

Commercial Leases

WHAT TO LOOK FOR AND WHAT TO LOOK OUT FOR

In today's business world, virtually every business person is required to develop significant negotiating skills for responsibilities such as hiring, working with vendors, or selling the firms' products or services.

Nevertheless, those same managers often find themselves ill-prepared to negotiate a lease for office space with their prospective landlord or the landlord's broker/representative. That inadequacy stems from the fact that most business typically negotiate a new lease once every five to ten years, while the party on the opposite side of the table goes through this same process virtually hundreds of times every year.

However, if you are faced with the task of negotiating for the lease of new space, you have an opportunity to turn this disadvantage into your advantage by first bringing together a team of professionals to work on your behalf. That team will gather all pertinent data and assist you in analyzing the impact each lease proposal will have on the cost of your businesses' occupancy.

SELECTING YOUR NEGOTIATING TEAM

Probably the single most important step to reviewing lease alternatives is selecting an effective negotiating team to work for your company. These professionals must be able to put aside their own financial gain, overcome conflicts of interest due to relationships with building owners, and eliminate any other issues that could pose a conflict of interest to your negotiating and financial success.

Your team should consist of the following:

- A lease strategy person from your own corporation, and
- A tenant representative from a reputable brokerage firm, and
- An architect/space planner, and
- A legal professional with extensive experience in commercial real estate.

Lease Strategist

The "lease strategist" should be very knowledgeable about your corporation, its operations, its personnel, and its personality. This person does not need to have extensive real estate experience, but he or she should be able to analyze a complex situation, direct the resources of the corporation, and, most important, have good listening and communication skills.

This person might be a senior individual in the finance department, a

partner, or someone with a similar background. Once selected by senior management, the strategist will need to coordinate with the other team members and attend all lease-related meetings, including strategy sessions, landlord interviews, building tours and all other discussions that will help formulate your position on the suggested alternatives. He or she should have a direct and open line of communication to, and the absolute support of, senior management.

Naturally, the selection of this person does not preclude senior managers or partners from participating in the process. However, experience has proven that it is better to appropriately time and strategize the appearance of senior individuals to support your negotiation strategy.

Tenant Representative

The selection of a tenant representative or broker is also crucial to the entire process. This individual should be a veteran of the real estate industry, and be extremely familiar with the local environment, from both a real estate point of view and a general economic point of view. The tenant representative must also be highly regarded in the brokerage and real estate industry, and he or she needs to be able to coordinate vast amounts of data and know a great deal about potential buildings and landlords.

One of the most important elements this person can bring to the process is the ability to eliminate any conflicts of interest. Specifically, the negotiation process could be skewed if this individual represents a landlord that could potentially become your landlord through the lease selection process. This individual must be able to understand that all of his or her fiduciary obligations are to you, the tenant, and not to the landlord. Finally, this individual should also have access to information regarding properties on a national scale. This can be beneficial in coordinating with a national real estate department if one exists, particularly if the department is not located in the subject city.

Architect

The next member of the team, the architect or space planner is quite often overlooked until after a particular group of buildings has been selected for your review. However, it is imperative to include this person on the team from the beginning to give him or her a true understanding of all firm's needs, operating relationships, etc., that could affect your ultimate lease decision.

The architect's or space planner's major role will be in determining the structural amenities and deficiencies and evaluating the difference between the usable and rentable square feet of space alternatives.

Additionally, he or she will be very involved in deciding whether or not you can function effectively within the demised space (the usable space that will you occupy) and what alternative methods could be employed to ensure your long term beneficial occupancy.

Much like your tenant representative, the architect or space planner needs to 1) eliminate any conflicts of interest with potential landlords, and 2) fully understand that he or she is representing you and no one else.

Real Estate Lawyer

The final selection is the real estate lawyer who will provide the team and the management group with competent advice on the strength and weaknesses of the various landlords you may be considering. The individual will also help formulate the request for proposal, review the landlord's response, understand ownership documents, do a detailed review of the actual lease document (if not the development of the lease itself), and advise the management group on the legal issues that could arise.

Like the architect and tenant representative, legal counsel should be chosen at the beginning of the process to allow time for a thorough understanding of your needs and long term goals.

Although the negotiating team need not act as a committee, the individuals should be able to interact and assist each other throughout the various stages of the negotiation process. Obviously, it is important that, in addition to technical skills, these team members be selected based on their personalities and their ability to interact with your management and other team members; a cohesive team will be more apt to successfully work together over a sustained period of time.

NEGOTIATING FOR YOUR RENEWAL RIGHTS

Most landlords derive a substantial share of their profit from the expansion and renewal of space existing tenants, yet most tenants neglect this area since the need for it seems far into the future. No matter how far off it seems, considering your future space requirements and the negotiating position you will enjoy at the termination of the original lease is as important as negotiating your original lease.

