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HOW TO ACQUIRE YOUR FIRST U.S. BUSINESS SPACE

STRUCTURING FOR SUCCESS

John Busey Wood
Akerman Senterfitt


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This booklet is to help the general business person gain a broad understanding of the process and the issues involved in purchasing or leasing a real estate space for its business and how to structure that business to minimize liabilities. This booklet is not intended to provide specific legal or other professional advice. Individual situations have their own distinct considerations and appropriate professional assistance should be sought.

HOW TO ACQUIRE YOUR FIRST U.S. BUSINESS SPACE – STRUCTURING FOR SUCCESS



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## ABOUT THE AUTHOR

**John Busey Wood, Esq.:** John Busey Wood is a member of the New York City office of the commercial real estate group at the law firm Akerman Senterfitt LLP. Mr. Wood has represented owners in the design and negotiation of commercial leases covering in excess of 50 million square feet of retail, office and mixed use space projects and assisted large volume space users in the effective management of their facilities portfolios and reduction of costs and risk. Because of this experience, his unique blend of professional disciplines and his design and deployment of sophisticated new-generation commercial lease forms during the late 1970's and the 1980's, Mr. Wood was featured in an article on the impact of commercial leases on companies and was referred to by The Wall Street Journal and other publications as "the father of the modern killer lease." Among noteworthy projects, Mr. Wood directed the legal team in a national portfolio acquisition program with a value in excess of $2 billion; he participated in the development and leasing of over 4 million square feet of regional shopping malls and retail centers nationwide, and, in 1998, negotiated the largest ground/space lease transaction in the history of New York City — more than 1.6 million square feet. In addition, Mr. Wood has advised, directed teams and designed correlated construction contracts for "fasttrack" design-build projects, conversions and renovations in New York City in excess of 8 million square feet, with values in excess of $4 billion. Mr. Wood is a licensed Class "A" commercial real estate broker and a Certified Public Accountant and holds B.B.A. (Accounting and Economics), M.B.A. (Accounting and Finance) and J.D. degrees. Mr. Wood is the author of many articles and publications including the national treatise Negotiating and Drafting Office Leases, published by Law Journal Seminars-Press (Library of Congress ISBN 1-58852-061-7, 1995) and Navigating The Dangerous Shoals of a Commercial Lease, published by New York University Graduate School, 1992-5 and the ABA. Mr. Wood is listed in Who's Who in Real Estate, Who's Who in American Law, 2nd and 4th Editions, and Who's Who Registry of Global Business Leaders, 1993-4 Edition. Mr. Wood is AV rated by Martindale-Hubbell and is a Commercial National Neutral Panel member of the American Arbitration Association and an American Bar Foundation Fellow.





CHAPTER 1

# HOW TO ACQUIRE YOUR FIRST U.S. BUSINESS SPACE:

## STRUCTURING FOR SUCCESS

Real estate transactions in the United States can be surprising for many German business persons. It can be a revelation for experienced executives to find out, first-hand, how the same straightforward and logical acts, usual and appropriate in Germany, can, when done in the United States, result in surprising and unintended, but considerable, financial and legal consequences.

For example, consider the fictitious German executive sent to New York City by the parent company in Germany to explore possible locations for a flagship retail store – the first to be opened in the United States as part of the parent company's global expansion strategy. After a day spent in exploring different New York neighborhoods, the executive sees an attractive streetlevel vacant store with a sign taped to the window: "Available: For Rent/Purchase" and indicating a name and phone number to call "For More Information". Based on what is able to be seen from outside, the executive thinks that this store may be perfect for the company and the executive calls and sets up a meeting with the person whose name and phone number were listed on the sign in the vacant store's window. During this telephone conversation, the executive expresses interest in the property, discloses the affiliation with the parent company, and provides a general idea of the intentions with respect to acquiring space. The executive then goes on to express interest in seeing the inside of the store and asks about the rent, how long the property is available for leasing and whether it is in good condition or there is work to be done in the space to accommodate the business contemplated by the German employer. The person on the phone provides the information requested as well as some information about the market in general,

and offers assurances that this particular property is in "great shape". An appointment is made to see the property and the conversation is concluded with expressions of interest all around and thanks expressed by the executive for the information that has been provided on the market in general and on this space in particular.

Unbeknownst to the executive, this initial contact will determine the nature of the company's relationship with this property as well as with every other property the executive may see or about which the executive may acquire information or descriptive materials.

There are many variations on the "initial contact" scenario described above: For example, if, instead of being vacant, the space was occupied by an ongoing business, the German executive probably would have had a face-to-face conversation with someone at the store itself; if, on the other hand, the space was vacant, but it was part of a property under development, the executive most likely would have spoken with someone who had been placed in the space for the express purpose of responding to inquiries, and possibly also, if a telephone call was also placed by the executive, to the person whose name and number appeared on the sign. No matter what the particulars, the effect of the initial contact is the same. By the time the German executive has concluded the initial conversation about the space — regardless of intentions – the executive (depending on the exact words exchanged) has inadvertently triggered a host of legal and financial liabilities for the company and perhaps even its parent company back at home. At the very least, the executive has effectively waived the company's rights to employ a broker that has been deliberately chosen, one whose loyalty the executive has specified to be undiluted by conflicts, and one who will provide only the specified services needed at prices that have been fully negotiated, or even discounted, as appropriate. A further result of the initial contact is that the executive has effectively caused the cost of this real estate transaction to have increased considerably, without having gotten a commensurate added value.

Additional consequences of such a conversation during such an initial contact also depend on, among other things, the place where the conversation and the property are located (here, we are assuming New York City) and the identity and function of the person with whom the executive has had the initial conversation. If the executive spoke with the landlord's broker, the executive has most likely retained the broker as the company's broker, and perhaps even, depending on the exact words, as its "exclusive" broker for this property requirement or other properties or locations. If the broker is employed by the landlord, the executive has placed the company in the less-than-desirable position of having brokerage representation that will be





compromised by the broker's pre-existing loyalty to the landlord. It is important to note that the landlord's interests are not aligned with to tenant's needs on many issues, including the condition of the property, about which the executive specifically enquired. Any oral declaration made by the broker (or by anyone for that matter) that the property is in "great shape" cannot, in fact, be relied on to protect a tenant or purchaser from the consequences of latent or hidden defects in the space or in the building, or issues of legal compliance affecting both, which will not be apparent from even the most exacting visual inspection.

If the executive spoke with an owner or landlord, the executive may have not triggered an immediate brokerage liability for the company, but the executive has, equally unknowingly, created an additional expense for the company, because the company will now need to employ a broker to act as a consultant to represent it on issues that ordinarily would have been dealt with the broker acting as its broker. (The tenant's or purchaser's broker's fees are customarily paid by the landlord). The landlord, who has "found" the executive without benefit of any broker, will (understandably) refuse to pay for the services of any broker other than the one the landlord already employs. In fact, in such a situation the landlord will further protect itself in the lease or the contract of sale, as applicable, by providing in the applicable document that the tenant or purchaser will be responsible for any claims made by any broker other than the landlord's own. In addition, the executive has also disclosed or registered the identity of the company, and perhaps even the parent company, as a "party interested" in the property, thereby making that interest very public. The timing of such a disclosure of identity and/or interest should always be controlled by the tenant or purchaser. This is valuable strategic information that should be used and distributed only when appropriate to obtain maximum leverage and impact. In addition to making an inadvertent commitment to that property and the broker or owner by such disclosure of information, it may well have an adverse affect on the company's bargaining position.

If the executive's conversation was with a representative of the current occupant of the premises, a somewhat less likely occurrence, other different, but no less significant, legal and financial consequences will follow, with predictably problematic effects. This could include, among other things, the possibility of a claim by a third broker, that third broker being the broker employed by the current occupant offering the property for sale or lease.

While there can be a great many different initial contact scenarios and a great variety of consequences, what is important to remember here is that as a direct result

of one simple conversation, intended purely to gather information without further commitment, the German executive almost certainly has incurred significant liabilities and responsibilities for and on behalf of the company for brokerage commissions and/ or consulting fees, placed the company in a disadvantageous position by being represented by a broker with divided loyalties, and caused the significant erosion of the strong bargaining position that may have been enjoyed by the company. In addition, the German executive's company, and possibly the related and affiliated German companies may also be affected with unintended consequences since now it may be considered to be "doing business" in New York, and, as a consequence, subject to the jurisdiction of the Courts of the State of New York for tax purposes as well as for purposes of other liabilities. Once the company enters into a lease or a contract to purchase property in New York, it will doubtless subject itself to the jurisdiction of that state; however, the timing of the decision to "do business" in New York, and consequently be subject to the courts of that state, should be controlled by the company and should be undertaken deliberately when the company is fully prepared for the consequences, not as here, with the company finding itself in a serious situation for which it is not yet prepared or yet structured itself.

Our example of the fictitious German executive was designed to illustrate — in the simplest terms — what could happen as a result of a single initial "exploratory" conversation or visit to a property. In reality, it is possible, even likely, for an executive whose mission is to understand and seek out properties in a United States real estate market, to have many such initial exploratory conversations with a variety of different parties about multiple candidate properties and possibly in several additional cities before finally returning home to report. The total financial and legal impact of all these multiple conversations could be so significant as to foreclose, or at least temporarily postpone, the company's expansion plans because these actions may have inadvertently made the space acquisition too risky or too expensive to accomplish.

