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Real Estate Due Diligence in Corporate and M&A Transactions

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In almost every asset purchase, stock purchase, and merger transaction (generally referred to in this practice note as "M&A transactions"), the purchaser will acquire an ownership or leasehold interest in at least one real estate asset. However, the real estate asset(s) do not drive a typical M&A transaction. In most cases, a particular real estate asset will only have significance because of how it will be used in the purchaser's business operations after closing (i.e., the real estate only has incidental value).

If real estate is not driving the transaction, the purchaser may be inclined to forego, substantially limit, or postpone the real estate due diligence commonly performed in a real estate transaction. This practice note provides general guidance and practice tips for a real estate attorney assisting with the real estate due diligence in such an M&A transaction.

Preliminary Items

Timing

The real estate component of an M&A transaction runs more smoothly if real estate due diligence is addressed in the early stages of the transaction. M&A transaction agreements rarely include a due diligence period, and much of the due diligence is performed before contract signing. By addressing real estate due diligence early in the transaction, the purchaser can:

- Identify real estate costs (e.g., transfer taxes) that may be material in the purchaser's pricing decision
- Gain negotiating leverage on real estate issues
- Modify the deal structure to mitigate real estate issues
- Account for real estate due diligence items requiring significant lead time in the deal timeline
- Otherwise factor real estate due diligence considerations in its decision-making process

Confirm the Transaction Structure

The real estate due diligence process varies depending upon how the M&A transaction is structured. At the outset, make sure you completely understand the applicable transaction structure. The three most common structures are asset purchases, stock purchases, and mergers.

- **Asset purchase.** In an asset purchase, the purchaser acquires all (or a portion) of the seller's assets. Unless "successor liability" is imposed pursuant to applicable laws, the purchaser is only liable for those obligations of the seller (if any) that the purchaser expressly assumes under the transaction documents.
- **Stock purchase.** In a stock purchase, the purchaser acquires all of the ownership interests in the target company, and the target company's assets and liabilities remain the same.
- **Merger.** In a merger, two companies are combined, and the surviving company succeeds to all assets and liabilities of the disappearing company.

For a discussion of choosing a transaction structure, see [Benefits and Drawbacks of Asset Purchase, Stock Purchase and Merger Structures](#) and M&A Practice Guide § 2.04.

For a complete understanding of the applicable transaction structure, you must confirm specific factual information. For stock purchases and mergers, confirm whether the purchaser is acquiring an entire company or a division. For asset purchases, confirm the specific real estate assets to be acquired and how the purchaser intends to take title to those assets; for example, the purchaser may want each asset to be transferred to a separate single-purpose subsidiary company. For mergers, confirm the type of merger

and whether the surviving entity is the target, the purchaser, or a subsidiary of the purchaser. Ask whether pre- and post-transaction structure charts are available. Structure charts provide a clear and concise summary of the transaction and are likely to include the above factual information.

Other Confirmation Items

A variety of other transaction-specific items are relevant to the purchaser's real estate due diligence plan, including:

- Why the purchaser is pursuing the transaction (e.g., expanding the purchaser's customer base or acquiring new technology)
- The relative importance of the real estate, which will depend on a variety of factors (in particular, whether and how the purchaser intends to use the real estate in the purchaser's post-closing business operations) and can fall anywhere on the spectrum from boot collateral (e.g., acquisition of a technology company whose only real estate asset is an office space that the purchaser does not intend to use post-closing) to the key asset (e.g., acquisition of a target that owns a portfolio of shopping centers)
- The transaction timeline
- Whether the transaction agreement has been executed
- Whether the applicable real estate assets are owned and/or leased
- The purchaser's risk tolerance
- Whether local counsel (if required) has been engaged
- Whether any lender(s) are financing the transaction
- Whether any existing property-level financing is to remain in place / be assumed
- Whether there is a materiality threshold (i.e., the purchaser does not want due diligence to be performed unless the maximum exposure with respect to a particular due diligence item exceeds a specified threshold)
- Whether the target is publicly traded
- The purchaser's relative bargaining power in the transaction
- The target's willingness to cooperate with the purchaser's due diligence efforts

You should attempt to confirm as many of these items as possible at the outset.

Establishing a Real Estate Due Diligence Plan

Each M&A transaction is different, and each transaction has a unique real estate due diligence plan that is influenced by a variety of factors, including many of the transaction-specific items described above. Typically, the most significant factor is the relative importance of the real estate in the context of the overall transaction.

As mentioned above, real estate does not drive the typical M&A transaction, and the purchaser may not want the comprehensive real estate diligence commonly performed in a real estate transaction. While you may find this uncomfortable, it is important to keep in mind the relative importance of the real estate, certain fundamental differences between a typical M&A transaction agreement and a typical real estate purchase and sale agreement, and your supportive role in the determination of the real estate due diligence plan.

