

NEGOTIATING LEASE PROVISIONS

LEASE COMMENTS KEY

KEY	DEFINITION
Legal Disclaimer	At the onset of negotiating the lease document you should explain to your client, both verbally and in writing, that you are not an attorney and you are prohibited by the Texas Real Estate Commission to give legal advice. Tell your client that while we are familiar with negotiating leases, you encourage them to seek the advice of an attorney.
Method of Redlining the Lease	Do not "play attorney". Make all of your changes in side comments to the lease in layman's terms and only add basic additions and deletions to the language in the lease.
Common Sense and Attention to Detail	No lease is written the same and new things are learned on every lease. There is an endless number of items and variations that can be negotiated and leases are always changing just like the real estate market. Each lease should be read with common sense and if something new doesn't make sense, address it! In addition to the provisions below, pay attention to details (for example note the difference between may vs. will) and negotiate consciously.
Holdover Provision	The holdover provision requires the tenant to pay substantially higher rent as a penalty for not renewing its lease and "holding over" after lease expiration. Negotiate 125% to 150 % of the last month's rent, preferably on a per diem basis. Make sure this applies to every month in holdover. Sometime the landlord will sneak in that it is 150% for the first month and then it bumps to 200% thereafter.
Operating Expenses	<p>The typical gross lease will allow the Landlord to "pass on" increases in operating expenses to the Tenant over the expense stop amount. It is important to negotiate a cap on the controllable expenses the Landlord is allowed to pass on to the Tenant. This cap can be either accumulative or cumulative and range from 2 to 8 percent. Obviously, a 2 percent cumulative (or annual) cap is best. Controllable expenses are everything EXCEPT Taxes, Insurance and Utilities. Strike anything that are not these three items, such as security services.</p> <p>If you are negotiating a triple net lease, placing a cap on the controllable expenses can be difficult. If you are unsuccessful, try for these exclusions at a minimum:</p> <p>All operating expenses that the landlord can pass on that are controllable should have the word "Reasonable" in front of it. For example, reasonable management, reasonable janitorial, and reasonable administrative, etc. and similar to what is being charged by comparable buildings in the area.</p> <p>Delete the word "ownership" anywhere it may appear. The Landlord should not have the right to pass through any costs of ownership, only costs of operations. The following items should not be included in Lessor's calculation of common area operating expenses: (i) capital expenditures including capital replacements, capital repairs, and capital improvements, (ii) all original costs including development, ground rent, depreciation and amortization of the building, its components, and operating systems, (iii) insurable casualties, (iv) new tenant expenses including marketing costs and leasing commissions, (v) financing costs, bad debt loss, rent loss or reserves for such losses, (vi) expenses incurred for necessary replacement under warranty, (vii) costs associated with business income of the building including accounting and legal fees related to ownership, construction, leasing, sales or litigation, (viii) costs of correcting defects in the construction of the building or building systems, (ix) salaries, fees and expenses for individuals beyond the level of building manager and Lessor's general overhead expenses not related to the building, (x) costs of services to the extent such costs exceed the cost obtainable through competitive bidding or a competitive selection process, and (xi) management fees in excess of 4% of rents received.</p>

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Audit of Landlord's books	<p>Most leases will provide Tenant the right to Audit the Landlord's books used to calculate pass-through or escalation expenses. Double check that this is included in the lease and specify that if an overage is found the Tenant will receive a credit and the Landlord will reimburse Tenant for the audit. You may strike any provision that revokes Tenant 's right if Landlord provides its own audit, as this defeats the purpose and is a conflict of interest. There will sometimes be an exception that the Tenant cannot hire a firm on contingency-based compensation basis. You could strike this if you would like.</p>
