

THE REAL ESTATE LEASE AGREEMENT

By Mark S. Litner

In a sense, a lease is a simple agreement. The landlord agrees to make certain space available to the tenant, and in return, the tenant agrees to pay rent (and sometimes its share of taxes and expenses) to the landlord.

While this simplistic analysis is accurate, most leases contain, like our firm's motto, "Much More". This article discusses a few common lease provisions and offers some suggestions for both landlords and tenants to consider in lease negotiations.

Rent Abatement. During soft market conditions, tenants often try to negotiate free rent for a portion of the lease term. Although most rent abatements typically occur at the beginning of the term, there is no requirement that this be the case. One way for the landlord to reduce its risk that the tenant might walk away after enjoying the free rent period is to spread the rent abatement over a longer period of time. This can be achieved in any number of ways, including alternating months during the lease term, the first month of each lease year, abating rent during certain calendar months for a retail tenant with seasonal fluctuations in sales, or any other arrangement mutually acceptable to the parties. The landlord should insist that any rent abatement is conditioned upon the tenant making all other payments due under the lease. If the tenant moves out early or otherwise defaults, the landlord can then recoup the "free rent."

Assignments and Subleases. Due to the possibility of unanticipated changes in business or other unforeseen circumstances, tenants frequently seek the right to either assign the lease or sublet all or a portion of the premises to a third party. While tenants want to achieve as much flexibility as possible with respect to possible assignments or subleases, it is good practice for landlords to prevent the tenant from assigning the lease or subletting the premises to any existing or future occupant in the building or shopping center, as the case may be, including any affiliates of such occupants. Since existing tenants in a building or shopping center are often logical prospects for expansion, landlords should try to retain the exclusive right to negotiate with these desirable, potential customers rather than allowing one tenant to take advantage of another tenant's expansion needs. To discourage a tenant from competing with the landlord, require the tenant to pay landlord all "excess" rent.

Letters of Credit. During lease negotiations, much attention focuses on the security deposit to be given to the landlord. In many cases, the security deposit is in the form of cash and is equal to one or more month's rent due under the lease. However, a letter of credit is an alternative form of security that is attractive to both parties. The advantage to the tenant is the ability to avoid tying up additional cash that the tenant may need for its business operations or working capital. From the landlord's perspective, the third party advantage provides quick access to the cash and access generally is not subject to the automatic stay order if the tenant files for bankruptcy. As a condition to accepting a letter of credit in lieu of cash, the landlord should insist that (i) the letter of credit be issued by a reputable financial institution that regularly issues letters of credit, (ii) the term of the letter of credit must be long enough to cover the entire lease term or contain an automatic renewal provision on an annual basis, (iii) the letter of credit should provide that the only condition for payment is the landlord's written statement that the tenant is in default under the lease after the expiration of any applicable cure periods, and (iv) because the amount of the letter of credit may exceed the amount of any specific monetary default by the tenant, it should provide for partial draws enabling the landlord to either draw

down the specific amount owed by the tenant, or to draw down the entire amount, apply a portion to the existing default and retain the balance as a cash security deposit.

Duty to Restore. If tenant improvements are made to the premises before the tenant takes occupancy, one issue often overlooked is the tenant's responsibility to restore the premises to the original condition when the lease term expires. A tenant usually wants to disclaim any responsibility to restore the premises (other than removing tenant's portable trade fixtures) at the end of the lease term, but in some cases, the tenant may desire to remove certain alterations which also have value to the landlord. The parties need to address each party's responsibility with respect to the removal or non-removal of these tenant improvements. In addition, if during the term of the lease the tenant wishes to perform any additional alterations, it should obtain a commitment from the landlord prior to performing any alterations as to which items can remain and which items must be removed when the lease term is completed. At the inception of the lease, the parties should establish a threshold dollar amount for work or alterations in the premises which will not require the tenant to obtain the landlord's prior consent, particularly with respect to decorations and minor non-structural alterations.

Tenant Signage. Signage and visibility are critical for the success of the tenant's business for many tenants, particularly those leasing retail space, single tenant office or industrial buildings, and ground floor space in office buildings. Nevertheless, it is important for the landlord to retain certain elements of control by requiring the tenant to obtain the landlord's consent before the tenant can install any signs or otherwise alter the appearance of the building. The landlord should insist that the tenant obtain and pay for all necessary licenses and permits before installing any signs, and that any signs comply with all applicable zoning laws and ordinances and the insurance requirements of the landlord's insurance carrier and lender. If the tenant desires to install an electric sign, the landlord should require the tenant to be responsible for replacing light bulbs, requiring the sign to be illuminated during the tenant's business hours and to pay for all electricity used to illuminate the sign. Finally, although this is a subjective issue, the landlord should insist that any sign installed by the tenant will not be unsightly or diminish the appearance of the property, as reasonably determined by the landlord.

If you have any questions about the topics covered in this article or any other leasing issues, please feel free to contact me at 312-372-0414 or mlitner@jaffeberlin.com.