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Loan Due Diligence: Estoppel Certificates



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Estoppel certificates are often the source of much angst for both lenders and borrowers in the context of closing a commercial mortgage loan. Where the collateral property relies upon commercial leases for a material portion of its income, tenant estoppel certificates are crucial to verifying the stream of rents necessary to support the subject mortgage loan. Since delivery of the estoppels relies upon the responsiveness of a third party typically receiving no direct benefit from the mortgage loan, tenant estoppel certificates may be difficult to obtain quickly or may be held up by a tenant conditioning delivery of its estoppel on the landlord's willingness to remedy an issue with the lease or demised premises. As such, the number of acceptable estoppel certificates that must be obtained prior to closing (whether based on a percentage of rentable square feet or a percentage of tenants in occupancy) is often a well negotiated point in the term sheet stage of a loan transaction. All too often, however, after a challenging collection process and the rush to close a transaction, the estoppels themselves may contain problems, whether of a technical nature pertaining to the execution and delivery of an estoppel or, more frequently, to particular lease terms that conflict with the actual lease itself. This article addresses some common issues that arise for lenders reviewing or seeking to enforce estoppels found to be problematic after funding of a loan.

As a general matter, estoppel certificates are delivered by a tenant in favor of a property owner and/or its lender setting forth and acknowledging the veracity of certain facts related to its lease and tenancy, including, in most cases, the precise term of the lease, the current monthly rent due (including any prepayments thereof), the status of any defaults under the lease and the existence of any options to extend or shorten the term. Additional terms are frequently added to clarify ambiguities in the original lease document or to verify that certain lease milestones have been achieved. Property purchasers as well as lenders rely upon estoppel certificates to verify

both their own diligence as well as rent rolls provided during underwriting stages. Once an estoppel certificate is signed and delivered, the tenant is expected to be estopped from claiming anything contrary to the statements set forth therein. As such, sophisticated tenants take the execution of estoppel certificates very seriously and seek to limit the content of such estoppels quite deliberately. Other tenants tend to be less precise with the content and manner of delivering



their estoppels. Questions of corporate authority and enforceability are raised, for instance, when such estoppels are signed by a local property manager rather than an authorized officer of the property owner. Relying on improperly executed and delivered estoppels can raise significant issues for the property owner and landlord.

Generally, courts strictly enforce estoppel certificates based on factors such as the relative sophistication and bargaining strength of the particular parties and the need for certainty in real estate transactions.¹ In *Plaza Freeway Ltd. P'ship v. First Mountain Bank*, the court held that "[e]ven if the estoppel certificate contains an erroneous recitation of the lease terms, the facts contained in the certificate are conclusively presumed to be true under [Evidence Code] section 622."² In this case, the parties, respective successors-in-interest to the original landlord and tenant, were trying to determine a particular lease term (the expiration date) by examining an estoppel certificate previously delivered by the tenant. The *Plaza* lease itself was silent as to the actual commencement date and the parties had no evidence that a commencement date addendum had been executed as required by the terms of the lease. Without having the addendum, calculating the actual expiration

date was impossible, other than relying on the previously delivered estoppel that made reference to an expiration date. When the tenant attempted to exercise an option to extend that was, by the terms of the lease, required to be exercised by written notice not later than a certain number of days prior to lease expiration, the landlord commenced an action claiming that the option had lapsed as calculated on the expiration date set forth in the original tenant's estoppel certificate. As such, the *Plaza* tenant was a holdover tenant and had no right to exercise the option. The court enforced the estoppel certificate and the expiration date contained therein reasoning that lenders and buyers rely upon estoppel certificates in finalizing loans and purchase and thus "application of Section 622 to estoppel certificate would promote certainty and reliability in commercial transactions. A contrary conclusion would defeat the purpose behind the widespread practice of using estoppel certificates."³

Although as a rule of thumb, estoppel certificates are enforceable against the executing party, there are exceptions. As the stakes can be high, before a lender relies on an estoppel certificate, there are several factors a lender must understand to access the enforceability thereof. First, lenders should question whether an estoppel certificate has been duly executed by someone with the proper corporate authority, as opposed to a local manager overstepping his authority.⁴ While it is obviously much quicker and more convenient for a landlord to get the signature of the local store manager rather than to go through the process of finding the appropriate officer of a national company, such haste can render an estoppel certificate unenforceable. It is axiomatic that a business entity must necessarily act by agents, and it is bound only by the acts and contracts of its agents done and made within the scope of such agent's authority.⁵ Therefore, lender's counsel should make sure that the person executing the estoppel certificate has the corporate authority to bind the tenant.

Lenders should also confirm that each estoppel certificate is complete and, to its knowledge, accurate. Many lenders assume that the tenant will investigate and insert the correct factual information before signing the estoppel

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certificate. In our experience, however, statements are often left incomplete or blank and, in such a situation, the courts may place the risk of an incomplete estoppel on the relying party. For example, in *Robert T. Miner, M.D. v. Tustin Avenue Investors*,⁶ the estoppel certificate drafted by a new landlord and executed by the tenant, stated, among other things, that (1) the lease remained in effect and (2) there were no options "except as follows" but the blank space that followed was not filled in. The lease, in fact, contained several options to extend the lease. Subsequently, the tenant notified the landlord of its interest exercising its option to extend the term of the lease but the landlord objected, claiming that the executed estoppel certificate did not reference the option. The court held that the contradictory provisions in the lease and estoppel certificate created an ambiguity as to whether an option existed as of the date of the estoppel certificate. The court reasoned that even though the estoppel certificate did not affirmatively set forth the tenant's option rights, the estoppel certificate referenced the lease as being in full force and effect. Accordingly, the court held that whether option rights existed should be found in reading the lease and the estoppel certificate together. It should be noted, however, that the estoppel certificate at question in *Miner* did not state that there were no options; rather it left the statement blank. The court likely would have arrived at a different holding if the executed estoppel certificate affirmatively stated that no tenant option existed.