Two methods of negotiating for renewal lease rates are 1) utilizing the then-current market value, or 2) using a fixed renewal rate. Typically, either one presents risks for both the landlord and tenant, but the fixed rate method is superior to market value. When using the market value or a percentage thereof you, as the tenant, are exposed to substantial cost increases should your lease expire at a time when there are not ample

alternative spaces available to you. The larger the space that you are leasing, the more important this is, for it is typically easier to find smaller spaces than space for larger tenants.

The argument against a fixed rate renewal is that, should your lease expire at a time when a soft market exists; the tenant could be exposed to a higher rate. However, even soft market conditions you should always have the alternative of simply not exercising your renewal option and opening negotiations with your landlord for renewal at a preferential market rate.

If you are not able to negotiate for a fixed rate and are forced to use a market value, be sure to define that market value and how it will be established. Find out what comparable buildings will be used to determine the market, the size of your space, the degree of the tenant improvements that will be required and other items that could affect market value. Furthermore, be sure to define your space as broad as possible and possibly even state, "for any legal and lawful use." Having the right to change the use of the premises gives the tenant the flexibility to expand and modify a successful use or to completely abandon an unsuccessful business and pursue a new one.

Also, your architect and tenant representative should take special care in defining what tenant improvement allowances would be available to you at the time of renewal. It is typical to require a minimum of paint, carpet and other fixtures; you may also require of your layout, perhaps adding more private offices or other items. The extent of your improvements and who pays for them should be defined at the time of renewal.

Finally, your tenant representative and legal counsel should be careful to negotiate a favorable holdover clause. This will allow you ample time to negotiate with your landlord or to lease new space outside of your existing facility at a minimum cost increase. It is not uncommon for a landlord to require that during a holdover period the tenant pay 200 percent of the then-current rent. Obviously, this would be a costly oversight for you as a tenant.

Staying in compliance with California leasing and corporate laws is overwhelming. Tamara L. Harper, Esquire advocates and protects not only your corporate interests but also your employment and labor law liability exposure. Tamara Harper understands how you all feel, as she is an employer and manages a corporation too. Many of her clients felt the same way too before they worked with her. Ms. Harper's clients have found as a result of working together, that they feel confident in the final outcome of their situation.

Tamara L. Harper's unique competitive advantage is that she is very approachable as an attorney, which makes her clients feel at ease and in capable hands and further brings twenty years of litigation experience as a trial attorney to the drafting table.

Tamara Harper, Esq. is an aggressive fighter that is reliable and ethical. Ms. Harper not only offers quality work, but enjoys a good location in Westlake Village, California.

Tamara L. Harper prides herself on her good personal and business relationships with clients, and uses her insight and knowledge to obtain successes for each client.

PART TWO

Lease Execution Checklist

The intent of the following is not to provide legal advice on how to document the business or legal points of a lease, but rather outline the points that should be brought to the surface by your negotiating team and resolved in your favor when possible.

The list below provides guidance to several pertinent lease requirements that should be considered before signing a lease. This list may not be inclusive, thus, please discuss further issues with your counsel. Your attorney should review a negotiated lease for the following:

YES Date of Lease: Make sure the lease is correctly dated including the month, day and year.

YES Lease Commencement Date: Make sure the lease clearly sets forth a specific commencement date. If the date set forth is at some later point in time, i.e., 90 days after Landlord completion, make sure an Estoppel Certificate is executed at that point in time to confirm the exact start date of the lease. See below for further information regarding an Estoppel Certificate.

YES Rent Commencement Date: Make sure the lease sets forth an exact date for the rental payments to begin. If rental abatement is negotiated make sure the months in which rent is not accruing is spelled out clearly within the lease.

YES Renewal Option Date: Check to make sure the dates are correct, timely notice is provided, and the rental increase reflects the negotiated rate correctly.

YES Notice Address: The address set forth for service of legal notice should include not only the Landlord's address and your corporate address, but a clause should be inserted providing for a copy to be sent to

the premises and to your attorney. Check the accuracy of the address as well. Also verify a clause exists in the lease providing for changes in address to be given by written notice only.

YES Taxes and Utilities: Verify accuracy of negotiated terms.

Commonly, the Tenant pays.

YES Condition of Premises at End of Lease: There should be inserted a clause within the lease allowing for the condition of the premises upon termination or expiration of the lease to be "as is."

YES Square Footage: There are three primary terms you should be familiar with: gross square feet, rentable square feet, and usable square feet. Gross square footage refers to the measurement of the exterior or outside walls of the building. Quite often you measure from the drip line—meaning the farthest exterior point of the building, including the building's overhang. This adds substantial square footage to your measurement. Rentable square footage is calculated on what is known as the Building Owner's and Manager's standards.