However, that situation is not at all inevitable, and, with the kind of thoughtful pre-planning that is described in this booklet, including making use of the checklists provided, it can be avoided, and the real estate and related corporate transactions be carefully structured to successfully acquire the property and minimize legal and financial liabilities to the tenant or purchaser.

The purpose of this booklet is to provide a guide to German companies or individuals that have decided to do business in the United States and are seeking to purchase or lease office, warehouse, manufacturing or retail store space for their business. It covers the entire process of acquiring space, including how to find the





property by finding and employing a broker, and how to determine the appropriate nature and scope of the broker's employment as well as how to secure additional services from the broker and the pricing of such services. This booklet also describes the principles involved in contracting for the property, whether purchasing or leasing, and the kinds of protections that should be built into the documents to protect the purchaser or tenant from assuming liabilities inappropriate to the levels of risk and ownership inherent in the transaction. In addition, it will address what is involved in fixing up the property so it will be suitable for the specific purpose of the occupant All of these aspects of the transaction will be considered in the context of allowing the purchaser or tenant to do what it needs to do to be successful in running its business and still avoid costly hidden traps and missteps resulting from not following customary business practice in the United States or from peculiarities of United States law.

Although we have prepared this booklet principally as a guide to real estate matters, it will also address, on a more limited basis, related corporate issues raised in structuring the U.S. business in order that it may hold or acquire the property or the lease and, at the same time, minimize its liabilities, and the risk of exposure to liabilities of the home company in Germany. It will also review relevant Federal and state real estate and cross-border tax concerns of German companies holding real estate interests, guaranteeing obligations or otherwise "doing business" in the United States. And, it will discuss some of the more striking cultural differences between Germany and the United States and common attitudes, assumptions and approaches that the German business person will most likely encounter when doing business in the United States.

We note that it is essential that the process of acquiring space for the new United States–based business is not undertaken until the form and structure of the new business has first been determined and established, so that the appropriate legal safeguards are in place by the time the representative of the German company is ready to take action in the United States, or, at a minimum, by the time the German company is ready to commence business operations in the United States. As shown in our example, without such careful planning, once that representative comes into the United States the representative may unintentionally trigger liabilities that can stretch across the Atlantic to cause the home company in Germany to be exposed to those liabilities as well.

CHAPTER 2

# WHAT TO EXPECT WHEN YOU DO BUSINESS IN THE UNITED STATES:

## DIFFERENCES IN EXPECTATIONS AND HOW THESE AFFECT DEAL FORMULATION

The many shared values between the United States and Germany are an important part of why many German companies are so comfortable and successful in the United States. However, there are significant differences in expectations and approaches as well. It is extremely important before beginning the process of a real estate transaction in the United States to understand the custom and practice that surrounds the way business is transacted — including the nature of the formal and informal relationships that come into existence among the various participants in the transaction — in order to avoid inadvertently misunderstanding the dynamic of the interaction, and, as a result, losing the deal, or, even worse, making the deal and winding up being hurt badly as a result of incurring unintended or unanticipated liabilities.

### The Importance of Caveat Emptor

In the United States, the principle underlying most business transactions is "caveat emptor" — or "let the buyer beware". This phrase is a warning to the buyer or tenant that in the transaction to follow it will get just what is offered by the seller or landlord, and nothing more. In fact, what the buyer or tenant will actually get is only what is put into the written document signed by both parties that memorializes the transaction, that is, the contract of sale or the lease. Moreover, since the seller or landlord is under no legal duty to disclose all of the relevant information about the property, what it appears that the buyer is offered may be very different from what is,

in fact, actually offered, and, thus, what it will ultimately get. Accordingly, if the buyer or tenant wants or needs something more or something different from what the owner or landlord is offering, it must ask and negotiate for what it wants or needs and then confirm that the needs are properly reflected in the transaction documentation. The common practice in the United States is that every seller or landlord negotiates for nearly every aspect in a real estate transaction and expects that the prospective tenant or purchaser will negotiate as well. In a real estate transaction in the United States, the parties understand that the first offer is simply a starting point, and nothing more; it is not intended to be the "best" offer, nor even a "fair" offer.

For example, consider the condition of the property, a fundamental component and a very material part of a real estate transaction. In the United States, "as is/where is" is the standard condition in which property is offered for sale or for rent. This means the property is offered in the condition in which the purchaser or tenant sees it —- or more accurately, the condition in which it presently exists, which may in fact be quite different that what is revealed by simple observation. There is no obligation incumbent upon the landlord to voluntarily disclose to the prospective seller or tenant the condition of the property, whether that condition is appropriate for the purchaser's or tenant's purpose or whether it can legally be made so. In fact, the condition of the property is nearly always highly negotiated, with the extent of the negotiations being a function of the bargaining power of the parties. The tenant or purchaser can develop a more favorable bargaining position by having a thorough understanding of the property through its investigatory due diligence and professional physical inspection of the property. The parties negotiate for the "physical" as well as the "legal" condition of the property. Thus, the tenant or purchaser will seek assurances for the physical condition of the property (what is seen as well as unseen) to be appropriate to allow the business to be conducted. Accordingly, the tenant or purchaser (and its architect, engineer, and counsel) will be concerned with things like the sufficiency of the electrical capacity of the building and the premises, the strength of floors, and the functionality of mechanical and other building systems serving the premises.

In addition, the tenant or purchaser will seek assurances that the owner has complied with relevant laws that affect the property, and will seek information as to the state of title of the property. In this situation, the tenant or purchaser would need to be concerned with, among other things, whether the owner has complied with laws concerning safety, including fire safety and the presence of certain hazardous materials at the premises, and laws concerning the upkeep of the appearance of the premises and/or the building if the building is "landmark" property and required to





meet specific requirements under the appropriate preservation law. In addition, it is up to the tenant or purchaser (and its counsel) to do the research and be satisfied that there are no zoning or comparable laws or regulations that will prohibit the tenant or purchaser from conducting its business in the particular building or the premises. Finally, the purchaser or often the tenant (depending on the nature of the lease) must research and understand the status of the owner's title to the property, and as appropriate, secure title insurance as to the quality of the title granted. This process of negotiating with respect to the legal condition of the property may be surprising to German busines spersons, inasmuch as the practice in Germany is very different: In Germany most items affecting the legal status of the property have been established and disclosed to the prospective purchaser or tenant by requirement or operation of law before the property is ever actively marketed.

The goal of tenant's or purchaser's negotiations with respect to the condition of the property, is, through their attorneys, to insist on certain written "covenants", "warranties" and "representations", which are formal statements of the existence or absence of a state of facts, or promises with respect to particular aspects of the condition of the transaction or the real property that is the subject of the transaction, or other similar protections for their clients. Thus, if a purchaser or tenant wants to be sure that it will acquire a space that is in the condition which is appropriate and required for the conduct of its business, those conditions must be specified, must be agreed to and "represented" or "covenanted" or "warranted" to by the seller or landlord, and, in all cases, must be made part of the written agreement or lease. Such expected conditions must also then be confirmed and proven by investigations, testing and proper "due diligence" studies and efforts. This principle applies as well with respect to the type of business that the tenant or purchaser expects to conduct at the property. It is possible for there to be limitations on the uses to which a property may be put or even prohibitions against specific uses. These limitations on use may found in the deed by which the property is transferred or in applicable zoning laws, or both. There may even be a restriction in the deed (or other conveyance) on a particular piece of property being used for a particular stated purpose even though it is permitted by law. The tenant's or purchaser's real estate attorney, architect or zoning specialist should be the resource to which the tenant or purchaser turns to find all of this out — it should in no event rely on the assertions of the seller or the landlord. Moreover, and as discussed further below, the seller's or landlord's assurances or representations, whether they concern the physical or legal aspects of the property, will not be of any real value to the tenant or purchaser unless that have been put in a form that is enforceable, and, in the appropriate circumstances, secured by collateral.

The principle of caveat emptor is also applicable in transactions that involve brokers and the commissions they can earn for finding a property as well as the services they offer with respect to the property and the process of establishing the prices of those services. A licensed commercial real estate broker, being bound by a code of ethics unique to that profession and subject to the oversight of governmental authorities, is required to disclose to a prospective tenant or purchaser of property whether it represents the landlord or any other client whose interests are adverse to or competitive with the prospective tenant. Although dual loyalty of a broker may be permitted under the applicable ethical guidelines, the reality is that the level of loyalty that will be shown to a prospective tenant or purchaser will pale against that provided to the property owner. Consistent with caveat emptor, the prospective tenant or purchaser will not know the level of loyalty it will be getting from its broker unless it asks before retaining the broker as to the existence and scope of any relationship with the landlord and others.

