New England Real Estate Journal

nerej

THE LARGEST WEEKLY COMMERCIAL/INVESTMENT NEWSPAPER IN THE WORLD

Friday, May 16, 2014 NEREJ.COM Reprint

Sign a flexible lease that is a win-win for both parties

Fran Mastroianni, Trilogy Law LLC

When clients indicate that their business is growing or shrinking, the discussion often turns to their space lease. If their lease was well drafted and negotiated, it often spares them the time and expense of relocating to smaller or larger space and provides the flexibility landlords and tenants need to create a win-win situation when business conditions change for better or worse.

Tenant Considerations:

Keep Lease Terms Short. Tenants should strive to negotiate a short-term lease to avoid several risks associated with long-term leases. For example, depending on when in the economic cycle a long-term lease was negotiated, a tenant could face many years of rent payments above then current market rates with no chance of relief and the risk of default for failure to pay. However, tenants also need peace of mind that they will not have to relocate and/or sign a new lease every few years. Solution: Tenants should negotiate shorter-term leases that contain one or more options to extend the term of the lease. Option rent can either be at a rate pre-set in the lease or at market rates at the time of option exercise.

Don't Lease more Space than Needed. If a tenant is downsizing, it may end up paying rent for quite a while on space it does not use. Solution: Tenants should negotiate the ability to sublease unneeded space or, ideally, "put" space back to a landlord at specified times during the lease term without payment of a penalty. If a tenant is growing, the challenge is to ensure that increased space requirements can be met. Solution: Tenants may wish to negotiate an option or right of first offer to lease contiguous space, thus avoiding the need to relocate and saving both time and expense.

Ask for Incentives. When it comes time to exercise an extension option, a well negotiated lease will require the landlord to provide extra improvements in the form of fresh paint, new carpeting, or other amenities or several months' free rent in the same way that a new tenant would be offered a tenant improvement allowance and/or a period of free rent as an incentive to sign a lease. Alternatively, a tenant might request a discounted rent during an option term (typically 95% of market rates) to share in the savings landlord will realize in not having to market vacated space to a new tenant.

Operating Expense Cap. In a lease where there is a pass through of expenses to tenant, tenants should consider, and often landlords will agree to, an annual cap on increases in any expenses "controllable" by landlord. A typical expense cap may provide that controllable expenses may not rise more than 3% per year. Controllable expenses may include cleaning and landscaping and typically exclude real estate taxes and insurance.

Measure the Space. Tenants should always negotiate a right to measure their space during the initial months of the lease term to ensure that they are paying rent based on the actual amount of usable square footage in their space.

Landlord Considerations:

Recapture. Landlords can control the use and occupancy of tenants' space by negotiating a recapture clause. A recapture clause allows a landlord to "recapture" space that a tenant no longer needs and may wish to sublet or let go dark. A recapture clause offers a landlord the ability to take back space in the event landlord can lease it at a higher per-square-foot rent, grants a landlord further ability to control who occupies its building, and prevents a tenant from competing with landlord by subleasing space at a lower rent than other available space in the building.

Relocation: Relocation clauses allow landlords to relocate existing tenants to other space in the building in order to assemble larger blocks of space to lease. Landlords looking to relocate a tenant do not do so lightly, as typically there are significant costs involved in fitting out the relocation space, paying for tenant's moving costs, brokerage commissions, and possible rent concessions. That said, relocation rights are an important and valuable tool to landlords in improving the economics of a property.

Operating vs. Capital Expenses: Whether all operating expenses are passed through to the tenant or a lease provides for tenant's payment of operating expenses over a base year, landlords will want a broad definition of what constitutes these expenses. Landlords' cost of capital improvements, on the other hand, are usually "capitalized" by spreading the cost of the capital expense over the useful life of the improvement and tenant's reimbursement obligation over the lease term. Landlords typically negotiate for a broad definition of operating expenses so that certain arguably capital expenses fall within the definition of operating expenses resulting in a tenant paying its pro-rata share of such expense in one lease year rather than paying its pro-rata share of the capitalized cost over its lease term.

Whether you are a landlord or a tenant, knowing the leasing market and engaging counsel who knows how to address these issues is imperative in order to sign a lease that provides maximum flexibility and is a "win-win" for both parties.

Fran Mastroianni is a partner and founder of Trilogy Law LLC, Boston.

Tel: 781-878-4540 / Fax: 781-871-1853 / 800-654-4993 / info@nerej.com / www.nerej.com