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Insights

Basic Elements of Letters of Intent

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Letters of intent (LOIs) are used to summarize the material terms of a proposed transaction, typically involving the leasing or sale of real property. Sometimes called term sheets, letters of interest or deal sheets, LOIs are usually prepared by one of the parties to the transaction, or by a leasing agent or broker for one of the parties.

LOIs are important because they include terms that will be incorporated into a formal and binding lease or sales contract with more detail about the proposed transaction. An attorney is likely be involved in preparing or negotiating the lease or sales contract, so each party should have an attorney review and comment on the proposed LOI before it is signed.

Once signed, LOIs are not supposed to be subject to change absent some compelling reason, such as the occurrence of a significant new circumstance or the discovery of new information. Attempting to otherwise renegotiate the deal after an LOI has been signed can adversely affect a party's credibility, can strain relations between the parties, and will likely be met with significant resistance. That is why it is important to get the LOI right from the start.

Although typically non-binding in most respects, sometimes LOIs contain confidentiality or other clauses that the parties want to be binding. This is fine provided the LOI is clear as to what is binding and what is not, as well as what the remedy is for the breach of a binding clause.

In addition to confidentiality clauses, all LOIs should contain the proper names, states of formation and addresses of the parties, along with a description of the affected premises or property. If brokers were involved, the LOI should identify them, what their commissions are and when they are payable. For a lease, it is possible that brokerage commissions may be payable if the tenant exercises a renewal option in the lease, so that should be addressed if applicable. If the tenant or buyer has an inspection or permitting period, that should be mentioned. It is also customary for a tenant or buyer to have a review period for title and survey matters, and sometimes the LOI will describe the process by which title objections are raised and addressed. Events of default and remedies should be included.

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Gary M. Kaleita

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Some of the other basic elements of an LOI for a lease are as follows:

• Amount of security deposit;

• Rent amounts (including adjustments, concessions and pass-through expenses);

• Rent commencement date;

• Guarantor (if any) of tenant's obligations;

• Landlord's and tenant's work, including any tenant improvement allowances;

• Delivery date for premises, including condition of premises upon delivery;

• Other conditions to tenant's occupancy;

• Permitted uses and tenant's use restrictions;

• Exclusive uses granted to tenant;

• Tenant's operating covenants;

• Assignment and subletting;

• Renewal or extension options;

• Tenant's right of first refusal or option to purchase, if any;

• Maintenance, repair and replacement obligations;

• Alterations;

• Tenant's signage rights;

• Subordination, non-disturbance and attornment;

• Allocation of costs.

An LOI for the sale of property will address similar types of concerns tailored for that type of transaction, and can include the following:

• Purchase price;

• Earnest money deposit, including identity of escrow agent and timing for furnishing same if being lodged in installments;

• Due diligence documents to be delivered by seller to buyer;

• Closing date;

• Condition of property;

• Conditions to closing;

• Allocation of closing costs, prorations and adjustments;

• Form of deed;

• Assignment of leases, contracts, etc.

An LOI should include enough material terms to guide the party or attorney preparing the lease or sales contract and preclude potential disagreements over matters of significance, without becoming overly complicated and burdensome. This is a balancing test.

LOIs can be of any length... the more complex the deal is, the longer the LOI is likely to be. Sometimes a party may be tempted to state that other terms of a lease or sales contract not specifically mentioned in the LOI shall be determined based on "custom" or "practice" in similar transactions in that locality. Before doing that, the party should make every attempt to describe with specificity any term that is important to them.

An attorney should review the proposed LOI to ensure it contains sufficient material terms for the proposed transaction, lacks internal inconsistencies, and avoids ambiguities and other pitfalls. The attorney may also point out potential legal issues of which the client may be unaware. Given that LOIs are usually short documents, it should not be very expensive for the client to run it by their attorney beforehand, which can save the client money down the road.

If a party is engaged in multiple lease or sales transactions over time, it is a good idea to create a form or template of an LOI that contains the terms the party typically wants in all similar transactions. The template can contain blanks that get completed on a deal-by-deal basis as individual LOIs are prepared. It is useful for the party to involve their attorney in the creation of such a form, since that can identify potential issues at the front end and reduce the attorney's fee for reviewing individual LOIs.

Sometimes attorneys are given a signed LOI and told to prepare or negotiate a lease or sales contract. Clients think they can save on attorneys' fees by not involving the attorney earlier, but this delay can end up being very expensive. Rectifying mistakes in an LOI is difficult (if not impossible), and such an effort not only reflects poorly on the party who made the mistake, but also increases their fees.

For example, an LOI may specify that one party obtains its title insurance through its own title company or agent, but the other party pays for it. Many parties (including their leasing agents and brokers) do not consider that title insurance premiums in Florida can be negotiated, frequently resulting in substantial savings. The party obtaining the title insurance has no incentive to negotiate the premium if the other party agreed to pay it. Even worse, they may negotiate to obtain and keep the savings even though the other party is paying the premium. An attorney reviewing a proposed LOI should catch and address this.

LOIs are useful tools for parties, leasing agents, brokers and attorneys, and if thoughtfully prepared, can save them both time and money when preparing and negotiating the applicable lease or sales contract.

Gary M. Kaleita is a shareholder at Lowndes and has been certified by the Florida Bar as a specialist in real estate law since 1993. He is a member of the firm's Commercial Leasing Group and can be reached by phone at 407-418-6334 or gary.kaleita@lowndes-law.com.