

Critical Elements of Tenant Estoppel Letters

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If you are an investor buying a leased property, you are undoubtedly looking to the rental income as the return on your investment, in addition to the appreciation in the value of the property that is likely to occur over time. Your primary focus is probably the amount of rent being paid, but there are other aspects of a lease that are important to consider.

A prudent buyer will not only review all leases in detail but will also want tenants to provide estoppel letters addressing whether potential issues exist under their leases that would adversely affect the buyer after closing. Because of this, a buyer often includes in the purchase contract a requirement for the seller to obtain acceptable estoppel letters as a condition to the buyer's obligation to close. If multiple leases exist, the buyer may be willing to get estoppel letters from only a percentage of tenants, or only from specific ones whose leases are considered critical, or a combination of both. These points will be negotiated in the purchase contract, along with what it means for a tenant's estoppel letter to be considered "acceptable" to the buyer.

Of course, there is no guarantee that tenants will give estoppel letters, even if required by their leases, so a seller will generally only agree to use commercially reasonable efforts to obtain them. If a lease includes as an exhibit a form of estoppel letter that the tenant has agreed to give upon request, that is what the buyer can expect. If the lease does not include such a form, the buyer should provide a form for the seller to send to the tenants.

What types of assurances should be in a tenant estoppel letter?

The estoppel letter should specifically reference the lease and all amendments by title, parties and dates, ideally have copies attached, and state that they are true and correct, in full force and effect, have not otherwise been modified or amended, and there are no other agreements, written or oral, relating to the tenant's leasing of the property. This gives the buyer the comfort that the tenant cannot come back later and claim that there was a modification of the lease unknown to the buyer.

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The tenant should confirm the commencement and termination dates of the lease (taking into account all options to renew), and that no notice of termination has been given by the landlord or tenant with respect to the lease.

There should be an affirmation that there exist no uncured defaults under the lease, or events which, with the passage of time, and the giving of notice, or both, would be a default.

The estoppel letter should disclose the amount of any security deposit or last month's rent (or both) deposited with the landlord. It should also indicate that all payments due to the landlord under the lease through and including the date of the letter have been made, including the current installment of minimum rent and the period to which it applies, as well as the amount.

If the rent is calculated based on the square footage that the tenant is leasing, the tenant should certify that it has been measured and what it is.

If the landlord is holding other funds besides rent that the tenant paid pursuant to the lease as escrow reserves for future expenses, the estoppel letter should specify them. These typically include funds for real estate taxes, personal property taxes, insurance and common area maintenance, but may include other purposes depending on the lease.

The estoppel letter should confirm that there are no disputes between the landlord and the tenant with respect to any rental due under the lease or with respect to any provision of the lease.

The tenant should consent to the assignment of the lease by the seller to the buyer, and agree that no terms and conditions of the lease are altered, amended or changed as a result of such assignment.

The tenant should agree to give the buyer copies of any notices which the tenant is required to deliver to the landlord under the lease with respect to defaults or failure to perform by the landlord pending closing. After that, the buyer will be the landlord and get those notices anyway; however, the buyer will want to know of any issues that arise before closing (and presumably address the ramifications of that in the purchase contract).

If the lease required the landlord to perform any construction work, the tenant should represent and warrant that (a) all conditions and requirements to be undertaken by landlord under the lease with respect to construction have been completed, (b) all improvements have been approved and accepted by tenant, (c) all utility sources and utility companies which service the property have been approved and accepted by tenant and utility service is available, (d) the tenant is in occupancy pursuant to the lease, (e) if applicable, the parking spaces provided at the property are acceptable and in compliance with the terms of the lease, (f) the tenant has no offsets, counterclaims or defenses with respect to its obligations under the lease, and (g) there are no punch-list items or finish work which remain to be completed by landlord.

The tenant should specifically acknowledge that the buyer and its proposed lender (if any) are relying on the estoppel letter in connection with the buyer's purchase of the property.

These assurances cover most of what a buyer would want to know, but all leases are different. Some statements may not be necessary. If a lease has an unusual clause or another provision that is significant to the buyer, or if the lease contains any ambiguities that deserve clarification to preclude a future dispute with the tenant, statements should be added to the estoppel letter to address them.

When received, estoppel letters should be carefully reviewed by the buyer to identify any issues and their potential significance, taking into account what the purchase contract says about “acceptable” estoppels. If the issues are serious enough to affect the economics of the transaction, the buyer may wish to terminate the contract if the seller is not obligated to cure them and refuses to do so, or if the seller does not provide an appropriate purchase price adjustment.