This includes all of the space on your occupied floor or floors, excluding vertical penetration such as elevators, stairwells and mechanical shafts. Thus, you are paying for not only the space you are using, but common areas as well. Usable square footage is the actual space you will occupy. In evaluating your lease costs, it is crucial that you do so based on the usable square footage. Thus, it is recommended that you refine the term of square footage as usable square footage. Your architect should be able to tell you what space within your demised area is truly usable.

YES Security Deposit: Verify accuracy of negotiated terms. Generally the landlord will hold without interest accruing.

YES Confidentiality: The lease should provide for a "Confidentiality Clause," stating that the terms of the lease are to remain confidential and are not to be released without prior consent of an authorized representative of your company or President of your company.

YES Tenant Improvements: Verify the dollar limits set forth by a clause stating that the Lessor must approve in writing Tenant improvements of a certain amount. Negotiate whose contractor is to provide such, whether you can use your own contractor and who is to be responsible for obtaining permits.

YES Non-Disturbance Clause: Your lease should have a "Non-Disturbance Clause." This is also known as a "Quiet Use and Enjoyment Clause." This clause will ensure that upon Lessee paying the rent for the premises and observing and performing all of the covenants, conditions, and provisions on Lessee's part to be observed and performed, Lessee shall have quiet possession of the premises for the entire term subject to all of the provisions of the lease.

YES No Continuing Operation Clause: Your lease should not under any circumstances have a "Continuing Operation Clause." Generally, if a

Tenant defaults under a lease with a continuing operation clause, the Landlord has two options. The Landlord may terminate the lease, in which case the Landlord is required to re-let the space to reduce or mitigate the Landlord's damages. Alternatively, the Landlord may keep the lease in effect and sue for the rent as it becomes due, sometimes referred to as the "lock-in" remedy.

__YES Use Clause/Negative Use Clause: The "Use Clause" should be as broad as possible and include the phrase, "for any legal and lawful use." Having the right to change the use of the premises gives a Tenant the flexibility to expand and modify a successful use or to completely abandon an unsuccessful business and pursue a new one. A Landlord typically wants a restrictive use clause to indirectly obtain additional ground to control assignment and subletting. However, many leases will require specific wording and in order to provide for conformity the following clause should be used:

__YES Exclusive Use Clause: An "Exclusive Use Clause" grants to your company the right to business use specified within the shopping center or marketplace and disallows the Landlord from leasing to any type business offering the same services specifically listed on the clause within that center. A typical clause reads, "It is agreed that the Leased premises shall be used and occupied exclusively for your business' services, sale of your company's name trademark items, and any other uses which may be customary from time to time in other your company's name stores or any other use which is reasonably comparable. Provided Lessee is not in default hereunder, Lessor agrees that it will not, for the term of the lease, execute any new lease to any other person, firm or corporation for a store in the XYZ Shopping/Market Center whereunder said Lessee would be permitted to any of the uses enumerated above on a retail basis and grants the exclusive right to conduct the aforesaid business on the Center."

__YES California Only – Use Restriction: Unless the lease specifically limits the use, the Tenant may make any reasonable use of the leased property. A strict use clause can hinder any further possibilities of subletting. Even though a lease may not allow subletting without prior Landlord written consent and specifically states the Landlord's consent may not unreasonably be withheld, a Landlord can still restrict an assignment or sublet through the use clause. Upon relocation under strict use clause, your company would not be allowed to sublet to any business, but rather only to a business as defined under your own use clause. Simply put, this means that your company would be forced to rent only to a competitive business.

__YES Adequate Parking/Stripping/Exclusivity: The lease should reserve an appropriate amount of parking spaces for the demised premises exclusively for your business.

__YES Adequate and Visible Signage with Your Company Colors and/or

Trade dress: Your franchisor's or company's trade dress should be negotiated per the applicable specifications from the franchisor, if applicable; to ensure not only conformity but also make sure it conforms to your specific city's ordinances.

YES Percentage Rent: No lease should under any circumstances have a percentage lease clause. This could require you to send to your Landlord confidential financial data. Beware of percentage rents, even if it is not foreseen that such a clause would be trigger. Sometimes the amount set applies to the corporation, and not just the leased premises. Further, this clause allows the Landlord access to confidential corporate financial records and can be used against the Lessee in further rent re-negotiations and renewals.

YES Guarantor: Most Landlords' will require a personal guarantee. Try to negotiate out of such at the onset of the negotiations. If however, a guarantee is necessary, you should attempt to limit the time, i.e., if the lease is a five-year leasehold interest, strive, for a guarantee for only the first year.

YES On Site Visit: An attorney or lease negotiator should always visit the site. If unable to visit, at a minimum, you should request a panoramic view picture from the broker. Strategic negotiations cannot be performed without some idea of the demographics of the demised premises.

YES Business Hours: The lease items should provide for 24 hour/7 day use even if not in use now, in order to allow for future expansion in hours.

