



Top Ten Tips for Reviewing a Commercial Lease

PRESENTATION TO CONTRA COSTA COUNTY BAR ASSOCIATION

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12:00 – 1:15 pm

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1. Type of Lease

- What type of lease is this?
 - Office
 - Often a “gross” lease which means there is a base year and tenant pays increases in operating expenses over that base year, or a “modified gross” lease in which Tenant pays certain costs over a base year and other costs directly (i.e. utilities and janitorial).
 - Base year is usually the year in which the lease is signed; however, as it gets later in the year, tenants will try to push this forward (so if a lease will be signed in 4Q of 2022, a tenant might push for a 2023 base year)
 - Retail
 - Typically triple net – meaning that Tenant pays a pro rata share of all common area costs, landlord’s insurance and taxes for the shopping center (or building) – this can be tricky if there is ground floor retail in an office or mixed use building
 - Tenant may also have to pay percentage rent (i.e., a percentage of its gross sales from the premises) and the Lease will typically include an operating covenant with minimum hours.
 - May also be additional charges – e.g., merchants association fee
 - Typically tenant will perform its own build-out (usually with an allowance from landlord) as retailers have their preferred store model
 - Industrial
 - Usually triple net
 - Tenant usually has additional maintenance obligations like HVAC, including repairs and replacement
 - Certain specialty industrial users may need a back-up generator which they would purchase, install and maintain
 - Other: life sciences, data center, call center, medical & dental offices, ground, build-to-suit

2. Premises – make sure that Tenant’s facilities person has carefully reviewed the physical elements of the premises and that same are appropriate for Tenant’s required use

- Condition of Premises
 - Building operating systems in good operating condition

- Path of travel/other ADA issues
- What is the rentable square footage?
 - What is the load factor?
 - BOMA measurement
 - Is Landlord permitted to remeasure the Premises during the Term (and revise rent)? Tenant may want to ‘verify’ square footage before the Lease is signed, or in some instances, push for a remeasurement right.
- Does Landlord have the right to relocate the Premises?

3. Permitted Uses of the Premises

- What uses of the premises are permitted?
 - Are there any exclusives affecting the premises that will impair tenant’s proposed use of the premises?
- Is the permitted use broad enough to accommodate Tenant’s use?
 - If the use such that tenant should investigate zoning & if yes, should this be a contingency in the lease?
- If Tenant’s use is specialized or narrow, does the Lease provide that Landlord will not unreasonably withhold consent to a change in permitted use in connection with a valid sublease or assignment?
- Is the use allowed by applicable zoning ordinances?
- Are there any density restrictions in the Lease?

4. Tenant Improvements/Allowance

- Turnkey : LL performs at LL’s cost based on approved space plan
- Turnkey subject to a cap: LL performs at LL’s cost subject to maximum; tenant to pay excess
- Allowance – partial disbursements allowed
- Unused allowance – credited against rent or FF&E – can be hard to get unless it is a pro-tenant market
- Additional allowance (i.e., loan for additional improvements amortized over term of lease)

5. Initial Lease Term

- What is the commencement date of the lease?
- Will the tenant have “early access” to the premises in order to fixturize?
- What happens if the space is not ready on the commencement date? Is there rent abatement, monetary damages, right to cancel the lease, or other remedies specified?
- What is the expiration date?
- Does the tenant need to have the right to terminate early by payment of a fee? [not standard]
- Does Tenant have an option to extend? If so, how is rent determined? Is it personal to Tenant?

6. Rent

- What is the base rent for the primary term?
 - Is there a rent tax? (e.g., San Francisco, 3.5% rent tax)
 - If yes, who pays?
- Are there escalation clauses and do they match the LOI?
- Is there a reasonable grace period and written notice before a late charge or interest is imposed? Landlords will often agree to waive the first late payment in a certain time period.

