This downloadable and printable PDF document is NOT the course; it is only the study material of the course provided to you as a courtesy in a downloadable and printable format for your convenience. After reading/studying this PDF, you still must log back into your account and complete the TREC-required final exam in order to successfully complete the course and receive course credit at TREC. To do so, please log back into your account at www.AbsoluteCE.com, open the course, and press the third (>) arrow button at the top of the course window to navigate through the online material.
How to Successfully Negotiate Commercial Leases

The Purpose of this Course:

This course is an introduction to and discussion of the written commercial lease document, its typical clauses, and negotiation strategies from both the landlord and tenant’s perspectives. This course is valuable to the tenant rep broker and the property manager, as well as the building owner’s representative.

Why Leases are Important

The Commercial Lease

A lease is a binding legal contract, or agreement, giving possession and use of land or improvements to one party (the “lessee” or tenant), in return for a specified consideration (rental payment) to the other party (the “lessor”, owner or landlord). All references to “lease” in this Course will mean a written, as opposed to verbal, lease.

Leases Determine Property Value

Leases are vitally important because the underlying value of most commercial real estate is its ability to generate new income from leasing. Lease agreements directly affect net income and property values because they dictate rent and expense payments. Most property managers and owners carefully scrutinize the profitability, or “yield”, of all their lease agreements to protect the value of their asset. Leases provide the written mechanism for establishing the generation of income from the property to the owner.

Leases Create a Legal, Binding Arrangement

A tenant contracts for the use of the owner’s business space by means of a legally binding lease. The lease establishes the terms of the tenant’s use of the lease space, as well as the business relationship between the parties.
Leases Distribute Risk

Like any business agreement, real estate leases involve substantial risks, responsibilities, and costs. Leases help both parties fairly distribute these risks, responsibilities, and costs. Most courts would like to see leases that are inherently balanced. This means both parties to the lease share the risks relatively evenly.

Leases Protect the Landlord’s Interest

Well-drafted leases protect the landlord by clearly setting forth the terms and conditions pursuant to which the tenant may use and occupy the property. A well-drafted lease will also clearly set forth the rights and obligations of both parties during the lease term.

Leases Protect the Tenant’s Interest

Just as for the landlord, a well-drafted lease will clearly state the terms by which the tenant may use and occupy the lease space. Both landlord and tenant have a vested interest in clearly understanding what his/her obligations are regarding the property, as well as what to expect from the other party in return. A well-drafted lease will address these issues so that neither party has any misunderstanding nor surprise after the lease has been signed.
The Parties to the Lease and Space Description

The Parties to the Lease

All parties to the lease must have the authority to execute the lease, and they must be legal entities. For example, if the tenant is a corporation, that corporation must be in good legal standing in the state of incorporation, as well as have a current certificate of authority to do business in the state where the lease premises is located. An individual who executes a lease on behalf of a corporation must have the legal authority to represent the corporation (generally an officer of the company).

An individual who executes a lease on his or her own behalf must have attained the age of majority as well as have legal capacity to enter into contracts.

Premises Description

A key component of any lease is the accurate description of the leased space. A clear, accurate description can go a long way in precluding or mitigating any future misunderstandings or disputes.

To be thorough, it is best to describe the leased space in several fashions, including:

- The name of the building complex
- The street address, city, county, state and zip code
- The building number or identification if the building is part of a larger project (especially important where portions of common area expenses are determined from project related expenses).
- The actual suite number the tenant will occupy
- The correct legal description of the underlying real property
- The amount of square feet contained within that leased space, and in the building containing the leased premises.

It is also typical to have a phrase such as “or as particularly described below” or “as described in the attached Exhibit A” included in traditional office, retail, and industrial leases. Such an exhibit might be an accurate floor plan drawing of the leased space.

There are exceptions for a ground lease or agricultural lease involving land that is likely to be unimproved. Such a lease might contain a legal description referencing a survey (preferably attached) and/or a property identified by a metes and bounds description.
Most landlords do not want the tenant to have the right to re-measure the lease space. Accordingly, they include language in the lease that effectively states the tenant agrees to the stated size.

Tenants, however, should insist upon the right to have an independent third party (either an architect, space planner, or interior designer) re-measure the space according to some agreed upon standard. The BOMA (Building Owners and Managers Association) methods of space measurement constitute such a standard. A reasonable landlord will normally agree to this request if the tenant agrees to pay the expenses involved. Both the landlord and the tenant should agree, in writing, to accept the results of such re-measurement before such services are initiated and the lease is signed.
Term, Rents, Fees, and Security Deposit

Lease Term

All parties to the lease will need to know and agree upon the primary term of the lease (occasionally described by a number of days, but more likely by a number of months or even years). This term will have a beginning date (such as January 1, 2005), as well as an ending date and time (such as December 31, 2009, at 11:59 PM). This establishes the beginning and ending times, and thus the term, of the lease.

Occasionally, the date the tenant actually moves into the lease space is delayed beyond the start date stated in the lease, due to renovations, remodeling, permits, etc. To address such situations, both parties would be wise to consider executing a lease addendum that specifies an “actual commencement date”.

The “actual commencement date” can be described and triggered by a variety of events. If a leased space must undergo renovation or remodeling before it is acceptable to the tenant, the actual commencement date may be specified as the date the local building permit authority grants a Certificate of Occupancy, or the date the space is substantially completed for the tenant. In the event no such renovation or remodeling is required, this clause may state the actual commencement date to be a date certain, or the date the tenant actually occupies the space.

This clause is normally restricted to the initial or primary term of the lease and does not include any right to hold over. Any provisions or option rights granted to the tenant to hold over, extend, and/or renew the lease for additional terms in the future are usually addressed elsewhere in the lease document.

Lease Renewals

Generally, most commercial leases do not grant any rights or specify any obligations of either party regarding renewals after the initial term of the lease has expired.

Nevertheless, many tenants want the right or option to renew (or at least have the opportunity to renegotiate) the lease when the primary lease term has expired. The tenant wants the option, but not the obligation, to renew.

Lease renewals should include certain parameters such as:

- The length of the renewal term
- The date by which the tenant must indicate his intention to renew. The landlord is likely to want at least 4 to 6 months’ prior written notice, whereas a tenant (and their tenant Rep) should be advised to enter the date the notice of intent to renew is due on their calendars so oversights do not cancel such rights.
• The rent for the renewal term. Understandably, both landlord and tenant are reluctant to specify exactly what future rental rates will be, particularly when the primary lease term is longer than one year. Accordingly, the lease should include a provision clearly setting forth the procedure to determine the renewal rate when the primary term expires. Practically speaking, however, the final negotiated renewal rate may not be able to be negotiated and determined much before 60-90 days prior to expiration of the primary term.

For example, perhaps the lease was written with an original term of 10 years and the lessee has the option to renew for two additional periods of 5 years each. The base rent for the primary term would be spelled out in the lease. If possible, the base rent for the option or renewal period, or the formula used to calculate that base rent, might also be spelled out in the lease. [In this example, the primary term is quite long and it is unrealistic that either the landlord or the tenant would try to determine a base rent so far into the future.]

Instead, most parties would prefer a phrase that states, “mutually acceptable market rates will apply,” or that “a mutually acceptable appraiser or commercial real estate lease representative will help determine such rates.” The tenant may ask that the renewal rate be capped; conversely, the landlord may ask that “the base rental rate will not fall below a certain amount, upon renewal”.

Purchase Options

Occasionally, a tenant desires a purchase option or a right of first refusal to purchase the lease space. It is beyond the scope of this course to go into the nuances of such rights, options and agreements. Consult your attorney for further assistance in such matters.

Utilities

This specific clause may not be used, because the intent is covered in another area of the lease. If used, this clause sets out who will contract for the utilities and if they are a part of the base rental fees or will be part of the operating fees, which may be shared among the tenants in some fashion.