Whether a mistake on an estoppel certificate is found to be enforceable appears to depend on the particular circumstances of the subject dispute. In *Yee v. Weiss*,⁷ an estoppel certificate signed by the president of the tenant failed to disclose a potential landlord default. When the tenant's president testified that he failed to make even a cursory examination of the estoppel certificate before signing it and therefore should not be bound by its affirmations, the court stated that "had the document been lengthy, his failure to examine it would have been understandable." Here, however, it was one page document with a clear heading reading "Tenants verification of Existing Lease/Estoppel certificate," which made the president's failure to perform even a quick review unreasonable. The Court also factored in that the estoppel was signed by an "experienced businessman" and not a neophyte being taken advantage of and thus held the waiver of the default to be enforceable.

Alternatively, a clear mistake in an estoppel certificate should not serve as an actual amendment to the subject lease. In *K's Merchandise Mart Inc. v. Northgate Ltd. Partnership*,⁸ a tenant certified in an estoppel certificate that it was obligated to pay a

certain management fee in addition to rent. Subsequently, the tenant refused to pay the management fee and argued that it was not required to do so pursuant to its lease, despite the executed estoppel certificate and reconciliation statements previously sent by the landlord. The court found for the tenant, stating that "a party who executes an estoppel certificate that there are no defaults is under a duty to inquire and determine, insofar as reasonably possible, what claims exist. On the other hand, an adverse party may not use an estoppel certificate as a device to make undisclosed changes to the lease."⁹

Although produced in the context of a transaction, estoppel certificates must always be drafted with an eye towards potential litigation. In addition to accuracy and proper execution, there may be a question of who is entitled to enforce or rely on such a certificate. Although there is an argument that a lender is a third party beneficiary to an estoppel certificate directed to a landlord,¹⁰ lender's counsel should insist that each certificate is in favor of either the lender or, in the alternative, the landlord and its successors and/or assigns.

Estoppel certificates can be a reliable way to verify the leases and rents that underwrite a mortgage loan, but failure to confirm their accuracy and proper execution, among other details, can render such certificates unenforceable or otherwise useless for the lender's purposes.

A properly executed estoppel certificate will, in all likelihood, trump oral testimony in resolving ambiguities and missing language in a lease. In *Yee v. Weiss*,¹¹ a tenant entered into a commercial lease with the predecessor-in-interest to its then current landlord. Six months after taking possession, the tenant experienced parking problems, which allegedly deteriorated to the point that such problems allegedly became a direct cause of the failure of the tenant's business. The tenant complained to the prior landlord, but it did nothing to alleviate the problem. Several years later, a new landlord asked the tenant to sign an estoppel certificate. The tenant stated in the estoppel certificate that all conditions of the lease required to be performed by the landlord to avoid a default had been satisfied. While the tenant did not specifically note the parking problems in the estoppel certificate, it had orally informed a representative of the new landlord about such issues. At some point later, the tenant informed the new landlord's agent that if the

parking situation was not resolved, it would terminate its tenancy based on constructive eviction and a breach of the landlord's obligations under lease. After the tenant vacated the premises, the landlord filed a complaint. The Supreme Court of Nevada held that the tenant was bound by the estoppel certificate, even though the tenant orally made a statement that contradicted the written estoppel certificate. The Court reasoned that a tenant was bound by any document it signs in spite of any ignorance of the document's content, assuming there had been no misrepresentation.¹²

In addition to preventing disagreement about the condition of a tenancy, estoppel certificates have been found to be evidence of agreement among the parties as to terms not actually set forth (or at least not clearly set forth) in the subject lease. For example, in *Kitts Land Assocs. v. Lawandowski*,¹³ when the alleged signature of a tenant on a lease was challenged, the court held that the tenant's subsequent execution of an estoppel certificate precluded it from claiming that it had never signed the lease (which would have rendered the lease unenforceable). Similarly, in *Travelers Ins. Co. v. Liljeberg Enters. Inc.*,¹⁴ the court found that the estoppel certificate confirmed a termination date of April 30, 1992, when the lease stated that "the term of this lease shall be Ten (10) years commencing on the 1st day of May, 1987 and ending on the 30th day of April, 1992" (a five year period, not ten).

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1. *Plaza Freeway Ltd. P'ship v. First Mountain Bank*, 81 Cal.App.4th 616 (2000).

2. *Id.* at 628.

3. *Id.* at 629.

4. *Plaza Freeway Ltd. P'ship v. First Mountain Bank*, 81 Cal. App.4th 616 (2000). In *Hall v. Passaic Water Co.*, a contract by a superintendent of a water company to furnish water to a private consumer was not binding, in the absence of his authority to make the contract. 83 N.J.L.771, 85 a. 349 (N.J.Ct. Err. & App. 1912).

5. *Bank of New York v. UBS Warburg, LLC*, 4 A.D.3d 112 (N.Y. App. Div. 2004).

6. 116 Cal.App.4th 264 (2004).

7. 877 P.2d 510 (Nev. 1994).

8. 835 N.E.2d 965 (App. Ill. 4th Dist. 2005).

9. *Id.* at 972.

10. *Ninety Avon Lane Meadow Lane Inc. v. Apple Health Care Inc.* 1996 Conn. Super. LEXIS 3126 *3 (Conn. Super. Ct. Nov. 29, 1996).

11. 877 P.2d 510 (Nev. 1994).

12. *Id.* at 661.

13. 1996 WL 240421 at *1 (Conn. Super. Ct. April 15, 1996).

14. 38 F.3d 1404 (5th Cir. 1994).