Before the broker is retained is also the time to find out if the broker is representing clients who are competitors of tenant or purchaser, or if there is any other situation existing that would dilute the broker's exclusive loyalty to tenant. The dangers of retaining a broker who also represents a competitor are far from theoretical. The broker, as part of understanding the space needs of the company, can't help but be aware of its long-term strategic expansion plans, financial and operating budgets, and sometimes even more. Understand that while brokers are required to act within certain ethical parameters, brokers are not bound by the same confidentiality constraints as lawyers; there is no "brokerclient" privilege. A client's proprietary or other information will not be protected as "confidential" unless the written brokerage agreement specifically provides that is the case. Consider a situation where the unique needs of a product line require an equally unique "special use" property, of which, by definition, there can be only one. Certainly, the knowledge of the availability of such a property is very valuable and it is information that should not be shared with a competitor. Thus, the goal for the tenant or purchaser must be to get the broker's exclusive loyalty in addition to the broker's expertise. Put another way, if the tenant or purchaser wants the exclusive loyalty of the broker, it must be bargained for, and the written brokerage agreement must so state. This notion of bargaining for exclusive loyalty of the commercial real estate broker is another peculiarity of the real estate transaction in the United States. The amount of the commission that the broker earns for "finding" a property for the tenant or the purchaser and when and how it is to be paid is also subject to negotiation and is often highly negotiated.





Negotiating is similarly necessary and appropriate when the tenant or purchaser attempts to ascertain, select and price the level of services it wants from its broker. In the United States, there are no "standard" prices for brokers' services; they are established by the give and take of negotiation. Although formulas for calculating the prices for brokerage services do exist (for example, the "Lehman formula") the resulting calculations can vary widely depending on various factors. While the fundamental nature of the services offered by many brokerage firms may appear similar, each firm has its own unique way of packaging, and thus pricing, its services. And while the broker may advise as to the availability of services generally, the process of negotiation is truly the only sure way for the tenant or purchaser to get exactly the services needed and to pay what is, in fact, appropriate. The process of negotiation is also an effective way to establish a long-term brokerage relationship which would include services (and prices for them) which address long- term needs, such as those pertaining to relocations and exit strategies, all of which should be incorporated into the written brokerage agreement. Having a successful long-term relationship with a broker can be valuable on a number of levels; an experienced broker that has been with the company as it has grown can also provide valuable input in the process of developing a company's long term geographic expansion strategy.

It is not unusual for tenants and purchasers to unknowingly forfeit their ability to negotiate, and thereby give up all the advantages that will come with it, including the chance of making a good deal and obtaining the best information and levels of services. This can happen all too easily. Initiating the process — even informally – of looking at properties, meeting people and/or discussing the prevailing or customary pricing or terms offered by the owner may in all likelihood trigger the commencement of a legal business relationship regardless of the intentions of the purchaser or tenant. Thus it becomes essential that all discussion of employment, commission, services and pricing be designated as such and that all of these subjects are covered in appropriate depth and detail before the business relationship is formalized, otherwise there is the very real possibility of unintentionally employing a broker on the terms that may have been stated during such discussion, and those terms may turn out to be for the lowest level of loyalty and the highest commission rate with the highest price for the lowest level of services.

As a general rule, it is wise to recognize that the notion of caveat emptor remains fundamental to law and business in the United States, although with respect to certain specific and highly regulated areas, it has become somewhat less so. Today, in nearly every aspect and phase of a real estate transaction the United States — the physical condition of the property, the quality of ownership, priority of rights, levels of

brokerage services, to name just a few — caveat emptor still applies in some way, depending on the jurisdiction of the transaction.

### The Necessity for Complete Written Agreements

In the United States, in general, and in real estate matters in particular, a legal document, whether it is a contract or a lease, is drafted to explicitly set forth and articulate all of the rights and responsibilities of the parties with respect to the particular real estate transaction and property interest at hand. The document is expected to address and to cover all foreseeable eventualities. It will be the first place to which the parties turn to clarify a perceived ambiguity or to resolve a difference of opinion with respect to the transaction. A good rule to remember is this: If the issue is important enough to discuss, it is important enough to be included in the document.

This approach is very different from the prevailing approach in Germany, where comparable legal documents in a real estate transaction are generally perceived as and drafted to be an overview, executive summary or a broad outline of that transaction. For example, in Germany it is not unheard of for a commercial lease to be not much more than a page or two; in the United States it is not unusual for a commercial lease to be 80-to-100 pages — without counting various schedules and appendices and ancillary large reference documents, all of which relate to and affect the rights and responsibilities set forth and embodied by the commercial lease itself.

This German approach, so effective in Germany, will not be effective in the United States. There are significant consequences in the United States of having a document that does not carefully and thoroughly address all issues or concerns of the parties, or one that contains any significant ambiguity. Relying on such a document can result in the disputed items being resolved through litigation, which is an unpleasant, expensive and timeconsuming process. Litigation may result, in the worst case, in the dispute being "resolved" in court by a judge who may fill any gap or ambiguity in the documents with reference to common or case law, which, often, due to the influence of caveat emptor, is unfavorable to a purchaser or tenant.

In addition, in the United States since nearly all documents in a real estate transaction are very heavily negotiated, there is yet another departure from common German practice. In the United States, the custom and practice is that the first draft of a document will in nearly all cases, be drafted by the landlord's or seller's lawyer, and be drafted irrespective of the term sheets or proposals to strongly favor the drafter. (In fact there is much case law in the United States concerning the rules of construction





or interpretation of written contracts or other documents, that stands for the proposition that because of this usual practice, judges will consider any differences of opinion as to the meaning of the final document in a light least favorable to the drafter, who is presumed to have had more control over its wording.) What this means for the prospective tenant or purchaser (and its counsel) is that the first draft of a contract of sale or lease will have a significant bias towards the drafter and will not necessarily represent the deal as the parties have negotiated it – in fact, it may be very far from what was discussed between the parties. This tactic can also be used as a very effective negotiating strategy.

Other drafting techniques can also be part of the negotiating strategy, and some can have a very bad affect on and even eliminate rights that have been bargained for. For example, under accepted principles of contract drafting, the later occurring or written and more specific reference will be deemed to modify or overrule the earlier and vaguer one. These drafting techniques are common in the negotiations and drafting of the deal. Thus, a right referred to early on can be wiped out by specific reference that appears later in the document. Experienced commercial real estate practitioners are familiar with this technique and will be able to spot it and effectively neutralize it.

Depending on the approach and attitude of the individuals involved, it is not unusual for there to be many rounds of drafts until the deal as originally understood and agreed on by the parties is accurately reflected in the documents. While the landlord's attorney customarily does the drafting — historically the most time consuming and therefore expensive part of the transaction — a tenant, or its counsel, who does not understand or have experience with this common practice in commercial real estate and thus, has not developed a strategy and tactics to counter it, can easily waste a lot of time and money reviewing and attempting to negotiate multiple drafts without either significant progress or any favorable result for its client. Today widespread use of computers and word processing in the legal profession has eliminated much labor intensive activity associated with the landlord or owner's cost of negotiation, such as typing and retyping a document, with the result that the landlord's or owner's cost of negotiating have gone down significantly.

### Litigation as the Principal Dispute Resolution Mechanism

Business persons from Germany as well as those from other countries often remark on what has been described as the "litigious" nature of society in the United States. The frequent resort to the courts to resolve disputes in the United States

represents a different approach than the more amiable and informal manner in which business conflicts in Germany are usually resolved. Accordingly, it is crucial when doing business in the United States to keep and maintain scrupulous records and careful documentation of any and all agreements, representations and the like, since an agreement based on "a handshake" is not generally sufficient to be enforceable in the courts. (The biggest and most meaningful and most potentially dangerous exception to this principle is the ability to orally employ a broker, which we have discussed earlier.) Generally, in order to be able to enforce the rights contained in them that have been bargained for, agreements must be in writing and signed by the parties, and they must conform to certain specific legal formalities. If those agreements contain "representations", these representations must be in writing as well, and, as a practical matter, they are often secured or collateralized.

The significant differences in approach that distinguish a real estate transaction in the United States from one in Germany should not in any way imply that most individuals in the United States are less than reliable or trustworthy. In our experience we have found people in the United States, for the most part, to be straightforward. But invariably, disputes will arise, and when they do, whether the dispute arises as a result of intentional or unintentional circumstances, in the United States the mechanism that is relied on as being the best and most effective way of enforcing broken promises or resolving disputes is the court system. And the courts will look for clear and complete written and signed documents and factual authenticity in their adjudication of disputes.

### Conclusion

As a result of the unique and particular ways in which the legal and business conditions in the United States interrelate in commercial real estate transaction, successfully initiating and concluding a commercial real estate transaction is very different in the United States from the way it is in Germany. Understanding those differences and avoiding the problems that they potentially present is indeed a challenge. However, armed with the appropriate knowledge and experienced advisors who will insist on legal and commercial protections, the German company can avoid the obvious as well as the not-so-obvious pitfalls, and complete a commercial real estate transaction that will successfully establish its presence in the United States.