Rental Amount

The rent owed by a tenant is normally due on the first of every month. Most landlords grant a short ‘grace’ period for late payments and thereafter a late fee penalty may apply. The tenant will want such fees to be reasonable; the landlord, in an effort to discourage late payments, will want the late fee penalty to be significant.

This clause should include language that clearly states:

• The amount of rent payment. This amount can be rather convoluted. It may be a flat-rate fee or an amount per square foot (often called the “Base Rent”), plus other charges for parking, operating expenses (often referred to as “Pass-Through Expenses” or “Operating Expenses”), etc.
• The address where the rent payment is to received
• How the rent payment is calculated.

**Base Rental Fees**

Base rents are usually just a portion of the total fees a tenant must pay for commercial space. There are still some buildings where one rental fee (usually a flat-rate per square foot) still exists. But most landlords have become more sophisticated and are now asking tenants to share in all the ancillary costs to maintain, manage and operate the property.

While some written leases for terms of one year do exist, generally terms are much longer. It is not unusual to see lease terms of 5, 10, or even 15 years or more. Longer-term leases generally have mechanisms for adjusting base rental fees every few years. These mechanisms may be some percentage adjustment or may be determined by the cost of living index for that specific locale. There are no hard and fast rules and both tenant and landlord can negotiate these details.

The base rental fee in most commercial property leases is tied to a dollar rate per square foot of rentable space. Many professional building managers defer to the rules for measuring space as described by their national trade association, the Building Owners and Managers Association (BOMA). To complicate matters further, there is a vast difference in *usable* versus *rentable* square footage, how each is calculated, and which is to be used as the basis for rent calculations.

“Usable square feet” refers to the exclusive space a tenant actually occupies. It is the square footage within the leased space. However, rents are usually based upon the “Rentable Area” calculations. The difference between usable and rentable is sometimes referred to as the ‘add-on’, the ‘loss factor’ or ‘load factor’.

**Essentially, two scenarios exist.** In a single tenant property, the tenant is paying for the use of the entire building. In multi-tenant properties, each tenant is paying for his/her specific space plus a portion of the building’s common areas. Common areas typically include hallways, foyers, entrances, elevators, stairs, restrooms, etc. These spaces generally amount to between 10 and 30% of the total building size.

For instance, if a tenant has 4,000 square feet of usable area, the landlord will add-on 15 percent to account for his/her share of the common areas. The resulting rentable square footage would then be 4,600 and it is this number upon which the rate per square foot is calculated.

Tenants deserve to know both how this square footage has been calculated and what the basis is for the rent calculation.

**Operating Expense Obligations**

Many leases have additional fees they require a tenant to pay beyond the base rental fee. The landlord wants his tenants to pay their fair share for some (or all) of the operating expenses to
run the property effectively. Sometimes these operating expenses are called ‘common area maintenance’ charges (or CAMs). Tenants should insist upon a precise description of what expenses are to be included in such calculations.

**Net or Triple Net Leases (NNN)**

A ‘net’ or ‘triple net’ lease is one where the tenant pays a base rent and all of the operating expenses. These types of leases are common for industrial properties or large ‘big-box’ retailers such as Wal-Mart or Circuit City. These kinds of firms are willing to be responsible for all the operating expenses.

**Gross Leases**

Gross leases are the opposite of ‘Net Leases.’ In Gross Leases the “gross” is analogous to ‘all’. The tenant pays one monthly rent amount, usually for the term of the lease. The landlord is saying he will cover virtually all the operating expenses out of the rents being charged. The landlord has calculated, based upon research and/or history, what these expenses will be and he has apportioned them among each gross lease. There is a risk to the landlord that if he miscalculates and the rent is insufficient to cover these expenses he may have to secure those fees from other resources.

In some cases a gross lease might contain a mechanism that limits the amount of expenses that a landlord can pass through to the tenant. “Expense Stops” (as they are called) limit such passed-through expenses in either of two ways. In one way, the passed-through expenses for a particular year (often the first year –or ‘base year’- of the lease) are limited, and only the amount of expenses that exceed that first year historical limit are passed through in future years. With the second way, expenses above a certain amount based upon a per square foot basis are passed-through each year.

Gross leases are sometimes referred to as “Full Service” leases. They have been quite common in the past. For example, most multi-family projects are master metered for utilities. The landlord has a fairly good idea what those expenses are likely to be and has added them into what he calls his base rental fee. Likewise, many older and smaller office projects still write full-service, or gross, leases.

**Percentage Leases**

This type of lease is commonly seen in retail-oriented business leases. The landlord is willing to rent a space for a minimum flat fee; however, additional rent is collected above this initial rent amount based upon a percentage of sales revenues above a stated baseline amount. The rationale is simple enough. The landlord believes that in good economic times (ostensibly times of good sales) he should be able to share in that increase in sales with the tenant. In tough economic times, the base rent is more than fair. This is one form of risk sharing.
Definition of Operating Expenses

**Operating Expenses** are the charges the landlord incurs to operate, manage, maintain, repair, and secure the property and its buildings. The lease should define what is included in operating expenses.

Operating expenses would likely include janitorial services, trash service, landscape maintenance fees and security services (including maintenance contracts with independent contractors). Other normal expenses might be those supplies and materials directly used in the operation, repair or replacement of the property.

Occasionally, a landlord may wish to include the depreciable cost of capital improvements. Tenants may negotiate to limit or exclude such expenses unless they can be shown to reasonably reduce the normal operating costs of the property. Tenants may wish to include language that “the landlord must demonstrate an actual cost reduction” in order for those kinds of expenses to be passed through, or negotiate that such pass-through expenses exclude major capital expenses, such as replacing a roof.

One exception might be those capital expenditures mandated by governmental statutes or regulations. Such expenses would normally be amortized over the useful life of the expense. They may occur in the attempt to limit energy consumption, enhance conservation, promote public safety or provide for disability access.

Management fees constitute another operating expense. They would include those wages, salaries, employee taxes, and other employee fringe benefits (but not profit-sharing arrangements) for those who directly manage and/or maintain the specific leased property.

Tenants may wish to limit or exclude management fees. One way to limit them is to agree to a specific percentage of total base rental fees collected. Some have tied such fees to comparable charges of other management organizations in the vicinity of the leased premises.

**Additional operating expenses include the following:**

- All normal utilities (but not the excess that individual tenants may be directly responsible for, whether actually paid to the landlord or not, or those directly metered to other tenants).
- All taxes (including any governmental assessments, but not including any income or franchise taxes)
- All insurance (including liability, casualty, rental abatement, and any other insurance required by secured lien holders of the property)
- A reasonable reserve for replacement items.

Tenants may reasonably negotiate that professional fees, such as leasing commissions, legal fees, accounting fees and other expenses associated with the production of income be excluded from the definition of operating expenses. For example, most tenants are unwilling to pay for legal fees incurred to draft a new lease.
A prudent tenant typically requires that any costs for which the landlord is entitled to be reimbursed (regardless whether they are actually reimbursed) be excluded from the definition of operating expenses. For example, a tenant might require a reserved trash dumpster for its specific use and expense. If the tenant fails to reimburse the landlord for that expense, the landlord may not add that extra expense to his/her normal operating expense pass-throughs.

**Other expenses that tenants typically seek to exclude from the definition of operating expenses are:**

- Any excess of market rates or fees paid to any affiliate of the landlord
- The costs to install new technologies as they relate to telecommunications
- Any construction or remodel costs to correct building defects or that are directly attributable to any other tenant’s space.
- The costs for either environmental insurance or the costs to remediate, abate or test for hazardous materials
- Decorations and/or gifts for holiday events
- Any cost incurred due to the negligence of the landlord or other tenant
- Any fines or penalties assessed to the landlord for failure to comply with current laws and regulations
- Any above-standard cleaning
- Advertising expenses
- Leasing commissions
- Political or charitable contributions
- Employee expenses for any officers beyond the level of the official property manager.

