

Estoppel Certificates – A Critical Due Diligence Tool

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For the prospective purchaser of commercial real estate, obtaining estoppel certificates from each of the property's tenants is a critical but often overlooked aspect of what is commonly called the "due diligence process."

An estoppel certificate is a series of statements about the lease that the tenant is certifying to the current landlord or to a potential purchaser to be accurate and true. It is a one or two page form that contains blanks for the tenant to complete. For example, a typical statement could read, "The fixed monthly rent payable under the Lease is \$_____ and has been paid through __/__/__." By completing this sentence within the estoppel certificate, the tenant is certifying its understanding of the monthly rent and the date of the latest rent payment. Once the certificate is signed, the tenant is "estopped," or legally barred, from ever asserting a contrary claim.

Most leases drafted in the past 40 years require the tenant to complete an estoppel certificate upon the landlord's request. The operative portion of an estoppel provision found in the majority of commercial real estate leases is typically worded as follows: "The tenant, upon 10 days written notice, must deliver to the landlord an estoppel certificate stating....." Many leases will detail exactly what the tenant is expected to state. Sometimes the form of estoppel will be attached to the lease as a schedule or an exhibit. A provision of more recent vintage has estoppel provisions automatically appoint the landlord as the tenant's "attorney in fact" to execute the estoppel on the tenant's behalf, if the tenant does not cooperate as required by its lease obligations. The benefits of an estoppel to a potential purchaser are obvious. There is no better way for a potential purchaser to confirm the financial, legal and physical nature of the tenancy than to have the tenant list and be bound by that information.

It should be noted that a potential purchaser is not the only party that benefits from an estoppel certificate. Most lenders also require landlords to provide estoppel certificates for all tenants, or at least a significant number of tenants. Failure to comply can result in the transaction not closing.

As a due diligence tool, an executed estoppel certificate is an invaluable resource, and to the extent obtainable, should be required for every acquisition. Reading the lease provides a theoretical picture of reality – a statement of how things ought to be if the landlord and tenant are exactly in sync about their respective rights and obligations under the lease. An estoppel certificate, on the other hand, is a window into the tenant's mind and informs the reader of the tenant's perceptions of its rent obligation, of the lease expiration, and of any existing problems.

Five Pointers for the Drafting of Estoppel Certificates

1. Longer is not necessarily better. If the estoppel is too long or cumbersome, the tenant is less likely to fill it out in a timely manner.
2. Do not draft a document that the tenant will be uncomfortable signing – in other words, it shouldn't be unreasonable. If the language is overly complicated or demanding, the tenant or the tenant's attorney may stall or refuse to sign.
3. Restate all of the documents that exist within the lease file, including any amendments and modifications of the lease. This ensures all parties are in agreement as to all relevant documentation.
4. Cite the section number from the lease that refers to the tenant's obligation to complete the estoppel certificate and its timing requirements. This provides context and reminds the tenant that completing the certificate is an obligation, not merely a formality or favor.
5. In the certificate, it is best to have statements that can be answered either by true or false or with a specific number. The more open-ended the question, the less likely a tenant will be to return the estoppel promptly.

Information Typically Included in Estoppel Certificates

An estoppel certificate typically states the parties to the lease agreement, sets forth all relevant lease documentation, states that the lease is in full force and effect, and then requires the tenant to comment on the following:

- the current base rent
- any current additional rent
- the permitted use of the premises
- the lease expiration date
- any remaining lease renewal options
- the remaining security deposit
- the existence of any landlord or tenant defaults