

Tenant Improvement and Leasing Commission Reserve (Commercial Real Estate Loan Agreement)

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A set of Standard Clauses used in commercial real estate loan agreements and security agreements to establish a reserve account for paying tenant improvements and leasing commissions for property leases as those costs become due during the loan term. These Standard Clauses describe how tenant improvement and leasing commission reserves are funded and disbursed. They contain integrated notes with important explanations and drafting and negotiating tips for all loan parties.

Section 1.01 Tenant Improvement and Leasing Commission Reserve Account (“TI/LC Reserve Account”).

- (a) Use of the TI/LC Reserve Account. Amounts in the TI/LC Reserve Account shall be used in accordance with this [Loan Agreement/[DOCUMENT NAME]] for the purpose of paying the costs of Tenant Improvements and Leasing Commissions.
- (b) Deposits to the TI/LC Reserve Account. [On [the Closing Date/[DATE]], Borrower shall deposit \$[NUMBER] with Lender as an initial deposit to the TI/LC Reserve Account.] Beginning on [the first Payment Due Date/[DATE]] and on each Payment Due Date thereafter, Borrower shall pay \$[NUMBER] (each, a “**Monthly TI/LC Deposit**”) to Lender for deposit to the TI/LC Reserve Account. [If, on any Payment Due Date, the balance of the TI/LC Reserve Account equals or exceeds \$[NUMBER][for [NUMBER] consecutive full calendar months] (“**TI/LC Cap**”), no Monthly TI/LC Deposit shall be due. [If thereafter, the balance of the TI/LC Reserve Account falls below \$[NUMBER], then, [upon notice by Lender,] Borrower shall resume payments of the Monthly TI/LC Deposit in accordance with this Section until such time as the balance of the TI/LC Reserve Account shall again reach the TI/LC Cap[./ for [NUMBER IN WORDS] ([NUMBER])] consecutive months.]]

DRAFTING NOTE: DEPOSITS TO TI/LC RESERVE ACCOUNTS

Depending on the amount and timing of the anticipated expenditures, the TI/LC Reserve Account can be funded in fixed monthly installments, lump sum payments, or a combination of both. For example:

- Fixed monthly installments may:
 - begin at loan closing;
 - begin at a future date (if the risk of tenant rollover occurs later in the loan's term);
 - stop once a target amount is reached; or
 - stop when the account balance reaches a designated amount but later resume if the account balance falls below that amount.
- Lump sum payments may be required in addition to fixed monthly installments:
 - at loan closing;
 - at specific intervals or on specific dates during the loan term; or
 - both.

Lenders sometimes require a separate reserve for a specific tenant if the termination of that tenant's lease would pose a special risk to property cash flow, such as an anchor tenant in a shopping mall. The special tenant's reserve can be required in addition to (or instead of) the TI/LC Reserve (see Practice Note, Loan Reserves and Escrows (Commercial Real Estate): Special Tenant Rollover Reserve ([W-020-0183](#))).

CUSTOMIZING THE FUNDING PROVISIONS OF THESE STANDARD CLAUSES

Funding at Closing

Use the first square-bracketed sentence of Section 1.01(b) if a lump sum payment to the TI/LC Reserve Account is required at closing or at a date certain in the future. Terms relating to lump sum payment requirements are usually supplied by one or more of:

- The loan underwriters.
- The loan term sheet.
- The loan closing statement.

If no lump sum deposits are required in the TI/LC Reserve Account, delete the first square-bracketed sentence.

Monthly Installment Amount

The second sentence of Section 1.01(b) establishes the monthly installment amount required to be paid into the TI/LC Reserve Account. The drafter can select between monthly installments that begin either:

- On the first payment due date.
- At a date certain in the future.

If there is no cap on the TI/LC Reserve Account, delete all remaining optional language in Section 1.01(b).

Capping the Reserve

If the TI/LC Reserve only needs to reach a certain dollar amount, use the third, bracketed sentence. The drafter must select whether the cap is reached when the account balance:

- Achieves the targeted amount.
- Remains at or above the targeted amount for a specified number of consecutive months.