Assignment and Subletting	<p>Every lease should and typically does include an assignment and subletting provision, allowing the Tenant to assign or sublet its space with prior written consent by the Landlord. The following points should be negotiated:</p> <ul style="list-style-type: none">- Often times the lease will state that the Landlord may permit to an assignment or sublet at its sole discretion. Revise the language so that the Landlord' s consent will not be unreasonably withheld or delayed.- The landlord often times cites several scenarios where the landlord' s refusal to permit a sublease will not be considered unreasonable, for example if the proposed subtenant is a government agency, conflicts with the tenant mix or lacks acceptable financials. Attempt to remove the following scenarios: Any existing tenant in the building, any tenant in a building owned/managed by the landlord, any tenant in negotiation with Landlord or that has been in negotiation with Landlord in the last 6 months, and strike anything else that seems unreasonable. Many leases will require Tenant to pay any profits received from the sub lease to the Landlord. Revise language so that profits are retained or split evenly. Often times leases will require Tenant to pay a subleasing fee of \$1,000 or other high amount to landlord. Reduce to \$250 - \$500, or define as Tenant will pay Landlor d "s" reasonable expenses". Strike any limitation that the Tenant cannot charge less than market rent or the building's rate. Strike anything that seems unreasonable. <p>Also, provide for an exception that if there is a transfer of related parties or sale of a business that it is not considered a default. The language and metrics regarding this exception can get comprehensive, so just use common sense in working through an agreement.</p>
Landlord's Lien/ Security Lien	<p>Most leases have a provision that gives the Landlord a security lien interest in the Tenant's personal property (computers, desks, printers, files etc.) in order to secure payment of rent or other obligations due by Tenant. You can almost always successfully strike this provision. If the Landlord first refuses, tell them that some of the Tenant's property is financed and the provision must be revised so that the Landlord's security interest in the property take a secondary interest to the primary lien holder. They will almost always decide it is too much trouble and permit to the removal of the provision.</p>
Landlord's Insurance	<p>The landlord 's insurance will cover the cost of reconstructing base building components of the building if it suffers casualty due to fire, flood, natural disaster or any other event that causes the building to be untenable. It is not uncommon to find that there is no paragraph covering landlord's obligation to carry insurance. Make sure that there is a paragraph included that requires the landlord to carry insurance for the full replacement value of the building. If you are unsuccessful at doing t his, there should at least be a dollar amount or metric stated for the amount of insurance the landlord should carry. Sometimes a landlord will own a portfolio of real estate and will not individually insure a specific building, rather it will carry insurance for the entire portfolio in amounts less than the full replacement value for the entire portfolio of buildings. The reasoning for this is that not all of the buildings will suffer casualty at the same time, so carrying partial insurance for the portfolio of buildings will be more than enough to cover the total value of a single building. This is a very important provision to include as lack of insurance becomes a real problem if there is a building casualty (ask about Younan Properties after Hurricane Ike).</p>

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Relocation / Substitution Provision	<p>This provision allows the Landlord to relocate the Tenant during its lease term. The reason for this is so that the Landlord can accommodate a larger tenant's space requirement by moving a smaller tenant out of the way if there is no longer enough space elsewhere in the building. This is typically a standard provision until a tenant get to be over 7,000 square feet. Regardless, striking this provision should always be attempted and discussed with a client as it is often a reason sighted for not rehiring a broker on the next lease (by the tenants that are relocated). If removal of this provision is not successful then there are several improvements to the relocation provision that can be made:</p> <p>Landlord should pay for all costs associated with the move Landlord should pay for all construction to make the relocation space substantially the same size and configuration, using the same tenant finishes and quality materials. In no event should the base rent increase if the relocation space is larger. Some leases allow the Landlord to charge the same rental rate on a larger space, causing the rent to be higher. Landlord can only relocate Tenant within the same building. Some leases allow the landlord to relocate Tenant inside the "complex or project" or any building owned by the landlord inside the city or submarket. Landlord does not have the right to extend the lease by additional term in order to pay for the construction cost. If the Tenant does not agree with the relocation premises it may terminate the lease. Consider adding a "hassle factor" relocation fee in order to compensate the Tenant for the hassle of being relocated.</p>