CHAPTER 3

# FINDING YOUR BROKER AND FINDING YOUR PROPERTY

To find the property or rental space that is right for your business, you will, in nearly all cases, require the services of a commercial real estate broker. Brokers can provide their clients with access to their inventory of available properties or space, as well as to provide them with valuable information as to the financial and non-financial terms with respect to the prevailing commercial real estate transactions in a particular market. It should be noted that Brokers can greatly assist in the inspection and engineering review of candidate properties and provide feasibility analysis and comparisons not only on efficiencies and conditions, but on the financial impacts long term so as to compare the candidates more uniformly. Brokers also can model or analyze the financial implications of the real estate transaction, from the initial costs to the projected long-term costs of holding the space. This information and analysis is crucial to understanding the transaction and how it relates to the tenant's or purchaser's business plan.

Brokers are regulated by governments, and must be duly licensed by the jurisdiction (the state, and/or municipality) in which they are operating. Licensing is the government's way of ensuring that the broker has met certain prescribed standards of education, experience and knowledge, and is committed to function on a specified ethical level. In addition, the broker is subject to the oversight of the state licensing authority, so that in the event there is a dispute between the client and the broker, there is a clear process available to resolve any such dispute and to enforce the mandated resolution.

## Assembling the Team

Finding a suitable commercial real estate broker that maintains strong expertise and professional team members in engineering and construction is a very important part of assembling the team that will participate in the selection and preparation of the new space. In fact, assembling the team is a really part of the planning phase of the space search process, which also includes getting prepared and educated before going out to the real estate market. The team also needs to target the location of operations as well as the use needs for the space. The team should be headed by a representative of the business entity that is looking for the space who knows and understands the criteria for the space decision. The space criteria should be determined by the business that is looking for the space in advance of assembling the team. The Facilities Manager, responsible for the space needs of the business, including space planning, use layout and technological and other service capacities, must provide the general, operational and crucial input.

In addition to a broker who is experienced in the market area where the business is to locate and site selection and architectural and engineering review, the team should include, at a minimum, a real estate lawyer who is familiar with commercial leasing (or acquisitions, as the case may be) and with the local real estate market and the laws of the area; an architect who is familiar with local laws and building codes, the facilities manager, if any, or a project manager, an engineer, and if there is a technical aspect to the project, and whatever other additional consultants may be necessary, based on the space criteria previously determined for the project.

## What the Broker Does: Finding, Negotiating and More

The most important function of the broker is to put the tenant or purchaser together with a property that is suitable for the particular needs of the project or business seeking to acquire the space. The broker can screen out the properties to exclude those which do not meet the tenant's or purchaser's criteria. The broker is "key" because in the world of commercial real estate, Landlords or Sellers of property do not always list all of their properties in a way that may be accessed directly by the tenant or purchaser. The broker can provide an entrée to properties that the tenant or purchaser would not have otherwise had the opportunity to see, or even know of. The experienced professional broker also brings knowledge of market conditions, including the reputations and history of landlords and sellers and their properties. Even if a tenant or purchaser is lucky enough to find what appears to be an "appropriate" property without a broker, an experienced professional broker can and will help the tenant or purchaser and its lawyer in negotiating the transaction, since





these brokers are familiar with issues that are typically concerns of a commercial tenant or purchaser.

Most commercial landlords or sellers — certainly the larger ones — will have brokers (and lawyers) of their own, and it is very often the case in the United States that the principals do not negotiate face-to-face at the inception of the deal. In fact, it is often the brokers, each with their respective "wish lists" supplied by their respective clients, who begin the negotiations by preparing a written "term sheet" or "letter of intent". This is a selfproclaimed non-binding document that serves to establish the broadest outlines of the transaction. Sometimes each side will prepare a term sheet; often they will not match up. But, whatever the form, the term sheet stage is where the negotiation process begins in earnest.

Less frequently used, but often adopted by larger commercial users of space with commensurately larger bargaining power, is the Request For Proposal, or "RFP" process. This can be a very effective method by which a strong tenant or purchaser initiates serious negotiation. In its simplest form, the tenant, through its broker and in consultation with its architect, engineer, lawyer and other members of its team, provides to various landlords its requirements with respect to the space it needs, e.g., the type of space, duration of the proposed lease, a range of acceptable rentals etc. Landlords respond to such a request with what they call their "best offer", which the tenant may select as a starting point for negotiations. Brokers, with their experience and knowledge, are important participants in this process as well.

In the United States it is customary for the landlord or seller to pay the fees or commission of the purchaser's or the tenant's broker. These fees can be considerable, and are generally calculated by applying an agreed-upon percentage against the amount of each year's rent (or, in the case of a purchase, the purchase price). Not surprisingly, brokerage fees, too, are subject to negotiation, and where they are substantial, they can be highly negotiated. Negotiated reductions in brokerage fees may be applied against and reduce the costs of other brokerage services.

An effective broker can and will do more than finding and negotiating for a space or property for a tenant or purchaser. Many larger brokerage firms are "full-service firms" that also provide, for additional fees (that are, once again, negotiable) certain additional specialized services in addition to finding and negotiating space or property. For example, brokerage firms may offer services to monitor and manage the construction of the new space, assist in planning the move to the new space, and assist in monitoring and/or auditing certain ongoing financial and or contractual aspects of

the transaction such as lease charges or other obligations. These services can be very valuable, especially if the leasing or purchasing entity (or its parent) does not have a facilities management department, or has one that is not experienced in the management of space in the United States. Retaining a fullservice brokerage firm can be an effective way of helping an existing facilities management department in understanding and learning the techniques of how properties in the United States are managed.

## Finding Your Broker

The commercial real estate lawyer can be very helpful with the selection and employment of the broker. As seen through the example at the beginning of this booklet, the law concerning the employment of a broker is not at all intuitive, and, as a result, it is all too easy — even for experienced business persons — to find themselves in situations that they did not at all intend. Since real estate brokers can be employed orally, such oral employment of a broker can and will generate problems in addition to the obvious issues relating to the uncertainty of what the terms of employment are. For example, merely by having multiple conversations it is possible to inadvertently employ multiple brokers, and, as a result, create liability for commissions to each and every broker so employed. Obviously, this can have disastrous consequences since no landlord wants to incur responsibility for multiple brokerage commissions, which can make a transaction too expensive to ever come into existence. As discussed earlier, landlords will protect themselves from the possibly of liability for multiple brokerage commissions with respect to the same transaction in the contract of sale or the lease by requiring that the purchaser or tenant indemnify it if any such claims are asserted and "hold it harmless" from the related costs and expenses.

The search for the "right" real estate broker is one that can be effectively orchestrated and managed by the experienced commercial real estate lawyer either through recommendations based on personal experience, or through the RFP process, the same process that was discussed earlier as being a sound methodology for finding property to purchase or to lease. In managing the RFP process, the experienced commercial real estate lawyer will help to develop and communicate the search criteria to certain select brokers, which are of an appropriate size and scope to be considered for employment by the prospective tenant or purchaser. Those search criteria will take into account what services the tenant or purchaser will need (such as project management or engineering) in addition to having the broker find and negotiate the purchase or lease of the property. The purchaser or tenant, through its lawyer, will request various candidate brokers to offer their specified services at





specified fees, all of which will be subject to negotiation in the brokerage agreement that the lawyer subsequently drafts. In this manner it will be absolutely clear under what set of specific services a broker is being retained, including the amount and timing of the commission, and which services will be provided and for what price. Since fees are negotiable, depending on what is needed and in what volume, it may be possible to negotiate substantial discounts. In addition to discounts on pricing, the written brokerage agreement will be negotiated by the real estate lawyer to provide appropriate legal protections for the tenant or purchaser, such as indemnifications in cases of claims by other brokers, which is an all too frequent occurrence. A written agreement is also a way of ensuring that the broker is obligated to and will work together with the attorney, architect, engineer and other members of the tenant's or purchaser's team. This will help to secure the broker's participation during the "due diligence" investigation period, which is the time provided to the purchaser to investigate any issues concerning the property, as well as with respect to any physical investigation of the space itself.

Using a the experienced commercial real estate lawyer to locate a suitable broker and contract for appropriate services may be done by the lawyer acting on behalf of its client, but without disclosing the client's identity at such time, a technique which may be very effective especially with respect to larger entities which want more control over when they publicly disclose the existence of their plans for expansion or other sensitive information.

No matter which technique is employed, searching for an experienced commercial real estate broker and contracting for its services is a process that should be undertaken and completed well in advance of looking at properties. In this way, the purchaser or tenant can be assured that its property needs will be addressed confidentially and to its exact specifications, and no unforeseen liabilities will occur.

## Finding Your Property: Space Criteria and Costs

The initial criteria for space may have been carefully developed by the business entity and its parent; however, there may be refinements and other considerations that need to be taken into account in moving these criteria to the final form in which they will be used by the broker in the search for the space. These criteria will include the location, the permitted use(s) for the property and the type of space required. For example, for a retail tenant, it will need to consider whether to consider, among other venues, space in a large regional mall, strip mall or downtown shopping center. If the decision is to be downtown, the next choice is ground floor or second floor. If the decision is to be in a mall, other questions for consideration are whether the tenant

wants to occupy an "anchor" position, be near or away from competitors or to be a non-anchor tenant or even to be a "standalone big box".

