty and condemnation (as discussed above), this will probably create substantial concern for a lender. Here are some examples of "bad" termination rights from a lender's perspective:

- Sales-Based. Right to terminate for failure to achieve specified level of sales.

- Right to terminate if some other tenant (or group of tenants) is no longer in occupancy, or never enters into occupancy.

- Landlord Default. Termination rights arising from a possible landlord default.

- General. Unilateral right of the tenant to terminate, even if the tenant must make a payment to the landlord.

- Bad Timing. Tenant right to terminate without giving enough notice for the landlord to find a replacement tenant.

In some types of project, the lender may just need to live with these termination rights, as tenants typically obtain them. In those cases, the lender will need to assess the likelihood that any termination right will actually arise. If the project is somehow "on the edge," with a higher than normal risk that these rights might activate, the lender might insist on negotiating some backup mechanism to pay for retenanting and repositioning should it become necessary. The lender might also mitigate these concerns based on the lender's comfort with the borrower's management skills, and ability to prevent problems. If the lender goes too far down that road, though, it stops being a traditional commercial real estate loan.

F. Unreasonable Burdens

A lender will also worry about any lease that imposes unusual and atypical burdens on the landlord. In the short term, such burdens may produce unpredictable adverse effects on cash flow or increase the likelihood of mistakes, issues, or complexity. In the long term, the lender must see itself as a successor landlord, i.e., the most likely owner of the property after any hypothetical foreclosure. In that capacity, the lender will not want to bear obligations that vary dramatically from those of a typical passive landlord receiving a steady stream of real estate income. Any lender's counsel reviewing a lease should therefore look for unusual or burdensome obligations or restrictions affecting the landlord, such as:

- Transfer Restrictions. Beware of prohibitions on transfers by the landlord or by the ultimate owners of equity interests in the landlord. In assessing any such restriction, lender's counsel must ask whether it will significantly impair the lender's exit strategy (including, in the first instance, the lender's ability to conduct a foreclosure sale). In general, both lenders and landlords highly disfavor any restriction on transferability of the landlord's position.

- Restrictions on Other Property or Activities. Watch out for anything at all that restricts the landlord's operations, leasing, activities, construction, or use of—or anything else involving—the landlord's property outside the leased premises. Some examples in this category would include restrictions on signage, "exclusive" rights for a particular tenant, restrictions on leasing to particular types of tenants, obligations to maintain particular parking, uses, standards, "no-build" areas, lines of visibility, circulation pathways, and the like. Strong tenants may even sometimes impose "radius clauses" on their landlords, prohibiting the landlords and their affiliates from leasing space to competitors in any other properties the landlord or its affiliate owns within the radius area. Any major retail lease will probably restrict at least some landlord flexibility within the same property where the leased premises are located. Lender's counsel should identify these restrictions—know what to look for—and then bring them to the client's attention. The lender must then decide whether they create a problem. To the extent that they merely restate what any reasonable landlord would or would not do in any way to maintain an economically viable property, a lender often won't care. But it is ultimately a decision for the lender to make in the context of the transaction as a whole. And if the landlord obligations relate to real property outside the scope of the lender's collateral, even "reasonable" provisions can create serious problems. If the lender were to foreclose on this particular property, could it control what happened elsewhere?

- Subtenant Recognition Traps. A substantial lease may allow the tenant to enter into subleases. To facilitate those future subleases, the lease may obligate the landlord to enter into agreements with subtenants ("recognition agreements" or "nondisturbance agreements") by which the landlord agrees that if the landlord-tenant lease ever terminates, then the landlord will recognize the subtenant as a direct tenant. A tenant's and a subtenant's desire to obtain recognition agreements from the landlord makes perfect sense, but a landlord—and hence a lender—must remember that these agreements could force the landlord to become a direct landlord under whatever sublease the tenant negotiates. Therefore, before a landlord agrees to enter into recognition agreements with any subtenant, the landlord must know that the terms of the sublease will be tolerable to the landlord. One can develop scores of criteria to define what would be "tolerable," but ultimately the lender may insist on having the right to reasonably approve any sublease before giving the subtenant any protection.

