

Lease Negotiations Beyond The Lease

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Joshua Stein (www.joshuastein.com); **S.H. Spencer Compton** (shcompton@firstam.com); and New York State Bar Association. This checklist is a continuation of The Landlord's Checklist of Silent Lease Issues (Third Edition), initiated and edited by Joshua Stein. The first and second editions of this checklist were contributed to extensively by a subcommittee of the New York State Bar Association, Real Property Law Section, Commercial Leasing Committee. That subcommittee was chaired by Messrs. Stein and Compton, who have been the primary authors of every edition of the checklist. Messrs. Stein and Compton prepared the third edition without subcommittee involvement. For the third edition, the co-authors acknowledge the editorial assistance of Obianuju Enendu (obianuju.enendu@gmail.com), who previously worked with Joshua Stein at Latham & Watkins LLP. Numerous attorneys commented on drafts of this third edition, and on the first and second edition. Those commenters are recognized at the end of the checklist, as it appeared in the previous issue of this publication.

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When you negotiate a lease for a landlord, some of the most important issues lie outside the four corners of the document.

THE MAY ISSUE of *The Practical Real Estate Lawyer* consisted exclusively of the third edition of the Landlord's Checklist of Silent Lease Issues — a checklist that originally covered only “silent” and nonobvious leasing issues for a landlord, but that now includes a wide collection of issues that any landlord should consider.

To supplement the main checklist, this article offers landlords and their counsel a much shorter checklist of issues to consider beyond the four corners of a lease. Those issues fall under three broad headings: due diligence and external considerations; other lease-related documents and deliveries; and actions to take after signing the lease. The third category doesn't exactly represent “issues,” but it still seems appropriate to cover here.

Some matters covered in the first two parts of this article could ultimately lead the parties to adjust the language in the lease, so the landlord's counsel very much needs to think about them in the lease negotiation process, and in any case before signing the lease. These items can require a reasonable amount of homework outside the lease document itself. Much of that homework will involve the

landlord's personnel and other consultants, such as brokers. In those cases, the landlord's counsel may, at a minimum, want to make sure that the other players know what they need to do, and do it when it needs to be done.

That homework, the other documents mentioned in this article, and proper post-signing administration of the lease may collectively make all the difference for the landlord over the long lifespan of any commercial lease.

1. Due Diligence, External Considerations

1.01 Accounting Implications. The Financial Accounting Standards Board has tormented real estate professionals for at least half a decade with proposed new guidelines on how to account for leases. That process continues, creating uncertainty about possible accounting disasters ahead for landlords and tenants. The proposed guidelines, if adopted, may drive substantive changes in the terms of leases, such as by leading tenants to favor shorter leases. Any such trend would not only affect lease negotiations but also affect the entire dynamic of commercial real estate ownership. Any attorney negotiating a commercial lease, especially a substantial one, for the landlord or the tenant should involve the client's accountants.

1.02 Background Check. Perform suitable background and credit checks, including online checks. Check the Office of Foreign Assets Control ("OFAC") list of terrorist entities online at www.fincen.gov to see if the tenant, or any of its principals, appears on the list. Perform a UCC and bankruptcy search for the actual specific entity that will be the tenant, as well as its parent company and perhaps major affiliates. Look online for general information about the tenant's past litigation, other history, activities, and plans. Some types of background investigation will require a consent from the person being investigated. Don't assume the prospective tenant can consent to a background check for some other person, such as a guarantor.

1.03 Consents. Does any mortgage, ground lease, other space lease, development agreement, or reciprocal easement agreement limit who may be a tenant in the building? Confirm that this tenant complies. If appropriate, obtain suitable representations and warranties (for example, not a "prohibited person"). Does the transaction require any consent on the landlord's side, such as from a joint venture partner, mortgagee, mezzanine lender, or ground lessor? Do any of these parties require the landlord to include particular provisions in space leases? If so, include them. And what will the consent process require? How long will it take? Can the landlord seek consent based on just a term sheet, or must the landlord wait until the transaction has been fully documented? What needs to go into the package sent to the party whose consent the landlord needs? And what else can the landlord or its counsel do to expedite the consent process?