7. Operating Expenses

- What does the tenant have to contribute for common area maintenance?
- Did Landlord agree to cap operating expenses?? If yes, almost always limited to “controllable” costs : uncontrollable costs: taxes, insurance, utilities
- Common exclusions: capital costs, compliance with laws in effect as of commencement date, maximum property management fee
- Real estate taxes:
 - Does the tenant have to pay a portion of the real estate taxes?
 - Is there a cap on tax increases? E.g., Prop 13 protection [NOT in this market – sometimes available to tenants during a strong tenant market. Best practice to do a ‘back of the envelope calculation’ to determine possible exposure.]
 - In new construction, are taxes grossed up to reflect a fully assessed Building?
- When is payment due? E.g., monthly, annually
- Has Landlord required to provide an annual reconciliation statement which is properly itemized?
- What audit rights does the tenant have to review the landlord's books and records?

8. Alterations; Tenant Improvements

- What tenant improvements will be necessary?
- How much time will it take to complete the tenant improvements?
- Will the landlord contribute to the cost for the tenant improvements?
- What approvals/permits will be necessary?
- Does the landlord or the tenant own any improvements? [typically ownership transfers to landlord upon completion of improvements]
- What is the relationship between the completion of the tenant improvements and the rent commencement date?
 - If Tenant is performing the work, does the Lease provide a remedy if Tenant’s work is delayed due to Landlord or force majeure?
 - If Landlord is performing the work, the Lease shouldn’t commence until Landlord delivers the Premises with the improvements substantially complete (and any required certificate of occupancy) subject to tenant delays.
- Does the Tenant have the right to make cosmetic alterations without consent?
- Is Landlord required to notify Tenant at the time of consent to an alteration whether it must be removed at the end of the Term?
- Who is responsible for abatement of asbestos uncovered during construction or common area compliance triggered by the Tenant Improvements?

9. Repairs and replacements; surrender:

- What responsibility does the tenant have for repairs or replacements?
 - For office tenant should be very minimal
 - Retail & industrial tenants will have more repair obligations
 - Single tenant make take on most of LL normal repair obligations
 - Do any ‘building systems’ such as HVAC exclusively serve the Premises? If so, Tenant is typically responsible for repairs and replacements.
- What responsibility does the landlord have for repairs or replacements?
- At the end of the tenancy, is tenant's obligation to return the premises in same condition at the beginning of tenancy, excluding (1) ordinary wear and tear, (2) damage by fire and other unavoidable casualty, and (3) alterations previously approved by landlord?

10. Insurance:

- Insurance/indemnity provision to be reviewed by Tenant's risk manager/insurance broker
 - Standard requirements:
 - Commercial general liability [\$3M per occurrence/\$5M annual aggregate]
 - Automobile liability
 - All risk personal property coverage on Tenant's personal property and Tenant's improvements
 - Business interruption insurance
 - Builder's risk (if there are improvements being constructed)
- Many Insurance companies are not agreeing to provide 30-day advance notice of cancellation or material change
- Make sure only required to provide certificates not copies of policies
- Make sure amount of deductible is reasonable
- Waiver of subrogation

11. Utilities:

- Is the electrical capacity sufficient for tenant's needs?
- Direct supply or individually metered?
- Method of computing payment?
- If leasing an entire building, has landlord provided energy history in accordance with California law (applicable to commercial buildings of greater than 50,000 sf) or any local energy reporting ordinances¹
- Are there provisions made for weekend and holiday service? What are the charges? Are there after-hours charges?
- Are the premises separately zoned for HVAC?
- Does the tenant have a remedy for service interruption? Common compromise is that if Landlord causes an interruption in electricity (or other utilities) then rent abates after a few days

12. Assignment and subletting (Exit Strategies):

- Standard for Landlord approval should be reasonable
- Does the landlord have the right to cancel the lease (i.e., recapture) if notified of a proposed assignment of sublease?
 - Tenants may want to limit to assignments or subleases or substantially all of the premises for substantially all of the remaining term (particularly if the Tenant invested substantially in the Premises).
 - If there is a recapture right, limit to the specific space to be transferred, rather than the entire Premises.
- If the assignment or sublet is at a higher price than the base rent, who keeps the excess?
 - Standard is 50/50 split after deduction of subleasing expenses
- Can the lease be assigned to affiliates of the tenant or as a result of merger/sale of assets without landlord approval? – super important for tenants that landlord approval not be required

¹ <https://www.energy.ca.gov/programs-and-topics/programs/building-energy-benchmarking-program>. For example, San Francisco has enacted the Existing Commercial Buildings Ordinance pursuant to which a landlord is required to meet certain energy disclosure reporting requirements with respect to a single tenant commercial building containing at least 10,000 square feet. Additional information about this requirement is available at: <https://sfenvironment.org/energy-benchmarking-compliance-san-francisco>
Other jurisdictions with similar requirements: Berkeley, San Jose, Los Angeles, San Diego.

