



REVIEWING A LEASE AGREEMENT- TRAPS FOR THE TENANT¹

Typically an initial draft of a lease will be prepared by the Landlord's attorney and will be based on a term sheet between the two parties. The term sheet will outline the basic business terms: rent, additional rent like taxes and operating expenses, renewal options, use of the Premises, square footage of the space- but it will be vague as to the details of many important topics covered in the Lease that could affect your client going forward. It is quite important before even reviewing the Lease, to review the term sheet with your client and confirm any questions that you may have regarding the basic business terms.

Here is the list of issues to consider once you receive the Lease. Of course, anyone using this list must do so selectively and intelligently. Which terms to raise will depend on circumstances. A Tenant taking less space in a large Building would typically raise only a small minority of these points. In response to each of these items, Landlord may push back. Many of these terms also apply to other types of leases. Some do not.

Credit Issues. Who is Tenant? Tenant should use a corporate shell, if possible, or make sure the rent level compensates Tenant for providing a higher level of creditworthiness. Common "middle-ground" compromises: (a) "shell" corporation with parent guaranty of (specified amount of) fixed rent and escalations; (b) letter of credit; (c) "good guy guaranty" from creditworthy guarantor (a commitment to pay (i) construction costs, and (ii) rent so long as Tenant is in possession); (d) security deposit; (e) reduction of credit enhancement over time; (f) release after specified period; (g) release upon assignment to creditworthy assignee; (h) eliminate "free rent" period or spread over term of lease; (i) etc.

Use. Confirm the use of the Premises. For an office lease, this will usually say that Tenant may use as general office Premises and incidental uses. But the use section becomes more important for the Tenant of a retail space. You must confirm that whatever the Tenant has planned for the space will be permitted by Landlord (and also is permitted by the Certificate of Occupancy in place for the building). If the Use clause is too narrow and limiting, it could frustrate a future assignment or subletting.

Free Rent. Is there a free rent period and if so, delete any concept of repayment of that free rent in the event of a Tenant default.

¹ Copyright (c) 2015 Joshua Stein and Deborah Goldman, www.joshuastein.com. All rights reserved. Permission is granted only to adapt and use for transactions, provided that the user forwards to the author any comments or improvements.

Tenant's Alterations. Many Landlords will try to obtain a fee for plan review for the Tenant's initial build-out. Push back on that. Landlord must be reasonable, and pre-approve Tenant's build-out, to the extent the build-out has been defined at signing. Landlord will want to have sole discretion to approve structural alterations, which is acceptable for the typical office or retail Tenant, but Landlord must be reasonable for non-structural alterations. No bonds. Landlord must promptly sign permit applications and cooperate with Tenant to get any permits.

Tenant Improvements/Landlord's Work. Who will perform and/or pay for Tenant improvements to prepare the Premises for Tenant's initial occupancy? If Landlord will perform Tenant improvements, consider need for outside date and incentive structure for prompt completion. Typically the first month of delay is "free," and then after that Tenant will receive one day of free rent (after rent would otherwise start) for every day of late delivery. If Landlord is, e.g., 90 days late, then Tenant can terminate.

TI Allowance. If there is a "Tenant improvement allowance", Tenant may apply to any "hard" or "soft" costs of Tenant's work, including network and other communications cabling. Many Landlords will try to limit soft costs to a certain percentage; up to 20% is fair. Disburse in installments as construction progresses, not just on completion. Lien waivers for final disbursement only. Disburse any remaining allowance to Tenant upon completion of work. If Landlord fails to disburse within 90 days after required to do so, Tenant may abate rent, plus interest at prime.

Assignment and Subletting. No Landlord consent needed for transactions with Tenant affiliates; any merger, consolidation, or other transaction affecting Tenant; transfer of Tenant's equity or business; or occupancy by Tenant's suppliers, consultants, or others in the ordinary course of Tenant's business (all of which are considered "permitted transfers"). For any permitted transfer, allow Tenant to provide a substitute guarantor. Require Landlord to not unreasonably withhold or delay consent to any other transactions and to act within a certain short period of time. Many Landlords will try to obtain 100% of any profit that the Tenant may obtain on any assignment or subletting. NY standard is to split profits, while deducting all of Tenant's costs incurred in connection with the assignment or sublease.

Landlord Services. Confirm what services Landlord is providing. That is important so that there is no dispute later. Most Tenants want Landlord to provide cleaning, security, maintenance, repairs, utilities, HVAC, freight and passenger elevator, and other services to a standard comparable to similar first-class buildings, for Premises and common areas. Tenant's name should also be displayed on a directory listing in the building at no additional cost.

Operating Expenses. In the past, many leases charged Tenants for operating expenses. Many NYC Landlords have moved away from this and are charging a fixed increase in rent to cover increases in operating expenses. If there is an operating expense provision, limit to actual expenses. Most initial bills to the Tenant are based on estimates, with a true-up at the end of the year. After receiving Landlord's final bill for any operating year, ask for 6 months to audit (18 months for base year), using Tenant's choice of auditor. If audit discloses an overcharge of 3% or more, Landlord should pay for audit.

HVAC. Overtime fees must reflect Landlord's actual costs, allocated among multiple simultaneous users. Make sure that Lease clearly states what hours are considered overtime and what the current hourly rate is in the building. Try to cap increases by the increase in the Consumer Price Index. Most retail Tenants are responsible (maintenance, repairs and replacements) for their own HVAC systems, but confirm with your client that they have inspected the current HVAC system and know what condition it is in, as this can be very costly down the road and you may want to push the Landlord to be responsible for replacements.