- Unusual Obligations. Does the lease impose on the landlord any obligations that are difficult to perform, not capable of being quantified, or outside the scope of typical landlord obligations under a lease? As an example, a lender may be concerned if a lease allows the tenant to require future upgrades to building systems without defining what those upgrades are. Obligations to provide building security may also create concern.

G. Options

Although expansion and renewal options in and of themselves do not typically cause great concern, they can create serious problems if they are: (a) significantly below market; (b) conflicting; (c) on uncertain terms; or (d) scheduled in a way that denies the landlord sufficient time to find a replacement tenant if the tenant does not exercise an option. Any landlord also should consider how the options interact with the possibility that landlord might recover possession of leased space before the scheduled expiration date of an existing lease.

For a substantial property, parsing out the options and how they might interact over time can be a very large project, which someone else can do or has probably done, but whose work will still require checking. If the leases suggest the need for such an exercise, lender's counsel should try to recognize the possible problem as early as possible, and determine how to proceed. Counsel will typically want to advise the lender to insist on a complete analysis of all the options, to confirm that none potentially conflict under any circumstance.

Any purchase option, or even a right of first refusal or first offer to purchase, should raise an immediate red flag. Such options are very atypical in space leases, even the largest space leases, and can and should create substantial concern for a mortgage lender and its counsel. At a minimum, a lender will insist that they not apply to a foreclosure (or substitute) transfer, and no longer apply to any post-foreclosure owner.

H. Exculpation

Does the lease say that, no matter what, the landlord's liability will always be limited to its interest in the premises? Any landlord and any lender will always want to see such a provision, although a lender that really wants to make a particular loan can usually figure out a way to live without such language. The lender can, after all, probably send a suitable subsidiary to bid at the foreclosure sale and take title to the asset if the

need arises. That way, the lender may be able to get comfortable with the lack of an "exculpation" clause, although a conservative lender may worry about the risk of forgetting about the problem and taking title in its own name. Substantial institutional lenders have been known to make mistakes like this, at great expense.

I. Protection on Alterations and Contest

Many leases give a tenant some flexibility in two areas that can produce direct economic loss to the landlord: alterations and the tenant's right to challenge the validity of legal requirements that apply to the building.

In the case of alterations, if the tenant does not pay for any construction work, the unpaid contractors and other parties may have the right to file a mechanic's lien. In some states, that lien attaches to both the tenant's leasehold and sometimes even the landlord's fee estate. In the worst case, a mechanic's lien may obtain priority ahead of the lender's mortgage. The landlord and sometimes even the lender may therefore find it needs to pay the tenant's construction bills to protect itself from a foreclosure under the mechanic's lien.

Similarly, if the lease allows the tenant to contest the application of particular legal requirements, the landlord and lender may find themselves stuck with the adverse consequences if the tenant's contest fails and the tenant chooses not to, or cannot, comply with the legal requirements as finally determined.

A landlord may mitigate each of these risks by requiring the tenant to post a bond if the lien or amount at issue in a legal contest exceeds a certain level, depending on the size of the lease and the landlord's comfort with the tenant. A lender will have similar concerns, but often more strongly felt than the landlord's. A landlord may be willing to waive any requirement for bonds, in the interest of "getting the deal done," but a lender may not want to be as flexible and accommodating.

Therefore, if a lease does not require the tenant to post bonds under the circumstances described here, counsel will probably want to bring the issue to the lender's attention, so the lender can decide whether it creates a serious problem.

J. Concessions to Creditworthy Tenants

Leases with unusually creditworthy tenants—such as a chain store that has not yet filed bankruptcy or has completed its latest round through bankruptcy and has not yet started to consider the next one—will often contain concessions to the tenant premised on the assumption that the tenant is creditworthy. For example, tenants of this type will often not be required to post bonds of the type suggested in the preceding section, because the landlord believes the tenant's credit is good enough to eliminate any need for bonds. The landlord may also dispense with a security deposit, loosen the "use" clause, agree to significant restrictions outside the leased premises, give the tenant extra flexibility on its activities in the space, and so on, all premised on the notion that the tenant is creditworthy and therefore these concessions make sense to "get the deal."