Tenant's Insurance	<p>Depending upon the Landlord or Lease, this provision can range from one small paragraph to several pages long. The important things to do here is advise the Tenant to send this paragraph to the Tenant's insurance agent to report on the cost and whether their current coverage includes the stated insurance requirements. Typical coverage for a tenant is \$3 million aggregate and \$1 per occurrence. There is often times a requirement for the tenant to carry additional insurance that covers all of its personal property in the Premises, as well as Business Interruption insurance. Business Interruption insurance covers loss of revenue if something happens to the building and they cannot occupy the lease space for a period of time. There is sometime s a requirement for the Tenant to carry Workers Compensation, Automobile or other insurance that may not apply to the Tenant's business - in this event strike those requirements.</p>
Casualty / Damage to Building	<p>There is a provision in the lease covering the ground rules for what happens when there is damage to the building caused by fire, storm or other natural disaster, commonly referred to as " Casualty ". There will be exclusions regarding property insurance and Tenant's fault that should be reviewed carefully and negotiated using common sense. There will be language allowing the landlord to terminate the lease if construction is estimated to take longer than a specified period of time, the cost of insurance does not cover the repairs or the lender elects to take the proceeds of the insurance claim rather than repair the building. Make sure the following is included in the provision as well:</p> <ul style="list-style-type: none">- If repairs take longer than 180 days then the Tenant may terminate the lease.- There will be an abatement of rent until the building is restored. The abatement will apply proportionately or completely, however the Premises is affected. You can negotiate an additional improvement that if a casualty causes only a portion of the premises to be untenable, but it effectively makes the use of the premises inadequate to conduct Tenant's business, that the rent will be fully abated.- During period of repair the term WILL NOT be extended.

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Basic Services / Essential Services	Somewhere in the lease there will be a section covering Landlord's obligations to Tenant, which among other things include "Basic Services" i.e. utilities, elevator service, janitorial service, water, management, security, etc. If no such section exists, require that the Landlord provide such a section. Make sure to include that if there is ever a stoppage of Basic Services for reasons within Landlord's control, that rent will be abated until Basic Services are restored.
Compliance with Laws	There will be a provision in the lease that Tenant is responsible for conforming with all applicable laws and that it is responsible for the cost associated with any changes required by governmental agencies (ex ADA or Fire Department). Make sure you limit Tenant's obligations to the premises and exclude capital improvements.
Condemnation	There will be a provision in the lease explaining what happens in the event the building is "taken" by a government agency for public use, most commonly for a roadway or utility expansion. The provision mainly states that the tenant will receive an abatement of rent in proportion to the percentage of the Premises taken or affected, and that Landlord not Tenant is entitled to compensation received in connection to the condemnation. Make sure to add that if more than 25% of the rentable square feet of the Premises is taken, or if access to the Premises is substantially impaired, Tenant shall have the option to terminate the Lease.
Accepting Possession of Premises	There will be language in the lease requiring Tenant to acknowledge it is responsible for its own evaluation on the suitability and condition of the Building and Premises and it accepts the property in its "As-is, where-is condition". Make sure that you add an exception for Latent Defects and Defects that could not be reasonably detected during inspection. These types of defects should be the responsibility of the Landlord.
Tenant's Default	There will be an entire section regarding Tenant's default and the remedies available to Landlord. The specifics you could choose to negotiate are almost endless, but generally they are difficult to negotiate and the Landlord's counter is "don't go into default". The main thing to negotiate throughout this section is whenever an event of default is cited, the Tenant must be provided notice and given an opportunity to cure default before the Landlord is permitted to exercise a remedy.
