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In 2021, Maybe Commercial Tenants Shouldn't Settle For "Market Standard" In Their Leases

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

Standard lease forms create landmines for commercial tenants. RANJAN SAMARAKONE

When property owners and tenants negotiate commercial leases, the owner or its counsel usually prepares the first draft of the lease. The lease typically starts out benignly enough, by documenting the commercial deal. But then

the owner's lease form meanders into dozens of legal byways, adding dozens of clauses that respond to past reported litigations in which the tenant prevailed. Other clauses build in pitfalls and minefields that could create future revenue opportunities for the owner or future unexpected costs for the tenant.

When the tenant's counsel objects to these clauses, the owner's counsel usually responds by declaring that the clause in question is "market standard," so the tenant's request is "off market," which is a bad thing. As the subtext, the owner's counsel implies that the tenant's counsel doesn't really know what they're doing, because if they did know, they wouldn't be making such a stupid request.

This negotiating dynamic has for many years typically assumed the property owner had the upper hand. The tenant was a supplicant lucky to get a few crumbs from the leasing table. As commercial real estate rental markets shift in favor of tenants, that negotiating dynamic should start to shift too. And perhaps tenants should start to ask for concessions in leasing documents that would have been unthinkable – terribly "off market" and perhaps naive – as recently as 2019. Here are a few suggestions:

- Push back on rent escalation clauses, pass-throughs, and periodic rent bumps. These provisions, when piled on in the same lease, virtually assure rent will rise faster than inflation and market rents for new leases. In particular, avoid agreeing to any operating expense pass-through, as it creates endless opportunities for mischief and disputes.

- Allow the tenant to assign the lease to any new tenant that meets objective and simple tests that involve no exercise of discretion or judgment by the owner.

- If the owner will contribute to the tenant's build-out of its space – something that will become more prevalent and larger in the coming months – then simplify and streamline the disbursement process. In

particular, don't require the tenant to go out of pocket and seek reimbursement. Instead, the owner should just pay the unpaid bills. And try to minimize the required paperwork.

- If a mandatory shutdown substantially impairs the tenant's revenues, allow a temporary rent reduction.
- Reduce late charges, interest, and nuisance fees. In particular, trim back the "holdover" rent that applies if the tenant doesn't move out on time, especially the requirement to pay for a full month if the holdover lasts for only a day or a few days. Also try to get rid of language that has accreted in recent years to require a holdover tenant to "indemnify" for the hypothetical loss of the property owner's next tenant.
- Eliminate as many other fees and reimbursements as possible.
- Give the tenant a termination option or a right to reduce the size of the leased space, in each case with ample notice to the owner and perhaps a walkaway payment.

- Entitle the tenant to ample warning before anything, even failure to pay base rent, constitutes a lease default. Maybe ask for a double warning.
- Even for a small tenant, require the owner to deliver a so-called “nondisturbance” agreement from its lender committing to honor the tenant’s lease if the lender forecloses against the owner.
- If the owner doesn’t properly maintain or service the building or the space, give the tenant the right to withhold rent, or even fix the problem and bill the owner, after a certain period.
- Trim back any owner consent or approval requirements, wherever reasonably possible (e.g., contractors, construction plans, subtenants). Each consent requirement means the owner can in theory require the tenant to do something different from what the tenant actually wanted to do. Instead, just set objective standards for what the tenant can and can’t do.
- If the tenant assigns or subleases at a “profit,” standard leases often require the tenant to pay the owner 50% or more of the “profit.” The owner does not, however, participate if the tenant suffers a loss, which is what usually happens. In today’s market, a tenant ought to try to get rid of the “profit participation” concept completely unless the landlord signs up to participate in any loss as well (unlikely).
- Push back against clauses that might allow the owner to terminate the lease or relocate the tenant.

- If the tenant defaults, try to negotiate a dollar cap on the maximum exposure of the tenant and any guarantor. (This is historically unheard of, but tenants have proposed it in recent lease negotiations.)
- Have the owner affirmatively waive any claims against the members or owners of the tenant, under any theory whatsoever, except to the extent anyone has signed a guaranty.
- What services does the owner provide at extra cost? Try to eliminate the extra cost and roll the service into the rent, with a clear obligation for the owner to provide that service.
- At the end of the lease term, excuse the tenant from any obligation to remove any work it did.

The preceding list covers most of the major pain points and pitfalls for tenants in owners' standard leases. Of course many more exist. A tenant negotiating a new lease should address at least some of these points in the term sheet or letter of intent. Failure to do that invites the owner to argue its position is "market standard." For example, owners often think a real estate tax escalation and a 50% "profit participation" are so "market standard" that they automatically belong in every lease even if not mentioned in the term sheet or letter of intent.

Almost every clause in an owner's standard lease invites a more tenant-friendly alternative in a more tenant-friendly market. And since the commercial real estate world is heading into a more tenant-friendly market, tenants shouldn't be bashful.



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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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