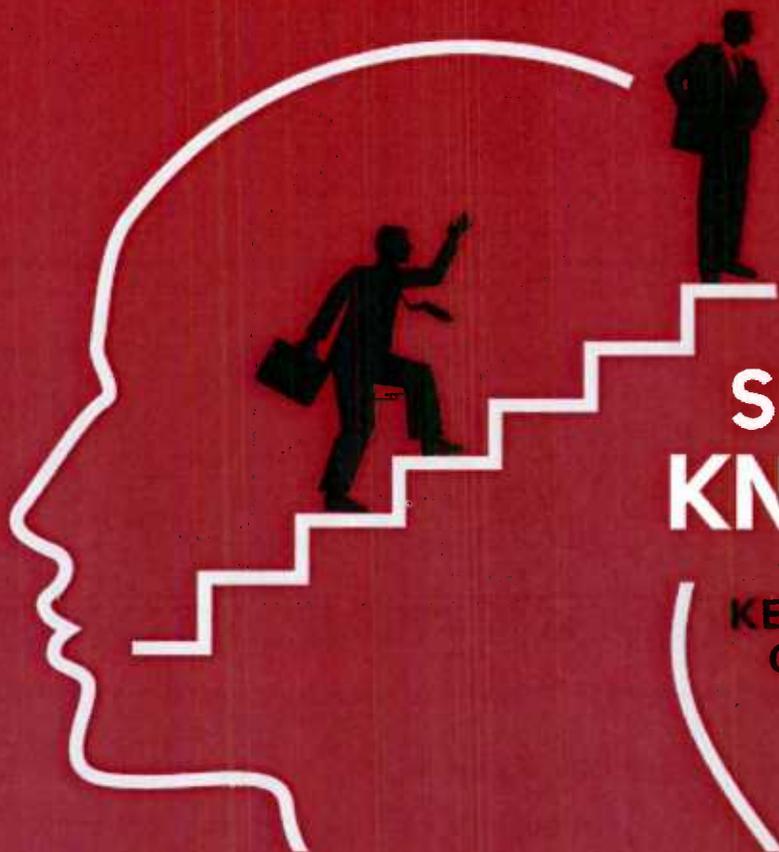


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# Major Issues in Real Estate Leases

BY AMOL PACHNANDA

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The role of an organization's Office of General Counsel in the negotiation of a lease can vary widely. In an organization that has various offices, the OGC may have standard operating procedures for control, quality and uniformity in the leases. In this type of organization, OGC may be involved throughout the whole process – interviewing commercial brokers, negotiating the brokerage agreement, and negotiating the letter of intent and the lease. If an organization has few leases, OGC may take a more hands-off approach by leaving the day-to-day management of the process to the organization's real estate person.

Both approaches can work, and in each it's incumbent upon general counsel to have a full understanding of the major issues involved in a lease. This article will identify those issues, and offer suggestions and negotiating strategies from the tenant's point of view.

Keep in mind, though, that leasing is an art and not a science, and that various factors, such as negotiating leverage and the marketplace, will impact whether or not a tenant prevails on a given point. (This article addresses office leases only. Retail and warehouse leases, though similar, have additional issues that merit independent discussion.)

**1** *Delivery of the Premises.* The actual delivery date of the premises is important, especially if the tenant is nearing

the end of its existing lease. The lease should provide for an anticipated delivery date, and the landlord should provide prior notice to the tenant of the date of substantial completion. If the landlord misses the anticipated delivery date, then the rent should be abated. Initially, the rent may be abated one day for each day of delay. Thereafter, the abatement should be increased to two or three days for each day of delay.

The tenant should negotiate for an eventual termination right after a certain number of months following the anticipated delivery date. However, the additional abatements of free rent that the tenant may have accumulated because of late delivery are of no value if the tenant terminates the lease. Therefore, the tenant should negotiate a liquidated damages amount in the event of termination.

In a situation where the tenant is up against the expiration of the existing lease, tenant should ask landlord to "turn-key" the premises, thereby shifting the burden of late delivery to the landlord.

**2** *The "SNDA."* The subordination, non-disturbance and attornment (formal acknowledgment of transfer) agreement provides that: (i) tenant subordinates its lease to the lender's mortgage; (ii) landlord agrees that tenant's occupancy of the premises will not be disturbed if the tenant is not in default under the lease at the time that the lender succeeds to the landlord's interest under the lease; and (iii) the tenant agrees to attorn to the lender as if it were the original landlord under the lease. The SNDA is meant to preserve the "original business deal" that the tenant negotiated with the original landlord.

