

WHERE DO WE BEGIN? NAVIGATING PRE-LEASING  
ISSUES FOR A MIXED USE DEVELOPMENT--THE  
LENDER'S PERSPECTIVE

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# WHERE DO WE BEGIN? NAVIGATING PRE-LEASING ISSUES FOR A MIXED USE DEVELOPMENT--THE LENDER'S PERSPECTIVE

## The Hypothetical:

### The Ideal Live, Play, Work Center City of Springfield

Some time ago, the City of Springfield Redevelopment Agency (the "Agency") acquired an abandoned factory site. Among its other features, the site includes an historic building and a variety of brownfield issues that complicate any plans for the property. The property is in a key location between two revitalized parts of town. The Agency is looking for a private developer ("Developer") interested in redevelopment opportunities. Developer wants to redevelop the property into a mixed-use project with a grocery and other retail, office space, a residential condominium and possibly a hotel (the "Project"). Developer has been a successful developer in the past, but only on projects that were on a smaller scale. Though no development entitlements have yet been obtained, the Agency expects any redevelopment to include an affordable rental housing component. The citizens group, Save Our Stack, is adamant the property will keep its historic character, low density and plenty of green space. You represent the construction lender (or construction lending group) (collectively, "Lender") making the construction loan (the "Loan") to the Developer for the construction of the retail and/or office component of the Project.

## The Goal:

To help Lender structure and document the Project pre-leasing requirements for the opening of the Loan, with the ultimate objective of maximizing the possibility of the successful completion of the Project and the full repayment of the Loan to Lender.

Developer, Lender and the Project tenants all have the successful construction and lease-up of the Project as a common goal. The development, implementation and satisfaction of Lender-imposed pre-leasing requirements increases the likelihood of the completion, economic viability and success of the completed Project, which in turn increases the likelihood of (i) a successful Lender "exit" (i.e., the repayment or long-term refinancing of the Loan), (ii) a successful Developer "exit" (i.e., a stabilized project which would facilitate a (more) profitable sale of the Project), and (iii) happy tenants at, and patrons of, the Project.

Navigating the Issues:

Lender-imposed pre-leasing requirements often are expressed in the Loan documentation as some combination of the execution of leases in form and substance and by tenants satisfactory to Lender (i) with respect to a specified minimum aggregate amount of rentable space at the Project, and/or (ii) that provide for payment by the tenants under those leases of a specified aggregate annual minimum net rent amount (and that also contains tax, insurance and operating expense reimbursement provisions satisfactory to Lender).

In considering what pre-leasing requirements to impose, Lender must think and act as though it, and not Developer, is going to develop and own the Project. As part of its evaluation process, Lender should do the following:

1. Underwriting Tenant Financials. Underwrite the financial strength of (i) anchor and other key tenants (i.e., the ability of those entities to pay the specified net rents and fund their pro rata shares of any tenant improvements), and (ii) any lease guarantors. If a tenant is posting a letter of credit, cash escrow or other security for its tenant improvement obligations (or as a security deposit), then Lender should receive a collateral pledge of that security from Developer as additional security for the Loan.

2. Reviewing, Understanding and Approving Leases. Review, understand and approve leases. The pre-leasing requirement must provide that leases, not merely letters of intent, be fully executed and in place prior to initial disbursement of loan proceeds. In particular, Lender should carefully review and understand:

- a. overall Project and tenant construction schedules (including key dates and tenant space delivery dates);
- b. financial penalties payable by Developer for failure to meet tenant delivery dates, and the source of Developer's funds to pay those penalties (or other security given by Developer in favor of tenants to secure delivery obligations);
- c. sources of funds for tenant construction and tenant improvement obligations;
- d. tenant approval rights and timetables regarding plans and specifications;
- e. estoppel letter and subordination, non-disturbance and attornment agreement provisions of the leases;
- f. lease provisions relating to the use and application of insurance requirements;
- g. lease provisions relating to the allocation of, and timing for, reimbursement of taxes, insurance and operating expenses, as well as any landlord right to reimbursements for capital expenditures;
- h. with respect to any retail leases, tenant operating covenants and tenant opening requirements;
- i. rental payment schedules and security deposits; and

j. lease provisions permitting termination or granting tenants termination rights for construction delays or failures to meet specified milestone dates.

3. Understanding the Role, Rights and Obligations of the Authority. Understand the role and obligations of the relevant governmental authority, if any, with respect to the Project.