In addition to refining location criteria, which will result in differing financial impacts, there are other considerations affecting the space criteria where the financial impact can be dramatic, not all of which are always immediately apparent. These considerations relate to the condition of the property; the effect of applicable zoning and use regulations as well as the effect of alterations either mandated or limited by applicable law. Certainly, the condition of the property is crucial and will also have considerable financial ramifications. For example, upon a visual inspection the observer can see whether a space appears nearly ready for tenant's occupancy and the conduct of its business, or whether it will need more than just a paint job to put it in shape. However, while a property may appear to look good, without a thorough engineering and architectural inspection, there is no way to tell whether there may be latent (or other hidden) defects in or affecting the space, such as "floor load" or other structural issues, or whether there is asbestos or other hazardous material that is required to be remediated (a highly costly process) or whether electrical wiring must be replaced, or whether or to what extent other work must be done to bring the space into compliance with applicable safety, fire, insurance or other applicable law. (This latter assumes that the tenant or purchaser will be responsible for conditions in the space which pre-existed its presence, an obligation the commercial real estate lawyer will negotiate hard to remove. Nonetheless, it is possible, depending on the way the lease is negotiated, to require that the landlord deliver the property to the tenant or the purchaser in a "delivery condition" that is in compliance with applicable law, as well as providing that applicable building systems servicing or at the premises are in good condition and working order. The tenant's or purchaser's subsequent alterations, however, may uncover hidden problems which can trigger a different level of compliance under the lease or applicable law, with a considerable increased expense, or even prevent the intended use of the space. This is the reason why a thorough inspection by the architect and engineer (and maybe even an environmental hygienist) is essential before making a decision to take the space. Understanding the condition of the property will help a tenant or a purchaser to make informed choices and enable the lawyer to negotiate the lease and ancillary documents so that they will not create unexpected financial or other surprises once construction of the space begins. The complex and multiple issues surrounding the condition of the property become particularly important inasmuch as most properties, whether for lease or sale, are offered in a condition described "as is/where is". Accordingly, it is crucial to understand exactly what that means, both literally and financially, in all circumstances.





Zoning and use regulations can prohibit the tenant's or purchaser's intended use of the space. Even if that use is permitted at the time the lease or contract of sale is signed or possession of the property is taken, it is still possible for a subsequent law to be enacted after tenant takes the space that would in fact stop the tenant from using the space for the purpose which it intended. Generally, such a scenario would not affect the tenant's rent obligation under its lease nor its obligation to go forward with the transaction — whether it is a purchase or a sale — unless its lawyer has insisted on the appropriate legal protections in the transaction documents which will operate to prevent the tenant or purchaser from getting "stuck" with a property from which it is unable to conduct its business. Another effective way for the tenant to protect itself from this problematic and financially devastating situation is to have the Landlord do the construction or built-out of the premises as a "turn-key" or "build-to-suit" space, as will be discussed later in this booklet. Both of these terms have the effect of putting the responsibility for compliance with applicable zoning and other laws squarely on the Landlord.

Laws such as the Americans With Disabilities Act, which, for the benefit for individuals with disabilities, prescribe (among other things) exact dimensional requirements with respect to ingress and egress of a space as well as other related requirements within the space, or landmarks' preservation laws, which require that changes to designated "landmark" buildings or buildings within designated "landmark" neighborhoods may not be significantly altered without prior approval of a designated governmental agency, and may make every detail of such an alteration subject to the prior approval of that governmental authority. These and other such laws can have significant financial ramifications and need to be understood before making any decision on a property.

CHAPTER 4

# CONSTRUCTION AND ALTERATIONS:
## HOW TO PLAN FOR AND MAKE CHANGES TO YOUR PROPERTY

Generally, in commercial leasing, it is most unusual for a tenant to simultaneously sign its lease and get possession of the property. This is because often at the time the lease is signed, the space may be occupied by another tenant whose lease is yet to expire, or because work must be done in the space to prepare it for tenant's occupancy. It is highly unusual, if not downright impossible, for a tenant or a purchaser to find a space that, without some further changes or alterations, perfectly meets the physical requirements that the tenant or purchaser has for its business. The new space may just need some "cosmetic" sprucing up, like a new paint job, or it may need extensive repairs or even to be totally demolished and reconfigured and specifically fixtured, so that the space can meet the requirements dictated by the specific business to be conducted in that space.

Landlords understand this, and accordingly, part of what is negotiated in a lease is what construction or other alteration work will be done in the space, and by whom. This division of responsibilities and the related economic information about initial alterations is found in specific lease sections and, in addition often found in a detailed addendum to the lease known as the "work letter". All of this is highly negotiated.

In general, once a tenant and its team have done the due diligence investigation and understand the economic implications of the nature and condition of the space, and, having this information, decide to take that space, the negotiation process begins again. It is at this time that the lawyers take their most active outfront role in the lease negotiation and drafting process especially with respect to the work letter.

### The Work Letter: A Roadmap for Construction

The Work Letter will specify in great detail the nature of the construction that will go on in the space. Among other things, it will provide a detailed description of what will be in the space (referred to as the "core and shell" or the "base building") when it is delivered by the landlord. This would include, among many other things, the extent of electricity, heating, ventilation and airconditioning ("HVAC"), waste pipes, alarm, fire/safety, sprinkler and other building system services that are to be delivered to the space. It will also specify who is paying for the construction being done in the space and exactly how such payment is being made. Payment is often made by way of a "tenant allowance", or an amount that is provided by landlord and gradually paid out by the landlord as the construction progresses and the requirements contained in the lease are met. This, as well as every aspect of the work letter is highly negotiated. This is because every aspect of the work letter translates directly into an economic effect; conceptually, there is, by definition, a direct and consequential financial impact built into each item. The landlord will generally offer the space "as is/where is", while the tenant will try to negotiate that the space be delivered in the condition which minimizes both the construction work required to be done by the tenant, and the tenant's potential liabilities. Any negotiations concerning the work letter must include consultation with and input from the tenant's accountant and tax advisor inasmuch as there are significant tax implications depending on how the tenant's allowance is structured.

Depending on what has been negotiated, the construction will usually proceed in accordance with one of two negotiated scenarios: Either the landlord or the tenant may do the construction. If the tenant does the construction, the space will be delivered to the tenant in the agreed-upon condition often called "delivery condition" and the tenant, utilizing its tenant allowance, will construct the space in accordance with tenant's plans and specifications that have been previously approved by the landlord. If the landlord does the construction, it will deliver the space, fully built out in accordance with plans and specifications agreed to by the tenant, and ready for the tenant to move into and begin to operate its business. This latter scenario is often referred to as a "turn-key".

The date the rent obligation under the lease (the "rent commencement date") begins is established based on who is responsible for the construction in the space. Most simply put, when the landlord constructs the space, the rent commencement date will begin once the Landlord has notified the tenant that it has completed the construction. If the tenant is doing the construction, it is given a period of time during which the construction must be completed. The dates are subject to "landlord delays"





and "tenant delays" both of which are carefully defined and highly negotiated. Also highly negotiated are abatements of or special lower rates of rent or electricity to be effective only during the construction period.

Generally, in the case of larger properties, it is most usual for the tenant to do the construction and for the landlord to provide the tenant's allowance. In the case of smaller tenants and smaller properties often the landlord itself will do all of the construction of the space. Which scenario is negotiated is a function of economics and related experience; smaller tenants often find it easier and more economical to have the landlord deal with the construction and absorb the financial results of delays from unforeseen events during the construction period. Larger tenants may be more experienced with and thus better equipped to deal with the construction process and the risks involved, as well as with their own special and often unique construction needs with which landlord has little or no familiarity. Great attention should be paid to the details of the construction process, since construction is a place where there can be numerous hidden costs and liabilities. The services of an architect, engineer and project manager are invaluable here.

For example, while the cost of constructing and building out a space to accommodate and office or retail store can be considerable, it will be increased many times over if the tenant does not understand, before the construction commences, whether it has sufficient air conditioning or electric power in the space to accommodate the occupants and equipment, or whether it will be faced with the necessity of later installing, at its own expense, supplemental air conditioning units. If tenant finds out too late, (that is, during the construction period after the lease is signed), that it will have to install supplemental air conditioning, it may not have negotiated required permission from the landlord for such an installation. In addition, the tenant may not have bargained for sufficient electrical capacity to operate such supplemental units, and it may not have budgeted for the costs involved, both immediate and annually or more frequently occurring. Furthermore, the tenant would be unprepared for the delays in construction resulting from this new-found knowledge, which would not suspend its obligation to begin paying rent on the space in accordance with the terms of the lease. Careful inspection by tenant's architect and engineer – before the lease is signed – will insure that the tenant understands that its construction or subsequent alterations may unearth violation conditions, or even worse, conditions that may turn into violations as a result of the new construction being initiated. While no tenant can reasonably expect to be fully protected from unforeseen events, the consequences of these unforeseen events can be understood, and protections for the tenant or purchaser can be negotiated by the lawyer and built

into the lease or purchase documents so that unpleasant and costly surprises will be minimized, if not eliminated altogether.