1.04 Green Construction. Every company now seems to say it is a "green" company — whatever that means. Leases are starting to sprout new "green" covenants, e.g., obligations to recycle, as mentioned in the main checklist. But most new occupants of commercial space still fully demolish their new space, if it wasn't already raw when delivered. Every time a space turns over to a new

tenant, huge amounts of construction debris still go to landfills. If a landlord wants to reduce the environmental impact of its building, what can that landlord do over time to change construction techniques in the building, to eliminate or reduce those truckloads of construction debris? How can landlords make their spaces more adaptable to the needs of multiple tenants over time, so every tenant will not need to fully demolish the space? Those questions go beyond lease negotiations and legal issues. A “greener” approach to tenant improvements would eventually affect the terms of leases.

1.05 Identities of Tenant and Guarantor. Determine early the exact name of the tenant. Understand the tenant’s equity ownership structure. Get the right entity as the tenant. Cross-check the tenant’s name against its charter certificate as filed. The same comments apply to any guarantor.

1.06 Incentives and Subsidies. Understand any incentive and subsidy programs available for the contemplated lease. Can this tenant qualify? If so, the landlord should consider that qualification — and any economic benefits the tenant will realize — as part of rent negotiations. If the tenant will save a dollar through incentive and subsidy programs, perhaps the landlord can charge an extra 90 cents of rent, demonstrating that geographically targeted incentive programs may ultimately do nothing more than increase the value of real estate investments (and ultimately land) in the targeted area. These programs often require that when the beneficiary applies for benefits, the beneficiary has not yet taken some action to “commit” to a particular location, such as filing a building permit or signing a lease. Keep these pitfalls in mind in managing the process.

1.07 Lease Cross-Check. Just before signing the lease, take one last look at the term sheet or deal summary. Recheck to confirm that the final lease documents, after whatever negotiations occurred, still fully conform to the term sheet or deal summary. If the landlord moved away from that starting point in negotiations, counsel should confirm that the landlord signed off on those concessions in writing, at least by email. In the morass of leasing issues great and small, don’t lose sight of the single most important issue: the rent. Consider circulating just the final rent numbers to the client and the client’s broker — separately from anything else — with a request for final confirmation that they are right. As with any other numbers in a legal document, these numbers can look right but be very wrong. And so can the rent adjustment dates.

1.08 Legal Requirements. Do any special legal requirements apply to this landlord? For example, if the landlord is somehow a governmental contractor, then procurement regulations may require this landlord to include in its leases an obligation for tenants to comply with equal opportunity requirements, hiring of particular categories of person, or other governmental agendas, including for example the foreign policy of the City of New York.

1.09 Other Leases. Does any other tenant have a right of first refusal or other pre-emptive right for the space now being leased? The landlord should understand all possible preemptive rights under other leases in the building, to assure that no two tenants can ever claim the same space at the same time. Does any other tenant’s lease contain any other provisions that this lease ought to

take into account, such as a right to enter the premises to run cable or obtain access to telecommunications installations? Particularly in a retail context, has the landlord given any other tenant an exclusive right that this one might violate? If the tenant requests any rights outside the leased premises (for example, an antenna on the roof), can the landlord accommodate that request without running afoul of rights already given to other tenants? Rather than deal with all these issues on a one-off basis for each lease, the landlord or its counsel should maintain — and keep updated — a correct and complete master list of all rights of the types mentioned in this paragraph.

1.10 Plans. Does the landlord plan any significant changes, redevelopment, repositioning, or sale of the building in the term of this lease? How would those plans affect the terms of the lease? Does this lease match the landlord’s plans for the building?

1.11 Previous SEC Filings. If the tenant is publicly held and any previous lease of the tenant was a “material obligation,” the tenant should have incorporated that prior lease in a previous SEC filing. As a strategic matter, the landlord may wish to review that filing and see what the tenant accepted in the previous transaction.