Invariably the lender will try to renegotiate the deal by limiting its obligations while still expecting the tenant to pay the full rent under the lease. For example, lenders will refuse to pay the allowance that the tenant negotiated in the lease. In such a case, the tenant may consider asking the landlord to deposit

with the lender an amount equal to the allowance so that the tenant's original bargain is preserved.

If the tenant does not receive an SNDA, then the lender has the right to terminate the lease if it succeeds to the landlord's interest. For larger deals, this is an unreasonable risk.

**3** *Landlord's Services/Amenities.* The tenant should require that the landlord operate and maintain the building to a standard that is comparable to other similar buildings in a geographic area, and to the extent possible, the tenant should insist that a schedule is attached to the lease, establishing the baseline for certain services.

The most common schedules are janitorial specifications; security specifications; and heating, ventilation and air-conditioning specifications. If during the term of the lease there are issues with respect to the level and scope of such services, then the parties will be able to resolve them by reverting to the attached schedules. With respect to janitorial specifications, tenant may consider negotiating for the right to require landlord to change the janitorial services provider if the level and/or scope of services falls below the baseline threshold.

In some situations, tenants should require that the landlord provide that at least half the elevators in an elevator bank will be operational during normal business hours, and that some lower ratio will be operational outside of normal business hours.

If the building provides amenities, such as a conference or fitness center, then the tenant may  
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insist that the landlord make such amenities available during the entire term of the lease.

**4** *Tenant Improvement Allowance.* If the landlord is to provide an improvement allowance, the tenant needs to make sure it actually receives it. The tenant may consider negotiating for the right to receive the entire allowance up-front. Generally, landlords will agree to make periodic disbursements, but sometimes they don't pay it.

that landlord may suffer vis-à-vis the next tenant – for example, additional free-rent or other payments for late delivery. Tenant should ask for a 30-day grace period before it becomes liable for such damages.

**7** *Options.* Options come in various shapes and sizes. For example, the tenant may increase its presence in the building by way of a must-take expansion option, or a right of first offer. Alternatively, tenant may reduce its presence in the building by exercising a partial termination option.

## Usually, the general counsel's biggest concern is whether the lease can be assigned to a successor without the landlord's consent.

The tenant should have the right to offset the unpaid allowance against the rent, with interest. In certain circumstances, the tenant may ask the landlord to either provide a parent guaranty or a letter of credit to backstop the landlord's obligation to pay the allowance.

**5** *End of Term Removal and Restoration Obligation.* Tenant should not agree to surrender the premises in the condition that it was delivered. Additionally, the tenant should only be obligated to remove atypical office installations, such as convenience stairs, kitchen, executive restroom and dumb-waiters.

The tenant, when it seeks approval for alterations, should require notification as to whether those alterations will need to be removed at the end of the term. Finding out 30 days before the lease expires that certain alterations need to be removed may put the tenant in a bind, especially if the decommission budget did not anticipate such a cost.

**6** *Holdover Rent.* Construction delays at the new premises can force a tenant to holdover [in the old location]. To mitigate the damages resulting from a holdover, tenant should insist that holdover rent be calculated on a per-diem basis instead of monthly. So, if the tenant holds over for 15 days, it is only liable for 15 days of rent and not the full month.

Some leases may provide that, in the event of a holdover, the tenant is liable for any damages

Having a full bag of options is a time-tested strategy to grow or shrink the footprint as needs arise. This approach is preferable to the approach tenants too often take – lease more space and pay more rent than they need, and never grow into the space.

**8** *Assignment/Subletting in Connection with Corporate Transactions.* Usually, the general counsel's biggest concern is whether the lease can be assigned to a successor without the landlord's consent.

The lease should provide that corporate and related party transactions do not require the landlord's approval. All that is required is notice to landlord. Landlords will insist on a net worth test for the new entity. Such a test is not unreasonable and tenants routinely agree to it. However, tenants may inquire why the test is appropriate since the original tenant remains on the hook for the lease obligations.

The above list of major issues is not meant to be the list to end all lists. Different situations call for negotiating different provisions. The tenant's real estate expert, along with real estate counsel, will have to identify the particular major issues in the transaction. Whether or not the tenant succeeds on any particular issue depends on a variety of factors, including the marketplace, creditworthiness, negotiating leverage, and expertise of real estate counsel. ■



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