YES Efficient Lighting: Lighting is an invisible selling tool and probably the most powerful tool in merchandising today. Creating the proper light level in the store is also understood as brightness, which is an overall even balance or ambient amount of light throughout a space. This result is achieved by using the proper color balanced lamps in your light fixtures.

YES Fixed Landlord Buildout Completion Date: Very often the commencement date is thirty (30) days after Landlord completion and in such case there should be a Delay in Possession Clause.

This clause should state verbatim:

"Notwithstanding said commencement date, if for any reason Lessor cannot deliver possession of the premises to Lessee on said date, Lessee shall not be obligated to pay rent until possession of the Premises is tendered to Lessee; provided, however, that if Lessor shall not have delivered possession of the Premises within sixty (60) days from said commencement date, Lessee may, at Lessee's option, by notice on writing to Lessor within ten days thereafter, cancel this lease, in which event the parties shall be discharged from all obligations hereunder; provided further, however, that if such written notice of Lessee is not received by Lessor within said ten day period, Lessee's right to cancel this lease hereunder shall terminate and be of no further force or effect."

YES Estoppel Certificate: An estoppel certificate should be completed

after Tenant has occupied the premises. The certificate should set forth Lessor and Lessee names, date of lease, location or premises, and lease commencement date. Furthermore, the following clauses should be verbatim:

1) An Incorporation by Reference Clause- “the lease document is incorporated by reference,”

2) A Non-Default Clause- “as of the date of this certificate, Lessor/Lessee is not in default in the performance of the lease and has not committed any breach of the lease,”

3) A Setoffs, Claims, or Defenses Clause-“the lease is in full force and effect; Lessee has accepted the premises and presently occupies them, and is paying rent on a current basis; Lessor has no setoffs, claims, or defenses to the enforcement of the lease.”

YES Insurance Specifications: Discuss the landlord’s insurance requirements with your insurance agent prior to signing the lease to ensure that you are able to meet such requirements.

YES Hold Harmless Clause: At a minimum, make sure the hold harmless clause states verbatim: “Tenant agrees to hold Landlord harmless from liability, except for Landlord gross negligence.” This area is complicated and it is recommended that you seek the advice of your counsel.

YES Hazardous Materials Clause: This clause should state: “Landlord has not utilized the property, nor any part thereof, to treat, deposit, store, dispose of, or place any hazardous substance, as defined by 42 U.S. C.A. §9601 (14), any pollutants or contaminants as defined by 42 U.S.C.A. §6904(5) or any other toxic or hazardous substance prohibited under similar State or Federal law under any regulations and ruled promulgated in connection with the laws referred to above (“hazardous substance”) nor has Landlord authorized any other person or entity to treat, deposit, store, dispose of, or place any hazardous substance, as defined above, on the property, or any part thereof. To the best knowledge of Landlord, no other person or entity has treated, deposited, stored, disposed of, or placed any hazardous substance, as defined, on the property, or any part thereof. In the event a release or threatened release of a hazardous substance is discovered on the property, regardless of whether Landlord is in any way form whatsoever under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, 42 U.S.C.A. §9607, or under any other statutory or common law, Landlord agrees to indemnify and hold harmless Tenant from any such liability which may be imposed.”

YES Americans with Disabilities Act Requirements: An employer is required to make reasonable accommodations to the known physical or mental limitation of a qualified individual who is an applicant or employee, unless such covered entity can demonstrate that the accommodation would impose an undue hardship on the operation of the business.

Reasonable accommodation may include making existing facilities used by employees readily accessible to the disabled. The duty to provide reasonable accommodation applies to all non-work facilities provided or maintained by you for your co-workers.

YES Updating Your Corporate Records: A Board of Director resolution will need to be executed authorizing an officer of the corporation to sign the lease. Your corporate attorney can handle this for you.

YES Lease Renewal: Upon renewal negotiations, review all the above and applicable clauses. Further, have your architect and tenant representative offer suggestions as to how your current space is to be measured (see Square Footage above). Quite often, the Tenant assumes that the original measurement is unchangeable, when, in fact, it could be possible to renegotiate the actual footage that you occupy.

YES Lease Termination: Anyone who is considering terminating any lease should also be aware that Landlords are becoming very tough about letting Tenants out of their leases. This is a potential ground for litigation. Please make sure you consult with an attorney before proceeding with a lease termination.

This list is just a highlight of some important deal points to consider in reviewing a lease. Frequently a broker working for both the landlord and tenant will prepare a Letter of Intent which only touches on very few deal points and lease terms. The items above are important to negotiate prior to the landlord or its counsel sending the lease to you for final signature. Please involve Tamara L. Harper, Esq. in the early stages and be proactive. Being reactive and having to hire counsel to litigate an already negotiated and signed deal is far more expensive!