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Core Concepts 2

Letters of Intent and Basic Real Estate Terminology: LOI Stands for "Leave Out/Include"

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Why a Letter of Intent?

Before drafting a lease or a purchase agreement, the parties may choose to start with a letter of intent or "LOI". A letter of intent sets forth the material terms and conditions to be incorporated into the final agreement and can be an important first step in the parties' negotiation. This article and session will cover the concepts and terms, both business and legal, typically contained in a LOI, noting certain practice considerations to keep in mind and pitfalls to avoid.

A letter of intent focuses the parties – either landlord and tenant, or purchaser and seller – on a meeting of the minds for the most significant business, and sometimes legal, terms of a transaction. Agreeing on a letter of intent at the initial stages of a transaction can save time and money by helping identify major issues early on, which in turn helps avoid stalemates or "deal breakers" during the negotiation of the ultimate purchase agreement or lease. A LOI can be valuable if there are critical deadlines in a transaction, such as a tenant who needs to obtain new space based on upcoming expiration of an existing lease, or a seller who needs to dispose of property in order to pay off existing financing or take advantage of a 1031 exchange deadline. A letter of intent can also be an important tool for sellers or landlords to evaluate whom they wish to sell or lease a property to; for example, sellers may use a bid process to compare multiple letters of intent from potential purchasers to decide who will win the deal.

Binding vs. Non-Binding

However, letters of intent can also present issues because, based on how they are drafted, they can be construed to be binding agreements. Generally, it is intended that letters of intent be non-binding, with the possible exception of certain binding provisions as discussed below.

Obviously, any ambiguity about whether the deal terms in a letter of intent are binding presents a significant problem if the deal dies – one party may try to rely on the letter of intent as a binding contract to consummate the transaction, while the other party may argue that the LOI was "only" an expression of terms that might be acceptable or at most an agreement to negotiate, not an agreement to consummate the transaction, or even an agreement to agree. Letters of intent can also create problems in a changing market. For example, in a retail market with strong demand and limited supply, it could be detrimental for a landlord to commit itself to a certain rental price in a LOI that is below-market once the lease is executed. Since it is common business practice to draft letters of intent, and often without getting legal counsel involved, it is important to be cautious regarding what can or should be considered binding.

It is highly recommended that the parties include clear and conspicuous language in the letter of intent expressing their intent that, and to what extent, the LOI is non-binding. Further, as contemplated in the following example and discussed below, it is helpful to label the terms and provisions included in the LOI as "Non-Binding Understandings" and "Binding Understandings". An example of a non-binding disclaimer provision for an LOI that could be used or modified for a lease or purchase agreement is as follows:

> *Except for the agreements contained in the paragraph entitled "Binding Agreements" immediately preceding, the Parties each acknowledge and agree that neither Party shall be legally bound to the other by reason of this LOI or the acceptance thereof, nor shall any rights, liabilities or obligations, express or implied, be created hereby or thereby. It shall be and remain in the sole discretion of either Party whether or not to enter into the transactions contemplated by this LOI and not until the [Lease or Purchase Agreement] has been executed and delivered by each Party will there be any legally binding obligations of the Parties with respect to the transaction contemplated herein. Any such the [Lease or Purchase Agreement] will cover material points not addressed in this LOI. If the Parties disagree over any provision of the [Lease or Purchase Agreement] that is proposed, but not yet signed by both Parties, then either Party may unilaterally terminate negotiations.* ***THE EXECUTION OF THIS LOI, AND ALL OTHER CONDUCT, DISCUSSIONS, OR CORRESPONDENCE (WRITTEN, VERBAL, OR ELECTRONIC) BETWEEN THE PARTIES SHALL NOT BE CONSTRUED AS A CONVEYANCE OF, OR OFFER TO CONVEY, ANY INTEREST (LEGAL, EQUITABLE, OR OTHERWISE) IN THE PROPERTY UNLESS AND UNTIL THE PARTIES HAVE EXECUTED THE [LEASE OR PURCHASE AGREEMENT].*** *This LOI supersedes any prior discussions or agreements, written or oral, between the parties regarding the transactions contemplated by this LOI.*

The parties may agree, in consideration of committing time and expense to consider the viability of the transaction, undertaking due diligence review, and preparing and negotiating final transaction documents, for certain provisions to be binding. Some examples of LOI terms which parties may agree to be binding, and which should be expressly labeled as such, are as follows:

- Confidentiality: The parties may agree that the transaction negotiations are confidential, so the LOI will prohibit disclosure of the terms and conditions contained therein, except as required to a third-party advisor or direct agent of a party to the LOI, if necessary for the contemplated transaction. Typically, a binding confidentiality provision will contain express survival language for a period of time after the effective date of the LOI or until the date of execution of the PSA or Lease, which will contain provisions superseding the terms of the LOI.
- Transaction Costs: The parties will typically agree that it is a binding term of the LOI for each party to pay its own costs with respect to negotiation of the LOI, due diligence (if purchaser or tenant), and negotiation of the final PSA or lease.
- Exclusivity, "No Shop", and/or Removal from Market: In order to induce a purchaser or tenant to expend resources to conduct its due diligence and consummate the transactions contemplated in the LOI, a seller or landlord may agree not to solicit or accept offers, or negotiate with (or enter into any letter of intent, commitment or agreement with), any prospective purchaser or tenant other than the purchaser or tenant named in the LOI with respect to the subject property for a specific period of time. Typically, these provisions are drafted to require the purchaser or tenant to continue to negotiate in good faith during the agreed period of time in order to benefit from such exclusivity protections.
- Brokers: Brokers can be involved in the deal representing sellers, purchasers, landlords, tenants, or all of the above. Parties typically have separate agreements with the brokers who represent them, and commissions to brokers are usually paid when a deal "closes", i.e., the property sells or the lease is executed (or the tenant starts to occupy the premises).
- Due Diligence and Access to Property: The parties may agree to "start the clock" on due diligence and allow the purchaser or tenant party to have access to the subject property while the final forms of PSA or lease are being negotiated. In this case, it is recommended that the parties execute an access agreement to specify the "inspector party's" (purchaser or tenant) scope of access and inspection ability, notice and insurance requirements, and indemnity obligations for any damage to the property resulting from such inspections.

If specific non-binding language is *not* included in the letter of intent, and a dispute arises about the binding effect of the LOI, it will be up to the courts to decide if the parties intended for the LOI to be contractually binding. Courts rely on facts and circumstances to make this determination, such as (i) the level of ambiguity vs. detail in the terms set forth in the LOI; (ii) if the LOI indicates that a subsequent formal agreement is required and/or whether the parties have ratified the LOI in other writings; (iii) the parties' actions (e.g., expending significant money or time) or inaction indicating their reliance on the LOI or intent for it to be binding. Courts may also consider (iv) whether the LOI contains language typically found in enforceable agreements, such as "shall" versus "may," or references to "binding obligations," which can signal intent even if not explicitly labeled as such; (v) the presence of partial performance by either party—such as delivering earnest money or beginning due diligence—can also weigh in favor of enforceability; and (vi) the sophistication of the parties and whether they were represented by counsel may influence the court's analysis, as courts often presume that represented parties understood the legal significance of the language used. Ultimately, it is possible that a court may find that, although the terms of the letter of intent are not binding with respect to the contemplated transaction, the LOI is a binding "agreement to agree", or an agreement to negotiate with a standard of good faith and fair dealing.

Business Terms – Purchase and Sale Agreements

A letter of intent for a real estate purchase agreement should clearly describe the property to be acquired. The LOI should include, at a minimum, the commonly known name or address of the property and the legal description and may additionally include specifics about the property such as parking areas, outparcels, or development rights. If

the property includes multiple parcels or portions of a larger development, it is important to be clear in the LOI exactly what property is included to avoid confusion later.

The purchase price for the property and earnest money deposit should be specified. A growing trend—especially in competitive markets—is for sellers to negotiate for a non-refundable earnest money deposit that becomes “hard” or non-refundable at signing, subject to limited exceptions (e.g., environmental issues or major title defects). This is an important area to highlight in a LOI, as it reflects the seriousness of the purchaser and can become a point of leverage or concern if not clearly delineated.

A defined feasibility or inspection period is also typical in a LOI for a PSA, allowing the purchaser time to conduct due diligence and usually a “free look” at the property before the entirety of the earnest money is “hard”. This diligence includes physical inspections, environmental assessments, financial reviews (e.g., operating statements for income properties), and legal review of entitlements and recorded exceptions to title. The LOI may also contemplate a separate entitlements period, particularly for development deals, where the purchaser is responsible for obtaining zoning or land use approvals prior to closing.

The closing date for acquisition of the property should be specified in the LOI, as well as any rights of either party to extend the closing, including terms for how an extension may be exercised and whether any additional deposits are required. For example, a purchaser might be granted one 30-day extension upon delivery of additional non-refundable earnest money, or a seller may be able to extend for a period of time if it is unable to satisfy delivery of tenant estoppels.

The LOI should identify the title company or escrow agent that will manage the transaction, which may be important to the parties based on their business relationships and prior dealings. This provision in a LOI often includes details regarding which party will order the title report and updated survey and who is responsible for paying for the cost of the title policy and any endorsements thereto.

Finally, the parties should address who will be responsible for drafting the first draft of the purchase and sale agreement in the LOI. Although sellers often want control of the initial draft, this is negotiable and should be clearly stated so that work is not duplicated.