Subordination, Non Disturbance and Attornment Agreement (SNDA Clause)	The subordination, non-disturbance and attornment agreement ("SNDA agreement") is the document that the landlord, tenant and lender often employ to resolve how their rights do and will intersect. As its name infers, the SNDA agreement addresses how and when the rights of tenants will be subordinate to the rights of lenders. It assures tenants that their rights to their premises will be preserved (that is, "nondisturbed") so long as they abide by the Lease even if the landlord defaults on its loan and the lender forecloses. The final component of the SNDA agreement assures a lender that the tenant will attorn to (agreeing to continue as tenant) the lender or a purchaser following a foreclosure. Often times the Subordination and Attornment portion of this agreement will be part of the standard lease and you will have to negotiate the addition of Non-Disturbance. Landlords typically only agree to the addition of a Non-Disturbance agreement for larger tenants, but always consider asking for one if it is not already included. Preferably you want to negotiate that the Landlord "will obtain" a Non-Disturbance agreement from the current Lender vs Landlord "will use its reasonable best efforts to obtain" a Non-Disturbance agreement from the current Lender.
Death and Disability Provision	A Death and Disability Option is very uncommon, but is an option when needed and contains the same negotiable points as the Cancellation Option if the Tenant dies or becomes permanently disabled.

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Quiet Enjoyment	<p>Quiet enjoyment is a right to the undisturbed use and enjoyment of real property by a Tenant. In the covenant of quiet enjoyment, the landlord promises that during the term of the tenancy no one will disturb the tenant in the tenant's use and enjoyment of the premises. Quiet enjoyment includes the right to exclude others from the premises, the right to peace and quiet, the right to clean premises, and the right to basic services such as heat and air conditioning, water, electricity and elevator service. In many respects the implied covenant of quiet enjoyment is similar to an Implied Warranty of habitability, which warrants that the landlord will keep the leased premises in good repair. Often times this provision is missing in the lease. Make sure that it is added, as it can later be used as a claim of Landlord's Default if the Landlord is not providing basic services.</p>
Right of First Refusal or Expansion Option	<p>The Expansion Option, or Right of First Refusal ("ROFR"), obligates the Landlord to first offer vacant space to the Existing Tenant before leasing it to an outside tenant. It can be for vacant space next door, on the same floor, in the same building or in the same complex. The vacant space can be current vacant space only or any space that becomes vacant in the future. It can also be a one-time or on-going right. Negotiate for the areas of the building that are needed by your client and don't over negotiate for the amount of vacant space. An on-going right of first refusal is always preferable. In order to exercise the ROFR, the Tenant must typically agree to abide by the exact terms of a "bona-fide 3rd party offer", meaning that if the outside tenant previously agreed to a 10 year lease at higher rates and a low tenant improvement allowance, the Existing Tenant must agree to those exact terms to exercise the ROFR. This is oftentimes a fair agreement, but you could negotiate that the terms not be set, rather the Landlord and Tenant will venture to agree on reasonable terms for the ROFR. Lastly, an important component of the ROFR to negotiate is the number of days the Tenant has to respond to Landlord's notice of the ROFR. Usually the Landlord will give the Tenant 5 business days to respond with its election to exercise the ROFR and 5 business days to enter into a lease amendment. Try for 5 business days to give notification and 15 business days to enter into a lease amendment.</p>
Renewal Option	<p>The Renewal Option gives the tenant a right to renew the lease and protects the tenant in situations where the landlord does not want to renew tenant i.e. an expanding neighbor wants the tenant's space, a "user" purchases the building for itself or the landlord decides he doesn't want the tenant's business use in the building. Pay close attention to how the "market rate" is defined; it should be based on comparable buildings and include the rental rate, tenant improvement allowance, free rent and other inducements/concessions. Strike any language that restricts the rental rate of the renewal, for example language that states in no event will the renewal rate be less than a certain amount i.e. the last year's rate. Conversely, if the tenant is big enough and it is a tenant's market it may be possible to negotiate a set rate or maximum rate for the renewal period. Also pay close attention to the notice requirement, which can range anywhere from 12 to 3 months before the lease expiration and restrict the window of time the tenant can renew the lease. The tenant may only be permitted to renew its lease inside a 1 month window, for example between the 13th and 12th month before the lease expiration. Try to negotiate the largest window possible and make the expiration of the window as close to the lease expiration as possible. The most typical renewal option will allow the tenant to renew anytime 12 to 6 months before the lease expiration. Negotiating for 12 to 3 months before expiration is probably a good idea.</p>