What happens though, if during the long life of the lease the premise for all these concessions turns out to be wrong? To the extent that the lease contains concessions to the tenant based on that tenant's credit quality, the landlord (and particularly the lender) may want those concessions to go away if the tenant's

credit quality goes away. Any such "concession clawback" provisions are quite unusual, but recent history—particularly with chain retailers once regarded as having impeccable credit—demonstrates that such "clawbacks" may become quite important and relevant.

To the extent that: (a) a lender is uncomfortable with any tenant-oriented concessions based on the assumption that the tenant is creditworthy; but (b) the lease does not provide for a "concession clawback" if the tenant becomes less creditworthy, a lender may regard that fact as a serious problem with the lease. It might also not care, or decide it can live with the risk. But this issue represents a business decision that cannot be made unless counsel identifies and raises it in the lease review process.

VI. LENDER PROTECTION ISSUES

For most of the issues discussed so far in this article, the concerns of the borrower (landlord) and the lender (possible future landlord or seller to the next landlord) are quite similar. Both share each of these concerns, although a lender may care more than a borrower because of the lender's more conservative and "downside" orientation.

For another category of issues, though, a landlord or borrower will probably have no direct interest at all. Instead, the landlord or borrower will only have an indirect interest in making sure that a lender—today's or tomorrow's—will not object to the lease.

The issues in this latter category relate to the relationship between the tenant and the lender, and the effect of a loan default or other possible problems with the mortgaged property. Any lease review project may need to consider these issues, though their importance will vary depending primarily on the size and importance of the lease, as well as other circumstances.

A. Estoppel Certificates

Does the lease require the tenant to provide estoppel certificates, i.e., certificates confirming the continued existence and status of the lease, that the tenant has no claims against the landlord, and similar matters? Does the lease establish any burdensome restrictions or limits on the landlord's right to obtain estoppel certificates? A lender will want the tenant to be unambiguously obligated to deliver an estoppel certificate for today's closing, as well as for any future closing. And the lender will be uncomfortable to the extent that anything in the estoppel certificate might limit the lender's (or a future lender's) ability to rely on it.

B. Priorities

In a lender's perfect world, the lease will simply say that it is subordinate to all mortgages. But leases with substantial tenants rarely contain such a provision. Instead, subordination will at a minimum be conditioned on the lender's entering into a nondisturbance agreement. These agreements and this relationship create a host of issues, which generally attract far more negotiation and attention than they justify. For a typical lease review, lender's counsel just needs to make sure its client understands what the lease says about

this issue. Specifically, the lender needs to know the answers to these questions:

- Subordination. Does the lease say it is subordinate to mortgages?

- Nondisturbance. If so, is subordination of the lease nevertheless conditioned on the lender's delivering a nondisturbance agreement?

- Conditions. What must that nondisturbance agreement say? Will this lender or a hypothetical future refinancing lender be willing and able to satisfy those requirements? Does the lease define the form of the nondisturbance agreement, and will a lender tolerate it? Can the landlord satisfy its nondisturbance obligations by providing whatever form of nondisturbance agreement a future lender might require?

A lender would prefer to see any subordination clause be as simple and straightforward as possible, with no need for the lender or landlord to remember to do anything at all. If the lease conditions subordination on the lender's entering into a nondisturbance agreement, then lender's counsel should note this fact, and the necessary agreement must then be entered into as part of the closing, another example of how the lease review process can drive closing requirements and why it helps to identify those requirements early in the process.

If the lease requires a nondisturbance agreement that the tenant gets to approve, a careful lender's counsel will assume that the tenant will never approve the agreement, and therefore the subordination will never become effective. When a lease contains such a requirement, lender's counsel should regard it as a red flag that requires immediate attention. For a major tenant, the lender will probably want to resolve any such uncertainty at the time of the closing, as a condition to making the loan. Whatever resolution the parties craft, it should apply not only to today's loan closing but also to any future loan closing.