Utilities. Which utilities are submetered and which are directly metered with the utility company? If space is submetered, Tenant should reimburse Landlord only for actual cost of submetered power at Landlord's tariff[, plus an administrative fee of __%], and try to assure that multiple meters are read as a consolidated single meter. If Tenant requires additional power, Landlord should arrange it at Tenant's expense. Tenant should insist that Landlord pay all costs for initial provision of electricity to single entry point and meter. Confirm the space already has adequate electric capacity.

Legal Compliance. Tenant will be responsible to comply with legal requirements for Tenant's particular manner of use of the Premises and for any alterations that Tenant made in the Premises. Landlord shall be responsible for all other compliance for the Premises and all compliance with laws for the Building (or shopping center, as applicable).

Repairs. Be clear in the Lease that Tenant is responsible to make all nonstructural repairs in the Premises, but with respect to structural repairs, Tenant is responsible for only those repairs that are applicable to Tenant's particular manner of use of the Premises, Tenant's alterations or any repairs the need for which is caused by Tenant. Landlord shall be responsible for all other maintenance and repairs.

Environmental. Tenant shall have no liability for any environmental matters except arising from Tenant's acts or omissions in violation of law. Landlord will deliver the space with all asbestos or ACM abated in compliance with law and Landlord is responsible for any conditions that existed before the lease began.

SNDA. All leases state that the lease is subordinate to any existing and future mortgages. What this means is that if a lender forecloses on the building, it can terminate the Lease. For larger sized Tenants, the lease should require Landlord to deliver subordination, nondisturbance and attornment agreement(s) ("*SNDA*") at signing and have an obligation to deliver an SNDA to Tenant for any future lenders. The SNDA should be on a form reasonably acceptable to Tenant. For mid-size Tenants, many Landlords will agree to use reasonable efforts to get Tenant an SNDA, but there's no liability if the Landlord fails to obtain. The costs of any SNDA would be paid for by the Landlord, except for any legal fees for negotiations that Tenant pursues with lender's counsel. Any present or future SNDA will not exculpate successor liability for (a) TI allowance; or (b) offsets or abatements accrued under express terms of Lease, provided Tenant gave mortgagee notice of Landlord's default.

Insurance. Tenant's insurance broker should review the insurance section of the Lease to confirm Tenant can obtain what is being required under the Lease. Tenant should have the right to satisfy all insurance requirements by delivering appropriate certificates under Tenant's

reasonable company-wide insurance program. Add requirement for Landlord to provide casualty (90% of replacement cost) and liability insurance.

Security Deposit and Default. In NY, the security deposit should be deposited in a separate interest-bearing account. If a security deposit is required, check with the Tenant if they prefer cash or a letter of credit. Cure periods after notice of default: monetary, 10 days; nonmonetary, 30 days plus diligence.

End of Term. Tenant will probably not want to remove any of Tenant's installations and alterations or restore at the end of the term so try to avoid any obligations to return the Premises to any particular condition at the end of the term. As a common compromise, Tenants may agree to remove "specialty alterations," defined as unusual and nonstandard alterations that are unusually difficult to remove – but the removal obligation arises only if Landlord identifies "specialty alterations" at the time of plan approval (or lease signing).

Holdover: Most leases will state that if the Tenant holds over, rent is 200% of the then rent (both fixed and additional). Ideally, for first 30 days of holdover, prorate holdover rent daily at 125%-150% of fixed rent (with additional rent being the actual amount). Try to remove any indemnity for consequential damages or loss of next Tenant.

Signage. For retail Tenants, Tenant will want very clear rights for its signage and will want to receive its share of any outdoor signage. If Tenant has a signage package or a national program, get that approved prior to Lease signing. Be clear that in no event can the Building be named for Tenant or its competitor.

Rent Abatement. For larger sized Tenants, it is fair to request a right to abate rent and exercise self-help rights if services are interrupted, Tenant cannot access the Premises or Landlord's work interferes with Tenant's use and occupancy for more than 3 to 5 business days. Larger sized Tenants will also right the right to self-help if Landlord fails to perform under the Lease. In this case, Tenant would have the right offset rent, with interest at prime, if Landlord does not reimburse Tenant's costs within 30 days after receipt of an invoice.

Minimize Interference. If Landlord enters Premises to perform work, etc., or suspends utilities in an emergency, should minimize interference with Tenant's use and occupancy of the Premises. Most Landlord's will agree to this, but will add that it doesn't have to use overtime labor in order to comply. Abate rent if Landlord interferes for more than [five] business days.

Force Majeure or Unavoidable Delay. Make this mutual.

Casualty and Condemnation. Add right for Tenant to cancel if reasonably estimated repair time will exceed 12 months or damage affects more than 20% of space or occurs during last two years. If building is partially condemned and Tenant cannot reasonably conduct its business, allow Tenant 90 days to decide whether to cancel. Prevent Landlord from cancelling Tenant's lease because of casualty/condemnation unless Landlord also cancels other leases satisfying some standard. Bear in mind that casualty and condemnation do in fact actually occur, especially over a large portfolio of properties.

Special Landlord Rights. Delete any demolition clause or relocation clause.

Defaults. Extend cure periods: for monetary, ten days from notice; for nonmonetary, thirty days plus reasonable extension of time for Tenant's commencing within such time and exercising diligence to cure. Do not agree to both interest on late payments AND a late charge; one or the other. Interest on late payments at prime plus 2%, rather than 18% or highest rate allowed by law.

4812-0968-6057, v. 1