

**COMMERCIAL LEASES:  
A COMPANY'S MOST IMPORTANT CONTRACT**

**By: W. Leighton Lord III\***

**I. INTRODUCTION**

A well run Fortune 100 company has an internal legal policy that all contracts that could potentially cost the company over \$100,000 are to be reviewed and approved by either in-house or outside counsel with expertise in the area of the contract. However, the company also had a policy that any commercial leases – regardless of their term, monetary value, or importance to the company – would be reviewed by “someone” in its real estate department only. Leases were inevitably reviewed by the person with the lightest workload at the time the lease arrived. This policy remained in effect until the company became involved in a complicated lease dispute in which a landlord used a sophisticated lease provision to force the company to either leave the leased premises or pay substantially more rent. After that experience, the company quickly changed its policy so that all leases would be reviewed and approved by in-house or outside counsel with expertise in commercial lease law.

The point of this story is that many companies today do not give their leases the same respect they give commercial contracts. The problem is that most leases are far more important than the majority of contracts the company enters into. There are two primary reasons for this. First, the dollar value of many leases over an entire lease term can be staggering. Second, the disruption to operations when the provisions of a lease do not work in the company's favor can do incalculable damage to the company.

This article will attempt to address some of the basics of understanding and negotiating a commercial lease on behalf of a tenant. While many companies may be landlords, typically a company is a tenant. That being said, the issues raised in this article are of equal interest to a landlord.

This article also assumes that the corporate tenant has been asked to live with the landlord's form lease. Most landlords will insist that their form lease be used. Few tenants have the financial clout to insist that their lease form be used in the landlord's building; even the most financially desirable tenants do not always get to use their form lease. In addition, in a multi-tenant building it may not make sense for a tenant to use its own lease, as all of the leases need to work together on such issues as common area maintenance and additional rent. A tenant will have the best luck using its lease if it is the only tenant in a building.

## II. BUSINESS POINTS

Commercial leases can be divided into two essential parts: Business points, such as the rent and the term; and standard lease provisions, such as insurance, condemnation, and events of default.

The attorney's review of the business points is primarily focused on assuring that the business points are those for which the client bargained. In many cases there will be a letter of intent or at least a term sheet that lists the business points of the lease. If this is the case, the attorney merely needs to be sure that the business points in the lease match those of the term sheet or letter of intent. Where no term sheet or letter of intent exists, the attorney often has to work through the business points with the client to be certain they meet the client's needs.

Key business points are as follows:

A. The Parties - Be sure that the appropriate tenant is listed. Does the parent company sign leases or should a subsidiary?

B. The Building - The lease should accurately identify the building in which the tenant will rent space. Ideally, some type of metes and bounds or survey will be attached to the lease. At minimum, an accurate address and description of the premises need to be in the lease. If the tenant is obligated to pay a portion of the common area expenses, be certain that those areas are accurately identified.

C. The Demised Premises - The space to be leased must be accurately described by floor, location, and square footage. The floor plan is the best way to identify the demised premises and the square footage.

D. Commencement and Expiration Dates - The commencement and expiration dates need to be clearly defined. If the commencement date can move, define the expiration date as a certain period after the commencement date.

E. Term - Remember that the lease date, the commencement date, and the rent commencement date may all be different. The term and any renewal options need to be set out clearly.

F. Rent - The rent and any rent escalations need to be clearly set out. If escalations are by a formula, be sure to run the formula and share the results with the client.

G. Expansion and Contraction Options - The landlord will probably not offer these, but you may want to request them. The bigger the tenant, the more likely the tenant will get expansion rights. Contraction rights always come at a price, however, even if a landlord grants them.

H. Additional Rent - Be sure to determine what additional rent – such as operating expenses or real estate taxes – the tenant will be obligated to pay. The real rental rate is a total of everything the tenant must pay to lease the space.

I. Parking - This is an important issue to most tenants, and assurance of adequate parking and assigned or reserved parking is often necessary.

J. Signage - Many tenants depend on some form of signage, and this needs to be contained in the lease. At a minimum, the landlord should allow or provide identification and directional signage.

K. Upfitting – The tenant’s right to upfit or make improvements to the demised premises – and who will pay for those enhancements – needs to be set forth. If the tenant improvements are extensive or costly, the lease may need to include plans and specifications, designation of a contractor, and a separate work letter.

L. Fixtures - If a tenant plans to install trade fixtures in the demised premises, it should be stated that such installation is allowed and that the fixtures will remain the property of the tenant.

