



Commercial Leasing

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In the Spotlight: Drafting Better Leases for the Commercial Tenant

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Too many tenants' businesses have suffered severe financial consequences or lost leases as a result of poorly drafted provisions. Therefore, it is imperative that tenants negotiate better leases in order to protect their interests. The suggestions in this article provide proposed remedies for a few of the harshest lease provisions. Although market conditions always play a factor in providing negotiating leverage to a landlord or tenant, some of these proposals should survive scrutiny in any real estate market.

Requiring the Landlord to Mitigate Damages

In a number of American states, landlords are not required to mitigate damages when a commercial tenant defaults on its lease and surrenders or is removed from the premises. As the tenant of record remains liable for all rents due during the remainder of its term of the lease, a landlord has no incentive even to attempt to re-rent or alleviate a defaulting tenant of its duty to pay rent. Landlords are not obligated to mitigate prospective losses in the event of default on rent payments. This has produced exceedingly harsh results.

Hence, every lease should contain a clause providing that upon a default in the lease that results in the surrender or eviction from the premises, the landlord agrees to mitigate its losses and to use reasonable efforts to re-lease the demised premises. If it can be negotiated, such a clause should include a requirement by the landlord to advertise weekly and to employ a qualified real estate broker to find a new tenant to lease the premises. This clause should also include a duty by the landlord to attempt to rent the premises for at least the same rent to reduce any remaining tenant liability.

When one contemplates the potential amounts that could be owed without a mitigation of damages clause, it is clear that negotiating such a simple clause may provide a tenant a life preserver in an ocean of financial devastation.

A 'Prevailing Party' Clause

Most commercial leases include a provision that a tenant must pay a landlord's legal expenses and attorneys' fees in connection with any default in the lease.

Although some states have laws that mandate that such an attorneys' fee clause in residential leases is deemed to be reciprocal, this statute does not apply to commercial leases. Despite many failing arguments to the contrary, attorneys' fee provisions providing payment to the landlord in connection with a legal proceeding will not provide the same rights to a tenant unless specifically stated in the lease.

Hence, a "prevailing party" clause should be negotiated into the commercial lease agreement. The provision should read that the losing party to any legal action shall pay the prevailing party's legal fees and expenses. Such a clause should prevent, or at least lessen, the number of frivolous and harassing lawsuits initiated by both parties. As neither party will be able to commence legal action without the threat of having to fund the victorious party's legal bill, parity should prevail and thereby preclude attempts to exploit any inequitable leveraging positions.

Right of Expansion Clause

An expansion clause is the right or option to lease a specific additional space in the demised premises for a defined term in the future. Such an option becomes significant when a company has outgrown its space and wishes to avoid having to move to a new location and save the cost and inconvenient time

delays that relocation necessitates. Financially, it saves the tenant from being forced to lease additional space if its financial situation does not dictate growth when the option becomes available.

The expansion clause allows a tenant the flexibility of either: a) taking an entirely new and larger space in the building without any financial consequences for vacating its present space, or b) expanding its tenancy by taking additional floor space or additional square feet. The expansion option also benefits the landlord by allowing it the flexibility to deliver different floors or rental space to the tenant at different times. The expansion clause also requires communication between the landlord and tenant at certain fixed times which might not otherwise occur without a lease provision dictating such contact.

Because the landlord knows when existing leases expire, it will be able to determine vacancy dates before the execution of the initial lease. As such, the negotiated expansion clause should address different possibilities for potential expansion. The expansion clause should be expressly negotiated to include: a) a detailed description of specific potential expansion spaces, b) the yearly rent due or an agreement to use the fair market rent, and c) any increases in taxes and/or operating expenses. In addition, a provision requiring the landlord to use reasonable efforts to recover possession from a holdover tenant in the chosen expansion space should be included. Tenants should also attempt to negotiate a Right of First Refusal to protect their long-term interests in the premises.