### The Construction Team and What it Does

If the tenant is going to be responsible for building out the space, the tenant will need a construction team. The tenant's construction team must include, at the very least, its architect and designer, broker, commercial real estate lawyer, and project manager and or facilities manager. The facilities manager is usually found in-house in the tenant entity or some corporate affiliate; the project manager is generally an "outside" person; however, their function is the same. The facilities manager or project manager is the point of coordination of the project. The importance of the project manager of facilities manager cannot be understated. The facilities manager or project manager has been trained to understand space needs and adapt space so it will most efficiently function for the user and the occupants. The facilities manager will also integrate applicable technology into the space. Accordingly, the skills, knowledge and experience that the facilities manager or project manager brings to the project enables that person to appropriately review, evaluate and suggest appropriate modification of the plans and specifications that have been developed by the architect and designer. This review and evaluation will ensure that the plans and specifications accommodate all of the needs of the tenant's business operation, including compliance with appropriate laws relative to zoning, safety and landmark preservation, as applicable. If the tenant has no in-house facilities manager, or does not have one with sufficient experience in real estate in the United States, many brokerage firms offer project management services for a fee. As discussed earlier in this booklet, these scope and cost of these services may be negotiated for as part of the process of retaining the broker.

Once this review and evaluation of the tenant's plans and specifications is completed and the tenant's construction team is satisfied with the plans and specifications, they must be submitted to the landlord, where the plans and specifications will then be reviewed by the landlord's construction team. This review by the landlord may also generate changes which may need to be resolved through negotiation. Note that all of this review (and any resulting negotiation) should take place before the lease is signed. After the lease has been signed by the parties and the tenant is legally committed to the space, the tenant automatically loses most of its bargaining power.





Once the plans and specifications are approved by the landlord, the tenant will send them out for bid by contractors which the tenant will consider to perform the construction work. Often the broker and the commercial real estate lawyer can provide meaningful input from their own experiences with particular firms as well as such firms' reputations in the market. Usually a construction manager or general construction consultant will also assist with this initial selection process. The tenant's team will compare and evaluate the bids and the tenant will decide on a construction firm to execute the final approved plans and specifications. Usually the landlord will want to approve the tenant's choice of construction company or general contractor. This is because the landlord is understandably concerned about the experience and reputation of whomever will be working in its building. Moreover, if there are disputes with the general contractor (or its subcontractors) even though the landlord may not be a party to whatever agreement the tenant has, the general contractor (or its subcontractors) have legal recourse against the landlord's building, as well as against the tenant, and can (as permitted by New York statutory law) assert a "mechanic's lien" on the building, which will have significant legal implications for the landlord, including the possible judicial foreclosure of that lien. The tenant's plans and specifications (and required drawings) will also be submitted to the department of buildings of the municipality in order to obtain the required permits. No construction may commence without the required permits. In addition, the municipality will require certain inspections at the conclusion of construction, and will issue various documents, such as the "Certificate of Occupancy", which may be temporary or permanent, without which the tenant cannot occupy the property as altered.

The lawyer again becomes quite actively involved drafting and negotiating the appropriate agreements between the tenant and the general contractor. Often these are "form" agreements prepared by the American Institute of Architects, but they are still negotiable. The tenant's lawyer will build into the agreement the best protections that can be negotiated for the tenant to minimize the risks of construction. To the extent there are subcontractors, they will have their own contracts with the general contractor, with which they have a legal relationship. They generally have no legal relationship with the tenant.

Of course, no construction can begin until the lease is signed and the tenant's insurance that has been negotiated for in the lease, is in place and tenant has provided appropriate evidence of such insurance to the landlord. The lease will provide that the tenant is required to provide a variety of types of insurance policies, depending on the nature of the property and the scope of the project, to cover various eventualities, including claims and damages with respect to the tenant's own property (first party

liability) and claims and damages with respect to the property or person of others (third party liability). In addition, there are particular types of insurance policies or bonds that the landlord will insist on to cover the period during construction. The landlord will specify in the document the types of policy and the amounts of coverage as well as the criteria to be met by the tenant's insurance carriers. In addition to any review or evaluation made by the tenant's lawyer during the lease negotiation, this section, as well as the sections of the lease that cover the tenant's indemnifications (which are expected to be covered by the tenant's insurance) should be carefully reviewed by the tenant's (in-house) risk manager or insurance consultant, to make sure that the insurance requirements stated in the lease are appropriate to the tenant and the scope of its project, and will coordinate with any existing insurance coverage that tenant already has.

### Timing and Coordination

It is clear that the process of getting a property, negotiating a lease and developing plans is a complex and multifaceted one; each aspect of this process has a lot of "moving parts" and each has considerable expense associated with it. As noted above, the process of drawing up plans and getting approval from the landlord – which is not inexpensive – needs to be accomplished before the lease is signed, so it takes place simultaneously with the lease negotiations. Therefore, it is essential that early on, before fully committing resources to a piece of property or a space, the tenant evaluates — on an ongoing basis — the likelihood that the deal will be actually be brought to fruition before the tenant goes too far and commits significant resources with respect to any of the space planning and lease negotiating issues. This can be accomplished by the tenant involving its team early on. The interaction of the team on their various issues will quickly cause "deal-breaking" issues to surface, and once that happens, the business decision of whether to commit to the property, or to consider another one can be made quickly and any losses can be minimized enabling the tenant to move on to something better suited to its needs and financial parameters.

### Finally, the Move In

This final step in the project — the move-in — is no less complex than the steps which preceded it. Depending on the geographical factors (that is, the "from/to" part of the equation), the number of persons involved and the extent of furniture, fixtures and equipment, not to mention retail stock, many tenants consider the move-in as a virtually separate project. Accordingly, many tenants (with sufficient budgets) hire a separate move-in coordinator to coordinate the movement of people and equipment





over the applicable period of time. Other tenants utilize the project manager or facilities manager for this function. In addition, larger entities may also look to their in-house corporate communication resources to coordinate the communications to employees about the move and, if appropriate, their public rela- tions resources, to communicate information about the move, and the entry into this new market, to their various public constituencies outside the company. Brokerage firms may also provide this move-in service; the pricing must be addressed at the time when the firm is considered for employment.

The acquisition of space in the United States is a process that must be carefully managed and monitored by a deliberately chosen experienced and professional team. However, the most important message that this booklet offers is that the process of entering the United States real estate market and beginning a business in the United States is sufficiently complex to not be left to chance. In addition to understanding the dimensions of the process and the project, careful planning must inform the entire project from beginning to end in order to help ensure a successful entry of the German business into the United States.

CHAPTER 5

# CORPORATE STRUCTURING FOR U.S. BASED OPERATIONS

## PLANNING AND STRUCTURING TO ENTER THE U.S. MARKET

As has been discussed in the earlier sections of this handbook, when the business decision is made to enter the U.S. market, structuring to limit liabilities to the operating assets to be exposed and deployed for the U.S. venture is properly implemented at start up of entry and at commencement of operations in each location in the U.S. Pre-planning and attention to and accommodation of the various state laws and the federal requirements should also occur at this point. In addition to limiting liability for operations by selecting a proper limited liability entity for incorporation or formation, segregation of commercial assets such as trademarks, patents, copyrights and long term real property assets which are not to be exposed to operations liability would be prudent. These valuable assets can be held in nonrelated entities to the operations ownership and leased or licensed to the operating companies on a commercially comparable basis.

In order to limit risk and minimize liability with respect to operations or resulting from disaster or other casualty, a commercially responsible insurance program should be implemented to deal with operations risks, products liability and losses of real assets from fire, casualty or other disaster. While the concepts of insuring operations and protecting persons and assets through acquisition of proper types and amounts of insurance such as Commercial General Liability, Directors and Officers and Fire, Casualty and Legal Liability Policies are beyond the scope of this handbook, counsel can assist in the selection of insurance risk consulting advisors and insurance brokers as well as selection of the best insuring companies and types of policies. Insurance

tends to be an after thought by many companies and seriously considered first when required by third parties such as landlords, banks other contracting parties when entering into transactions. However, insurance is best considered in the formation stage as a companion to other strategies to appropriately limit liability and secure operations and assets.

The following sections will introduce and compare the types of limited liability entities available for consideration such as Limited Partnerships, Limited Liability Companies and Corporations and also discuss some differences in benefits and treatments from the legal, accounting and tax perspectives.

## Operating Entities and Limitation of Liability

The major business consideration (as opposed to tax consideration) in choosing the form of a business entity is to limit to the entity itself all liabilities arising out of the operation of the entity's business or the assets it uses in its business, including the office or facilities that it leases. The result of this is that if an appropriate limited liability entity is chosen and it is managed properly, neither its owners nor its management should be at risk for the entity's liabilities. Various state laws allow limitation of liability to corporations, limited liability companies and passive partners in certain forms of partnerships.

A German company that decides to conduct business in the U.S. should consider establishing a wholly owned U.S. entity, through which to conduct the business. Depending upon the type of business the German company intends to conduct in the U.S., there are several types of entities to choose from. Just as under German law, the sole owner of a sole proprietorship (Einzelunternehmen) has unlimited personal liability for all the debts and obligations of the business, and income from the sole proprietorship is reported on the owner's personal tax returns.

