

Negotiating Lease Provisions: Turning Pitfalls and Problems into Opportunities and Value

by Joshua Stein

Companies that accept landlord leases at face value can face unpleasant surprises down the road.

Companies with far-flung operations and multiple locations should develop leasing strategies and standard leasing documents that create value and serve their overall corporate goals.

Whether a company occupies retail stores, sales offices, distribution facilities or other types of space, it should negotiate leases that will protect its interests and increase bottom-line performance. In too many cases companies instead allow their leasing programs to produce pitfalls and risks that reduce value and diminish flexibility, usually for years into the future.

Unpleasant Surprises

Many companies simply sign landlords' standard-form leases after checking that the rental amount is correct. An astonishing number of large corporations routinely accept the landlord's agenda as the starting point for negotiation. Often, hours of legal time are spent revising each form lease to make it less egregiously pro-landlord. Not only does this waste time and money, it also can create inconsistencies. Even the best negotiator cannot correct every problem in a lease.

Companies that accept landlord lease forms at face value — or negotiate only the most glaringly unacceptable provisions — can encounter unpleasant surprises down the road. When a corporation tries to attract new investors, obtain additional financing, spin off a division or simply relocate some of its operations, it may find that certain lease provisions prevent these actions unless the company first deals with its landlord.

For example, a future lender might demand "landlord's waivers," forcing the company to ask each landlord for its cooperation, which can cost money. If the company decides to close or relocate a facility and sublet or assign its lease, the landlord can frustrate the company's plans.

Before proceeding with any major capital transaction, the company may find that it has to review and interpret potentially hundreds of leases to be sure that the transaction does not violate any existing lease restrictions or trigger a

default. This can take time, cost money, and create needless uncertainty and risk. Ultimately, it may delay or destroy valuable transactions.

A company that signs more than one or two leases a year should systematically prevent these problems by employing effective leasing strategies. The company should be able to assume that the terms of each lease are reasonably consistent across the country and that no lease will interfere with the company's overall business strategy.

Controlling the Leasing Program

A company may not view its operations as real estate intensive. However, if the company occupies multiple locations, it is, for all intents and purposes, in the real estate business. Therefore, it should develop strategies that will prevent unexpected real estate problems.

A large user of space should take advantage of the current market — in which tenants have the upper hand — and not allow its landlords to set the terms for lease discussions. The company should focus on the provisions it cannot tolerate in standard landlord leases and on those that must be included in its own leasing documents.

A company that leases many sites around the country should have — at minimum — its own standard lease rider and perhaps its own standard lease. Time and effort can be saved if these documents provide reasonable, balanced resolutions to traditional issues without setting up the potential traps and grabs commonly found in landlord leases. By providing its own lease documentation a major tenant can make sure its leases contribute to the company's strength, rather than creating future problems and pitfalls.

To control its leasing strategy a company should centralize the leasing function and place it in the hands of professionals who understand the effect that lease terms can have on corporate operations and overall corporate goals. Lease negotiations should not be left to managers of individual



Joshua Stein is a partner specializing in real estate law in the national law firm of Latham & Watkins.

offices or be regarded as incidental to the expansion process.

A company's central real estate staff also should handle all amendments and renegotiations and should maintain complete and orderly files of executed lease documents. (Surprisingly, some companies have trouble figuring out the status of their leases because the original documents are not collected in one central place.)

Silent Issues

Whether a major tenant prepares its own lease documentation or uses a landlord's standard form, a lease negotiator usually can recognize and respond to assignment and subletting restrictions, burdensome insurance requirements or an overly restrictive use clause. However, it is more difficult to remember to raise "silent issues" that the lease does not cover.

‘
Standard lease forms give tenants no control over landlord actions that might decrease the building's desirability or even destroy a tenant's business.
,

The following list summarizes a few of the silent issues that a major multisite tenant may want to raise in lease negotiations or include in its standard lease documentation. Excluded are issues that ordinarily would be raised in response to most landlords' lease forms, such as the requirement that a landlord act reasonably in various contexts or issues relative to non-disturbance and other negotiations with lenders. Also excluded are issues referred to earlier in this article.

Operating Requirements: Many form leases do not specify that the landlord must provide services, access, security or any other benefits that tenants ordinarily expect. Lease negotiators should include specific obligations together with exact performance standards that the landlord must satisfy. The lease also should include any special operational requirements the tenant might have — such as 24-hour access to the space, special air conditioning or security requirements, building directory listings, elevator configurations, and use of fire stairways for access between floors. All of these matters should be negotiated into the original lease.

Landlord Restrictions: Standard lease forms give tenants no control over landlord actions that might decrease the building's desirability or even destroy a tenant's business at that location. A major corporate tenant should try to add language in the lease to prohibit or control landlord actions that might damage its business.

For example, a service organization might not want its landlord to name the building after one of its competitors. Or an office tenant might want to prohibit the landlord from installing a fast-food restaurant or allowing other undesirable uses on the ground floor or elsewhere.

Special Utilities and Communications Requirements: If a company needs to install special equipment or connections, such as a satellite dish on the roof, these issues must be discussed during lease negotiations. Otherwise, the landlord may later decide that the tenant's requirements go beyond the original deal and demand additional rent.