### **III. STANDARD LEASE PROVISIONS**

A. Use - Some leases provide that the demised premises may be used for any lawful purpose. Most tenants can live with this use restriction. Many use restrictions, however, go much further. Determine if the use restriction not only impairs the tenant’s intended use, but also the tenant’s ability to sublet or assign the lease.

B. Full-Service or Net - You must determine at the onset whether the tenant is getting into a full-service or net lease. With a full-service lease, services such as janitorial, utilities, and maintenance are provided by the landlord and included in the rent and/or in the additional rent charged to the tenant. In a net lease, items such as taxes, insurance, and utilities are either paid directly by the tenant, or the landlord forwards invoices to the tenant for these amounts. A full-service lease is typical in a multi-tenant building; a net lease is more likely in a single-tenant building. In either case, it must be determined what costs the tenant will be obligated to pay. With a full-service lease, items the landlord can “pass-through” to the tenant need to be scrutinized to be sure that costs unrelated to the building are not being passed along. In addition, certain costs – such as structural repairs to the building – are inappropriate pass-through items. The tenant should have the right to review the supporting back-up documentation of any operating expense pass-through the landlord charges. In multi-tenant buildings, especially one in the process of initial lease-up, the tenant should request a “gross-up” provision, which requires the landlord to calculate operating expenses based upon an assumed occupancy of 90 to 95 percent. This is a fair provision for the landlord and tenant.

C. Relocation - No tenant wants to be relocated, but certain small tenants should expect this to be in a landlord’s lease. No tenant should agree to this term unless the landlord will pay the costs of relocation. In addition, some landlords will agree to only relocate a tenant

once during the lease term. Large tenants can usually negotiate the relocation provision out of the lease.

D. Waiver of Subrogation - This provision often confuses tenants, but in fact it is to most every tenant's advantage. Basically, the concept is that the landlord will insure the building, the tenant will insure its property in the demised premises, and both parties will agree through waiver of subrogation that they will look to their insurance if there is damage to the building or the tenant's property and not sue one another – even if the other party may have been negligent. The tenant needs to make sure this is in compliance with its insurance coverage. Some leases will except gross negligence or intentional misconduct from the waiver of subrogation.

E. Condemnation - The tenant should have the right to terminate the lease if the building or any part of it is condemned to the extent that the tenant can no longer enjoy the demised premises. This provision and the concept of a partial condemnation need to be closely reviewed in cases where parking is adjacent to a busy street; there is a greater likelihood that a strip of parking will be taken rather than an actual building or a part of a building.

F. SNDA - Real estate and banking lawyers like to throw these initials out to confuse other lawyers, especially litigators. They are, however, very important. They stand for subordination, non-disturbance, and attornment. Such an agreement is especially important in certain judicial foreclosure states, because without one a tenant could be on the street for doing nothing wrong. The first part, subordination, means the tenant's lease is subordinate to the landlord's lender's lien on the land and building. The last part, attornment, means that if a new landlord takes over, potentially by foreclosure, the tenant will attorn or look to that new landlord as the landlord. Most important for the tenant is the non-disturbance, which means that as long as the tenant is not in default under the lease, the new landlord will agree not to disturb the possession of (i.e., evict) the tenant. In a foreclosure, if there was not a non-disturbance, a foreclosing party could "cut off" and otherwise terminate all subordinated leases. Be especially careful that there is not a subordination provision without a non-disturbance provision.

G. Events of Default - Standard events of default such as not paying rent or destroying the building should be considered non-negotiable. What can be negotiated are notice and cure rights. In other words, ask for notice and the right to cure a default. Be careful that the landlord does not have events of default that are inappropriate for the building and the demised premises. For example, a commercial office building lease may make an event of default the fact that the tenant has moved out of the demised premises even though the tenant continues to pay rent. This so-called "going dark" provision is often not appropriate in a commercial office building since as long as the tenant is paying rent, the landlord should not really be that

concerned with whether the tenant is in the space unless, perhaps, if the space is on the ground floor and visible to the public.

#### **IV. CONCLUSION**

When negotiating a commercial lease for a tenant, assess your leverage and negotiate accordingly. If you are representing a very small tenant against a very large landlord in a tight market or in a popular building, your leverage is limited and you should merely ask for those things that are most important. In addition, you should be certain that the business points are accurately reflected in the lease. As your leverage increases you can, of course, ask for more. But always remember that the landlord has important reasons to keep consistency in its standard lease. And, finally, take leases seriously. They impact the bottom line in more ways than one.

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