The normal course of these negotiations usually ends with a statement in the lease whereby the landlord will estimate his/her best guess for upcoming annual expenses. The tenant will pay this estimated amount over the course of the next 12-months in equal monthly installments at the same time and place that the base rent is paid.

A typical lease provides that if the actual operating expenses are less than the amount collected from the tenant, the landlord has the option of keeping the excess and applying it to future expenses. The tenant, however, may wish for the lease to provide that in the event of an overpayment of operating expenses, the excess will be refunded to the tenant within a reasonable period.

If the landlord’s estimate of operating expenses was too low, he or she will usually ask that the tenant pay the deficiency immediately. The tenant, however, should negotiate a reasonable period to pay such deficiency, after receiving written demand from the landlord.
Audit Rights

The charges for operating expenses can be significant. Accordingly, the tenant should have the right to audit (inspect, copy, or examine) the landlord’s files related to such expenses.

The landlord should agree as long as:

- The tenant is not in default on his/her lease
- The tenant has been making timely rent and expense payments
- The request to audit takes place within 6 or 12-months after receipt of the expense statement.
- The request to audit gives the landlord adequate notice to be prepared
- The audit takes place in a reasonable location (generally the landlord’s local place of business)
- The audit occurs during normal business hours, as determined by the landlord
- The costs of the audit are borne by the tenant except in the case where expenses have been stated incorrectly (usually a variance of 5% or greater). In such cases the landlord should agree to reimburse the tenant for such audit costs.

A tenant should negotiate that in the event any other tenant audits the landlord’s books and a discrepancy or variance in favor of the tenant of 5% or more is found, then this tenant should also receive due credits even though he/she did not directly cause or ask for the audit.

The Issue of Grossing-Up

All commercial property owners and landlords have expenses on their properties. Some expenses are fixed and some are variable. These landlords would obviously like to be fully reimbursed for these expenses.

Many leases contain language euphemistically called ‘gross-up’ provisions. They are mechanisms for the landlord to recoup from the tenant the actual costs of maintaining the leased premises.

Variable costs are sometimes referred to as “occupancy dependent costs.” The charges for utilities are an example of such a variable cost. These charges will ‘vary’ according to the percentage of occupancy in the project. The more tenants, the higher the utility charges. Usually, only these variable costs are grossed-up.

Fixed costs (such as taxes or insurance) are independent costs unrelated to occupancy levels. These costs are typically not grossed-up. The tenant, however, will still be responsible for his/her prorata share of such fixed expenses usually on a square footage basis (the size of the leased premises divided by the size of the overall project).
Sometimes gross-up provisions favor the landlord, as in triple-net leases where the landlord recoups all the variable costs incurred for the tenant’s benefit. At other times, such as in leases using the base year expense-stop method, the gross-up language may actually favor the tenant, by establishing a true expense level for the base year. In such a scenario all operating expenses are included in the rent during the “base” or first year. In subsequent years, the tenant pays its prorata share of the expense increase.

When the gross-up provision is used the variable expenses are commonly ‘grossed-up’ to a 90 or 95% level.

**How does this work?** Let’s take the example of a leased property that has variable costs of $15 at 25% occupancy, $30 at a 50% occupancy and $45 at a 75% occupancy and $60 at 100% occupancy.

What happens if tenant XYZ leases 25% of the building and the balance of the property remains unleased? Without a gross-up provision, the landlord bears the unfortunate brunt of the expenses. In this case the tenant would pay his/her prorata share of the expenses (25% of $15, or $3.75). In this example the landlord is not reimbursed for $11.25 of these variable costs even though it is obvious tenant XYZ causes those costs.

It would obviously be a fairer calculation if the lease contained gross-up language. In this case the expenses would be grossed-up to $60 (as if occupancy were 100%) and the tenant would pay his /her prorata share (25% of $60), or $15. The tenant pays for the expenses directly attributable to his/her lease.

**Special Charges**

Landlords have been creative in finding additional ways to generate tenant-based income through the assessment of special charges. For example, signage opportunities might constitute a special charge. Assigned parking (and therefore reserved) spaces may be another special charge.

**Parking Assessments**

In large urban areas the densities of businesses, traffic, parking, tenants, etc. begin to impact on one another in ways not seen in the wide-open suburban areas.

Older buildings may no longer have enough public street parking to accommodate tenants. Municipalities may grant them some concessions by reducing the number of spaces they are required to provide. One trend has been to allow those property owners to contract for dedicated parking spaces in facilities apart and often several blocks away from their buildings.

To keep downtown areas vibrant, some developers have built parking garages apart from their own leased properties. Often, because parking is tight, these spaces are leased to other buildings at a premium. These additional costs to the landlord of those other buildings are passed on to those tenants as added parking fees or incorporated into increased rents.
Security Deposits

Virtually every landlord requires a security deposit. It secures the tenant’s performance under the lease and can also be used to cover the related costs of re-leasing the premises in the event of a tenant’s default. While it is not meant to be used as a rental payment or to pay for charges the tenant is responsible for, it can be. The landlord determines the amount of security deposit, but to some extent, market conditions prevail.

Security deposits have been a source of irritation to both landlords and tenants for decades. Prudent landlords and tenants alike should require language in the lease that specifically explains when and how the tenant’s security deposit can be accessed and spent down. The landlord, for example, usually wants latitude to apply the security deposit to unpaid rent or to compensate for costs incurred due to the behavior of the tenant that is outside the lease terms.

Provisions regarding the security deposit can include the name and address of the financial institution where the security deposition will be deposited, who has signatory authority over the account, whether the security deposit account will earn interest and if so, whether the landlord or tenant gets that interest, how and when the account is to be replenished in the event it is used to cover the tenant’s obligations during the lease, etc. These issues are all negotiable depending upon how the parties wish to allocate risk.

Finally, the lease should clearly state the name and address of the person who will receive the security deposit upon expiration of the lease, as well as the time frame within which it will be sent.

In the absence of contrary lease provisions, Texas law provides that the tenant must first surrender the lease space to the landlord and notify him/her in writing of the tenant’s forwarding address before the landlord has an obligation to return any unused portion of the security deposit. If the tenant does so, the landlord must then assess the condition of the lease space after the tenant has vacated it, deduct from the security deposit any justified charges for damages caused or attributable to the tenant (normal wear and tear NOT being deductible), and return the balance to the tenant within the time allowed by law. Failure to do so timely may subject the landlord to substantial damages in court.
The Property Use Clauses

Allowable Uses of the Property

Allowable uses of the lease space are those lawful uses that the parties have agreed to and are clearly stated in the lease. Lawful uses would include those not prohibited or restricted by law, license, regulation, zoning, any lawful restriction or prohibition imposed by the landlord, etc. The primary allowable use for the property is usually not a hotly contested issue and is often described simply as “for general office or business use.”

Both parties, however, will have definite ideas concerning the allowable use(s) of the lease space. In a multi-tenant commercial property, the landlord must consider the potential impacts of the tenant’s proposed use(s) upon the other tenants, the area traffic and parking plans, and perhaps even the property’s insurance requirements.

These issues are most critical in retail properties where multiple tenants must coexist in close proximity. There, the landlord usually makes a concerted effort to consider what is best for all tenants. The landlord may even have a particular “tenant mix” in mind, which hopefully fosters synergy between the tenants, with each tenant attracting and sharing potential customers among themselves. In doing so, the center becomes a destination property to customers, and may even gain a certain reputation depending upon the tenant mix.

For instance, the anchor tenant may be a large sofa store. Both landlord and tenant may want related but non-competing businesses to move in, such as an interior designer, an interior decorator, a window treatments store, a hardware store, carpeting, paints, wallpaper store, a lighting store, etc. In this example it might not work well to have a shoe store or a pool hall operation in that same tenant mix, as they simply would not complement one another.

The parties should agree on the proper procedures, notification and timing to follow if the tenant were to desire a change in the business use. Most landlords will insist on prior written approval of any deviation from the original business use.

