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REAL ESTATE ALERT



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Lease due diligence: As a requirement for a commercial property finance transaction

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In order to minimise delays that could be occasioned by the lease due diligence process down the line, it may be prudent for a prospective purchaser to conduct such lease due diligence as part of its general due diligence process conducted at the inception of the transaction and which may also be included as a condition precedent in the sale agreement.

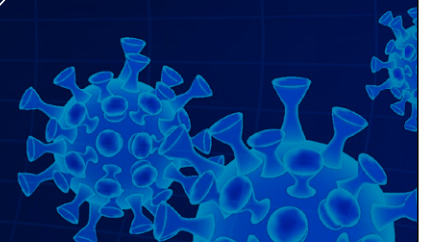
Certain of the below mentioned aspects may also be pertinent to an owner of a lettable enterprise on an ongoing basis in order to ensure the enforceability of the lease agreement and to pre-empt any lease issues being raised during a future financing transaction.

We set out hereunder certain aspects which may require investigation as part of the lease vetting process:

1. Does the landlord in terms of the lease agreement correspond with the person/entity that is required to provide the cession of rental income to the financial institution? Should the borrower be in the process of acquiring the lettable enterprise, the financial institution may require verification that the seller is the existing landlord in terms of any existing lease agreement and that the seller/landlord will be substituted by the purchaser/borrower (i.e. that the purchaser will acquire all the rights and duties of the landlord under the lease) on registration of the transfer.

CDH'S COVID-19 RESOURCE HUB

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Does the rental amount and the lease period comply with the lease agreement requirements stipulated by the financial institution?

2. Should either of the parties to the lease agreement be entities, is the landlord able to provide copies of the resolutions authorising the relevant signatory(ies) to conclude the lease agreement on behalf of the landlord and/or the tenant?
3. Has the lease agreement been properly signed by or on behalf of the parties thereto?
4. CIPC searches may need to be conducted in respect of any company or close corporation that is a party to a lease agreement in order to verify that the status of such entity is reflected as being "in business" and to verify the identity of any directors/members who may have signed the lease agreement on behalf of such entity.
5. Has the leased property/premises been adequately described in the lease agreement and does the leased property description correspond with the property in respect of which the financial institution wishes to secure rental income? It is advisable for the property description to include the erf description (for a conventional property) or sectional title property description (for sections or exclusive use areas in a sectional title scheme), street address, premises description (if only a portion of the property is being let) as well as the extent of the leased property/premises.
6. Does the rental amount and the lease period comply with the lease agreement requirements stipulated by the financial institution?
7. Does the lease agreement contain any conditions precedent? If so, the financial institution may call for proof of timeous compliance with or waiver of such conditions precedent.
8. The financial institution may require that a certain minimum percentage annual rental escalation be provided for in the lease agreement.
9. The financial institution may require financial statements evidencing that rental payments are consistent and timeous.
10. Does the landlord have sufficient loss of rental insurance, rental guarantees and/or rental deposits to protect it against non-payment of rental and damages caused by the tenant?

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Lease due diligence: As a requirement for a commercial property finance transaction...*continued*

If a suretyship or guarantee is required to be provided in terms of the lease agreement, the financial institution may require confirmation that such suretyship or guarantee has been concluded.

11. The financial institution may require that the lease agreement provides for an option to renew. If the lease agreement is close to expiry, the financial institution may require proof of renewal in order to verify that future rental income is secured.
12. The financial institution would normally require confirmation that the lease agreement does not contain any provisions prohibiting the landlord from ceding and assigning its contractual rights or restricting the landlord from alienating, disposing of or selling the leased property/premises.
13. Does the lease agreement contain any conditions that may be prejudicial to the financial institution including "escape" and rental reduction clauses, for example:
 - a. Clauses dealing with a reduction in turnover or a reduction in tenancy which would result in a subsequent reduction of the rental payable and which could therefore detrimentally affect the borrower's ability to fulfil its full repayment obligation to the financial institution;
 - b. Clauses providing for minimum occupancy or guaranteed thresholds or clauses dealing with delayed occupancy, which would allow the tenant the right to withdraw from the lease agreement.
14. Does the lease agreement contain any exclusivity clauses providing that only the tenant and no other occupant in the retail complex may engage in a particular type of business?
15. Does the lease agreement contain any handwritten amendments or insertions and if so, have all parties initialled such amendments or insertions in agreement thereof?
16. If a suretyship or guarantee is required to be provided in terms of the lease agreement, the financial institution may require confirmation that such suretyship or guarantee has been concluded.
17. Does the use of the property by the tenant comply with the zoning, town planning and title deed conditions applicable to the property?
18. In view of the direct and indirect causative effects of the current Covid-19 pandemic, the lockdown measures and the regulations published from time to time, additional requirements and vetting criteria could potentially be imposed. Additional considerations could, for example, possibly include the following:
 - a. Whether any rent reductions or deferrals or any other rent concessions have been negotiated and agreed upon between the parties;

Lease due diligence: As a requirement for a commercial property finance transaction...*continued*

It is difficult to anticipate all possible ramifications of COVID-19, but additional considerations could also include an assessment of the potential impact that the pandemic has on the continued viability of a tenant's business and the resultant ability of the tenant to continue meeting its rental obligations.

- b. The implications of any lease provisions fully or partially excusing or relaxing performance obligations or withholding rental (such as *force majeure* clauses) or exclusion clauses (the purpose of which may be to exclude certain claims or liabilities of the contracting parties);
- c. Whether any material terms of the agreement have been waived, which may in turn affect future enforcement of the provisions of the lease agreement and the minimum rental requirements stipulated by the financial institution;
- d. The rights and obligations of the respective parties insofar as the safety and accessibility of the premises are concerned, especially where the premises include common areas or shared spaces with the landlord or other tenants and whether any such rights and obligations could translate into rental remissions;
- e. It is difficult to anticipate all possible ramifications of COVID-19, but additional considerations could also include an assessment of the potential impact that the pandemic has on the continued viability of a tenant's business and the resultant ability of the tenant to continue meeting its rental obligations. This would assist the assessment by the financial institution as to the achievement of the projected rental income.

In conclusion, a proper lease due diligence at the outset of a transaction coupled with ongoing administrative and legal reviews of one's lease portfolio are recommended, not only to assist prospective borrowers in streamlining any future finance applications, but also to promote good business practices, mitigating against any potential legal and financial pitfalls that abound in these unprecedented times.

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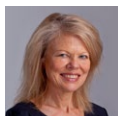
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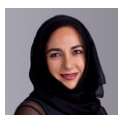
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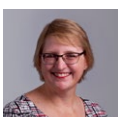
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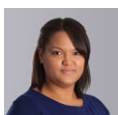
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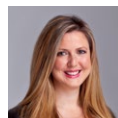
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Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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