- **Relative importance of real estate.** The purchaser may not have considered the real estate at all in deciding on the transaction. Depending on the circumstances, you may be asked to help the purchaser evaluate the relative importance of the real estate in the context of the overall transaction.
- **Fundamental differences.** In a real estate purchase and sale agreement, the seller does not typically make representations regarding title, survey, and other real estate matters that can be easily determined in customary real estate diligence. In an M&A transaction agreement, however, the seller typically makes comprehensive representations regarding such matters.
- **Your supportive role.** Your role is to work in conjunction with corporate counsel to help the purchaser make an informed decision about the real estate due diligence plan, including the scope of the real estate due diligence in light of the scope of representations and warranties in the corporate transaction documents. To make an informed decision, the purchaser must

also understand the utility of customary real estate due diligence and how real estate issues can materially impact the costs, timing, or other aspects of the transaction. Depending on the purchaser's real estate acumen (oftentimes M&A purchasers have little), you may need to educate the purchaser on customary real estate due diligence and provide specific examples of how real estate issues can impact the transaction.

The remaining sections of this practice note address essential categories of real estate due diligence in the context of a typical M&A transaction.

Title

You should first help the purchaser choose a title due diligence plan. You should then oversee the execution of that plan, including, if applicable, ordering title searches, reviewing title exceptions, and negotiating owner's title policies or endorsements thereto.

Establishing a Title Plan

To make an informed decision on a title due diligence plan, the purchaser must have the following basic information.

- **Covered risks.** Depending on the purchaser's real estate acumen, as a preliminary matter, you may need to educate the purchaser on the purpose and utility of title insurance and provide a few examples of the covered risks, including ground leases and other long term leases.
- **Survey.** Depending on the purchaser's real estate acumen, you may need to explain that a comprehensive title review is impossible without a current survey of the property.
- **Title search costs and timing.** Let the purchaser know approximately how long it will take the title company to complete a title search in each applicable jurisdiction. Also let the purchaser know that the title company may only charge a nominal fee for a title search: even if the purchaser does not want to pay for title insurance, a search may reveal material title issues at little cost.
- **Title policy costs.** Provide the purchaser the title policy rates and fees for each applicable jurisdiction.
- **Non-imputation endorsement.** In the case of a merger or a stock transaction, inform the purchaser that the owner's policy will not cover any loss resulting from:
 - Any unrecorded transaction agreed to by the target
 - Any title defect unknown by the purchaser but known by the target

These coverage exclusions significantly diminish the value of an owner's policy. A non-imputation endorsement (if available in the applicable jurisdiction) may eliminate these coverage exclusions in whole or in part. However, the seller may be unwilling to deliver the affidavit and indemnity required by the title company to issue the endorsement. Without a non-imputation endorsement, the purchaser may conclude that the costs of an owner's title policy outweigh the benefits.

Title Review Options

Purchasers in M&A transactions have a diverse set of title review options. These range from relying solely on the seller's title-related representations in the transaction agreement to performing a comprehensive title review for each property, with numerous customized options in between. A comprehensive title review may be performed for certain material properties, with other properties receiving limited or no title review. If timing is an issue, instead of new searches, review may be limited to the seller's existing title policies (if any). Instead of all title documents, the review may focus on specific types of issues or specific categories of documents, such as liens, purchase options, real estate tax deferral or abatement agreements, and development agreements. Providing a few examples of the various title review options may make it easier for the purchaser to determine an appropriate deal-specific scope of review.

Title Insurance Options

Purchasers in M&A transactions also have various title insurance options. Depending on the transaction and the policy terms, coverage may still apply under the seller's existing title policies following the transaction. If coverage applies, the purchaser may prefer to rely on the existing policies in lieu of obtaining new policies, especially if the policies are relatively recent and the insured amounts closely approximate current market values. Even if the purchaser wants coverage to be brought current, a "date-down" endorsement (if available) may be more cost-effective than a new policy. In the case of a stock transaction or merger, keep in mind the coverage exclusions for matters known (or agreed to by) the target (as described above).

Lender Requirements

If a lender is financing the transaction, confirm the lender's title insurance and other real estate due diligence requirements. Any material differences in requirements should be identified and resolved as early as possible in the transaction.

- **Simultaneous-issue savings.** The purchaser may not be aware of simultaneous-issue savings. If the lender insists on a loan policy for a particular property and the purchaser previously indicated it did not want a new owner's policy, reconfirm whether the purchaser wants an owner's policy after letting the purchaser know the amount that the loan policy premium will be discounted if the purchaser also obtains a new owner's policy.

Executing the Title Plan

The bullet points that follow include practice tips and other information that you may find useful in overseeing the execution of the purchaser's title due diligence plan.