The Proper Use of Building Common Areas

Almost all commercial multi-tenant properties have “common areas.” A well-drafted lease will set forth not only what areas are designated “common areas” but also how such areas may be used. As the term implies, these areas are common to all tenants, thus it is unlikely that a landlord would grant specific use or rights to a common area to just one, but not all, the tenants in the complex.

For example, often retail strip centers have covered walkways (generally deemed common areas in most leases) in front of their shops. A tenant may have plans to put occasional signage and/or displays out on these common area sidewalks to attract attention. It is best, however, to have this right clearly stated in the lease to avoid any dispute over this issue after the lease has been signed.
In the same manner, there will likely be hallways to common restrooms, elevators, etc. in a multi-tenant office building. Normally these common areas are not to be used for temporary storage, trash, the placing of vending machines, etc. Any permissible use of such common areas must be defined in the lease, with any exceptions generally requiring written approval from the landlord.

Parking Rights and Obligations

A well-drafted lease will clearly address the use of existing parking facilities, such as who may use them, how many spaces, if any, are allocated to each tenant, reserved parking, parking ratios, etc.

Most multi-tenant business properties will have a certain number of unassigned parking spaces based upon how much square footage the tenant is leasing. A rule of thumb for office properties is one parking space for each 300 square feet of rented space. For medical office space, zoning requirements may dictate a higher ratio, such as one parking space for each 200 or 250 square feet of improved property due to the increased parking needed for the more-than-normal numbers of patients.

Leases for retail properties in particular may not have reserved spaces for either a tenant’s employees or business visitors. These leases may also require that a tenant’s employees park in the farthest spaces from the building to allow business visitors the closer, more convenient locations. Additionally, most retail center landlords have a more generous parking ratio, often one parking space for every 200 square feet of rentable space, or better.

A tenant would be wise to ensure that the lease includes language that requires the landlord to maintain and repair parking areas in a timely fashion.
Possession Rights

Possession Prior to Lease Commencement

In certain circumstances, such as those involving lease space requiring remodeling or renovation, the landlord is willing to give the tenant possession of the premises prior to the commencement of the lease.

Where a landlord grants early possession, it is essential that the lease clearly address the details of an early possession arrangement, including but not limited to dates, insurance coverage, timing of events, and responsibilities of each party. There are absolute risks to be addressed in this situation and all parties need to understand what they are and who is to take them. Such risks involve potential liabilities for personal injuries and/or damage to the buildings and the personal property located within.

Delayed Possession

Imagine the havoc that would ensue if the landlord promised the premises to a tenant upon a date certain and the space was not available at that time. The tenant may have gone to great lengths to move its business to the new location, at a certain time. The lease needs to address the obligations and costs of any damages and/or lost opportunities that will accrue for both parties if the space is not or cannot be ready for the tenant when promised.

Termination of Possession and Holding Over Provisions

All leases eventually end and a well-drafted lease will clearly provide for the return of keys, inspections, and official termination of space. Details concerning the tenant holding over beyond the expiration date stated in the lease are usually negotiable; however, the landlord will normally ask a tenant to pay a rental rate of approximately 150% per month for the privilege (and inconvenience to the landlord) of holding over.

Exercise: What issues does possession prior to commencement of the lease raise? Write down the advantages and disadvantages to the landlord of a tenant moving into the premises before the lease commences. Then do the same from a tenant’s perspective. Include considerations of availability of the premises, partial v. total possession, exclusive v. non-exclusive possession, finish-out, and insurance.

Practice Tip: Where the parties negotiate for early possession prior the commencement of the lease, be sure that the early possession does not alter or otherwise affect the lease’s expiration date.
Insurance, Subrogation, and Damage and Destruction

Liability Insurance

One of the chief risks for any business is liability to others for accidents and mishaps. A well-drafted lease will include a provision specifying which party (and likely both the lessor and lessee) will provide and pay for liability coverages on the property.

Generally speaking, the landlord will provide and pay for liability and property insurance for the common areas, although the landlord will usually pass the cost of such insurance through to the tenant on a pro-rata basis.

The tenant will provide similar coverage for its own leased space. The landlord normally requires the tenant to purchase a policy with basic policy limits and to name the landlord as a co-insured on the policy.

Property Casualty Insurance

Lenders usually require landlords to secure and maintain both casualty and liability insurance on the property. Tenants normally carry their own casualty coverage on their possessions within the leased space.

A prudent tenant should insist that the landlord maintain fire and extended coverage insurance using ‘full replacement costs’ as the basis for insuring the entire project (less the contents of the leased space).

Subrogation

Subrogation is a mechanism that protects both landlord and tenant by placing the financial burdens relating to insured risks on the issuing insurance firms. Without this provision, an insurance company may attempt to place blame for a loss, and recover the amount of any claims paid from either the tenant or the landlord. A well-drafted lease should include a standard subrogation provision.

For example, assume a tenant negligently burned down the building he/she was leasing. The landlord’s casualty insurance would pay to rebuild the building. Without a subrogation provision, the insurance company could then seek to recover the cost of the loss from the tenant by ‘subrogating’ or standing in the shoes of the landlord and pursuing the landlord’s negligence claim against the tenant. This effectively negates the reason for the insurance.

A standard subrogation clause provides that the insurer waives any right to subrogation against either the landlord or the tenant. Both landlord and tenant usually agree that their respective insurance policies will contain such a waiver.
Any written provision about insurance needs to address the ‘what if’ situations.

Casualty losses can be total or partial; each situation has its own set of circumstances. To address situations involving partial loss or destruction, the lease language should include:

- A definition of what constitutes “partial loss or destruction”
- Language setting forth how and when repairs and restoration will be made, and who will coordinate such work
- Whether there is any reduction to the tenant’s rent during a period of partial destruction that has rendered the leased space unfit for occupancy.

In situations involving a total loss, such as by fire or other catastrophe, both parties usually desire some right to terminate or modify a lease.

To provide such flexibility, a well-drafted lease should:

- Define a “total loss” and specify who will make such a determination
- State whether the owner is obligated to rebuild. (In a total loss situation, the landlord may not want to rebuild, or may want to rebuild under circumstances that may not be favorable to a tenant.)
- Specify who will receive any insurance proceeds and how they will be used
- Provide for the situation where the property was not insured or was under-insured.
Condition of the Leased Space, Maintenance, Repairs, and Alterations

Condition of the Leases Premises

A well-drafted lease will describe the condition of the leased space, including:

- Whether the space is new or has been previously occupied
- Whether any repairs or improvements are to be made, and if so, a description of each repair/improvement, with reference to which party will be responsible for getting that work scheduled, completed, and paid for
- Whether the rent will be offset by the cost of any repair/improvement and if so, how that offset will be calculated and applied
- A description of the general condition of the leased space prior to occupancy, which can be particularly important when the lease expires and the tenant expects a full refund of its security deposit.

Utility Services

Landlords are normally responsible for providing utility service to the premises, such as HVAC service, water and wastewater services, lights and general office electrical service, and natural gas service, if available. Installation is usually the responsibility of the landlord, although the maintenance of these utilities and services may be negotiable.

Landlords of industrial space often provide only electricity to the electric meter/breaker array, with the tenant being responsible from that point on for its distribution throughout the facility. In new construction, however, this issue is more negotiable, and the lease should specify who is responsible for the meter/breaker array panel installation and maintenance.

Where a building has been sub-metered for utilities, it is likely that those accounts will be the responsibility of the tenant to establish, for direct billing purposes.

Interruption of Utilities

The lease should include a provision that the landlord will not turn off the utilities to the leased premises except in the case of repairs, maintenance or emergencies, and in the event of a utility interruption, the landlord must use reasonable efforts to remedy such interruption promptly.
Maintenance and Repairs

In most lease situations both the tenant and the landlord have obligations and rights relating to improving, maintaining, and repairing the lease space.