1.12 Real Estate Tax Assessment. Think about the real estate tax assessment in the base tax year. If for some reason the landlord knows it is “too high,” will probably drop in later years, but probably won’t drop for the actual base year, then over time the real estate tax escalation in the lease may not help the landlord much. How to handle this problem will depend in part on the particular building and the particular landlord, as well as local tax assessment procedures and timing.

1.13 References. Obtain references for the tenant and its principals.

1.14 Scope of Premises. Think about where the premises begin and end, identifying and resolving any uncertainties. Don’t just refer, for example, to “the eighth floor” or “all the rentable space on the eighth floor.” Prepare a clear floor plan (or at least a sketch) to attach to the lease. Even for a full-floor tenant, clearly demarcate where the premises end and the common areas (and other landlord-controlled areas) begin. Do the premises include service closets? Elevator lobbies and restrooms, in the case of full-floor premises? If someone prepares and throws onto the back of the lease an intuitive sketch of the space at the last minute, this can lead to serious disputes later if the sketch included even very tiny spaces that it shouldn’t have included. If the lease refers to rent as a function of “rentable area” — an undesirable approach — then a space sketch could even somehow create arguments or uncertainty about the amount of “rentable area” and hence the rent.

1.15 Tax. Consider any tax issues arising from, e.g., the structuring of the rental stream and allocation of depreciation deductions arising from any initial capital investment for the lease.

1.16 Tenant Representations. Obtain representations and warranties about the ownership structure of the tenant, perhaps backed by a secretary's certificate and copies of documents. Also seek confirmation that the tenant obtained all necessary approvals, especially if the tenant is a non-profit or other unusual type of entity. Consider obtaining the same for any entity guarantor.

2. Other Documents And Deliveries

2.01 Advice and Administration Memo. The landlord may desire counsel to prepare a memorandum summarizing important provisions of the lease and advising the landlord on actions it should remember to take to avoid problems, issues or disputes. Any such memorandum should also include reminders of any important dates (including any that recur periodically); a disclaimer of counsel's responsibility to remind the landlord of those dates; and a suggestion that the landlord maintain a tickler file. Because such a memo can't include everything, it should include appropriate disclaimers. But to the extent it does cover anything, make it 100 percent right. Check it three times.

2.02 Brokerage Agreement. Confirm that the landlord has entered into suitable brokerage agreements (or has obtained commission waivers) with every broker involved in the transaction in any way. Consider the effect of a possible tenant default on the landlord's liability for unpaid brokerage commissions. What about an early negotiated termination of the lease based on a change in the tenant's financial condition? Try to negate any further payment obligations to the broker in any such event. If the lease gives the tenant early termination options, then defer any commission payments accordingly. Try to express any brokerage commission as a dollar figure rather than as a formula, because formulas invite disputes, especially when they provide for exclusions, gross-ups, adjustments, hypothetical eventualities, and other sources of complexity and disputes. Did the landlord ever enter into any previous leasing transaction with this tenant, creating the risk that a broker involved in the previous transaction will expect a commission from this one?

2.03 Certificate of Insurance. Have an insurance consultant review the tenant's insurance certificate as well as the tenant's underlying insurance policy and endorsements. There is really no substitute for reviewing the actual policy and endorsements themselves.

2.04 Disclosures. To the extent that governing law requires a prospective landlord to disclose information to a prospective tenant, identify those requirements and make the disclosure. Ever-expanding disclosure requirements have become part of the territory for certain consumer transactions. The trend has started to affect commercial leasing. For example, New York requires prospective landlords to notify prospective tenants of certain vapor intrusion issues.

2.05 Environmental Assessment (Baseline). Particularly if a tenant will lease an entire building or conduct activities that might cause contamination, obtain an environmental assessment as of the beginning of the lease term. Attach it as an exhibit. Use it as a baseline to measure any possible contamination the tenant caused or for which the tenant might otherwise be responsible.

2.06 Estoppel Certificate. Attach a form of estoppel certificate to the lease. Make it as broadly acceptable as possible, and consistent with the form contemplated by any existing loan documents. It should allow reliance not only by third parties but also, if possible, by the landlord.