- **Obtain the seller's existing title documentation.** First, make sure the seller has provided the purchaser copies of (1) any existing title policies (and surveys) and (2) any recorded exceptions or other title documents in the seller's possession. Even if the purchaser does not want any title diligence, having easy access to this documentation will benefit the purchaser after closing.
- **Place the title order.** If a title order is required, the transaction will typically run more smoothly if you place the title order and serve as the purchaser's primary point of contact with the title company. The purchaser may ask you to select the title company; unlike a pure real estate transaction, the parties may not have any significant title company relationships or preferences. If asked, select a reputable title company (with a national scope if there are multiple states involved) that you are comfortable with and that can accommodate the timing and other particulars of the transaction.
 - If the transaction involves financing, before placing the order, confirm that the title company satisfies any applicable lender requirements (e.g., maximum risk limits).
 - When placing the order, provide the title company with:
 - Copies of any existing title policies or other title documentation obtained from the seller (this may expedite processing times)
 - The purchaser's title requirements
 - The lender's title requirements
 - A comprehensive distribution list
 - The Schedule B-1 requirements will vary depending on the structure. Make sure the title company has a brief description of the transaction structure and copies of applicable transaction structure charts.
 - Request delivery estimates for the title searches, and periodically check to confirm the searches will be delivered on schedule.
- **Title review.**
 - Confirm the process for delivering completed title reviews and to whom the reviews will ultimately be delivered. Prepare a form of title review checklist consistent with the applicable scope of review and tailored for the intended recipient (e.g., lawyer or businessperson); use that form for each title review.
 - Promptly submit comments to any owner's policies or endorsements that the purchaser wants to obtain in connection with the closing of the transaction. Monitor the title company to make sure comments are promptly addressed.
- **Title issues.** Regardless of the process for delivering completed reviews, promptly share any material title issues with the lead attorney. If contract signing has already occurred, the purchaser may not have any leverage unless the issue(s) are sufficiently material exception(s) to a representation and warranty made by the seller in the transaction agreement (this circumstance is unlikely for M&A transactions where the real estate is not a key asset).
- **Mitigating title issues.** Several methods of mitigating title issues are listed below. Whether a particular mitigation method will be available to (or adequately protect) the purchaser will depend on the nature and materiality of the title issue, its susceptibility to cure, the purchaser's negotiating leverage, and other transaction-specific factors.

- *Seller indemnity.* The seller may agree to specifically indemnify the purchaser in the transaction agreement (or, if contract signing has already occurred, an amendment) for the applicable title issue. Depending on the magnitude of the particular issue in the context of the overall transaction, the seller may agree that the particular indemnity will not be subject to any “basket” (i.e., minimum amount of damages that the purchaser must suffer before the seller’s indemnity will apply), liability cap, or similar limitations on the seller’s indemnities in the transaction agreement).
- *Excluding the property.* If the transaction is an asset sale, it may be possible to exclude the property with the applicable title issue from the transaction.
- *Seller cure / Delete exception.* The title company may be willing to delete the title exception causing the applicable title issue based on seller curative action. For example, the seller may be in possession of an unrecorded termination agreement for the title exception.
- *Affirmative insurance.* Even if the title company will not delete the title exception causing the applicable title issue, it may be willing to provide the purchaser affirmative insurance on the basis of certain actions taken by the seller (e.g., the seller providing the title company an indemnity or escrow deposit for the applicable title exception).
- **Make sure parties are in agreement on requirements.** If any policies or endorsements are to be issued in connection with the closing, make sure the parties agree who is responsible for satisfying each Schedule B-1 requirement.

Survey

As with title, you should first help the purchaser choose a survey due diligence plan, and then you should oversee the execution of that plan.

Establishing a Survey Plan

In order to make an informed decision on a survey due diligence plan, the purchaser must have the following basic information.

- **Function of surveys.** You may need to educate the purchaser on the function and value of surveys. As part of that education, provide a few examples of issues disclosed by a survey (e.g., lack of access, utility easement running under the improvements, encroachments, etc.) and explain that the title policy will not provide coverage for any matters that would be disclosed by a current survey.
- **Relation to title.** You may need to inform the purchaser that title and survey review go hand-in-hand and that it would be unusual to review a survey without also reviewing the title for the property in question.
- **Costs and timing.** Provide the purchaser cost and timing estimates for new or updated surveys in each applicable jurisdiction (bearing in mind that new or updated surveys can be expensive and require a long lead time) and consider a national survey company to coordinate your efforts for multi-property transactions.