The lease should state who is responsible for repairs and maintenance of the property outside the tenant’s leased space (such as the grounds, the parking lots, the building’s shell, foundation, roof, doors, windows, and the building’s common areas). Normally, this is the landlord’s obligation unless such repairs are the result of negligence or willful misconduct of the tenant, his employees, guests or customers (whereupon the tenant is financially responsible). In most retail leases, however, the tenant is responsible for his/her own storefront, the glass, the doors, closers and hardware.

The landlord is also typically responsible for the maintenance and repair of interior standard lighting, locks, electrical services, plumbing, and heating and air conditioning services, particularly in multi-tenant office buildings. If the property is leased to a single tenant, however, the tenant will be responsible for maintenance and repair of these items.

Alterations or Tenant Improvements

The perfectly located 5,000 square feet of lease space may not be the perfectly configured 5,000 square feet. If the space is to work, alterations or tenant improvements may be required. Who is responsible and who will pay for these improvements?

If a tenant needs to make alterations or improvements, the landlord will likely insist on some limitations to what the tenant can do. Additionally, the landlord will want to be furnished with a certificate of insurance showing coverage sufficient to protect him from liability for injury to anyone, protection from contractor’s or workers’ liens, etc., prior to commencement of any improvements.

If the tenant coordinates and pays for the work, then additional issues will need to be negotiated and addressed in the lease, such as:

- What the notice requirements are to the landlord
- Whether the landlord may reject the tenant’s desired changes, and if so, when and under what circumstances
- Whether the landlord can stop the improvements and if so, the basis for doing so.

At the end of the lease, the landlord will receive the lease space back. The parties should negotiate and address in the lease the issues relating to return of the property, including:

- Whether the tenant has to return the space to some previously agreed-to condition (and if so, that agreed-to condition should be described in detail to avoid any confusion or misunderstanding)
- Who will keep the tenant’s leasehold improvements (if not the tenant, whether the landlord must compensate the tenant in some manner for those improvements)?
Some leases provide that any alterations, additions, or improvements, except trade fixtures, even though installed at the expense of the tenant, shall remain upon the property and be surrendered to the landlord at the termination of the lease. Often, however, this issue is negotiable. A landlord may not want a tenant’s exotic improvements and may agree only to accept the leased space in more or less its original condition, with the exception of normal wear and tear.

Non-Disturbance

All tenants need to occupy the lease space uninterrupted and without unreasonable interference so that they may focus their time and energies on their business. A well-drafted lease will include language requiring the landlord to make reasonable efforts to protect the tenant’s right of peaceful and quiet possession of the lease space.

Issues relating to disturbance with a tenant’s occupancy of the lease space often arise when an owner is refinancing or selling a property. The tenant is usually tipped off by being asked to sign an estoppel letter or certificate. The lender can, usually upon request, grant what is known as a Non-Disturbance agreement wherein the lender agrees the tenant’s rights to occupy (and even all the details in the lease) will not change as a result of such refinancing.

Signage Rights

All leases limit a tenant’s rights concerning where, when, at who’s cost, and how a sign may be placed in, on or near their leased premises. Retail tenants in particular must pay close attention to the signage language in the lease. Some tenants believe they have certain rights to paint signs on the building or even on their storefront glass, but all signage rights must be specified and secured by written language in the lease.

Exercise: Make a list of those alterations which your previous clients have wanted to keep once the lease ended or was terminated, and the reasons why. For example, was the alteration an improvement to the space? Was the anticipated cost of its removal excessive? Was the new tenant moving into the space going to be able to use the alteration? Keep this list and add to it as your practice grows, so that you can discuss those items with your clients and negotiate them into the lease in the best way for the transaction at hand.
Applicable Laws and Compliance

Compliance with Applicable Laws

All leases contain language that the parties to the lease must act in accordance with all applicable laws and regulations. A well-drafted lease will further provide for a notice requirement as well as a cure period in the event either party is not complying with an applicable law.

ADA Compliance

Most leases now contain language specifically requiring compliance with the Americans with Disabilities Act (“ADA”) and specifying who is responsible for correcting violations of the Act. A tenant is normally only responsible for violations of the Act if their renovations or improvements caused the violation.

Exercise: The ADA makes both landlord and tenant responsible for compliance with its provisions, although the parties can negotiate responsibility for this in their commercial lease. Assume that you are representing the landlord: make a list of the reasons why your client should make any necessary ADA accommodations instead of the tenant, and then list the reasons why the tenant should do so. Then conversely, assume that you are representing the tenant: list why any ADA accommodations would be better made by your client as tenant, and then list the reasons why the landlord should be responsible for this. Keep in mind that if the parties negotiate the lease to provide that the tenant is responsible for making one or more ADA accommodations but fails to do so, the landlord could nevertheless be held responsible for the noncompliance.
Assignment and Sublet Rights

Assignment and Subletting Clauses

Occasionally, a tenant prematurely vacates the leased premises. There are numbers of reasons why the original tenant may need to do so, and he/she should have some right, not unreasonably withheld, to bring in a new, replacement tenant or a new owner of the business, and “assign” the lease or “sublet” the lease space to him/her.

Assignment and subletting are not the same. In an assignment, the original tenant assigns, or grants, his rights and obligations under the lease entirely to the new tenant, who agrees to accept them. The new tenant literally substitutes in for the original tenant, who no longer is bound under the lease.

A sublet situation is one where a new tenant occupies the lease space, but the original tenant remains liable for the lease obligations. Subletting is much less risky for a landlord, because two tenants are liable under the same lease: the original tenant, and the subletting tenant.

There are six major issues in any sublet or assignment situation. They are:

1. The parties
2. The terms desired by each party
3. The original tenant’s obligations
4. What each party is agreeable to in the event of name changes, mergers, etc.
5. The handling of deposits, tenant liens, etc.
6. Payment of any costs to the landlord when considering a replacement tenant.

Not surprisingly, landlords are traditionally much more reluctant to agree to an assignment because they are inherently more risky for the landlord. The main risk is whether the new tenant is financially able to assume the lease obligations of the original tenant. No landlord will willingly accept a replacement tenant that is weaker financially and thus unable to fulfill the lease requirements. Unless it can be shown that the new tenant is at least as strong financially as the original tenant, the landlord may be reasonable to deny the requested assignment. Additionally, the landlord must determine that the new tenant is desirable, which is subjective to a point. The landlord will be concerned that the new tenant is credit worthy, strong financially, of good reputation, and fits into the existing tenant mix well.

The lease must define the tenant’s rights regarding assigning the lease or subletting the space to another tenant. To be balanced, this language should also include the landlord’s rights to accept or deny an assignment or sublease agreement, with the allowable basis for his acceptance or denial being clearly defined. Both the tenant and the landlord must be careful when negotiating these types of clauses.
Regardless how desirable and/or financially sound the new tenant is, the landlord may insist that the original tenant remain responsible for his/her original obligations under the lease.

Additionally, the landlord may impose other conditions such as:

1. The landlord must agree to the proposed use of the lease space by the new tenant

2. The replacement tenant will have to execute acceptable documents with the landlord wherein it adopts the original lease and agrees to meet all the obligations therein of the original tenant

3. The original tenant must pay the landlord’s expenses and other reasonable costs (legal fees, financial analysis assistance) that may be incurred when considering any replacement tenant, whether or not that replacement tenant is ultimately approved. (Some landlords set a basic fee of $500 to $2,000 to cover his/her due diligence work necessary to evaluate the replacement tenant.)

Instead of these details being set forth in the lease, many tenants seek to simply have the lease provide that “the landlord shall not unreasonably withhold the right of the tenant to sublease or assign his/her interests in this lease.” Landlords are generally more agreeable to the use of this phrase when the potential assignee is an affiliate, parent organization, franchisor, subsidiary or successor corporation, purchaser or merging company of the original tenant rather than an unrelated third party.
Hazardous Substances

The rules and regulations that affect hazardous substances in our environment have become a very important consideration for commercial and investment real estate. The landlord will insist on language that protects his property from anything the tenant might do that may cause environmental problems. Conversely, the tenant will insist that the language in this clause is very clear that the landlord is totally responsible (legally and financially) to solve any environmental problems that are not caused by the tenant. The tenant will want the landlord to represent and warrant that at lease commencement he/she is unaware of any existing or prior hazardous substances conditions, which have not been fully remedied or corrected.