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Cancelation Option	<p>The Cancelation Option can be either a one-time or on-going option. Usually it is one-time right i.e. 3 years into a five 5 year lease, although less often you can obtain an on-going cancelation option after a period of time i.e. 3 years into the lease the tenant may terminate anytime with 3 months advanced notice. In almost all cases there will be a termination penalty for exercising this option; anywhere from unamortized up-front costs (construction costs, commissions, legal fees etc.) to several months' rent penalty and the paying back of any free rent received prior to termination. Pay close attention the tenant's obligation to give notice, which can range from 3 months to 12 months before the cancelation date. When asking for a cancelation option, it is a good idea to justify the request with an important business reason.</p>
Parking	<p>There will be a section or exhibit covering parking. Do not overlook this section when negotiating the lease document. Make sure the language is that the Tenant "may take" vs "will take" the number of parking spaces specified, and make sure that the charge for parking is "set for the term of the lease" vs "subject to change from time to-time." Also, if parking spot location is an important factor to your client get them involved in communicating with property management sooner than later to see what parking is available. Parking spaces are typically first come, first serve.</p>
Turn-key Agreement vs. Tenant Improvement Allowance	<p>Negotiating a turn-key agreement, based on an agreed upon space plan, is the safest way to negotiate a lease. This will require the Tenant to sign off on plans before executing a lease and will minimize Tenant's costs due to hidden surprises due to increasing construction costs, overlooked electrical or permit/regulation requirements, soft costs, project management fees, etc. because these costs must be borne by the Landlord if it agrees to turn-key the construction. Any changes made after the plans are signed by the Tenant will be considered a change order at the cost of the Tenant a.k.a. not your fault because the Tenant failed to address it before.</p> <p>Operating with a Tenant Improvement allowance is riskier and should only be negotiated when the Landlord refuses to a turn-key agreement, you strongly believe construction costs will be less than the allowance or you are very familiar with construction numbers and project management. If you choose to operate on a TI allowance:</p> <p>Be very aware of ALL costs included in the calculation of the total project cost - Hard Construction costs, Project Management Fees, Architectural Fees (Test Fits, Pricing Notes, Construction Documents, MEPs), Permitting Fees, Asbestos Reports and any other fees that may be included. Go above and beyond asking several times to provide and confirm that the number quoted includes ALL costs including all soft costs and hard costs. Remove or reduce the Project Management Fee charged by the Landlord. Negotiate to convert any unused Tenant Improvement Allowance into free rent or allow for the unused amount to pay for moving costs, furniture and cabling. Some brokers prefer to operate on a TI allowance when they feel the space requires little work. When this is decided, they generally negotiate the highest allowance possible and encourage the client to select high-end finishes or convert the unused allowance into credits.</p>
Build-out of Premises and Commencement Date	<p>When construction is involved, most leases will state that the term of the lease will begin on the estimated commencement date or when the Landlord delivers the space to Tenant with construction substantially completed, whichever happens last. It will further state that any failure of Landlord to deliver possession of the premises by the scheduled commencement date will not be considered a Landlord default and the Tenant's only relief will be that rent does not start and the commencement date will be pushed back until construction is complete. Make sure to negotiate that if the space is not completed by the scheduled commencement date that the Tenant will receive an additional 2 days of free rent (on the primary term) for every 1 day of Landlord's delay in delivering the space. Alternatively, negotiate that the Landlord is must pay for Tenant' s holdover rent until the construction is completed. Also add that if the landlord is 45 days (or a longer period) in delivering the space that the Tenant may terminate the lease. The Landlord will want to add an exception that this does not apply for reason caused by Tenant's delay or for reason s beyond its control. This is reasonable.</p>