Survey Review Options

Purchasers in M&A transactions have various survey review options. A comprehensive survey review may be performed for certain material properties, with other properties receiving limited or no survey review. Options include:

- **No review.** No review by the purchaser. Under this option, the purchaser relies solely on the seller’s survey-related representations in the transaction agreement.
- **Existing survey.** Review the most recent survey obtained by the seller. This scope of review would be useful only if no material alterations (e.g., expansion) have been performed that would render the survey inaccurate. Ideally, the transaction agreement would include a representation from the seller that no such alterations have been performed.
- **Survey update.** If there is a recent survey for a particular property, ordering an update of that survey (instead of a new survey) may result in significant time and cost savings. Also consider if the existing survey can be updated merely by a visual inspection if there have been no changes to the footprint of the improvements, making it acceptable for title insurance purposes.
- **New survey.** If the purchaser wants to obtain a new survey for a particular property, consider the items below.
 - Is an ALTA survey necessary? If no survey or title policy has ever been prepared for the property in question, and/or the property in question consists of an assemblage of large tracts of land acquired in numerous transactions (e.g., forestland owned by a paper company), the purchaser may not approve the costs and/or timing of an ALTA survey. A standard

physical survey or a computer-generated boundary survey added to a recent satellite image of the property may be sufficient.

- **Table A items.** If the purchaser wants a new ALTA survey:
 - Depending on the property type and other factors, many of the Table A items commonly requested in a pure real estate transaction involving an office, retail, or multifamily property may be inappropriate.
 - For certain non-standard properties that are very large in size (e.g., a power station located on, but not close to any boundary line of, a 100 acre parcel), it may be appropriate to select Table A, Item 15, which permits use of photogrammetric mapping and other alternative technologies (in lieu of on-the-ground measurements) to show the location of certain improvements. The selection will likely result in significant cost and time savings, and precise on-the-ground measurements of the improvements would not be as important for such a property.
- **Confirm the lender's survey requirements.** If a lender is financing the transaction, once the purchaser has determined its preferred scope of survey review, confirm whether the purchaser's requirements are consistent with the lender's and, if they are not, promptly resolve any differences with lender's counsel.
- **Confirm the title company's survey requirements.** Confirm whether the title company will remove the standard survey exception on the basis of applicable surveys set forth in the survey requirements agreed to by the purchaser and the lender. Typically, the title company will not remove the exception unless it receives an ALTA survey that is no more than six months old. The title company may agree to remove the survey exception (typically only for a lender's policy) if it receives an older ALTA survey together with an affidavit from the seller that there have been no alterations that would render the survey inaccurate or with a current visual inspection confirming no changes in the footprint of the improvements.

Executing the Survey Plan

The bullet points that follow include practice tips and other information that you may find useful in overseeing the execution of the purchaser's survey due diligence plan.

- **Get the seller's surveys.** Confirm the seller has provided copies of any surveys in the seller's possession. Even if the purchaser does not want any survey review, these may be helpful to the purchaser post-closing, and the survey may be certified to the seller and the benefits thereof transferred by merger or stock sale.
- **Order survey updates and/or new surveys.** As with title, the transaction will typically run more smoothly if you order the new surveys and/or survey updates and serve as the purchaser's main point of contact with each surveyor. Provide each surveyor the applicable survey requirements (as agreed to by the parties) and a comprehensive distribution list (which should include the applicable title company and the lender's counsel contacts, among others); follow up to confirm that the surveyor understands and is able to adhere to those requirements. Obtain delivery estimates, and periodically check in to confirm the applicable surveyor remains on schedule.
- **Order flood zone determination certificates.** If the purchaser does not want to obtain a survey update or new survey for any particular property, suggest at least obtaining a current flood zone determination certificate from a reputable provider (if the purchaser's insurance consultant does not obtain same as a matter of course) to ensure that appropriate flood insurance (if available) will be in place. These certificates are inexpensive and can typically be obtained very quickly and may well be required by any lender.
- **Survey review.**
 - Incorporate the applicable survey review items into the form of title review checklist described above.
 - If any new surveys or survey updates are being obtained
 - Send any comments as quickly as possible (complete your review as soon as possible, and ask the lender's counsel and title company to do the same)
 - Send all the parties' comments to the surveyor at the same time. This tends to make the survey revision process more efficient and accurate; ideally, you should incorporate the title company and the lender's counsel's comments with your own.
 - Monitor the surveyors to ensure timely delivery of all revised surveys

- **Survey issues.** Promptly disclose any material survey issues to the lead attorney. There are various methods of mitigating survey issues, including a specific seller indemnity, seller curative action, and excluding the applicable property from the transaction (in the case of an asset sale). The viability of a particular method will depend on the transaction specifics, and as mentioned above, the purchaser may have very little leverage if the issue is first discovered after contract signing.

Zoning

As with title and survey, you should first help the purchaser choose a zoning due diligence plan, and then you should oversee the execution of that plan.

Establishing a Zoning Plan

To make an informed decision regarding a zoning due diligence plan, the purchaser must have the following basic information.

