



Law & Accounting

Entering lease takeover agreements

In order to cement a deal for a lease with a prospective tenant, a landlord often will be asked to "take over" the remaining obligations under the tenant's existing lease. In common parlance, one might believe this means the landlord will assume all obligations under the existing lease, which could include duties of maintenance and repair, liabilities for breaches of covenants by tenant, obligations to restore the premises at the end of the term and other unquantifiable obligations. Landlords, however, desire certainty. As such, landlords prefer to contribute a set dollar amount towards tenant's ongoing obligations under the existing lease, rather than assume the entire lease.

Tenants, on the other hand, want the landlord to assume the existing lease — lock, stock and barrel — allowing the tenant to walk away and never look back after the landlord "takes over." Although this type of true takeover does occur, it is the exception rather than the rule. Accordingly, this article focuses on agreements where the landlord agrees to pay the tenant for specified obligations that the tenant will incur during the remaining term of the existing lease.

There are many questions and issues that a landlord and tenant should consider when entering into a lease takeover agreement, many of which are often overlooked during negotiations. These include, among others, the impact of the terms of the existing lease, representations and warranties, remedies upon default and rights to assign and sublet. Up-front analysis of these issues will help the parties shape the terms of their takeover agreement.

■ **Terms of the existing lease.** The landlord and tenant should review the terms of the existing lease to determine if there are any provisions that are inconsistent with the terms of the takeover agreement. This protects landlord and tenant from unintended and adverse economic consequences. For example, if the landlord is planning to assign or sublet the existing premises to offset its takeover obligations, it is critical to the landlord that the existing lease does not prohibit assignment and



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subletting, and does not have an overly restrictive use limitation.

■ **Obligations the landlord "takes over."** As discussed above, landlords prefer simply to pay the tenant for certain obligations under the existing lease. These typically include the payment of all or a portion the base rent, taxes, insurance and maintenance expenses. The parties should also consider whether the landlord will be obligated to pay for increases in these expenses during the term. Since landlords prefer certainty, they may negotiate for set caps on their obligation to pay for increases or ask for an overall cap on their obligations under the takeover agreement.

■ **Landlord control over assignment or subletting.** Landlords want the right to control assignment and subletting under the existing lease, the income from which can be credited as an offset against amounts payable by landlord under the takeover agreement. If the tenant grants the landlord the right to assign or sublet, the tenant will want the landlord to be responsible for all associated expenses, including brokerage fees, legal fees, tenant improvement allowances and all other inducements promised to the assignee or sublessee.

The tenant's liability exposure increases if there is an assignee or sublessee, since under the existing lease,

the tenant may be held liable for the negligent or intentional acts of, or breaches of the existing lease by, the assignee or sublessee. Accordingly, tenants should seek to have the landlord indemnify the tenant for such liabilities. Notwithstanding the fact that the landlord may agree to indemnify the tenant for such potential liabilities, a tenant may still want to retain the right to "reasonably approve" any proposed assignees or subtenants to ensure that the landlord is not unnecessarily exposing the tenant to imprudent risks.

■ **Representations and warranties by the tenant.** Since the landlord will be undertaking obligations related to the existing lease, obtaining representations and warranties from the tenant serves to reduce the landlord's risks and may provide the landlord with remedies (such as the termination of the takeover agreement and/or the new lease) against the tenant if any representations or warranties prove to be untrue.

The tenant may agree to make representations and warranties about some or all of the following matters regarding the existing lease: 1) current rent payable; 2) current amount of operating expenses; 3) term expiration date; 4) no modifications to the existing lease, other than disclosed; 5) no uncured defaults exist or will exist under the existing lease upon the commencement of the new lease; 6) no prior assignments have been made nor do any subleases exist, except as otherwise disclosed; 7) the tenant will not amend or modify existing lease without the landlord's consent; 8) the tenant will cooperate with the landlord to negotiate the termination of the existing lease if the landlord is willing to make an acceptable termination payment; 9) the tenant will deliver to the landlord a copy of all notices given under the existing lease; and 10) the tenant will provide proof of ongoing payments under the existing lease. If the landlord under the existing lease is obligated to provide an estoppel certificate, then it may also confirm some or all the above information.

■ **Landlord default under the takeover agreement.** If the landlord fails to make required payments under

the takeover agreement, there are many remedies a tenant should consider. A landlord may be required to pay a late fee to the tenant if the landlord pays late. Moreover, if the landlord fails to make payments within a specified time period, the tenant may be granted a right to offset the missed payment(s) against rent due under the new lease.

■ **Tenant default under the existing lease.** If a tenant defaults under the existing lease, it may be an indication that the tenant is facing broader financial problems. Accordingly, landlords prefer to have a default under the existing lease constitute a default under the new lease as well. If the existing lease is terminated, then the landlord's obligations under the takeover agreement should also terminate.

■ **Tenant default under the new lease.** During periods of default under the new lease, the landlord will want to suspend payments under the takeover agreement. If the new lease is terminated as a result of the tenant's default, landlords often attempt to negotiate a "recapture" provision that allows landlord to recover all prior payments made under the takeover agreement. This is done on the theory that the landlord's agreement to make payments was conditioned upon the full and complete performance by the tenant under the new lease. If the tenant agrees to a recapture provision, often it will ask the landlord to prorate the recapture for the portion of the lease term performed without default. For example, with a prorated recapture provision, if the tenant performed for two years of a four-year lease, the landlord would recapture one-half of the takeover payments.

As discussed above, there are many issues facing landlords and tenants when negotiating a takeover agreement. Lease term, representations and warranties, remedies upon default, and rights to assign or sublet are just some of those considerations. While one never can plan for every possibility, landlords and tenants should, at the outset, explore and define the material obligations of the parties to protect themselves from unintended responsibilities and liabilities.▲