A lender may decide that it wants to use its own form of nondisturbance agreement, rather than any form of nondisturbance agreement required by any particular lease. For a large building with many tenants, a lender may decide that it is just more efficient to use its own form rather than create a tailored document for each tenant based on its lease. Especially in the case of large tenants, the lender should be prepared to negotiate the required nondisturbance terms and conditions into the lender's form. Of course, a lender's willingness to tolerate these terms may depend on the tenant's size and remaining lease term, and how badly the lender wants to make the loan. Lenders with a very low tolerance for any negotiation of a nondisturbance agreement might be willing to close without entering into such an agreement with tenants it deems "immaterial" to the real estate's value. This is especially true where a building is primarily leased to a single "marquee" tenant and the lender doesn't much care about the rest of the tenant base.

C. Attornment

Does the lease require the tenant to "attorn" to anyone who purchases the property at a foreclosure sale, i.e., accept that person as the tenant's new landlord? In most cases, one assumes this new landlord would be the lender or its designee. What conditions and limitations apply to that attornment? Does the lease negate

any possibility that a foreclosure sale might "terminate" the lease and with it the tenant's obligations to the foreclosed-out landlord or any subsequent landlord?

D. Cure Rights

If the landlord ever defaults under the lease, particularly in a way that might entitle the tenant to terminate, a lender might want the right to receive notice of the default and to try to correct the situation. For that purpose, a lender might want some additional time, beyond whatever time the lease gives the landlord. Provisions of this sort are particularly important for leases with major tenants. Even, there, though, they will usually give the lender only a fairly limited additional cure period—far from the degree of additional protection that a lender would expect to see in, for example, a ground lease. In the author's experience, leases will often give a lender at most 30 extra days to cure the landlord's default, and very rarely much more time beyond that. In negotiating a subordination and nondisturbance agreement the lender will probably seek a longer cure period than whatever the lease provides. Unlike the case in a ground lease, though, a possible termination of a space lease would not deprive lender of its entire collateral—just some part of the rental income. And it is not reasonable to expect the tenant to wait around for very long while the lender tries to cure the landlord's default. The tenant needs to be able to operate a business in the leased premises. So, although a lender will often want a right to cure the landlord's default, the cure right may ultimately not be all that extensive. Whatever it is, lender's counsel should note it as part of the lease review.

E. Direct Rent Payment

If the loan goes into default, a lender may obtain the appointment of a receiver to collect rental income from the property. A lender may, however, seek an extra level of flexibility long before that, by having the right to require the tenants to pay rent directly to the lender after a loan default, even if the lender has not yet obtained a receiver. In a lender's perfect world, the lease would contain provisions to this effect, so that the lender (and the borrower) would not need to obtain a separate agreement with the tenant. More typically, however, separate agreements of this type are required. The issue remains one that counsel may want to look for and mention in any lease review, particularly for a major lease.

F. Conditions to Lender Protections

To the extent that the lease builds in protections for a lender of the types suggested in this section, lender's counsel will want to scrutinize those protections to understand what conditions the lender must meet in order for these protections to be activated. For example, if the lease requires the tenant to receive notice before the lender will qualify for a particular protection, the lender will not want to rely on the landlord to remember to give that notice. Instead, the lender's counsel should update the closing checklist to include the notice to the tenant, and the lender and its counsel should make sure the notice is given. It represents yet another example of how lease review can drive closing documentation.

G. One Last Category of Issues

In addition to all the lease-related issues this chapter specifically covers, a lender and its counsel should watch for any provisions in the leases that seem unusual or "weird"—anything that might create out-of-the-ordinary issues or problems. These provisions might include unusual tenant rights, unusual conditions to the tenant's obligations, evidence of a past dispute that may still fester, uncertainty about either party's obligations, evidence of possible zoning problems or disputes, unusual limitations on the landlord's remedies, or anything else that could undercut what the lender wants to see in the lease, as summarized earlier in this article.

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