- **Purpose of zoning report.** You may need to educate the purchaser on the purpose of a comprehensive zoning report and provide examples of items that it typically discloses, including
 - Whether the use of the property is permitted in the applicable zoning district
 - The extent of any nonconformities
 - Whether the applicable nonconformities are considered legal nonconforming
 - Any rebuild restrictions in the event of a casualty
 - Any open zoning, building or fire code violations
- **ALTA survey required.** In your discussions with the purchaser, explain that the zoning company needs a current ALTA survey to complete a comprehensive zoning report (without such a survey, the zoning company will be unable to compare the facts on the ground with the zoning code requirements).
- **Zoning endorsement.** Also explain that a title company will not be able to issue a zoning endorsement without issuance of a comprehensive zoning report.
- **Law and ordinance coverage.** Without a current zoning report, it may be difficult to ascertain law and ordinance insurance coverage needs.
- **Costs and timing of new reports.** Let the purchaser know that depending on the municipality and other variables, a comprehensive zoning report may not be available until 30 to 60 days after the order is placed. Certain zoning companies are able to produce more limited “summary” reports in about a week. As zoning reports are relatively inexpensive, cost is rarely a factor in a purchaser’s decision whether to obtain a zoning report for a particular property.
- **Review existing reports.** If timing is an issue, reviewing the seller’s existing zoning reports may be useful (assuming the reports are relatively recent and there have been no material alterations or changes in use).
- **Confirm lender’s zoning requirements.** As with title and survey, once the purchaser has determined its preferred scope of zoning review, confirm whether the purchaser’s requirements are consistent with the lenders and, if not, promptly resolve any differences with lender’s counsel.

Executing the Zoning Plan

- **Seller’s zoning materials.** As with title and survey, obtain any zoning reports or other zoning materials (e.g., variances, use permits, and certificates of occupancy) in the seller’s possession.
- **Ordering zoning reports.** As with title and survey, the transaction tends to run more smoothly if you order the zoning reports and serve as the purchaser’s main point of contact with the zoning company. When placing the order, provide the zoning company any relevant documentation (e.g., variances, use permits, and certificates of occupancy) obtained from the seller as well as a comprehensive distribution list. Obtain delivery estimates and periodically check in to confirm the zoning company remains on schedule.

- **Zoning review.**
 - Confirm the process for delivering completed zoning reviews and to whom they will ultimately be delivered.
 - Prepare a form of zoning review checklist consistent with the applicable scope of review and tailored for the intended recipient (e.g., lawyer or businessperson); use that form for each zoning review.
 - If any new zoning reports are being obtained:
 - Send any comments you have as quickly as possible (complete your review as soon as possible, and ask lender's counsel to do the same)
 - Send all the parties' comments at the same time, which tends to make the revision process more efficient and accurate; ideally, you would incorporate any comments of lender's counsel with your comments
 - Monitor the zoning company to ensure timely delivery of all revised reports
- **Zoning issues.** The discussion of survey issues above applies equally to zoning issues.

Transfer Taxes

Advice on real estate transfer taxes is an essential component of the real estate diligence. Ideally, this advice would be provided before contract signing because:

- Real estate transfer tax exposure may be material to the purchaser's pricing decision (particularly in jurisdictions with high transfer tax rates such as Philadelphia and New York City).
- Modifications to the deal structure may reduce or eliminate certain transfer taxes that would otherwise apply.
- The parties can negotiate who will pay the transfer taxes and include the negotiated resolution in the applicable transaction agreement or provide for appropriate indemnification if the obligation to pay transfer tax on the transaction is unclear.
- The parties can minimize uncertainty regarding the amount of transfer tax by specifically allocating a portion of the purchase price to the applicable real estate.

The transfer tax analysis in an M&A transaction tends to be significantly more involved than in a pure real estate transaction. Depending on the jurisdiction, transfer taxes may apply not only to a direct transfer of title but also to an indirect transfer resulting from a transfer of a controlling interest in an entity that holds title to the applicable real estate. Transfer tax regimes vary substantially from jurisdiction to jurisdiction, particularly with respect to indirect transfers. Whether a particular jurisdiction's indirect transfer tax regime will apply to the transaction in question may depend on a variety of factors, including:

- The jurisdiction's definition of controlling interest (a common definition is more than 50% of the applicable ownership interests)
- The tier of ownership interests being transferred (e.g., entity holding title, intervening subsidiary entity, or ultimate parent entity)
- Whether any exclusion or exemption applies to the transaction (e.g., certain jurisdictions exclude transfers of ownership interests that are publicly traded)

Given the complexity in this area, research and analysis of the applicable state, county, and local laws should be performed by competent state and local tax attorneys. Your role is to (1) make the purchaser and lead counsel aware of the importance of the real estate transfer tax analysis, (2) provide the tax attorneys the factual information needed for their analysis (pre- and post-transaction structure charts for each real estate asset are particularly helpful), and (3) provide other support and assistance (as requested).

Lease Review

If the transaction includes any real estate occupied or used by the target or its subsidiaries pursuant to a lease, lease review will be an important component of the real estate due diligence.

