

# THE EIGHT MOST IMPORTANT CLAUSES IN A COMMERCIAL LEASE

Whether from the vantagepoint of the landlord or the tenant, the eight issues examined herein should form the core of the negotiating strategy.

By Alan Fischl

What are the most important issues with which either a prospective tenant or landlord of commercial property should be concerned? The typical commercial lease may contain more than 60 paragraphs covering everything from alterations to window cleaning. There are eight clauses, however, that form the basis of the most important issues to be addressed in lease negotiations, even prior to involving your legal counsel. Knowledge of these clauses will allow your firm to conduct the most intense negotiations on them, perhaps conceding issues in other less important areas.

Generally, the most important clauses are the following:

**1. Rent:** The annual rental will undoubtedly be the first item to be negotiated directly by the landlord and tenant. The annual rental for the term of the lease may be the same each year or may escalate periodically during the lease term.

Make sure that the base year for the calculation of the increase is the year in which the lease commences. Also, be sure that the fraction for the square footage of the leased premises over the square footage of the entire building is calculated correctly, and that the measurements of square footage in both cases are accurate, particularly if rent negotiations revolve around "per-square-foot" rental figures.

**2. Additional rent and escalations:** With the exception of full-service leases, most commercial leases contain provisions obligating tenants to bear their pro rata share of common area maintenance (CAM) charges, such as real estate taxes.

Secondly, most leases provide that at the expiration of the lease term, all alterations and leasehold improvements to the

water and electric (unless the tenant is to be separately metered for these items), snow and garbage removal, sewer rentals, lawn maintenance, and building insurance, along with their pro rata share of periodic increases in these items during the term of the lease.

**3. Term:** The term of the lease would, on its face, appear to be the easiest clause on which to reach agreement. For both parties, the key consideration is often a lease term that is sufficiently long to allow amortization of necessary alterations and leasehold improvements, and sufficiently short so that they are not "locked into" a lease for more time than sound business practices would dictate.

While the ideal solution for a tenant would be to have a renewal option, landlords are often uncomfortable about giving tenants this option. In such cases, a renewal option at a rental equal to the fair market rental may be appropriate.

**4. Assignability:** Typically, a lease will provide that tenants may not assign, sublet, or otherwise encumber their leasehold interest except with the prior written consent of the landlord. This provision is obviously favorable to landlords, as it gives them complete and unfettered discretion in deciding whether or not to permit the tenant to assign or sublease to a third party. The tenant is usually permitted to assign or sublet to a financially viable third party - i.e., one whose net worth is not less than that of the existing tenant - with the landlord's consent, not to be unreasonably withheld.

premises belong to the landlord. Depending on the length of the lease term, leasehold improvements existing at

sonably withheld. This puts the onus of explaining why the proposed assignee or subtenant has been rejected squarely on landlords, preventing them from making arbitrary decisions.

It is important for a tenant to know that even if the landlord accepts the assignee or subtenant, the tenant remains liable under the lease. In the case of an assignment, this liability is secondary. Thus as long as the assignee fulfills his rental and other obligations under the lease, the original tenant has no actual liability, but only remains secondarily liable to the landlord for the performance of the assignee. In the case of a sublease, the tenant remains directly and primarily liable to the landlord and must look to the subtenant for damages in the event that the subtenant defaults under the sublease. Generally, there is no reason why landlords should not be both lenient and reasonable in accepting an assignee or subtenant, since they will now have two entities that are contractual

**5. Tenant alterations:** There are two aspects of alterations to be considered. The first is that leases usually prohibit any alterations to the premises without the landlord's prior written consent, and then only upon the tenant's obtaining the proper governmental authorizations and with contractors approved by the landlord. Again, such consent is not normally to be unreasonably withheld.

the lease termination date may have significant value. In many leases, if the tenant restores the condition of the

premises to that at the time of lease commencement, the tenant may be permitted to remove the leasehold improvements and take them with her to her new space.

#### **6. Maintenance and repairs:**

Depending on the type of property, leases may require the tenant to maintain and repair all of the lease appurtenances during the term of the lease, or the tenant may be entering into a full-service lease. In most cases, structural repair and maintenance obligations belong solely to the landlord.

Also, the question frequently arises as to who is responsible for maintaining the plumbing, electrical, air conditioning, and heating systems. This must be clearly defined. Generally, if the repair and maintenance obligations relating to interior appurtenances belong to the tenant, then the tenant is often able to select the particular contractors who are to perform these obligations as long as they are appropriately bonded for the work they perform.

**7. Renewal options:** From the tenant's vantagepoint, a renewal option is of great value for obvious reasons. However, it is strongly suggested that, if this issue is important to the tenant, these discussions take place early in the lease negotiations. This enables the landlord, not generally prone to grant-ing renewal options, to be aware of the fact that the existence of an option is a key ingredient to his prospective tenant.

**8. Subordination:** Most leases provide that the tenant's leasehold interest is subordinate to the existing mortgagee's interest. This means that if the mortgage on the building goes into default, the holder of the mortgage ("mortgagee") can evict the tenant even though there is no default by the tenant.

This seems unthinkable and, as a practical matter, is unlikely to occur as long as the tenant continues to pay his rent. Why would a mortgagee want to evict the tenant? Either the mortgagee

has found a buyer for the building who would like the entire building for himself or has found another tenant for the space who is willing to pay a higher rent.

For sophisticated and expensive real estate, the tenant may ask that the landlord try her best to obtain a nondisturbance and attornment from the mortgagee in favor of the tenant. This means that the mortgagee agrees that in the event of default by the landlord on the existing mortgage, as long as the tenant is not in default under his lease, the mortgagee will not be able to evict the tenant from his space. Mortgagees are understandably reluctant to give a nondisturbance agreement, since it limits their option to evict the tenant.

Focusing your energies in these eight areas will provide you with the best financial package, and one that assures you of maximum flexibility as well. \*

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