Ordinarily, a general partnership (Handelsgesellschaft) does not have limited liability under state law. As under German law, the partners are jointly and severally liable for all debts and obligations of the partnership business.

One way to circumvent the personal responsibility of a partner in a general partnership is to form a limited partnership (LP) (Kommanditgesellschaft). A limited partnership limits liabilities for some partners but not others. A limited partnership must have at least one partner who is a general partner with personal liability for all the debts of the limited partnership, and at least one partner must be a limited partner





with limited liability. The personal liability of the general partner in a limited partnership can theoretically be limited if the general partner is a corporation, which has limited liability (see below). Generally limited partners are investors in the partnership, but are not actively engaged in the management of the partnership's business which is the responsibility of the general partner.

Certain professionals (for example lawyers, architects, dentists and doctors) may organize themselves as limited liability partnerships (LLPs) which in terms of structure are general partnerships with the tax attributes of a general partnership. However, in general, the LLP partners are not personally liable for the debts, liabilities or obligations of the partnership, except for their own professional malpractice. In addition to LLPs, professionals may organize themselves into professional corporations (PCs), and professional limited liability company (PLLC). Like an LLP, these entities insulate their owners from business debts and liabilities, but not from liability for professional's malpractice, or depending on state law, certain other acts of partners.

Generally the owners of the corporation or a Joint Stock Company (Aktiengesellschaft) incur no personal liability for the actions of the corporation unless the corporate veil is pierced or transfers of funds or assets are made to the owners rending the corporation insolvent, and then, under certain circumstances, the owners of the corporation can become personally liable for the corporation's debts and obligations. A limited liability company (LLC) (Gesellschaft mit beschraenkter Haftung (Gmbh)) takes advantage of both the benefits of a corporation and a partnership. An LLC is not considered to be a separate tax paying entity so profits or losses can be passed through to the owners without taxation of the business itself and all the owners are protected from personal liability.

## Some Legal Factors to Take into Account When Starting a Business in the U.S.

Typically German companies choose to conduct business in the United States through wholly owned corporations incorporated in one of the states of the United States. The corporate form of legal entity has tax and legal advantages. A U.S. corporate subsidiary will normally shield its German parent from liability for federal and state income taxes. A corporate subsidiary also offers its parent a degree of flexibility in determining where income will be recognized for tax purposes through, subject to the Internal Revenue Service's rules on transfer pricing, sales of goods and services to and from the subsidiary, charging the subsidiary license fees for technology, or charging the subsidiary for management services.

Corporations are also the favored vehicle for conducting business in the U.S., because there is a time tested body of corporate law to guide corporations with respect to management structure and business governance. Delaware is the favorite state for incorporation. It is the home for most publicly held companies in the U.S., and therefore its statutory and case law is comprehensive and up to date. Also, Delaware does not have a corporate income tax, and with good planning the annual Delaware Franchise Tax and related fees payable by a U.S. subsidiary can be as low as $60 per year.

To ensure that the parent will be protected as fully as possible from claims arising out of the U.S. subsidiary's business, it is imperative that the U.S. subsidiary be operated separately from the German parent. It should have its own board of directors responsible for corporate policy decisions. Transactions between the U.S. subsidiary and its German parent should be on arms length commercial terms. If the U.S. subsidiary is operated as a separate entity, except as noted below, the German parent will not be legally responsible for the liabilities of the U.S. subsidiary, even if the U.S. subsidiary becomes insolvent.

However, a German parent should be very cautious about walking away from an insolvent subsidiary. In a bankruptcy proceeding creditors of the subsidiary will examine very closely all funds transfers from the subsidiary to the parent, whether for purchases of services or goods, license fees, amortization of loans, dividends, interest or otherwise, with a view to obtaining a court order voiding such payments and compelling repayment by the parent for the benefit of the creditors. German manufacturers selling goods or equipment through their U.S. sales subsidiaries are subject to products liability claims by individuals who are killed or injured while using the products, even if the products were sold by the U.S. subsidiary. Products liability exposure should be taken very seriously, as manufacturers may be liable for very large amounts as damages even in cases where the products are "state of the art" and no negligence is shown in connection with the design, manufacture or operation of the products (i.e., strict liability).

Following is a check list of items that should be considered in connection with setting up business inside of a corporate subsidiary.

*THE PURPOSE OF THIS CHECKLIST IS TO BRING TO YOUR ATTENTION SOME OF THE FACTORS THAT SHOULD BE TAKEN INTO ACCOUNT WHEN STARTING A BUSINESS IN THE UNITED STATES. IT DOES NOT PURPORT TO BE COMPLETE AND IS NOT INTENDED TO RENDER LEGAL OR TAX ADVICE, WHICH SHOULD ONLY BE OBTAINED ONLY FROM QUALIFIED EXPERTS FAMILIAR WITH ALL THE FACTS AND CIRCUMSTANCES RELEVANT TO YOUR PARTICULAR SITUATION.*





## A. Statutory Regulation.

***1. Product Design.*** As is the case in Europe, the United States and many of the states have laws specifying safety or health standards that classes of products must meet, such as the Flammable Fabrics Act which sets flammability standards for fabrics and the Food and Drug Act that regulates the sale of pharmaceuticals. If your product has to comply with statutory standards in Europe, be sure to check whether there are similar standards in the United States. Unfortunately the European and U.S. standards are frequently different, which may require specially designed versions of your product for the U.S. market. There are also U.S. laws that have labeling requirements that companies starting a business in the U.S. should take into account.

***2. Protection of Employees.*** The United States has laws that govern safety in the workplace (e.g., The Occupational Safety and Health Act), provide for minimum hourly wages and mandatory overtime pay and protect employees against discrimination in the workplace. There are laws that protect employees and applicants for employment against harassment or discrimination based upon race, color, ancestry, marital status, religion, sex, sexual orientation, national origin, citizenship status, pregnancy, age, medical condition or disability. Many companies develop employee manuals that contain the rules governing their workers and workplaces to ensure that all employee related matters are dealt with legally and in a consistent manner. Compared to many European countries, it is easy in the United States to terminate a person's employment. Unless there is a contract of employment, people are employed on an at will basis. An employer is free to terminate an at will employee at any time for any reason that is not covered by the anti-discrimination laws referred to above. Unless an employer has a severance pay policy, there is no legal requirement that an employer make severance payments to a terminated employee. Except for Social Security which provides a modest income for retirees, the United States does not have any mandated pension or retirement plans. Some larger companies have defined benefit or defined contribution pension plans. Many employers have deferred compensation arrangements known as 401(k) Plans, which permit participants to make tax deductible contributions to the Plan. Many 401(k) plans also provide for employer matching contributions. An individual's interest in a 401(k) plan is taxed as he/she withdraws from the plan during retirement. The Employee Retirement Income Security Act provides for standards that employee health and retirement plans, including 401(k) plans, must meet.

***3. Taxes.*** Every U.S. entity is required to obtain a taxpayer identification number from the Internal Revenue Service prior to the commencement of business. It is imperative that a newly organized subsidiary be guided by an experienced tax

accountant from the outset to ensure that it collects and pays federal and state income taxes required to be withheld from employees' wages and social security and Medicare taxes, that it pays its employer taxes for social security, and that it pays its estimated income taxes when due. Failure of companies to pay withholding and payroll taxes can result in personal liability for company officers. Companies that sell goods at retail will have to register with the states in which their retail outlets are located and collect and remit sales taxes collected on their sales. The United States does not have a V.A.T.

## B. Insurance.

***1. Business Insurance.*** Consult with an experienced business insurance broker about establishing an insurance program for you new corporation. The business will require insurance covering (1) losses, damage and destruction to owned or leased property from fire, casualty and theft, (2) liabilities for death, personal injury and property damage arising from occurrences on the new corporation's business premises or otherwise resulting from its business activities, (3) death, injury or property damage caused by it automobiles and trucks, (4) products liability arising from claims based on death, injury or property damage caused by the new corporation's products (i.e., product liability insurance), (5) business interruption, and (6) directors and officers liability. As mentioned above, a parent corporation is subject to lawsuits for products liability claims. Therefore, product liability insurance should also cover the parent company. Given the large judgments often rendered in the United States in products liability cases, it is also recommended that the parent company confirm that the amount of its excess liability insurance is sufficient.

***2. Legally Mandated Employee Insurance.*** Most states require businesses to cover their employees with worker's compensation insurance for job related injuries, unemployment insurance to provide payments to employees who are terminated or laid-off and short term disability insurance for employees who are unable to work due to a disabling accident or illness.

***3. Other Employee Insurance.*** It is typical, but not legally required, for U.S. companies to have group life, medical and long term disability policies covering their employees. Many companies require their employees to pay part of the premiums for these coverages.





## C. Immigration.

***1. Visas.*** If you intend to send someone from Germany to manage the U.S. business, he/she will have to obtain a visa that permits him/her to work in the U.S. and to bring his/her family members to reside with him/her in the U.S. Normally the visas are issued outside the U.S., so it is recom- mended that the question whether employee visas will be required be assigned a high priority before personnel transfers are made and that guidance on dealing with visa issues be obtained prior to setting up the U.S. operation.