Complete Lease Files

As a preliminary matter, confirm that there is a complete lease file for each applicable leased property. In addition to the original lease, the lease file should contain copies of all amendments and supplemental documents (e.g., commencement date agreement,

lease guaranty, and any documentation incorporated by reference). Make sure all agreements are fully executed, and that no pages, exhibits, riders, or schedules are missing.

Assignability

The preliminary question is whether any landlord consent rights are triggered by the lease “assignment” in the form of the transaction in question. This lease question must be addressed in any transaction where the target or a subsidiary is a tenant under a lease, not just asset sales: changes in control or ownership of the tenant, mergers, and/or assignments by operation of law may be treated as an “assignment” pursuant to the express terms of the lease or as a matter of applicable state law.

Lease provisions addressing assignments are often extensive and complex, and the bullet points below outline a subset of related issues that should be reviewed and summarized in order for the purchaser to understand the lease scenarios that the transaction may trigger.

- **Lease is silent.** A minority of states require landlord consent for an assignment even if the lease is silent. Therefore, if the lease does not include assignment provisions, you must then research whether landlord consent is required pursuant to applicable state law.
- **Is “change in control” an assignment?** Similarly, as mentioned above, for a stock transaction, if the lease does not address changes in control or ownership of the tenant, you must research applicable state law to see whether the transaction in question is treated as an assignment as a matter of law.
- **Carve-outs to landlord consent.** If the lease’s assignment provision was negotiated by the tenant, the provision may stipulate certain permitted transfers that do not require landlord consent (e.g., transfer to an affiliate of the tenant, a successor by merger, or a successor acquiring all or substantially all of the tenant’s assets). You may need to obtain more transaction-specifics or otherwise consult with the lead attorney(s) to determine whether the transaction is in fact a permitted transfer.
- **Procedural requirements.** If landlord consent is not required, is the landlord nonetheless entitled to prior written notice of the transaction, or to review and approve the “form” of any assignment document for certain criteria, and/or do other procedural requirements apply under the lease?
- **Approval standard.**
 - If landlord consent is required, is it conditioned upon the satisfaction of any particular requirements?
 - Does the lease specify a standard for the landlord’s approval?
 - If a lease does not specify a standard, in most jurisdictions, the landlord is not required to act reasonably.
 - If the landlord is required to act reasonably, does the lease specify reasonable grounds for withholding consent?
- **Landlord response time.** Does the lease require the landlord to respond within a specified time period? If so, what is that period and does the lease provide that a failure to respond results in deemed approval?
- **Transfer premium.** Does the lease entitle the landlord to share any consideration received by the tenant in connection with a lease assignment? This calculation can be difficult/problematic for assignments that are incidental to a larger corporate transaction. To the extent accurate, the parties may want to stipulate in the transaction agreement that no portion of the purchase price is allocable to the applicable leased property.
- **Recapture.** Does the transaction trigger a landlord recapture right? Is the lease below-market or are there any other factors to suggest the landlord may exercise that right? What impact would such an exercise have on operations?
- **Changed lease terms.** Will any lease terms change as a result of the transaction? Changed lease terms could result in unexpected increase in expenses and/or operational burdens for the acquirer. For example, a lease may provide for a fair market rental increase in the event of an assignment and/or stipulate that certain special options of the tenant (e.g., extension, termination, purchase, or expansion options) are extinguished upon an assignment.
- **Guaranty.** If the tenant’s obligations under the lease are guaranteed by an affiliate, the lease documents may require that a new guarantor execute a replacement guaranty in connection with the transaction. Provide a brief description of the guaranteed obligations, as well as the replacement guaranty process (including any landlord approval rights with respect to the guarantor).

- **Termination rights.** If the landlord or tenant has any unilateral termination options under the lease, summarize the material terms of same. The lease may either be highly important or purchaser may prefer that a lease be terminated at the closing instead of assigned (particularly where the assignment process is anticipated to be costly, difficult, and/or time-consuming).
- **Purchase option.** If the lease includes a purchase option, summarize the material terms of same. The purchaser may prefer to purchase the applicable leased property simultaneous with the closing.
- **Subletting.** What restrictions (if any) apply to subletting? In the case of an asset sale, would entering into a sublease avoid a difficult landlord consent process for an assignment?

Reviewing the issues above enables the purchaser to make an informed decision on structuring an approach. Depending on the importance of a particular leased property, if the process of obtaining a required landlord consent is expected to be extremely costly, difficult, and/or time-consuming, there may be an alternate structure acceptable to the purchaser that would eliminate that process. Depending on the transaction type, lease terms, and other factors, structuring alternatives may include:

- Excluding the applicable leased property from the transaction (in the case of an asset sale)
- Terminating the applicable lease in connection with the closing (if the lease affords the tenant a unilateral termination option)
- Exercising a purchase option for the applicable property in connection with the closing (if the lease affords the tenant a purchase option)
- Entering into a sublease instead of an assignment (if the lease requires landlord consent for an assignment but not a sublet)

Lender Requirements

If a lender is financing the transaction, confirm as soon as possible whether the lender will require a mortgage or other lien with respect to any leased location and/or any related personalty or fixtures of the tenant and whether same will require landlord's consent. A tenant's leasehold lender or a senior secured credit lender may also require the purchaser, as the new landlord to execute a landlord consent and/or statutory lien waiver under applicable state law.