- Add carve out for IPO and public trading of shares and for changes of control in connection with financings and investments.

13. Other:

- Entry – is Landlord required to notify Tenant prior to accessing the Premises? Does Tenant need to ‘secure’ any areas from entry?
- Estoppel Certificates– timing for delivery and impact for failing to properly complete (an improperly executed estoppel may result in a backdoor lease amendment and forfeiture of important rights).
- SNDAs –Especially important on longer term leases or where the tenant is investing substantially in improvements.
- Review the rules and regulations carefully with operations to ensure they are satisfactory and seek amendments where appropriate (e.g. do the hours for janitorial work? Does Tenant need approval for catering?)
- Does the Lease include a prevailing attorneys fees clause (sometimes missing in ‘simple’ lease forms.
- Expansion rights (ROFO/ROFR) – is tenant concerned about growth opportunities in the building?
- If representing tenant, make sure that all payment time periods are 30 days

14. COVID Update

- *Landlords are winning the vast majority of Covid litigation*
- *Force majeure does not excuse payment of rent*
- *Government-mandated closures are not a taking (eminent domain)*
- *Covid closures do not constitute a “casualty” under the lease entitling a tenant to rent abatement*
 - *But see, Café Nero and Hitz cases*

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Sample Leasing Checklist for Tenants

Location: _____

△ Basic Lease Information

Compare economics in lease to letter of intent

- verify tenant entity (and identity of any guarantor)
- Size of Premises
 - Measurement Metric (BOMA/load factor)
 - Remeasurement of Premises
 - Base Rent
 - CAM [Common Area Maintenance costs] or Operating Expenses (with base year)
 - If a retail lease – is there percentage rent
 - Term (end on last day of a month?)
 - Tenant’s notice address (premises only if this is tenant’s HQ)
 - Retail lease – percentage rent requirements

△ Tender of Possession

- Early access
- Time limit on Landlord’s tender of possession to tenant [delay in delivery]
 - Day for day rent credit
 - Outside date for termination
- Warranty – premises in compliance with applicable laws (ADA) including path of travel to the premises

△ Commencement Date

Relationship between rent commencing and completion of tenant improvements

Landlord build then commencement should be date on which work is substantially completed

Tenant build - Landlord will insist on a “hard” commencement date, e.g., 120 days after delivery

△ Rent

- prepaid rent only upon full execution of lease & Tenant’s receipt of a w-9 for landlord
- payment by electronic funds transfer

△ Delinquent Payment; Handling Charges

- No late fee for first late payment
 - Late fee should not be more than 5% of delinquent amount
- No interest charge for first late payment

△ Security Deposit – Letter of Credit

- Letter of Credit – delivered within 10 business days of lease execution [not practical to deliver concurrent with tenant’s lease execution]
 - Remember that LOC application will need to be made to the bank
 - Form of LOC to be attached as an exhibit to the Lease
 - Landlord to pre-approve Tenant’s Bank
- conditions for any reduction in Security Deposit/LOC
- timing for return of Security Deposit/LOC

△ Services; Utilities

- are utilities separately metered?
- Abatement for interruption of essential services to premises

△ Alterations

- Landlord deemed approval (i.e., 2nd notice)
- Consent not unreasonably withheld
- Waiver of consent for alterations costing less than a certain amount [*\$5.00 alterations per sf*]
- Advance notification of Landlord's costs
- Landlord's notification at time of consent regarding removal of alteration
- Landlord to use reasonable efforts to not disturb Tenant's business
- Deletion of any bond requirement

△ Repairs/Maintenance

- Allocation of maintenance responsibilities between Landlord & Tenant
- Make sure that CAM (OpEx) reflects Landlord maintenance obligations
- Tenant self-help rights for Landlord failure to repair

