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Everyone Does It This Way

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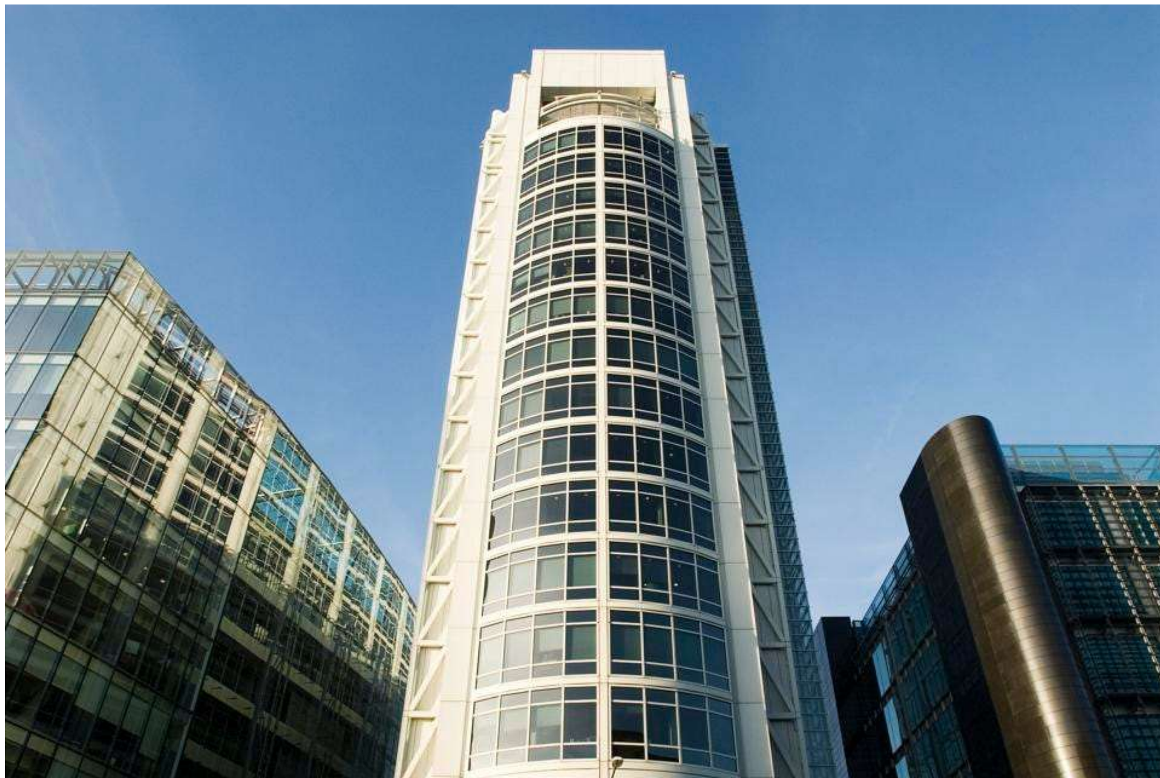
Real Estate
I write about commercial real estate negotiations, deals and legal issues.



Maybe real estate negotiators should look at issues a different way. GETTY IMAGES

It's market standard to handle this particular issue this way. In the last 10 deals we've done, we've always resolved it this way. You're off market to ask for something different.

That's the argument one often hears in any interesting negotiation of commercial real estate documents. Instead of arguing based on what

makes sense given the rest of the deal and the overall structure, one hears instead the argument that in all the other deals, the issue was resolved in this particular way.

Beneath the surface, the argument has a flavor that whoever is making it knows more than whoever is listening to it. The listener maybe doesn't quite know what they're doing. If they did know what they were doing, then they wouldn't be so stupid and naïve to suggest handling this particular issue differently than the way everyone else handles it.

But what if the listener isn't in fact that naïve or stupid? Often the listener has just as much experience with similar deals as the person making the argument. And in fact the listener's experience is precisely the opposite. In the listener's last 10 deals, the issue has always been resolved the way the listener wants to resolve it. That's market standard, according to the listener.

So we're even. The party making the argument thinks the other party doesn't know what's market standard. And whoever hears that argument typically has their own experience of what's market standard, and has some doubts about whether the first party knows what they're doing.

It's a draw. One of the most common arguments in any commercial real estate negotiation ends up proving nothing at all.

Ultimately in these cases the parties will need to resolve their argument in one of two ways.

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First, one party might have all the leverage, regardless of either party's view of what's market standard. In that case, the party that doesn't have leverage will just have to go along or perhaps not do the deal.

More often, both parties have some leverage and some alternatives available. They'll just have to figure out what makes sense given the logic of the larger transaction. Each party can pontificate all they want about how everyone else deals with the issue, but these parties will simply need to negotiate it out in a way that makes sense to them.

In one recent ground lease negotiation, counsel to the tenant's lender – a household name – tried to use the "market standard" argument against the landlord. The ground lease under negotiation said that if the lender wanted to preserve its collateral, the ground lease, the lender would need to make any payments the borrower/tenant had failed to make under the ground lease. So far, so good, and quite ordinary.

But the lender's counsel wanted to add a nuance: If the tenant owed money to the landlord because of some obligation of the tenant to indemnify the landlord for some risk (i.e., to pay any claims against the landlord because of that risk), then the lender wouldn't have to make those indemnification payments. Those payments would simply be excused and the lender could still preserve the lease.

If the landlord accepted that position, then who would end up bearing the risk at issue? Answer: The landlord. If the landlord ended up writing a check because of the risk, the lender could step into the tenant's shoes under the lease and preserve the lease without indemnifying the landlord for the risk at all.

The landlord didn't like that idea, because it runs against the underlying structure of ground leases and leasehold financing. These leases are supposed to shift all risks away from the landlord. The tenant's lender just has to accept that or not lend against ground leases.

The lender's counsel said it's market standard to handle the issue the way the lender wanted, so the landlord was being unreasonable.

The landlord stuck to its guns. Landlord's counsel, who handles many ground leases, had never resolved the issue the way lender's counsel wanted. According to the landlord's counsel, the lender's proposal was not only not market standard, it was also bizarre.

This time, the landlord prevailed. So maybe that's "market standard" for the next transaction. Until it isn't.

Joshua Stein

I help buyers, sellers, borrowers, lenders, tenants, property owners, and other commercial real estate market participants identify and achieve their business goals. To do that, I need to understand risk, security, numbers, value, financeability, flexibility, and exit strategy. Some legal issues matter a lot and many don't. It's important to know the difference. I write extensively on commercial real estate law and practice – over 300 articles and five books on leasing, lending, and other areas, with some emphasis on ground leases. I occasionally serve as an arbitrator or expert witness in complex real estate disputes. That lets me see how transactions go wrong. Often, the problems could have been avoided by keeping it simple and following the money, but everyone got sidetracked. As a Forbes contributor, I try to tell stories that teach worthwhile lessons for real estate deals. **Read Less**

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