Other Lease Issues

In some M&A transactions, the leases are reviewed for assignability issues only. The scope of review is the purchaser's business decision, but it is your job to make sure that decision is informed.

The purchaser's post-closing plans for each leased location, including which operations (if any) the purchaser plans on conducting, will inform the appropriate scope of review. Before discussing the scope of review with the purchaser, provide the purchaser (and be familiar with) the use, location, and lease term (including renewal and purchase options) for each lease. This basic lease information will help the purchaser finalize its post-closing plans and identify any lease extension(s), exclusions or terminations that the purchaser may want to require in the transaction agreement.

The purchaser may decide that certain leases require more thorough review than others. For example, the purchaser may only want a comprehensive review of certain types of leases (e.g., ground leases, leases with a remaining term that exceeds a specified minimum, and leases that are critical to the purchaser's post-closing operations). For other leases, the purchaser may prefer a more limited review, focusing on key provisions that may need to be addressed in the transaction agreement and/or that could impose material economic and/or operational burdens.

Listed below are examples of key lease provisions that are commonly reviewed and that, depending on the transaction specifics, may need to be addressed in the transaction agreement.

- **Landlord termination and/or relocation rights.** The landlord's exercise of a unilateral termination or relocation right under the lease could significantly impede operations. Leases are commonly reviewed for these types of landlord rights.
- **Tenant termination rights.** Unilateral termination rights of the tenant are also important, especially if a particular leased location is not (or ceases to be) critical to the purchaser's operations.
- **Tenant rent payments.** The purchaser may not realize the full scope of the rent payments due under the lease. Scheduled base rent increases, provisions requiring payment or reimbursement of operating costs, and other similar provisions need to be analyzed for the rent payments to be properly reflected in the purchaser's post-closing budgeting.
- **Tenant maintenance obligations.** Atypical tenant maintenance obligations (e.g., a space lease requiring the tenant to maintain building systems and/or structural elements) could significantly impact the tenant's monetary outlay under the lease and

may not be reflected in the purchaser's post-closing budgeting. Additionally, unless highlighted for the purchaser in the legal review of the lease, the purchaser may incorrectly assume that such maintenance obligations are the landlord's responsibility. The purchaser's failure to perform such maintenance obligations post-closing may result in a lease default or other adverse circumstances.

- **Radius restriction.** A retail lease may include a radius restriction. If the purchaser operates an existing retail location in the applicable restricted area, the radius restriction may be violated automatically upon closing.
- **Use restriction.** The purchaser's post-closing plans may involve a change of use at one or more leased locations (e.g., the purchaser may intend to operate a different division of its business at a particular leased location or sublet to a company that will conduct a similar (but not identical) use). Depending on the specificity of the applicable use restriction, a violation may occur as a result of a seemingly insignificant change in use.
- **Security deposit.** The purchaser will want to know the amount of any security deposit given to the landlord, the form thereof, and whether the deposit has been fully funded.
- **Self-help / abatement rights.** Does the tenant have adequate remedies if the landlord fails to perform any of its obligations?
- **Defaults.** Are there any uncured defaults by the landlord or the tenant? Depending on the severity, they may need to be factored into the deal terms.
- **Tenant improvements.** Purchasers often want to specifically identify outstanding obligations of the tenant or the landlord to pay for or perform tenant improvements.
- **Restoration obligations.** Standard form leases typically require the tenant, at the landlord's option, to remove its improvements and restore the premises to its original condition at lease-end. If this provision was not negotiated by the tenant and significant tenant improvements were made after lease commencement, this obligation could be very costly.
- **Subordination and attornment.** Depending on the wording of the lease's subordination and attornment provisions, a fee mortgagee may have the right to terminate the lease in the event of a fee mortgage default. Similarly, if the applicable leasehold location is used or occupied pursuant to a sublease, a superior lessor may have a termination right if there is an event of a default under the superior lease. If any such termination right exists, the purchaser may want the closing conditions to include a nondisturbance agreement from the fee mortgagee or superior lessor, as applicable.
- **Insurance.** A review of the insurance requirements is necessary for the purchaser or its insurance consultant to identify any requirements that the purchaser's insurance does not satisfy. If compliance will be difficult or cost prohibitive for the purchaser (e.g., the purchaser maintains a blanket policy, high SIR or deductibles), the purchaser may want the seller to obtain a waiver of the applicable insurance requirement(s) in connection with the closing.
- **Estoppel.** Is the landlord required to deliver an estoppel upon request of the tenant? If so, does the lease specify the form of estoppel and/or the timeframe within which the landlord must respond?
- **Alterations/signage.** If the purchaser's post-closing plans involve alterations or changes to signage, the purchaser may want a summary of the corresponding lease provisions (including any requirements for landlord consent).
- **Affiliated landlord.** If the landlord is an affiliate of the target, the purchaser may want your review to highlight any lease terms that are abnormally favorable to the landlord so that the same can be replaced with arm's-length terms in connection with the closing.