All parties’ need:

• To know what types of products constitute hazardous materials (such substances, products or materials are often defined by local, state, and federal guidelines)
• Clear notice provisions regarding the creation, storing, or use of such substances
• Clear notice provisions in the event of an accident involving hazardous materials
• Clear provisions to inspect the lease space
• Mutual indemnity (the tenant will want the landlord’s indemnity to continue beyond the lease expiration date)
• In the event of catastrophic negative environmental damage involving hazardous substances, clear provisions allowing the tenant to terminate the lease and vacate the property without further obligation.
Brokerage Relationships & Fees

The Agency Relationship

All parties involved in a lease transaction, including a real estate professional, must understand what is termed the ‘agency relationship.’ All parties must be informed whom the real estate professional is representing.

It is not unusual for both landlord and tenant to work with a real estate professional. The landlord’s agent is often called the ‘building rep’ (short for representative), and the tenant’s agent is often called the tenant rep (representative).

Many states now recognize the situation where the same real estate professional represents both landlord and tenant. Many states call this representation “dual agency.” The presence of a dual agency in a particular transaction must be fully disclosed to both parties at the commencement of negotiations, and a prudent representative should secure an acknowledgment of such from both parties in writing.

Brokerage Commissions

In most cases, the tenant rep receives a fee or commission for his/her assistance at the time the lease is signed. Sometimes, however, this fee is not paid until the landlord receives the first rental payment or security deposit from the tenant, or until the lease term commences. There may be occasions, too, where the tenant must be moved into the space before commissions are deemed fully earned and payable. Generally, the entire commission amount is paid in one of these ways, although other payment situations may also occur.

Occasionally, the parties may agree that the payment of the commission is to be paid out over a certain term and sometimes over the term of the entire lease, month by month. Payment schedules such as these would normally be found in an addendum to the lease agreement, or in a separate agreement between the broker and the landlord.

The commission earned may be paid by the tenant, but generally is paid by the landlord, regardless of who the broker represents. Bottom line, the real estate professional can represent either or both sides of the transaction, and can be paid by either or both as long as that fact is fully disclosed when the professional services first begin.

Commissions earned are usually a percentage of the total rental amounts to be paid on the lease over the entire term. Sometimes this amount is not known (as in the case of additional percentage rents, or fees associated with a lease renewal, option, or extension), but the timing and calculations for the payment of such future commissions should be established at the beginning of the relationship.

The lease should include an express declaration as to whether any other real estate professional(s) has been involved in the negotiations concerning the lease space as well as whether any other real estate professional(s) is entitled to participate in any fees earned as a result of the lease transaction.
Property Control Clauses

Tenant Default and Removal of Property

Most leases provide that upon default of the tenant or abandonment of the leased premises, the landlord can enforce the performance of the lease in any manner the law allows. The landlord is usually given the burden of notifying the tenant of a default. It is not unusual that such notifications may not be required upon the repeated occurrence of a tenant’s default within a specified period, although this point is negotiable.

The landlord normally gives the tenant a short time to cure the default. If the default is not cured, the lease may be terminated. Most leases provide that at that point, the landlord has the right to enter the tenant’s space and remove any persons and property, without waiving any other remedies he/she may have under law.

Typically, upon a default or abandonment (both of which should be defined in the lease), any remaining unpaid rents and other fees are due and payable (or accelerated). This issue is generally more important in retail leases than office or industrial leases, because the landlord can remove and sell any property within the lease space to mitigate the tenant’s financial obligations if the tenant does not claim that property within a certain period, often sixty (60) days.

The tenant’s main two concerns in this situation are:

1. A desire to limit the events that may be considered default
2. Negotiating for its own acceptable notice and cure rights for default occurrences.

Exclusion of Tenant

There are circumstances when a landlord may exclude or restrict the tenant from the leased space, such as for emergencies, repairs, maintenance, etc.

If a tenant has been barred from entry to the lease space due to non-payment of rents, the landlord is usually required to post a notice on the door as to when and how the tenant may gain access again. Access is the issue: the landlord is not required to give the tenant a new key if the locks have been re-keyed.

Tenant Bankruptcy

Most leases contain a clause protecting the landlord if the tenant declares bankruptcy, works voluntarily with creditors by assignment, or if a receiver is appointed for the tenant. Such a clause essentially gives the landlord the right to terminate the lease by giving (usually a very short) written notice of landlord’s intention to do so. The purpose is to get the property back and onto the market to become economically viable once again, as soon as possible.
Mitigation

A prudent tenant will want the lease to include language that requires the landlord to mitigate his/her damages in the case of a tenant’s breach, including marketing the property in a manner consistent with his/her normal marketing plan. Under such language, the landlord must use due diligence to relet the premises.

The landlord will want flexibility to re-let upon any reasonable terms (including concessions, free rents, etc.), without any obligation to re-let the tenant’s lease space before leasing comparable other space. If the re-letting is at a lower rate than what the tenant had been paying, the landlord will want the tenant to agree to pay any deficiency. (Of course, if the landlord relets at a higher rate than the tenant had been paying, he will not want to share any of the excess with the tenant.) The tenant is normally responsible for normal and incidental costs incurred in any re-letting. This might include such items as attorney fees, brokerage commissions, remodeling of the premises for a replacement tenant, and court costs if a lawsuit was instigated to enforce these provisions.

Exercise: What does the commercial lease form that you most often use say about mitigation? Write down what that means to you as agent for a landlord, and then as agent for a tenant. Texas courts have held that a landlord’s duty to mitigate requires him/her to use objectively reasonable efforts to fill the premises, and that the landlord is not required to simply fill the premises with any willing tenant: the replacement tenant must be suitable under the circumstances.
Condemnation, Subordination, Non-Disturbance, Attornment, and Estoppel Certificates

Condemnation

Governments have the power of eminent domain. This power grants the right to condemn, or “take”, private property, for a consideration, for public purposes. Naturally, the “consideration” means money.

The matter of the money, who gets it, and how it must be used, is critical to any condemnation clause. All parties lose something in condemnation: should all parties likewise share in the proceeds? On the surface, it might appear that the landlord is entitled to all of the money, since he/she owns the property that was taken.

The tenant, however, loses as well. Perhaps the state wants to widen the road in front of the leased premises and the property it condemns ends up causing the complex to lose fifty parking spaces. Prior to the taking, these were parking spaces that the tenant had the right to use: they were for his employees and customers, but now they have been eliminated. What is the monetary damage to the tenant, and should sharing in the condemnation proceeds compensate him? A well-drafted lease should address these types of situations in the event they occur.

In reality, eminent domain proceedings are quite rare. As a negotiating point, the tenant might be wise to give the landlord virtually everything he wants with regard to eminent domain and to negotiate other rights pertaining to something more likely to happen and of more importance to the tenant.

A mutually beneficial clause might state that should there be a condemnation of 20% or more of the leased premises, then the lease, rights, rents, etc. would terminate on the date of actual taking by the condemning authority. If less than 20% of the leased premises are taken, the landlord has the right, but not the obligation to terminate the lease. If he chooses not to terminate, the tenant has a period of time (usually up to 60-90 days after taking) to declare the resulting space to be impractical to conduct normal business, and therefore, the tenant may elect to terminate the lease and all resulting obligations.

If only the parking is affected by a condemnation, a lease usually remains in effect unless the landlord is unable to provide the number of parking spaces as promised in the lease. If that occurs, then either party typically has the right to terminate the lease upon thirty-sixty days prior written notice to the other.