Cap as Floor Versus Ceiling

If no further installment payments are required after the cap is reached (a maximum cap), delete the remaining language in Section 1.01(b). If installment payments resume if the account balance later drops below a minimum amount, use the fourth, bracketed sentence of Section 1.01(b) and complete the blank in that sentence. The drafter can select whether installments resume:

- Automatically.
- Only after notice from the lender.

(c) Disbursements from the TI/LC Reserve Account. Subject to the terms and conditions hereof, Lender shall make disbursements from the TI/LC Reserve Account as follows:

(i) Disbursements for Tenant Improvements. Funds in the TI/LC Reserve Account may be used to reimburse the costs and expenses paid or incurred by Borrower to perform Tenant

Improvements required under any new Lease or any modification, renewal, or extension of an existing Lease in accordance with the disbursement procedures (including evidence of lien-free performance) as set forth in Section [NUMBER] and provided further that:

DRAFTING NOTE: DISBURSEMENTS FOR TENANT IMPROVEMENTS

Disbursements from the TI/LC Reserve Account are subject to general and specific disbursement conditions that are common in loan escrows and reserves relating to:

- New or renewal property leases (see Drafting Note, Lenders’ Consent for New and Renewal Leases).
- Construction work performed to improve the property (see Drafting Note, Lien Free Completion Conditions).

Loan documents typically set out the disbursement conditions for TIs and LCs in a separate section of the operative loan document because these conditions apply to all loan reserves. They generally require the borrower to prove it has performed its contractual lease-related obligations and there are no resulting liens against the property.

Other loan reserves that typically involve construction work and establish lien-free completion requirements as a condition to disbursements are:

- Immediate repair reserves (see Practice Note, Loan Reserves and Escrows (Commercial Real Estate): Immediate Repair Reserve ([W-020-0183](#))).
- Replacement reserves (see Practice Note, Loan Reserves and Escrows (Commercial Real Estate): Replacement Reserve ([W-020-0183](#))).

LIEN FREE COMPLETION CONDITIONS

Section 1.01(c)(i) requires the drafter to complete the blank with the applicable cross-reference to the section in the loan agreement (or other loan document) that describes the conditions precedent that must be satisfied for disbursements relating to construction work. For standard clauses with typical conditions precedent for disbursements for TIs and LCs that ensure lien free completion of certain borrower obligations, see Standard Document, Lien-Free Completion Requirements for Reserve Disbursements (Commercial Real Estate Loan Agreement) ([W-020-4405](#)).

(A) any such Lease is entered into in accordance with the terms and provisions of Section [NUMBER] hereof;

DRAFTING NOTE: LENDERS’ CONSENT FOR NEW AND RENEWAL LEASES

Lenders only disburse for TIs and LCs if the expense was incurred for an allowable property lease. All property leases must meet specific basic criteria established under the loan documents. The borrower typically must also request the lender’s consent for any new or renewal property lease that:

- Is defined as a major lease (see Drafting Note, Defining Major Leases).

- Does not meet the criteria applicable to all new and renewal leases (see Drafting Note, Criteria for All New and Renewal Leases).

The specific conditions that apply to the lender’s rights to approve new and renewal leases are typically set out in one or more separate sections of the loan agreement (or other loan document) (see Drafting Note, Conditions Precedent to New and Renewal Leases).

Defining Major Leases

Major leases can be defined based on factors such as:

- The leased space as a percentage of the property's gross rentable space.
- The size of the leased premises (expressed in square feet).
- The rent the lease generates (typically expressed as a percentage of total property rent).
- Some combination of factors.

CRITERIA FOR ALL NEW AND RENEWAL LEASES

Borrowers have some leeway entering into small leases (or minor lease modifications) in the ordinary course of business without the lender's consent.

Provided the lease is a not major lease requiring prior lender consent, no lender consent is typically needed if the new or renewal lease:

- Is made on a lender-approved standard form without major deviations to the form language and lease terms.
- Provides for current market rental rates and terms (except in the case of a lease renewal if the rent or formula for computing rent is already established in the existing lease).
- Is an arms-length agreement with a tenant unaffiliated with the borrower.

