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Due diligence in leasing

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It is fairly common and in fact recommended, to proceed with a due diligence review of a property before its acquisition. At a minimum, title to the property is confirmed through a title search review. Often times, a much more thorough review is completed. Matters such as zoning and other legal compliance are reviewed together with the status of realty taxes owing as well as a physical and environmental inspection. All of these elements should be reviewed by a purchaser, even where the sale is made with legal warranty, that is where the vendor sells on the basis of its warranty that it owns the property and that the property is in good condition. In commercial transactions, a property is often sold without warranty or with limited warranties, such that the onus is on the purchaser to ensure itself of the quality and condition of the property it intends to acquire.

What is less common, but is also as important, is to complete a due diligence review of a property when a party is considering simply leasing a property.

The level of due diligence required will vary greatly depending on the nature of the lease. For example a review required when a party leases a small area in an office tower will be different from the case of a single tenant lease of an industrial facility. That being said in both scenarios, and those in between, some due diligence review will be required. The extent of the review required will depend on the obligations that the tenant will assume under the terms of the lease. The following are certain items that a tenant should confirm or review in the context of a lease.

TITLE

This review will confirm the ownership of the property. In many cases, the party signing the lease is not necessarily the owner of the property, either by error or where the owner prefers to act by another party, a property manager for example. In any event it is preferable for a tenant to have the lease signed by the owner or at a minimum, establish the consent of the owner and its authorization to have a party represent it for the purposes of the lease. A review of title will also show signs as to the landlord's financial situation, in that, it will indicate if it is default as to realty taxes, its lenders, and if there are any construction liens. This would be an indication of an owner's financial situation and its ability to respect its obligations under a lease.

CONDITIONS OF PREMISES

This review is of particular concern where under the terms of the lease, notably in a single tenant industrial or retail setting, the tenant will accept the leased premises as is, and agree to assume either through the payment of operating expenses or otherwise, the costs of repairs and maintenance. For example the roof may cost a significant amount of money to repair. Upon contemplating a lease of a single tenant facility, some inspection (which report can be requested from the landlord) on the condition of the roof should be conducted. This will allow the parties to

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clearly understand the possible liabilities and set out who will have the responsibility for any repairs either minor or major. Another example may be the existence of any environmental issues together with the existence of asbestos, PCBs and lead (again it would be common to require reports from the landlord). Typically any repair issues related to these are to the account of the landlord, but it remains preferable to have complete knowledge of the situation to clearly state each parties' responsibility in relation thereto.

ZONING AND LEGAL COMPLIANCE

In most leases, the landlord will not warrant or certify that the intended use therein will comply with applicable zoning rules. Even where a landlord has confirmed the use, the cost, inconvenience and damages incurred by a tenant will be difficult to recuperate in any related litigation, if in fact the use is not permitted. In an industrial or manufacturing situation, zoning by-laws may have restrictions as to access, noise and emissions. Retail situations will have limitations as to the nature of operations. A tenant therefore would typically need to confirm these elements.

GENERAL

Finally, a more general review of the transaction is also required. A lease can be viewed as a long term business relationship, where both landlord and tenant will be called upon to work together on a regular basis over a five (5) or ten (10) year term, if not more. Therefore it is important for a tenant to consider the record of the landlord in dealing with its tenants, the maintenance of the property and the landlord's overall financial situation. Where there is a record of poor management or where the landlord may have limited financial means otherwise required to conserve and maintain the value of the property, it is likely that there will be issues when problems need to be corrected even where the landlord has clear obligations under the lease.

SUMMARY

As with any commercial transaction a level of due diligence is required. What that level is will be subject to any number of factors, which can be determined with legal counsel. Not to forget, *tenant beware* applies to leases.

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