Subordination and Non-Disturbance Agreement

There are many parties who have legal rights in a commercial real estate project. The lease grants certain rights to a tenant: a loan grants other rights to a lender.
A subordination clause provides that the tenant agrees that his rights under the lease are lesser than, or subordinate to, the rights the lender has under a loan. Subordination is expected of almost all tenants: it is a reasonable and common requirement.

In return for a tenant’s agreement to subordinate its rights under the lease to those of a lender under its loan, most lenders should agree not to disturb or interfere with the tenant in the event of a foreclosure of the property. This would assume, of course, that the tenant is in full compliance with the terms and obligations of his/her lease.

**Attornment**

The dictionary defines attornment as ‘agreeing to be a tenant to a new owner or landlord of the same property’.

Attornment can arise when the owner/landlord of the lease space changes, such as when the property is sold or foreclosed upon. The new owner has certain rights, whether he bought the property in a sale or a foreclosure, but it is the landlord’s signature on the original lease. The question arises, “Does the lease survive the sale?” It should and can with an attornment clause.

An attornment clause establishes the rules when ownership of the property changes. In most cases, such a clause provides that the tenant’s lease remains binding regardless of who owns the property.

**The Estoppel Certificate**

All landlords should include language in the lease that requires the cooperation by the tenant, when requested, to sign an estoppel letter (or certificate).

An estoppel letter is a document signed by the tenant that sets forth his/her understanding of the terms of the lease.

**Why is this necessary?** In the event a loan is being placed on the property or the property is being sold, either the lender or the buyer will want to verify all the known and represented information as provided by the current owner. Additionally, there are occasionally side agreements or understandings between the landlord and tenant that are not contained in the lease or reduced to any written format. The estoppel letter alerts the lender or buyer as to all the written and special conditions the tenant feels exist under the current lease arrangement. More importantly, however, it prevents a tenant from later asserting something different from that, which is contained in the lease. Such letters are often a requirement for a new loan or refinance, or by the purchaser in a sale.

**Practice Tip:** Condemnation clauses in commercial leases can be one of the most important ones to fully negotiate. If you represent a tenant, make sure that the lease allows the tenant to be involved, and share in, any portion of the condemnation award that the tenant is entitled to, such as lost profits from interruption of business activity. If you represent a landlord, make sure that the landlord is not responsible for impairment of the tenant’s access to the property or lost profits attributable to any condemnation.
Specific Landlord Rights

Access and Inspection Rights of Landlord

Landlords will always need the right to access a tenant’s lease space. The lease should contain language specifying the access rights of the landlord as well as any limits to that access that the tenant successfully negotiates. Typical purposes for access include:

1. Matters of safety
2. Repairs
3. Maintenance
4. Routine inspections
5. To show the space to prospective lessees, buyers, or lenders.

For example, a tenant may want at least 24-hours written notice of upcoming maintenance, repairs or inspections. The tenant has a business to run and would normally desire to minimize unplanned-for inspections or disruptions. A tenant may negotiate to restrict such access during certain hours or limit access in other ways, such as an agreement that the landlord will not enter to show the space to prospective tenants until three months before the tenant’s lease expires, unless an emergency exists.

Whatever the parties negotiate, such negotiations almost always will include the right of the landlord to retain keys to a tenant’s space.

Relocation of the Tenant

Sometimes a landlord needs to relocate the tenant within the leased complex, usually to create a larger contiguous space for a new tenant. The landlord will want language in the lease granting the right to relocate a tenant within the lease space, and the tenant will want this language very narrowly drafted so that such relocation right applies only in very specific circumstances.

Normally, the relocation clause allows the tenant a significant amount of notice that he/she will be moved. Thirty days is probably not enough, whereas sixty days is more reasonable. The parties may also negotiate when such relocation cannot be imposed, such as a CPA with a tax-related practice would not want to be moved during the middle of his/her heaviest tax reporting periods.

A tenant should receive some consideration for the imposition of this clause. Landlords are usually agreeable to paying for moving and reasonable incidental expenses, including telecommunication charges and reprinting of stationary and other company collateral materials that contain the tenant’s address.
The landlord may move the tenant into larger space (or space of better quality), without any increase in rents, or may insist on a larger payment for larger space. The tenant can protect himself by limiting any increase based upon relocation to larger space to a rental fee not to exceed 5% of current rents.

Other issues may arise in a relocation situation, such as the substitute space not being properly configured for the tenant’s business purposes. The lease should be drafted to include language to give the tenant the right to accept the property ‘as is’ or to notify the landlord within a stated time period that the space will need remodeling to make it consistent with the original space. Failure to notify the landlord of the need for remodeling by the date stated in the lease can result in a tenant’s forfeiture of the right to have the space reconfigured.

AS-IS, WHERE IS

An “as-is, where-is” provision means that the tenant has inspected the lease space and accepts it in its current condition, and the landlord has no obligation to improve, repair, or remodel the premises. This language is essential for the landlord to protect against tenant challenges alleging breach of warranty or other misrepresentations.

Owner’s Signage Rights

Just as a well-drafted lease will contain detailed language concerning a tenant’s signage rights, so too should it contain language regarding signage rights of the landlord. Such rights will specify where and when the owner can place signs on or near the lease space indicating that the space will soon be available for lease or, in some cases, for sale.

Liens

Most leases grant the landlord an express contractual lien (as well as any others provided by law) in the personal property of the tenant located in the lease space. Such liens are intended to provide additional security that the tenant will comply with the lease. Both landlord and tenant typically join in signing a UCC-1 financing statement to give third parties notice of the landlord’s lien claim.

A prudent tenant should require that the landlord’s lien be subordinate to that of any third-party lender who may have an interest in the tenant’s property as a result of having financed it.

Indemnity

An indemnity clause protects the owner/landlord from any liabilities to the tenant or the tenant’s employees, visitors, or other persons for any injuries to them or their personal property caused by the tenant, the tenant’s employees or even by other tenants in the complex. In such a clause, the tenant promises to indemnify (literally ‘to cover or assure’) and hold the landlord, his agents and employees harmless (literally ‘risk-free’) from any and all claims for such injuries and damages, whether they occurred on or off the leased premises.
Indemnifications can be fault-based (the most common type) or location-based (used less frequently). Fault-based indemnity can lead to disputes over whose actions caused the injuries or damages. With location-based indemnity, the tenant indemnifies the landlord for any and all claims that originate or occurred within the leased premises, while the landlord indemnifies the tenant for any claims brought that originate or occurred on the landlord’s property that is outside the lease space, such as the common areas.

**Exercise:** Write down what “As-Is, Where-Is” means in your practice. Look at the lease form you use: what does it actually say about this? Note that Texas courts have held that the “as is” clause will not protect a seller in a case of willful concealment, and it will certainly be no protection if the seller engages in fraudulent inducement, even in the commercial setting.
Defaults and Breach

Default or Breach

All leases should include language clearly defining what actions constitute a default or a breach of the lease. Most leases define a default as a failure to do something required by the terms of the lease. Defaults do not always terminate the landlord-tenant relationship or necessarily end up in court. They may be temporary situations, such as missing the payment of rent on a certain date, which can and often are remedied by the tenant either on his/her own or after notice from the landlord.

A breach in the context of a commercial lease is the failure of a party to remedy or cure a default within a specified time. For example, a breach would occur where a tenant failed to pay the rent by the end of the grace period set forth in the lease.

Remedies

All leases should contain language stating the various actions a party may take in the event of a default or breach, together with any limitations on damages.

Waiver of Breach

A landlord may in the lease retain the right to overlook, or “waive”, a breach of the lease by the tenant. By doing so, however, the landlord does not waive any future breaches, whether the same or a different one.

Landlord Default

It is not unusual in a standard pro-landlord lease for there to be no mention of what constitutes a default or breach on the part of the landlord, much less notification and/or cure provisions. A tenant should negotiate for the inclusion of such language in the lease.