Legal Terms – Purchase and Sale Agreements

Although legal terms are often fleshed out in the final PSA, especially if legal counsel is not involved at the LOI stage, many parties address certain significant legal terms in the LOI to avoid surprises during negotiation of the PSA. Some of the key legal concepts which may be included in an LOI are:

- <u>Survey and Title Review</u>: The LOI may state deadlines for delivery and review of, and purchaser’s formal objections to, the title commitment, title exceptions, and existing survey. The LOI can also address the scope of permitted exceptions to title and any mandatory cure items that seller must cure prior to closing (e.g., certain liens on the property, etc.).
- <u>Closing Conditions and Contingencies</u>: The LOI should reference any closing conditions that will be built into the final PSA—e.g., purchaser financing, zoning or entitlement approvals, lease assignment (and estoppels and/or SNDAs) for tenant-occupied properties, and termination or assignment of certain service agreements. If third-party approvals or consents are needed to consummate the transaction or assign certain instruments related to the property, the LOI can allocate responsibility and timing.
- <u>Seller Representations and Warranties</u>: While most LOIs do not list every seller representation to be included in the final PSA, they may highlight major issues—e.g., confirmation of no pending litigation or violations, representations regarding hazardous materials and violation of environmental law, or certain tax abatements or restrictions applicable to the property. Specifying whether and for how long seller’s representations will survive closing of the transaction, and if seller’s liability will be subject to a cap, can streamline PSA negotiations later.

Business Terms – Leases

For leases, the LOI should clearly define the premises to be leased, including the suite or store number, floor, rentable square footage, and any common area allocations. If the space is part of a larger development, the LOI may also include site plans or demising wall locations.

The rent should be clearly outlined, including both base rent and additional rent such as common area maintenance (CAM), taxes, insurance, and other pass-through expenses. These additional rent numbers may be fixed or based on estimates with true-up provisions.

The lease term, including the initial duration and any renewal options, should be stated, along with any rental escalations (e.g., annual percentage increases or fixed bump schedules) and conditions for the tenant's exercise of its renewal rights.

Permitted use of the premises is also a key business term. This section may be narrowly tailored (e.g., "high-end women's apparel retail") or broadly defined (e.g., "any lawful retail use"). Depending on the property and market, the permitted use provision may be heavily negotiated and carry co-tenancy or exclusivity implications.

Landlord and tenant responsibilities for work to the premises should be clarified in the LOI. Who will make the initial improvements? Will the landlord deliver the space in a shell condition, or will the tenant construct its own improvements? Is there a tenant improvement allowance ("TI allowance"), and if so, how much is it and what are the conditions for its use and payment?

Many leases involve special tenant rights, which are often negotiated up front in the LOI. These may include:

- Parking rights: Exclusive or unassigned, ratio-based or flat number of spaces.

- Signage rights: Monument, facade, pylon, or directional signage and who pays for the installation and maintenance.

- Co-tenancy: The tenant's right to reduced rent or lease termination if key tenants (or tenants occupying a certain percentage of the leasable area) in the center fail to open or vacate.

- Early termination rights: These may be tied to delivery schedules and milestone deadlines, corporate restructuring, failure for a retailer to meet specified minimum sales volume, or other metrics.

Finally, just as with PSAs, the LOI should designate which party will draft the initial lease agreement. Landlords typically prefer to control the initial draft of the lease, since presumably they have other tenants and a preferred lease form (especially in a shopping center with all retail tenants), but this can be negotiable and some major tenants have the bargaining power to insist on using their own lease forms. Where time is of the essence, the ability for a party to produce an initial draft quickly can affect deal momentum.

Legal Terms – Leases

In leasing transactions, a few legal provisions may be discussed in the LOI if they are material to the business deal or viewed as potential deal-breakers. These include:

- Expansion and Extension Rights: Particularly in multi-tenant centers or buildings, tenants may request the right to expand into adjacent space if it becomes available. Similarly, extension rights (often at fair market rent) should be identified along with how FMV will be determined.

- Assignment and Subletting: While the lease will cover this in greater detail, the LOI may note whether the tenant will have broad assignment rights (e.g., to affiliates or in connection with a sale of the tenant's business), and whether landlord consent will be required for all transfers.

- Non-Disturbance Agreements: If the landlord's interest is encumbered by a mortgage, tenants often want the right to obtain a non-disturbance agreement from the lender. This ensures the tenant's lease remains in effect if the landlord defaults and the property is foreclosed. If this is important to the tenant's risk assessment, the LOI should require the landlord to obtain and deliver the non-disturbance agreement as a closing condition.

Conclusion

A letter of intent can prove to be a useful tool and step in negotiating a PSA or lease. On the other hand, a letter of intent can create issues and disputes if not carefully crafted. It is critical to clearly state that the LOI is not binding, with the possible exception of specifically designated binding provisions. In addition, it is important to ensure that the LOI clearly and accurately expresses the parties' intended deal terms. When using a generic template letter of intent, ambiguities, internal inconsistencies and misstatements of intended terms can arise if the drafters do not revise or delete template provisions that are not consistent with what the parties intend.