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Doron F. Eghbali Commercial Leasing Law

[What Does A Commercial Lease Encompass? Part I](#)

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Commercial leasing encompasses a rather disparate array of commercial properties ranging from shopping centers to multi-tenant buildings to free-standing buildings. In addition, the salience of lease in such context cannot be overemphasized as disparate scenarios warrant new tactics and approaches. In a series of articles, we explore some of the most common legal issues associated with commercial leasing of shopping centers. In this particular article, we lay out some of the concerns specific to landlord and tenants in the context of negotiating a commercial lease for a shopping center. In future related series, we will explore some of the specific provisions and delve rather more deeply into such provisions.

SALIENCE OF COMMERCIAL LEASES

Undoubtedly, commercial leases memorialize party's understanding and provide certainty and security, to some extent, to the parties involved. For both parties, it is salient to ascertain if a long-term lease would yield them profits or hamper their growth or even decimate their business or investment. If parties are not cognizant of their respective duties and obligations and the terms and provisions are not set out clearly, to the extent possible, the chances of losing hundreds of thousands of dollars are substantially increased. For instance, if a tenant cannot and will not intelligently assess the costs of a 10-year commercial lease, then the business might find itself suffocated by the crushing rent, taxes and maintenance and having no exit strategy. On the other hand, a landlord under the guillotine of lenders seeking to make relatively high monthly mortgage payments may be crushed if the lease does not provide for adequate adjustment of cost increases. In fact, failure or financial weakness of landlord to adequately and properly maintain the commercial property would not only diminish the value of the property, but also may cause landlord to violate its contractual duties and obligations to tenants or even lender.



1. LANDLORD'S CONCERNS TO SATISFY LENDER

Most importantly, landlords are inextricably tied to the contractual requirements and obligations foisted upon them by lenders. In fact, in most instances, lenders as a condition of lending to the landlord, require approval of the underlying lease(s) a precondition to their approval of the loan. Accordingly, the landlord is placed in a position to put lender's interests above its own and concomitantly ensure the lease with tenant actually materialize for a rather steady stream of income to satisfy the loan.

SOME OF THE ISSUES OF IMPORTANCE TO LENDERS

A) RENT

Landlords usually ensure the underlying lease is paid to the landlord without any:

- Reduction
- Setoff
- Guaranty a Particular Income Stream

Nonetheless, a common exception to the rather stringent requirements laid out above is the lender would agree to tenant's reducing rent by costs of repair **ONLY IF**:

- Landlord under the lease was obligated to pay for such repair; **AND**
- Tenant provides **PRIOR NOTICE** to **BOTH** landlord and Lender of the pending repair

B) EXCLUSIVE RIGHTS

Lenders cautiously and carefully review a lease agreement bestowing certain privileges on a particular tenant. Lenders deem such exclusive rights problematic as they might infringe upon or conflict with other tenants' lease provisions.

C) NON-COMPETITION

This provision could prove problematic as lender would not agree to landlord's covenant not to compete outside the property described in the lender's deed of trust.

D) PERMITTED USE

Lenders are rightly concerned about the permitted use of a tenant in a shopping center. Lenders seek to ensure permitted use of one tenant is clearly spelled out to foreclose the possibility of tenant changing the permitted use to something violating another tenant's exclusive right or use.



E) OPTIONS TO PURCHASE

Lenders, often, find an objection to tenant having an option to purchase for several reasons. First, lenders usually would not agree and approve tenant's option to purchase the leased premises if the tenant can exercise such option prior to the encumbrance out of the fear the tenant could take over the property free of the encumbrance. Understandably, this is because the lender in making the loan relied on the landlord's credit worthiness and conducted a risk-benefit analysis of the landlord.

F) LEASE TERMINATION

Lenders are generally opposed to a lease granting tenant the right to terminate if the landlord defaults. Tenant's remedy if landlord defaults would be to sue the landlord for damages or, if possible, cure the landlord's default and deduct from the rent for expenses incurred for curing such default.

Nonetheless, lenders MAY agree to tenant terminating the lease, if:

- The leased property is totally destroyed.
- The Leased property is partially or completely destroyed, and the property cannot be restored to what its previous situation within a specified time.
- The leased property is condemned.

2. SOME OF THE TENANT'S LEGITIMATE CONCERNS IN A COMMERCIAL LEASE

A) RENT

There are several issues tenants need to be cognizant of in negotiating a commercial lease, among which are:

- Not Paying Rent During the Time the Leased Property is Being Renovated or Improved (Fixturing Period). If There Is a Fixturing Period, How Long Would That Last?
- Not Paying Increased Rent Based On Cost of Living Index. Or Negotiate Over Any Increases and Clearly Set Out Thresholds Triggering Such Rent Increases.
- Not Paying for Percentage Rent Unless the Calculation Method, Gross Revenues, etc. Are Clearly Defined. Percentage Rent Refers to Commercial Tenant, Mainly Shopping Center Tenants, Paying a Percentage of Their Gross Revenues to Landlord. Note: Setting Out Clearly a Calculation Method Often Requires a Meticulous Methodical Approach Depending Upon the Sophistication of the Parties and Deal Involved.



B) COMMON AREA

In shopping centers, landlord MUST give tenants the right to use common areas with other tenants. Nonetheless, the following provides SOME of the concerns tenants should be mindful of:

- Negotiate with landlord, to the extent possible, to curtail building on or changing the common areas.
- Negotiate with landlord, to the extent possible, to avoid charging you for parking in the designated parking areas.
- Negotiate with landlord, to the extent possible, to avoid charging you for common area maintenance costs such as depreciation on improvements and equipment and landlord's administrative costs, etc.

C) LEASED PREMISES

- Negotiate with landlord, to the extent possible, what needs to be done to the existing leased premises to make the premises amenable to you and your business.
- Negotiate with landlord, to the extent possible, as to the length of time needed or required to finish any improvements or alteration by landlord to make the leased premises amenable and acceptable to you.
- Negotiate with landlord, to the extent possible, over any securities or guarantees for the work to be done timely to make the leased premises acceptable to you.
- Negotiate with landlord, to the extent possible, your rights to object to the improvements and alteration done by landlord and what materials landlord may use in the construction and the architectural changes.

SALIENT DISCLAIMER

This article NEITHER supplants NOR supplements the breadth and depth of such esoteric topic. In fact, this article ONLY provides a rather rudimentary synopsis of such expansive esoteric subject matter.

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