Lease Review Format

If there are numerous leases to be reviewed only for a select number of lease terms/issues, a chart may be the most user-friendly review format. If a purchaser wants a comprehensive review of a particular lease, a narrative abstract may be preferred.

For a basic form of Lease Abstract, see Lease Abstract.

Consents, Estoppels, and Other Third-Party Lease Documents

Your lease review will determine which lease-related documents should be obtained from any landlords or other third parties prior to or at the closing. Any required landlord consents will typically be a closing condition. Depending on the importance of the lease

and other factors, other lease-related documents (e.g., landlord estoppel, nondisturbance agreement, and lease extension) may be addressed in the transaction agreement either as a closing condition or as a commercially reasonable efforts undertaking of the seller.

Unless the applicable leases specify a form, the forms of landlord estoppel and other lease-related documents should either be provided (or reviewed and approved) by you. You should also coordinate the lender's review and approval of any such forms.

Work with the target's real estate attorneys to establish a plan and timeline for obtaining the lease-related closing documents. As the purchaser is unlikely to have any relationship with the landlords, typically the target and its real estate attorneys will initiate discussions with the landlords and take the lead. Request that no documentation is sent to the applicable landlord or other third party until both you and the lender have had an opportunity to review and comment; any comments should be sent as quickly as possible to minimize delay in an already time-consuming process. Request periodic status updates to keep up-to-date on any delays/issues.

Environmental Diligence

Environmental diligence is typically performed by specialists (e.g., environmental attorneys and other professionals), and a thorough discussion is beyond the scope of this practice note. However, you should have a general understanding of, and be able to provide preliminary guidance on, environmental diligence in M&A transactions.

Phase I Assessment

Most purchasers will not close without a current Phase I environmental site assessment for each owned property and each ground leased property. Even if the purchaser does not want any Phase I assessment(s), the lender most likely will, and the lender's requirements should be confirmed early on in the transaction. Reasons to obtain a current Phase I assessment include:

- Even if a property's use does not seem to involve any environmental risk, there could be significant environmental liabilities (e.g., office property with a leaking underground storage tank).
- A purchaser may be liable for environmental contamination at a property, even if it was caused entirely by a prior owner.
- In asset deals, the purchaser will not qualify for any liability exemptions (e.g., innocent landowner defense) under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 unless it obtains a current Phase I assessment meeting the standards of the statute.
- A property with an environmental problem may require substantial cleanup and other expenditures not reflected in the purchaser's post-closing budgeting, particularly if contamination has migrated to neighboring properties.

Environmental Liabilities—Asset v. Stock Transactions

In an asset transaction, the purchaser is generally not responsible for environmental liabilities of the target that are unrelated to the real estate assets being transferred (unless a third party is able to prevail against the purchaser on a claim under a successor liability doctrine). In a stock transaction, however, the purchaser will automatically succeed to all of the target's environmental liabilities, including those related to the target's prior operations and real estate assets as well as off-site disposal facilities to which the target sent hazardous substances. Accordingly, the environmental diligence in a stock transaction is typically more complex and larger in scope than in an asset transaction.

Environmental Liabilities—Owned v. Leased Properties

Environmental problems and liabilities relate not only to owned properties but also to leased properties. A ground leased property should receive the same scope of environmental diligence as would a comparable owned property. The extent of environmental diligence performed for other leased properties will depend on a variety of factors, including the lease term and the size and use of the leased premises.

Mitigating Purchaser's Environmental Liability

There are several methods of mitigating the purchaser's liability for environmental issues disclosed as part of its diligence efforts. The suitability of a particular mitigation method will depend on the nature and magnitude of the applicable environmental issue, among other factors. Mitigation methods include an unqualified seller indemnity, environmental insurance, and state voluntary remediation programs.

- **Unqualified seller indemnity.** The seller may agree to provide an indemnity for an environmental problem that is not subject to any of the limitations on the seller's indemnities in the transaction agreement.

- **Environmental insurance.** The purchaser may elect to obtain environmental insurance (examples of insurable risks include cost overruns for an existing remedial plan and personal injury claims of third parties arising from the property's environmental condition).
- **Voluntary cleanup.** The purchaser may be able to take advantage of a state voluntary cleanup program.

For a more thorough discussion, see [Environmental Due Diligence in M&A Transactions](#), [Allocating Environmental Risks in the Transaction Agreement](#) and [Environmental Due Diligence in Real Estate Transactions](#).

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