- Is not likely to cause a material adverse effect on the property. The term "material adverse effect" is usually defined in the loan documents to describe matters that can negatively impact:
 - the value of the property;
 - the ability of the borrower (or other loan parties) to perform their obligations;
 - the priority of the lender's lien and security interest in the mortgaged real property;
 - the lender's enforcement rights and remedies; and
 - the property's compliance with laws.
- Is subordinate to the lien of the mortgage or other security instrument.

CONDITIONS PRECEDENT TO NEW AND RENEWAL LEASES

Section 1.01(c)(i) (C) requires the document drafter to complete the blank with the applicable cross-reference in the loan agreement (or other document) that sets out the conditions precedent the borrower must satisfy before entering into new and renewal property leases. For sample clauses with typical conditions precedent applicable to a borrower's right to enter into new and renewal leases, see Standard Document, Leasing Covenants and Requirements (Commercial Real Estate Loan Agreement) ([W-020-4666](#)).

(B) the cost of such Tenant Improvements is market, reasonable, and customary;

(C) the Tenant Improvements are fully performed in accordance with the standards set forth in both the related Lease and in the Loan Documents and have been accepted unconditionally by the related Tenant;

(D) unless otherwise agreed in writing by Lender, the related Tenant is occupying the premises and is paying rent in accordance with the related Lease;

(E) [the amount requested does not exceed \$[NUMBER] per square foot with respect to a new Lease or \$[NUMBER] with respect to any modification, renewal, or extension of an existing Lease[./; and]]

(F) [the subject lease has an effective rental rate, net of any concessions, of at least [NUMBER]% of the pro forma rents at the Property[./; and]]

DRAFTING NOTE: FINANCIAL CONDITIONS PRECEDENT TO DISBURSING TIS

Optional subsections (E) and (F) impose financial conditions precedent on disbursements for TIs.

PER SQUARE FOOT ALLOWANCE

Optional subsection (E) gives the lender the right to limit or deny all or a portion of the disbursement request if the disbursement exceeds a maximum square foot allowance. Lenders often establish parameters for reimbursable TIs and want the ability to limit

or deny a disbursement request if the lender determines that the cost is excessive for:

- The property.
- The premises.
- The specific tenant.

LEASE PARITY

Optional subsection (F) requires new or renewal leases to be on par with other property leases.

(G) [the related Tenant shall have executed and delivered a subordination, non-disturbance, and attornment agreement or a tenant estoppel certificate, or both, on such forms as is [reasonably] acceptable to Lender.]

DRAFTING NOTE: TENANT AGREEMENTS

Optional subsection (G) should be used if the lender requires agreements or certificates from the tenant to:

- Confirm the terms of the new or renewal lease by estoppel certificate (see Standard Document, Tenant Estoppel Certificate ([5-503-1923](#))).
- Subordinate the new lease. For guidance and information about drafting and negotiating subordination, non-disturbance, and attornment agreements (SNDAs) from both lender’s and tenant’s perspective, see Standard Document, Subordination, Non-Disturbance, and Attornment Agreement (SNDA) (Pro-Lender) ([4-503-3456](#)) and Standard Document, Subordination, Non-Disturbance, and

Attornment Agreement (SNDA) (Pro-Tenant) ([W-018-4204](#)).

If the affected tenant has previously delivered the estoppels or SNDAs to the lender, the borrower would typically not be required to obtain further tenant certifications except in the case of:

- A major renovation of the leased premises.
- A major lease amendment.

Borrowers typically ask for the optional language of subsection (G) so that lenders will be reasonable in exercising discretion over documents that are not on the lender’s preferred forms. When requested, lenders usually agree to a reasonableness standard.

(ii) Disbursements for Leasing Commission. Funds in the TI/LC Reserve Account may also be used to pay or reimburse Borrower for Leasing Commissions incurred in accordance with the disbursement procedures set forth in [NUMBER] provided that:

DRAFTING NOTE: CROSS REFERENCE TO LIEN FREE COMPLETION CONDITIONS

The blank in square brackets requires a cross reference to another section of the same document that sets out the conditions precedent that apply to all disbursements for LCs that are conditioned on the borrower proving lien free satisfaction of its obligations.