△ Signs

- Building lobby directory signage
 - Monument sign rights
- Tenant permitted to install standard corporate signage

△ Use

- Permitted Use (make sure no conflicts with existing exclusives or CC&Rs)
- Exclusion of Tenant's responsibility for structural changes or changes required to cure non-compliance with Laws in effect on the Commencement Date
- any zoning issues?
- For retail leases – operating covenants
 - Right to go dark (i.e., cease operations)
- For retail leases – does tenant want an exclusive (right to be the only tenant in shopping center operating for a specific use, e.g., shoe store)
- For retail lease – does landlord include a radius clause (e.g., tenant cannot open the same type of stores within a certain radius of the premises)

△ Assignment and Subletting

- Carve-out for IPO and other stock
- Landlord deemed approval (i.e., 2nd notice)
- 50/50 profit sharing on assignment/sublet
 - Deduction of Tenant's costs from profit
- Limitation of Landlord's transfer fee
- Limitation of Landlord's attorneys' fees
- Permitted transfers
- recapture
 - If can't delete then Landlord to exercise right before putting space to market
 - Does not apply to permitted transfers

△ Insurance [Tenant's risk manager to review requirements]

- CGL insurance amounts
- limit on new kinds of insurance
- Best's standard: A- VII
- Tenant not responsible for consequential damages
- Landlord indemnity for Landlord's [gross] negligence
- Make sure there is a thorough waiver of subrogation clause

△ Subordination; Attornment; Notice to Landlord's Mortgagee

- SNDA at time of lease execution
Make sure to get form of SNDA ahead of time; attach as an exhibit to the lease & revise during lease negotiations
- future Subordination subject to receipt of non-disturbance agreement
- Extension of time for execution of subordination agreement
- No obligation to alter material provisions of lease
- Limitation on Mortgagee's right to cure

△ Rules and Regulations

- Revised rules may not modify lease
- advance notice of any changes to rules
- landlord not to discriminate in enforcing rules

△ Condemnation

- Tenant's termination rights
- tenant can claim condemnation award

△ Fire or Other Casualty

- Deleting Landlord termination right at end of lease if Tenant renews term
- rental abatement during landlord repair period
- Termination right for Tenant if actual repairs not completed within stated time period

△ Events of Default

- Extension of Tenant's cure time periods
- Written notice of monetary default
- for non-retail tenants – no obligation to occupy premises or to operate for business in premises

△ Surrender of Premises

- in same condition as received, ordinary wear & tear excepted

△ Holdover

- Reduction of holdover amount [150% of base rent is standard]

△ Certain Rights Reserved by Landlord

- Limitation on interference with Tenant's use and occupancy
- Defined notice period prior to Landlord's entry – 2 business days
- Confidentiality upon Landlord's entry
- Any secured areas of premises where LL should not have entry? (e.g., medical records)

△ Hazardous Materials

- Landlord's rep & warranty that premises are free of hazardous materials
 - If hazardous materials are found, then LL has to remediate & rent stops during remediation
- Landlord indemnity
- Tenant has no liability for pre-existing contamination or contamination caused by Landlord

△ Parking

■ Is there adequate parking for tenant's needs

Is there a charge for parking & if so how much?

△ Miscellaneous

- Attorneys' fees clause (prevailing party)
- Landlord to pay commission to named brokers
- Extension of time for execution of estoppels
- any issue with tenant being required to deliver financials to LL (condition on LL signing Tenant's NDA)
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△ Operating Expenses

- Cap on controllable expenses [*almost impossible to get in this market; if applicable this concept will be in the LOI*]
- Cap on management fees
- Definition of sound accounting principles
- Exclusions from CAM
- Savings credited against CAM
- Tenant's right to audit – try to get at least 180 days to exercise audit
- Landlord's payment of audit costs if overcharged by 5%
- Gross-up for base year
- Gross up does not allow Landlord to collect more than actual
- Sunset Provision
- Exclusion of Earthquake insurance from Base Year unless carried in future years

△ Work Letter (Turnkey)

- Landlord to build in compliance with all applicable laws
- Landlord to obtain a certificate of occupancy
- Delete or limit Landlord construction supervision fee
- Give tenant the opportunity to value engineer costs