Protection Against Landlord's Failure to Perform: Every landlord's lease devotes page after page to the consequences of nonperformance by the tenant. Conversely, if the landlord doesn't perform, the standard lease specifies only that the tenant cannot claim any deductions against rent. Few leases give tenants any rights if the landlord doesn't perform other than the theoretical right to bring a separate lawsuit.

A strong corporate tenant may be able to obtain more useful protection against a nonperforming landlord. For example, if the building is not properly maintained or repaired, the tenant may obtain the right to do the work itself and offset its costs against rent.

Landlords ordinarily resist such provisions, but these are not ordinary times. Many owners — and their lenders — are having to be more flexible to fill vacant space.

Flexibility on Insurance: A corporation must be able to provide insurance for each tenancy under a blanket policy that covers many locations. In some cases a company will choose to "self-insure" internally for such normal risks as fire or vandalism; the lease must not interfere with such a program. If a company-wide insurance program exists, corporate negotiators must make sure that the lease doesn't require coverage beyond what the tenant could ordinarily provide.

Right to Contest Taxes: Many leases require tenants to pay a portion of the landlord's annual taxes. At the same time the landlord usually has total control over filing applications to reduce the tax assessment of a building. Since landlords might not have the same incentive to minimize taxes, a strong tenant may want the right to file such applications or the right to require the landlord to file them upon request.

Memorandum of Lease: If a tenant will not take possession of the space immediately, it should record a notice of its lease in the county records to protect its future right to occupy the space. This will require the landlord's cooperation, which may be withheld after initial lease negotiations have been completed.

‘
A major tenant should consider asking for limitations on its liability under a lease.
,

No Nonmonetary Defaults: The standard landlord's lease imposes nearly limitless obligations on the tenant. If the tenant does not perform, the landlord can take various actions — including potentially terminating the lease.

Conceivably, a landlord may try to get rid of a tenant it no longer wants because the value of the space has risen. If the landlord can find some obligation in the lease that the tenant

has not performed, it could start lease termination proceedings on that basis. Although such an exercise rarely will succeed, it still can cost a tenant time and money.

To minimize the risk of facing this problem, the tenant can include the following provisions in its standard lease.

The landlord enjoys all the usual rights if the tenant fails to pay rent or make any other payment. If the default relates to anything else, however, the landlord's rights are more limited. Before it can take any action, the landlord must lay out its own funds to correct whatever the tenant failed to do and send the tenant a bill. If the tenant doesn't pay, then the landlord may try to terminate the lease.

In effect, this clause forces the landlord to disregard minor nonmonetary defaults and to think twice before trying to take action against even major nonmonetary defaults. Either way, the tenant knows the landlord won't easily be able to use fine-print lease obligations as a basis to terminate the tenancy.

‘
Appropriate assurances in a lease might save a tenant money and grief.
,

Limitations on Liability: A major tenant should consider asking for limitations on its liability under the lease.

If the tenant wants to build out its space, for example, it may ask for the right to terminate the lease at any time after it has finished the work. This would limit the tenant's exposure to the loss of its construction investment. If the tenant is a partnership, it may want to protect its general partners from personal liability by insisting that the landlord agree to waive any recourse against the individual partners and agree to enforce its rights only against the partnership assets.

The possibilities for limiting liability are endless, but these issues need to be negotiated as part of the basic business deal.

Assurances by Landlord: Landlords usually offer only minimal assurances — if any — about the condition of the building or the tenant's space, third-party rights to occupy the space and similar matters. Tenants should ask for protection in these areas.

In one recent case a tenant took over space previously occupied by an architectural firm. Soon after moving in, the tenant was named a defendant in a lawsuit brought by the prior occupant. The suit claimed that the prior occupant was never properly evicted and, therefore, still had the right to occupy the space.

Ultimately, the suit was dismissed. But the new tenant incurred significant legal fees, which the landlord never reimbursed. Appropriate assurances in the lease might have saved the new tenant money and grief.

Conclusion

These are only some of the issues that a strong tenant should insist upon raising in lease negotiations. Most real estate markets are overbuilt, and landlords and their
22 (592) / June 1992, Industrial Development Section

lenders are anxious to fill vacant space. Now is the time for tenants to press their advantage. Today's real estate climate creates a great opportunity for corporate tenants to develop leasing strategies and provisions that more closely reflect their needs, support their overall business goals and improve their bottom line.

SUGGESTED READING

- 1 Di Scala, Joe. "Strategies for Effective Lease Negotiation," *Industrial Development*, March/April 1990, vol. 159, no. 2, pp. 20-21.
- 2 DuPont, Raymond G. "Adding to the Corporate Bottom Line Through Leasing," *Industrial Development*, September/October 1991, vol. 160, no. 5, pp. 22-24.
- 3 Lang, Kendall R. "Statistical Market Analysis Gives BDO Seidman the Edge in Lease Negotiations," *Industrial Development*, July/August 1991, vol. 160, no. 4, pp. 15-19.

ID INDEX CORPORATE MANAGEMENT

STEIN, JOSHUA

"Negotiating Lease Provisions: Turning Pitfalls and Problems into Opportunities and Value," May/June 1992, vol. 161, no. 3, pp. 20-22.

- 1 Leasing strategies
- 2 Lease negotiations
- 3 Lease provisions