2.07 Financial Statements. Obtain for the tenant and any guarantor(s). Make sure the client has reviewed them.

2.08 Good Standing and Organizational Documents. Obtain and review the tenant's good standing certificate and government-certified copies of organizational documents. Ask for an organizational chart if the tenant's structure is complex.

2.09 Guaranty. Obtain a guaranty executed by the correct guarantor — check the name against some appropriate document — and acknowledged before a notary. Confirm the authority of the signer for any entity guarantor. Require the guarantor's taxpayer identification number and (for an individual) residence address under the guarantor's signature. If an individual guarantor resides in a joint property state, consider obtaining the signature of the guarantor's spouse as well. If the guaranty covers anything less than all lease obligations, think about how the landlord might enforce the guaranty in the context of various possible defaults, and try to prevent any surprises. If the tenant defaults and perhaps cures some of those defaults in various ways, how does that affect the landlord's claims under the guaranty?

2.10 Letter of Credit. Review the letter of credit form as early as possible in the process. Obtain lender sign-off as needed. If the lender requires any arrangements to give the lender control of the letter of credit, set up those arrangements. They may involve third parties, hence take longer.

2.11 Lender's Rights. Review the landlord's loan documents to assure that the landlord's rights and obligations under the lease track the landlord's obligations as borrower under the loan. What landlord consent rights do the existing loan documents require the borrower to retain? And what landlord consent rights will future lenders probably require? If the loan documents are being negotiated at the same time, try to correct any disconnects by modifying the loan documents if necessary. The concerns in this paragraph go beyond assignment and subletting, but seem most likely to apply to assignment and subletting.

2.12 Marked Leases. When preparing final lease documents for signature, mark them against the landlord's standard form to facilitate future lease review projects and administration. Do not give tenants and their counsel those marked copies.

2.13 Memorandum of Lease and Release. If the lease requires the landlord to sign a memorandum of lease, also obtain a release of memorandum of lease, and deposit it in escrow with the landlord's counsel or some other third party willing to assume responsibility.

2.14 Opinion of Counsel. For a major lease, consider obtaining an opinion of counsel about the tenant's due authorization, execution, and delivery of the lease, though probably not enforceability of the lease. Consider requesting a representation by the tenant that entering into the lease does not violate any pre-existing agreements. Similar considerations may arise for any guarantor. A landlord might particularly want an opinion of counsel for a foreign, governmental, or nonprofit tenant.

2.15 Original Documents. Create an audit trail showing who received original documents, particularly letters of credit. In general, original documents should go to the client and the landlord's counsel should retain a scanned copy of the entire lease and all related documents, with all exhibits. Is there anyone else to whom the landlord must send copies of new leases? What about the landlord's mortgagee or any ground lessor?

2.16 Plan Approval. If the landlord will perform any construction, have the tenant approve any plans at lease signing, if possible. Failure to do that may give the tenant an opportunity to delay the construction process (by withholding approval of future plans), which could delay commencement of rent.

2.17 Press Release. Particularly if the landlord wants to control or initiate press coverage for the transaction, the landlord may want the parties to issue a press release about their transaction. If so, the parties should resolve the form of that press release as part of negotiating documents, because it will need to go out immediately after signing to achieve maximum attention from the press.

2.18 SNDA Request. Without putting any ideas into the tenant's head, try to determine early in the process whether the tenant intends to require an SNDA. If so, start the process early. See what exactly the governing loan documents will require the landlord to do. Who acts for the lender? What information must that person receive? Match the form of SNDA attached to the lease (or otherwise expected by the tenant) to the form of SNDA contemplated by the loan documents. The same agenda arises for any ground lessor.

2.19 Taxpayer Identification Number; W-9 Form. Require the tenant's taxpayer identification number under the tenant's signature. Sooner or later the landlord will need it. If the tenant delivers an interest-bearing security deposit, the landlord will need the taxpayer identification number immediately. Consider incorporating the tenant's W-9 Form certifications into the body of the lease, as a backup for a separate form, which the landlord should also obtain.

