Negotiating Tenant Lease Comments - Deal Makers or Deal Breakers?

By Richard L. Seide

We are frequently asked to review proposed leases and in particular, tenant lease comments received in connection with lease negotiations. Unfortunately, we have seen too many situations where both counsel and clients get so focused on technicalities and the "small stuff" that deals are "killed" or delayed to the point that the proposed tenant goes looking for friendlier turf. On the other hand, we also see leases that were prepared too quickly and without enough attention to detail. Those leases are harder to enforce when and if a default of any kind occurs.

We also see situations where a landlord has paid legal expenses for lease review that seem excessive based on the size of the lease and the relative lack of complex issues that are involved.

The key is to know what battles are worth fighting and which ones to walk away from, all while handling the work in a timely and cost effective manner.

During the free fall recession that commenced a number of years back, most property owners went through a serious leasing drought. During that time, many leases were signed with the thought that an occupied space (even with a weak tenant) was better than a vacant space. As a result, many owners ended up with less than optimal tenants and leases. Over the last year or two, thankfully, the market has steadily improved and we are seeing lots of action in leasing and are reviewing new leases and tenant lease comments every week. We are also seeing a lot of tenant expansions and renewals. Given the increase in leasing, we thought this would be a good time to share some of our experiences with lease negotiations and discuss the most common issues that tenants (and tenants' counsel) have with lease language.

While portfolio managers, investors and leasing departments typically have their own list of "hot buttons" or "non negotiable items" we feel the following lease issues and clauses are worth discussing. The discussion below is obviously no where near all inclusive, but will hopefully give you a sampling of issues that should be considered important as opposed to those issues that should not be allowed to greatly impact the successful conclusion of a lease.

What Does Matter and Why

The Name: We can't emphasize enough the importance of knowing exactly "who" and "what" your tenant is before you prepare a lease. Naming your tenant

correctly and knowing the nature of the entity to whom you are leasing space is critical. While this may seem rather obvious, we see errors in this regard on a repetitive basis, and they can lead to some unpleasant problems such as an inability to be able to enforce the lease against a legitimate entity or individual. Know who your tenant is and get a copy of legal documents that substantiate the entity name and their legal capacity, i.e. LLC, LLP, corporation, LP, etc.

Lease Name Must Match Financials: If you name one entity on the lease but the financials are from a different but perhaps related entity, that doesn't give you what you have bargained for. The financials are only helpful if they are from the exact entity that signs the document, whether it is the lease or a guaranty. Owners decide to do deals, for the most part, based upon the financial stability and credit worthiness of an entity or an individual. Naming a tenant or a guarantor who is different from the entity or individual providing financials defeats the purpose of obtaining financials. We mention this because we see it on an all too frequent basis.

Square Footage: Most of you already know the danger of quoting "exact" square footage but we still see it in certain lease forms. Similarly we see leases that show, on their face, a direct relationship between square footage and rent. Since there are a number of ways to measure square footage, we recommend that rent be for a set amount and not tied to a square footage measurement in the lease document. A tenant may be able to connect the dots if the matter is litigated, but there is no

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need for an owner to do that for the tenant in the lease. If you must quote square footage in the lease document, make sure it is stated as an "approximate" number rather than an absolute.

Triple Net Language - What Can and Cannot be Included and Passed Through to the Tenant; and Timing of Annual Reconciliations: It is very important that your lease language is clear and thorough as to what can be passed through to the tenant. Costs to repair, maintain and, if reasonably required, replace items should be covered. The right to pass through a management fee and/or an administrative fee should be spelled out. The bottom line is that you aren't going to be able to pass through costs and charges to your tenants unless the lease language supports it.

Putting a "drop dead" date for providing a tenant with a reconciliation statement can come back to haunt the owner if the reconciliation statement is delayed. A better approach is to use words like "endeavor to provide" or "use best efforts to provide" and/or to make the date to provide the reconciliation statement far enough out that unanticipated delays won't really matter.

Default Language and Timing Issues: Make sure you give thought to any changes a prospective tenant requests in the default provision. Management will need to live with that language down the road. While a five (5) day cure period may be reasonable, we would not recommend a twenty (20) or thirty (30) day cure period for monetary defaults. However, these should not be "deal killer" issues as long as the number of days being requested is not completely unreasonable.

Insurance Requirements: You should always have your insurance department, broker or agent review the requirements spelled out in your form lease and, if appropriate, changes should be made. Types of coverage and levels of coverage are not set in stone and industry standards and recommendations change over time,often over relatively short periods of time. An annual review of the insurance requirements by your insurance agent or risk manager would be appropriate. Special attention needs to be paid to tenant requested changes in this area of the lease. An insurance expert needs to review those changes, as well as counsel. A good time to update insurance requirements is when a lease is being extended or renewed. Insurance requirements that made sense when a 10 year lease was signed, are often outdated when the end of the term of that lease is approaching. It is also crucial for leases to contain waiver of subrogation provisions, and consultation with counsel and insurance experts in this regard is important.

Use Provisions and Limitations: It is very important that the use provisions of a lease be drafted carefully and as narrowly as possible. This becomes a major issue in retail leases where tenants often decide to "change" or "supplement" their use when economic times are weak or there is a societal change that makes a previously "popular" use less popular. If the lease language is broad and generalized, and the retail center also contains uses that have been promised as "exclusive uses" to one or more tenants,broad,non-specific use clauses in leases can be a recipe for disaster. Even in non retail settings, defining the use with specificity can often avoid trouble with other tenants and/or give an owner a "hook" to remove an offending tenant.

Late Charges; Interest on Past Due Obligations: While late payment of rent does, indeed, cause damage to an owner, spending an inordinate amount of time negotiating the amount of a late charge or the rate of interest on delinquent rent is counterproductive. Those types of charges are often not imposed by landlords, or are waived, or may be found unenforceable by courts. As long as the lease contains some reasonable late charge and interest provisions to hopefully act as a deterrent against late payment of rent, a limited

amount of time should be spent on "negotiating" these issues.

Indemnity: Completely one sided indemnity provisions are typically desired by landlords, but are rarely acceptable to tenants. Making each party responsible in a lease for his/her/its own negligence or intentional misconduct is reasonable and landlords should be prepared, within reason, to agree to mutual indemnification provisions.

Hazardous Materials: This is a very important provision in a lease, particularly in industrial leases where the tenant's use may involve or generate hazardous materials and substances. A well drafted and up to date Hazardous Materials provision is mandatory. Larger landlords will have risk management departments who have extensive experience in this area. Smaller companies need to rely on counsel. This is an area of the lease we believe should be reviewed on an annual basis since the law in this area continues to evolve.

Option Language: Option provisions need to be clearly drafted. The language needs to provide for option exercise by written notice, for the option to lapse if the tenant is in default at the time of the exercise, and for clear language as to the method of determination of rent during the option period. Option provisions are strictly construed and lack of clarity or ambiguity can be extremely problematic.

The foregoing is just a small sample of where a landlord needs to focus its efforts in lease negotiation and drafting; and where intense focus may not be worth the time or effort. We recommend that landlords consult with counsel when negotiating leases, especially where the tenant has reviewed the landlord's form lease and returned numerous comments. Many of those comments may be well taken and relatively easy to accept. Some will be more problematic.

It is the role of counsel to wisely advise the landlord during lease negotiations with the goal of maximizing the benefit and making the deal "happen" if at all possible while being cost effective and time efficient.

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