



An overview of some surprises tenants and landlords may encounter during their leases - by Gerald Morganstern

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New leases often start with a letter of intent (LOI). The larger the space the longer the LOI. In many instances the LOI does not cover every important aspect of the proposal. A prospective tenant can be surprised by some paragraphs in the middle of a long lease, especially if it is for a small space. Owners should also read the below lease additions for consideration in their leases. Adding bullet points on these items could eliminate these surprises.

The first new paragraph finding its way into leases is a relocation provision. This permits the owner to relocate the tenant to another space in its building or shopping center. Typically, the owner provides similar space at the same rent with the same improvements and pays the tenant's moving expenses. In this manner the owner can create space for a new full floor or larger tenant by moving a small tenant. If this provision appears in its lease, the tenant must make sure the size and configuration of the new space is similar and there will be no increase in rent even if the new space is larger. Tenants should also seek a per s/f rent reduction if the new space is smaller. An office tenant should also consider whether the view is important and whether a high floor is important. A shopping center tenant has to consider access and visibility from the street. Every tenant should have enough notice to adequately prepare for the move.

In many leases, landlords now provide for annual percentage increases in rent in lieu of operating expense escalations. The increases are often fixed, but sometimes are tied to increases in a consumer price index. Despite language in the letter of intent or lease that these increases replace operating expense increases, some leases still provide that tenant will pay its share of landlord's insurance premium increases during the lease term. In such case the tenant should seek to eliminate the paragraph. Failing that solution, the tenant should find out what past increases have been and seek to cap this charge.

Cash is no longer "king," even in leases, when it comes to security deposits. While some landlords allow a tenant to provide cash or a letter of credit (LOC), more often the only choice is a letter of credit security deposit. A cash security deposit is considered to still be the tenant's property but being held in trust by the landlord. As a result, if the tenant goes bankrupt the bankruptcy court will determine the fate of that money. The letter of credit is for funds held by the issuing bank and gives the landlord the right to take the security funds directly from the bank. As it is the bank's obligation, the financial status of the tenant is irrelevant. The downside for the tenant (even if it does not default) is that the tenant will have to deposit cash to cover the letter of credit when it is issued to landlord (as opposed to when the letter proceeds are paid to landlord) and will also pay an annual

fee to the bank of 1-2%. The surprise is the extra cost. A secondary surprise for many tenants is that the letter of credit can take two to three weeks to be issued and landlords do not consider the lease transaction complete unless the letter of credit is received. Landlords will not start their work, if any, without the security deposit. A tenant could put up cash security with a provision that the cash is refunded when the LOC is delivered. This means putting up the security twice for a few weeks. A smart tenant will determine early on if a LOC is needed, will get his preferred bank approved by landlord as the issuing bank and will start the application process while the lease is being negotiated.

The last surprise for a tenant in this discussion is the demolition clause. The purpose of a lease is stability to the tenant knowing where it will be and what it will pay for a certain number of years. Landlords want the same certainty but as buildings age and zoning laws change there may be reason for a landlord to demolish or gut the building. The demolition clause states that if the landlord determines to demolish the building it will give tenant advance notice and pay a fee so it can empty the building.

When discovering this provision the tenant needs to provide safeguards and benefits. It will need evidence that the building will actually be demolished, sufficient notice to find alternative space and sufficient funds to cover its move and the loss by having to pay market rent instead of the lease rent earlier than expected. The tenant should be assured that a certain percentage of all building tenants are being removed to accomplish the demolition or substantial renovation.

One small surprise for landlords occurs when the tenant neglects to mention the entity has not yet been formed or it does not have authority to do business in the state or it does not have a federal identification number.

These surprises can all be dealt with so long as they are discovered timely so as not to unduly delay the lease process.

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