2.20 Term Sheet (Letter of Intent). Any significant leasing transaction often starts with a term sheet or letter of intent, prepared by the brokers. The landlord's counsel should try to participate in preparing that document, at least to the extent necessary to prevent unintended liability, obligations, and issues for the landlord. Typically, it will make sense to say that the term sheet or letter of intent does not bind the parties, except a few provisions that do, such as confidentiality, a brokerage indemnity, consents to background checks, nonreliance, and the agreement of the parties

about the otherwise nonbinding nature of the document.

2.21 Third-Party Consents. If the transaction will require any third-party consents, obtain whatever piece of paper evidences that consent. Like any other piece of paper, it may require drafts and negotiations. Start those early.

3. Post-Closing; Monitoring

The following suggestions on lease administration and enforcement do not constitute a complete guide to administering and enforcing leases. Some of these responsibilities will belong to the landlord's leasing broker or property management company, so they should be delegated accordingly in a way that is unambiguous.

3.01 Abandonment. If the tenant seems to have moved out, then before entering and taking control of the premises, consider sending an "estoppel" notice to the tenant reiterating the lease provisions on "abandonment" and inviting the tenant to confirm that it has not abandoned the premises, with payment of any unpaid rent. If any doubt exists about whether the tenant has abandoned the premises, consider using a summary possession action rather than self-help to avoid claims of wrongful eviction.

3.02 Alteration Consents. A lease sometimes says the tenant need not remove its alterations and restore the premises at the end of the term unless the landlord requires such restoration as a condition to the landlord's approval of the particular work. In those cases, the landlord must remember to exercise its right to require restoration when appropriate — thus creating a little trap for the landlord. So when the landlord receives a request for approval of alterations, the landlord should check the lease to see if it imposes such a requirement. (In a perfect leasing world, of course, the lease would require the tenant to give the landlord a conspicuous reminder of any such requirement whenever the tenant submits plans.)

3.03 Casualty and Restoration. If a casualty occurs during construction and affects the construction, identify and comply with any lien statutes or other contractor-protection statutes that might apply. In New York, for example, insurance proceeds that arise under these circumstances will be subject to the trust fund provisions of Lien Law article 3-A, a minefield for all concerned.

3.04 Changes of Address. If the landlord relocates, send formal notices to all tenants. Don't assume an ordinary emailed or bulk-mailed announcement will do the job. Update any filings, such as the Secretary of State and corporate service companies. If a tenant gives a formal notice of a change of address, the landlord should update its records. If the landlord becomes informally aware of a tenant relocation, the landlord should add the tenant's new address to its records, but use it in addition to continuing to use the old address. For clarity in that case, the landlord might request the tenant to give a formal update.

3.05 Commencement Date; Delivery of Premises. Issue formal notice and confirmation of delivery of the premises and commencement date, in a way that satisfies the specific delivery requirements of the lease. Exactly who needs to receive notice? Does anyone else need to receive a copy? The requirements may exceed those of the regular “notices” clause in the lease. Memorialize the commencement date with a document filed in such a way that someone will be able to find it in five years. If the lease (or a memorandum of lease) was recorded, consider recording notice of the completion date.

3.06 Consent Requests. If the tenant requests consent to anything, check the lease to see what conditions the tenant must satisfy. The tenant’s request for consent may give the landlord an opportunity to solve problems or uncertainties that may have arisen. If the landlord anticipates incurring attorneys’ fees in dealing with the consent, confirm that the lease obligates the tenant to reimburse those fees. If it doesn’t, try to have the tenant agree to do that before the landlord starts to consider the request for consent.

3.07 Document Files. The landlord should establish reliable procedures to assure that when the tenant requests an estoppel, the landlord will be able to list all documents that define the landlord-tenant relationship, such as option exercise letters, change of address notices, other notices, and the like. The landlord should prevent issues that might arise if the landlord delivers an estoppel certificate and forgets to include any of these other miscellaneous documents.