Typical lien free completion conditions require:

- The completion and full payment of the repair item, unless the lender allows disbursements (either automatically or with the lender’s consent) for partial completion of work.
- Submission of a formal written disbursement request to the lender. Lenders may restrict the number (or frequency) of permissible disbursement requests for some or all reserves.
- The absence of any loan default.
- The receipt of a certificate signed by an officer of the borrower (and countersigned by the project architect or engineer if requested by the lender) certifying, among other things, that:
 - all information in the submission (including in any attachments, invoices, and statements) is true and correct;
 - the work was performed in a good and workmanlike manner;
 - the work complies with all applicable laws;
 - each party providing services or goods has been paid in full (or in part if partial payments are permitted);
 - (if applicable) the leasing commission has been unconditionally earned and fully paid and the agent has acknowledged receipt of the commission in writing; and
 - (if applicable), the materials are installed (or securely stored) at the property.
- A site inspection by lender (or its representatives) to confirm:
 - full or partial completion of the work (as applicable); and
 - installation (or delivery) of the supplies (as applicable).
- A signed lien waiver from the contractor or supplier. For a form lien waiver for partial payment, see Standard Document, Partial Waiver and Release of Liens and Claims (Construction) ([W-002-6826](#)). For a form lien waiver for full payment, see Standard Document, Final Waiver and Release of Liens and Claims (Construction) ([W-009-8445](#)).
- A title search and, if required, a title insurance endorsement. A title search is a standard loan requirement but may be waived for routine replacements unless the property is in a state with strong mechanics’ lien laws. Title policy endorsements are standard for construction loans but are not usually available (or permissible under state insurance law) for fully funded permanent loans. For state specific information relating to mechanics’ liens and other super liens, see Real Estate Finance: State Q&A Tool: Questions 6 and 7.
- The payment of lender’s fees and expenses. Lenders typically only impose fees for evaluating disbursement requests if they incur third-party expenses, such as expenses charged by:
 - construction consultants;
 - title companies;
 - loan servicers; and
 - attorneys.
- The reserve must have sufficient funds to pay the requested expense.

Lenders usually also reserve the right to directly pay the contractor or supplier (instead of the borrower) for the expense being requisitioned.

For sample clauses, see Standard Document, Lien-Free Completion Requirements for Reserve Disbursements (Commercial Real Estate Loan Agreement) ([W-020-4405](#)).

(A) Such Leasing Commissions are market, reasonable, and customary for properties similar to the Property (or portion of the Property leased) for which a commission is due;

- (B) The amount of such Leasing Commissions is determined pursuant to an arm’s length agreement between Borrower and each leasing agent owed a Leasing Commission;
- (C) The Lease is fully executed and has been approved by Lender or, if Lender’s approval is not required, conforms with all requirements set forth in Section [NUMBER] of this [Loan Agreement/ [DOCUMENT NAME]];

DRAFTING NOTE: CROSS REFERENCE TO LEASING REQUIREMENTS

The blank in the first square bracket requires a cross reference to the document (and section of the document) with the covenants and requirements that apply to the borrower’s right to enter into new and renewal leases.

Typical conditions require the property leases to be:

- Approved by lender if:
 - The lease is a major lease; or
 - does not satisfy the other leasing conditions.
- On a lender-approved lease form, without material deviation.

- At market rents with lease terms that are customary, and reasonable.
- An arms-length leasing transactions with a non-affiliate.
- Subordinate to the lien of the mortgage.

No lease is permitted if it would have a material adverse effect on the property or the loan.

For sample loan clauses that set out typical leasing covenants and requirements, see Standard Document, Leasing Covenants and Requirements (Commercial Real Estate Loan Agreement) ([W-020-4666](#)).

- (D) Unless otherwise agreed to by Lender in writing, the tenant under the related Lease or for which the Leasing Commission is due is: (x) occupying the premises covered in such Lease; and (y) paying rent[./; and]
- (E) [The related Lease has an effective rental rate, net of any concessions, of at least [[NUMBER]]% of the pro forma rents at the Property.]

DRAFTING NOTE: FINANCIAL CONDITIONS PRECEDENT TO DISBURSING FOR TCS

Optional subsection (E) should only be used if the lender requires new and renewal leases to be on par with existing property leases. Include this optional provision if Section 1.01(c)(i)(F) applies.

The percentage in the blank is negotiable, but 90-95% is routine.

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