The Option to Renew

The Option to Renew has been in practice for hundreds of years. It is not the option itself, however, that led to its discussion in this article but the methodology of negotiating such a right on behalf of the tenant and the tremendous benefits provided to a tenant. The option permits a tenant to sign on for another five or 10 years at a negotiated rent. The renewal rent negotiated at the time of the initial lease is often only 3% to 5% above the rent for the last year of the original lease period. Since the tenant is not required to exercise the option, it can vacate the space without any liability after the initial lease term. Furthermore, after investing heavily to turn raw space into an office or store, a tenant will be more comfortable signing a lease with a shorter term with the knowledge that at its option it can remain for one or more renewal periods. In fact, a shorter term with option periods may be beneficial for a smaller company without the ability to forecast financial success. Finally, if the market calls for a lower rent than the renewal option specifies, negotiation may result in a decreased rent when it is time to renew.

The option to renew is beneficial to the landlord as a result of the incentives supplied and its importance as a negotiating tool. By making the option contingent on the tenant's good standing with its lease obligations during the current term, the tenant shall have an important incentive to be on its best behavior and to comply with all of its lease obligations to avoid losing the right to renew. Granting the option can also give the landlord an important negotiating tool that may overcome any stalemate that has impeded the lease negotiations.

The Use Clause and the Move-In Date

A provision should be negotiated into a lease giving a tenant the ability to cancel the lease upon a determination that the planned use of the premises cannot be legalized or that it cannot be made so within a reasonable time after submitting a proper application. During this waiting period, the lease should require that no rent become due. To facilitate the process, a provision requiring the landlord to complete any necessary forms to legalize the use or proposed alterations should be drafted. If the lease is cancelled, the landlord should be required to return all monies forwarded to it, as well as to reimburse any expenses incurred by the tenant in attempting to legalize the premises.

A tenant should also retain the ability to cancel the lease if it is unable to take possession on the move-in date or soon thereafter. A representation should be added whereby the landlord agrees to make a good faith effort to complete and legalize the premises, as well as to evict a holdover tenant. In an alternative to canceling the lease, the tenant should be granted a rent abatement for each day that the landlord fails to deliver possession. Upon the delayed commencement of the lease, the expiration dates of the lease should be extended, and the commencement date should be contingent on the issuance of the various approvals and permits necessary to complete construction.

The Signage and Alterations Clause

A disproportionate amount of commercial leasing litigation derives from disputes over signs and alterations. In an attempt to decrease the amount of litigation involving such items, attorneys should learn a tenant's business needs and carefully adopt them to the lease. In addition, the following suggestions may prevent litigation and provide a tenant with greater freedom in its space. Before the lease signing, negotiate the advance or pre-approval of any alteration changes and signage requests, as well as any foreseeable alteration changes during the term of the lease. Specific plans, measurements, drawings, and pictures should be provided and attached to the lease agreement. If possible, obtain the right to make nonstructural alterations without the landlord's approval, including any alterations that are insignificant or do not require building permits. Also, draft a representation by

any alterations that are insignificant or do not require building permits, draft a representation by the landlord to remove any existing violations against the premises, so that any permit applications needed to perform work will not be rejected. For all other alterations necessitating permission, ensure that such authorization will not be unreasonably withheld.

Repairs and Tenant's Self-Help Clause

Regarding repair responsibility, tenants should attempt to make the landlord liable for all structural repairs to the demised space and to the building, as well as nonstructural repairs occasioned by the landlord's negligence.

One of the most useful tenant-friendly clauses is the tenant's self-help provision. Such a provision permits a tenant to complete any repairs that the landlord neglects to complete within an allotted time period after notification from the tenant. Under this clause, a tenant shall seek reimbursement by obtaining a rent credit for the cost of the repair or by obtaining reimbursement from the landlord. Besides vitiating the tenant's dilemma of whether it can withhold rent until the repairs are done, it will provide a mechanism that should assist in keeping the premises free of necessary repairs. The self-help clause will also resolve the "independent covenant" dilemma, where any rental amounts due to the landlord are deemed independent of the landlord's obligation to do repairs. Any lease provision specifying that each provision in the lease is independent of every other provision should be modified to include the tenant self-help provision.

Conclusion

Dozens of other provisions exist that would be helpful to a tenant; however, this article has recommended a few that are not only the most essential, but also have a decent chance of being negotiated into the lease.