3.08 Estoppels. The landlord may wish to request periodic estoppel certificates simply to try to prevent future issues from arising. Request an estoppel certificate (or include equivalent language in the documentation) for any amendment, consent, waiver, favor, or other concession of any kind. Consider periodically requiring an estoppel certificate on general principles, including from guarantors. Obtain one when the landlord has finished initial build-out. If the tenant has a deadline to respond to these requests, and perhaps in all cases, communicate these requests in compliance with the notice provisions of the lease. Periodically ask the tenant to confirm its formal notice address.

3.09 Fair Market Value Determinations. If the lease will require the parties to determine fair market rental value for any rent adjustments or option terms, the landlord should plan ahead for those likely disputes. At a minimum, the landlord should maintain suitable notes on other transactions and useful information, and perhaps engage the “best” appraisers well in advance to try to assure the process goes well if the parties can’t agree on fair market rental value.

3.10 Future Amendments. If the landlord and the tenant amend the lease, the landlord should obtain guarantor consent (even if the guaranty waives such a requirement); amend any recorded memorandum of lease; and obtain any required consents from lenders, partners, or other parties. Consider including estoppel-type assurances in any amendment. Lease amendments can create their own minefields, as described in Joshua Stein’s article on the topic, *How to Stay Away From The Minefields in Lease Expansions, Extensions, and Renewals*, *The Practical Real Estate Lawyer*, March 2012, at 17.

3.11 Future Deliveries. To the extent the lease requires the tenant to make future or periodic deliveries of documents (such as financial statements, certificate of ownership structure, or insurance renewals), remember to ask for them. If the landlord fails to enforce a tenant obligation long enough, that might create a waiver.

3.12 Future Events. Memorialize any exercise of an option, delivery of additional space, and the like, and any resulting rent or base year adjustments. Keep a copy of any resulting documentation in the lease file, in a place where someone will find it when they want “all” the lease documents.

3.13 Guarantor. For an individual guarantor, check occasionally to see if the guarantor has died or has become disabled. If this occurs, the landlord may need to file a claim in probate, quite quickly, or lose its rights against the guarantor.

3.14 Insurance. Monitor expiry dates of insurance. Update coverage limits and requirements as markets change. Check insurance certificates for renewals, to confirm they continue to comply with the lease.

3.15 Lease-Related Agreements. If the landlord and the tenant enter into any future agreements related to the lease, think about whether they constitute lease amendments and require approval from lenders or other third parties. Unless they constitute lease amendments, any nonpayment or nonperformance under these future agreements will probably not constitute a default under the lease, and thus may not allow the landlord to exercise lease-related remedies.

3.16 Letters of Credit. Establish a single safe location to store letters of credit, and memorialize that location among all who need to know about it. Check that location once in a while to make sure the letter of credit has not somehow walked away. Monitor expiry dates. Pay attention to possible credit downgrades affecting the letter of credit issuer; they may allow the landlord to draw the letter of credit. If the letter of credit is an evergreen, consider obtaining periodic confirmations that the letter of credit remains in effect. It’s hard for a landlord to prove the landlord never received a cancellation notice. Typically, draw at the earliest possible opportunity, if necessary.

3.17 Preemptive Rights. Give the tenant notices of available space, and other notices, under any right of first refusal or other preemptive rights in the lease. Track this tenant’s rights, and potential triggering events for those rights, in a way that nothing will fall between the cracks. In giving notices, do it right the first time. For suggestions, see Joshua Stein’s article on the topic, *A Checklist for Giving Legally Effective Notices*, *The Practical Lawyer*, August 2005, at 11.

3.18 Tenant’s Name. If the tenant operates or identifies itself under any name other than its legal name in the lease, check with landlord-tenant counsel to see whether this could create an issue in an eviction action. Similarly, if checks for rent under the lease show the name of anyone other than the tenant, consider any issues this may create. If necessary, notify the tenant that future rent checks should come from the tenant, and not any affiliate or other party.

3.19 Tickler Reminders. If the tenant persuaded the landlord to remind the tenant of certain matters (e.g., option exercise deadlines), establish appropriate reminders in the landlord’s calendar. Counsel may also wish to make appropriate “tickler” entries, but should avoid assuming responsibility to remember. To the contrary, counsel should affirmatively warn the landlord that counsel does not assume responsibility to remember any dates.

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