Tenants should also seek to include language relating to the procedure to be followed if the landlord defaults or breaches his lease obligations. Generally, such language would require written notice to the landlord of the default/breach, and a reasonable opportunity to cure. In the event the landlord cannot or will not do so, the tenant should negotiate for the right to cure the breach himself/herself, with credit given for any costs incurred to do so, or in some cases, for the right to terminate the lease.

If the landlord is negotiable on this issue, he/she may want to include language that requires a tenant to notify the landlord’s lender in addition to notification directly to the landlord. Tenants usually can successfully negotiate out such additional notification.
Other Provisions

Notice Requirements

Every lease should contain clear language that adequately describes the means by which legally binding written notices are required to be given between the parties. FAX notifications have been gaining in popularity; however, notification of events that may trigger lease defaults should be delivered by verifiable means (such as certified mail where the recipient must sign for delivery and acceptance).

Time is of the Essence

This is a standard boilerplate provision by which both parties agree that time is an important element of the lease. This language can provide the means for substantial damages in the event of a dispute or default.

Grant of Lease Rights and Covenant of Quiet Enjoyment

This clause seems redundant yet it would be wise for the tenant to be sure it is included in the lease. Every lease contains certain tenants’ rights: this clause basically acknowledges that those rights exist.

Force Majeure

Certain events outside the control of either party may occur that would prohibit either the landlord or the tenant from performing the lease obligations. Examples include acts of God, labor disputes or unrest, strikes, major casualty events such as fire, or legal requirements. Most force majeure clauses tend to benefit only the landlord, but tenants should insist on mutual force majeure rights.

The force majeure clause excuses performance of lease obligations for a period equal to the time of the delay. Neither party is normally required to remedy a force majeure event that is outside of his/her control.

Tenants should note that while a landlord will normally be willing to grant mutual force majeure rights, the landlord might insists that payment of rents not be excused.

Binding Upon Heirs and Assigns

This clause provides that in the event of an assignment of the lease, the heirs, successors, or assigns of the original tenant remain liable to the spirit of the original lease.
Rights and Remedies Cumulative

This standard clause typically is drafted to provide that the rights and remedies expressed in the lease are in addition to any others granted by law.

Applicable Law

This clause specifies which state’s laws will be applied in the event of any legal dispute. Generally, the laws of the state where the property is located apply. A tenant should be sure that the lease does not require him/her to have to travel to another state in the event of a legal proceeding involving the lease.

Arbitration

Arbitration is the resolution of a dispute by a trained, impartial, third party. Arbitration is considered faster and less expensive than litigation, and is becoming increasingly favored in commercial transactions.

The arbitration clause should specify the procedure for choosing and paying for an arbiter, as well as state whether the arbitration will be binding, in which case the arbiter’s decision is final, or non-binding, in which case either party may take the dispute to court after the arbitration concludes.

Legal Construction

Most leases will, as a precaution, include language providing that if part of the lease is determined to be unenforceable, invalid or illegal, that such unenforceability, invalidity, or illegality has no affect on the rest of the lease, and it remains valid and enforceable.

Prior Agreements Superceded

This clause provides that the lease is the complete, and only, agreement between the parties concerning the subject matter of the lease: in other words, that there are no other written or oral agreements, representations, or warranties concerning the lease space that are not contained in the lease.

Amendments

To ensure the sanctity of the lease, both parties will want to include language providing, at a minimum, that only changes or amendments to the lease that are in writing, duly signed by both parties (or their duly-authorized legal representative) are binding.
**Attorney Fees**

Most leases will contain a clause providing for the recovery of the reasonable and necessary attorney’s fees, including any out-of-pocket expenses, of the prevailing party in the event of any legal dispute concerning the lease or lease space.

**Guarantees**

Many lease documents are in the name of the tenant’s business. The legal structure of that business may be in the form of a corporation, limited liability company, partnership, etc. A new business may not have established much of a credit rating or history. In those cases, the landlord will likely seek personal guarantees of the principals, the employees, or some other persons or entities that in effect guarantees that they (the guarantor) will honor the lease even if the tenant’s company cannot (or does not). The rights and the obligations affecting the guarantor need to be clearly defined in writing and the guarantor will be asked to sign an agreement to the guaranty, which can either be included in the lease itself or contained in a separate guaranty agreement.

In a depressed real estate leasing environment, this is one of the first items for tenants to negotiate for deletion. If the landlord insists on a guaranty, the tenant should negotiate for a monetary and/or time limit to the guaranty.

**Special Provisions**

The typical lease will include a “catch-all” provision containing those details that are either fairly unique, and/or are not addressed or defined elsewhere in the lease.

**Summary**

In the world of commercial/investment real estate, a lease is extremely important to the landlord and tenant, and can be of equal interest to other tenants, lenders, and buyers.

The essence of any well-drafted lease is to define and allocate the risks between the parties, as well as the behavior each can expect from the other. Many aspects of the lease are negotiable and should probably be drafted with the help of legal counsel.

Once a lease has been negotiated, reduced to writing, and ideally, reviewed by legal counsel for each party, it may be signed. The lease should be signed in duplicate, that is, both parties should execute two original copies of the lease, initialing each page at the bottom. A copy should be provided to each real estate professional involved in the transaction as a professional courtesy.

(The End)
COPYRIGHT NOTICE

The preceding Course is copyrighted by:

Absolute Continuing Education

ALL RIGHTS RESERVED

You are granted the right to view this Course on your computer monitor and to print it for your own personal use. Please contact us at support@AbsoluteCE.com if you become aware of violations. Thank you for your cooperation.

Contact Information

Mailing Address: 712 Congress Avenue, Second Floor
Austin, TX 78701
USA
Telephone: 800-833-1884 · Fax: 512-459-6200
Email: support@AbsoluteCE.com

The subject matter of all Absolute Continuing Education courses is designed to provide accurate, insightful, 'actionable knowledge' you can apply immediately. It is offered with the understanding that Absolute Continuing Education is not engaging in rendering legal, tax, accounting or other professional services. If legal advice or other expert assistance is required, you should retain the services of competent professional persons.
How Can You Take Advantage of this Course?

Consider the Following Steps:

Step 1: First, print this module, 3-hole punch it and save it into a binder.

Step 2: Open your calendar and schedule a personal training appointment just for yourself this week at the time of day you have identified as your peak mental energy time.

Step 3: At the scheduled time, separate yourself from all distractions in an undisturbed place. Ask co-workers to leave you to concentrate. Put the cares and worries of your world on hold – just for about 10-15 minutes or so. YOU deserve this special training time and so does your business, so enjoy it.

Suggested Routines for FAST Comprehension

1. Quickly read the entire module to get the overview of the situation.

2. With pen in hand, re-read for inspired learning.

3. Ask yourself these two Key Questions: (take notes in the margins or backs of pages.)
   - What changes should result in you or your business from learning this module? (This is a great time to set some GOALS in writing.)
   - What are you going to do as a result of your learning this module? (In writing, specify measurable actions you are going to take to reach the goals above.)

For Example:

Teaching someone else is a great motivator. Your GOAL might be to teach the essence of this module to another person. Your action steps might be:

- Decide who to teach
- Decide when to teach this person
- Call your ‘student’ to schedule the training
- Prepare to teach:
  a) Reorganize the material to fit your style
  b) Rehearse; then rehearse again
  c) Present to your ‘student’

Once you have reached your goals above, plan to reward yourself in some special way. Why not enjoy a special lunch with your ‘student’ to celebrate?

Congratulations on learning these new skills, tactics and proven strategies. Remind yourself these trainings are putting you in the top 3% of your field — a rare place to be!
Note:

This downloadable and printable PDF document is NOT the course; it is only the study material of the course provided to you as a courtesy in a downloadable and printable format for your convenience. After reading/studying this PDF, you still must log back into your account and complete the TREC-required final exam in order to successfully complete the course and receive course credit at TREC. To do so, please log back into your account at www.AbsoluteCE.com, open the course, and press the third (>) arrow button at the top of the course window to navigate through the online material.