***2. Employment of Illegal Immigrants.*** It is estimated that there are about 11,000,000 illegal aliens in the United States. An illegal alien is a person who (a) is not a U.S. citizen and (b) is in the United States without a valid visa. Many menial jobs in the U.S. are done by illegal aliens. Many illegal aliens have counterfeit identification cards and work permits, so it is not always obvious what a person's legal status is. It is against U.S. law for an employer to knowingly hire a person who is not a U.S. citizen. U.S. employers are required to check to make sure that all their employees are allowed to work in the U.S. As indicated above, some visas permit work in the U.S. The Immigration and Naturalization Service also issues work permit to certain aliens. It may be necessary for the new corporation to consult a lawyer to ensure that when it begins to hire it is complying with the immigration laws.

## D. Written Contracts – Their Importance.

As indicated in the discussion on commercial leases, contracts in the United States go far beyond just describing the business terms of a transaction. Contracts in this country are used to shift risk from one party to the other or to share risk where in the absence of a contract it would fall solely on one party. Also, as indicated in the commercial lease discussion, the United States is a culture where caveat emptor still applies in many types of transactions, so the contract is an instrument by which parties protect themselves by requiring representations and warranties and indemnities from the other parties. In sum, in American business a good contract protects a party by spelling out in detail the parties' obligations during the term of the contract under all circumstances that are likely to occur instead of leaving it to them to work out issues on an ad hoc basis as they arise. One reason for this approach is that when things go wrong in a business transaction, litigation is likely to ensue. Litigation is very expensive, time consuming and emotionally draining. It should be avoided if possible. A good contract is one way to avoid it. The United States legal system is largely derived from the British common law with sprinklings of French law (e.g. Louisiana) and Spanish law (e.g., California, Arizona and New Mexico). The laws of

the United States consist of statutes enacted by the federal and state legislatures and a large body of case law. Case law is law derived from written judicial decisions applying and interpreting statutes and/or prior cases with reference to the matter then before the court. Case law has the same force and effect as statutory law. Contracts are often negotiated partly with reference to avoiding or mitigating the effect that statutory or case law would otherwise have on the transaction. For example, the Uniform Commercial Code, which has been adopted by all the states with slight variations, provides that in a sale of goods there is an implied warranty from the seller to the buyer that the goods are merchantable and fit for a particular purpose. Typically these implied warranties are disclaimed in the standard terms and conditions of sale used by sellers and the seller's own warranties, including the duration of the warranty period and remedies the specified by the seller, will apply.

Depending on the nature of your business, you should consider meeting with your lawyer before you start up to review the advisability of preparing contract forms for use in your business. These might include employment agreements, confidentiality and non-competition agreements for employees, invention rights agreements for employees, terms and conditions of sale for your products, installment sale contracts, security agreements, equipment leases, technology and software licenses and sales rep agreements. These contract forms can enable a company to exercise a degree of risk management over its business relationships and transactions instead of having statutory or case law determine the outcome when things go wrong.





CHAPTER 6

# SENSITIVITY TO TAXES AND TREATIES WHEN SELECTING REAL ESTATE HOLDING ENTITIES

## EFFECTIVE TAX PLANNING FOR THE OWNERSHIP OF U.S. REAL PROPERTY INTERESTS

The organizers of a new business entity must decide on the most beneficial structure from both a tax and legal perspective at the time that the venture is created. While the approach from a legal perspective is reduce or minimize exposure to liabilities, other legal considerations must also be taken into account. They may include future transfer considerations, equity ownership and financing, term of existence, as well as state and local reporting and complexities.

However, the income tax planning of a new venture is of significant interest to an investor who is not familiar with the considerations under the U.S. income tax code.

There are two general choices for the ownership of real estate interests in the United States. Realty interests can be owned in either an unincorporated entity or in the form of a corporation. There are variations to these two general choices, but ultimately the choices reduce to those two. The tax rules of operations, and the filing requirements are different depending on the choice.

The use of an unincorporated entity has several variations as well, depending on the number of owners, and the desire to obtain limited liability for the venture. An unincorporated entity that has more than one owner, is referred to as a partnership, which can be constructed as a general partnership, a limited partnership or a limited liability company. Limited partnerships are referred to as LPs. Limited liability

companies are referred to as LLC's. There is no designation for entities created as general partnerships. General partnerships provide no limit on the liability of the owner. Risk of loss is not limited to the assets of the venture; the owners are totally liable for any potential loss. LPs provide limited liability to the limited partners of which there must be at least one. This structure requires that there be a general partner, who has no limit as to risk of loss.

In the late 1990s, there emerged a new form of ownership referred to as the LLC. The LLC is a hybrid form of entity. It operates under the tax code as an unincorporated entity but provides insulation from liability to the same extent as a corporation. The LLC does not require more than one owner, unlike either form of partnership. Such LLCs are referred to as single member LLCs. Single member LLCs are often used by a single owner who may own multiple properties. By holding only one property in each LLC the liability risks are further isolated.

The most significant trait of an unincorporated entity in any of the above forms is that the entity does not pay tax on profits derived from operations or gains from sale. The owners are responsible for the income taxes imposed on profitable transactions. Unincorporated entities are referred to as either passthrough or conduit entities. Entities that have more than one owner are required to file income tax returns for partnerships, and to apportion the tax attributes to the partners. Thus general partnerships, limited partnerships and multi owner LLCs are all required to file an income tax return for the venture. Single member LLCs are considered to be disregarded entities under the tax code and the tax attributes are reported directly by the sole owner.

Alternatively, real estate interests can be held in regular corporate form. U.S. corporations are referred to as C Corporations under the U.S. tax code. The issue of taxation for corporations that own real estate interest directly ultimately becomes the same as ownership using unincorporated entities, since profits or gains from those forms of ownership pass through to the owner and the tax is paid at the owner level. Thus a corporation that owns real estate interests, either directly, or through either a partnership or single member LLC, pay the same tax on profits or gains. Realty interests owned by foreign corporations, either directly or through any of the pass-through entities are subject to taxation under a different tax scheme than U.S. Corporations.

In the event a US Corporation is owned "upstream" by a foreign entity which provides capital or debt financing, there are commonly known tax considerations for





review of the interest rates associated with such funding or loans referred to as "Earnings or Income Stripping" and experienced tax advise should be sought out for the planning of the loans or capital funding and coordinating of offshore treaties and tax laws with tax requirements and laws in the United States.

Much is written about the capital gains tax under the U.S. tax code. However, to U.S. corporations, there is no difference in tax rates for income derived from operations, referred to as ordinary income, or derived from gains on sale referred to as capital gains. Ownership of real estate interests in U.S. entities are taxed at the same rates as non real estate activities. State tax considerations need also be taken into account as the rules of taxation vary from state to state in the United States.

IRS Circular 230 Disclosure: To ensure compliance with requirements imposed by the IRS, please be advised that any U.S. federal tax advice contained in this booklet and work (including any attachments) is not intended or written to be used or relied upon, and cannot be used or relied upon, for the purpose of (i) avoiding penalties under the Internal Revenue Code, or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein. While this work is intended to raise issues to be addressed when entering the U.S. market to conduct operations and business, it is not intended to be tax or legal advise and the authors advise seeking experienced tax and legal counsel with respect to all matters discussed in this booklet.

## FURTHER RESOURCES

This booklet was designed to be an introductory resource for the German company attempting to acquire its first real estate location for its first successful entry into the U.S. markets. It will also be useful for those German companies whose first entry was not everything that they expected. It describes, in narrative form, the process surrounding the acquisition of space, whether by purchase or leasing, in the United States, as well as the multiplicity of issues generated by it.

After the first narrative section is a Glossary of Common Real Estate Terms, which should make any conversations about real estate easier to understand. Also provided are various Checklists, which may be used to raise issues to be explored during the planning and structuring phase of the effort to inter the United States market.

Internet searches can provide other valuable resources. We particularly recommend the "New York City Commercial Leasing" website at ***www.officeleasingusa.com*** and ***www. leasingnyc.com*** for additional resources, market information and publications and seminars on the subjects covered in this work.

For an extensive treatise on the subject of drafting and negotiation of commercial leases, we recommend the three-volume (approximately 3,000 pages) reference work Negotiating and Drafting Office Leases, published by Law Journal Seminars-Press, October 1995-2011, (Library of Congress ISBN 1-58852-061-7) which is also available at www.officleasingusa.com. The treatise is updated two times per year by supplements and is in current use as course book for several classes at the New York University Graduate School and Real Estate Institute. However, this is only recommended for the advanced practitioner, commercial broker/institutional property manager or legal counsel.

Also available on the www.officeleasingusa.com and www.leasingnyc.com websites, at no cost, is a booklet entitled Navigating the Dangerous Shoals of a Commercial Lease. It was written by John Busey Wood, Esq. for The National Geographic Society when that not-for-profit organization was contemplating relocating some of its considerable operations in New York City. The booklet was provided to the Society to assist the facilities manager there in dealing with the complexities of New York City real estate commercial leasing. While it is over 15 years old, it remains relevant as a quantitative, conceptual, and operational guide for people trying to learn the ropes in a difficult area. The work was also used for approximately 10 years and published by the New York University Graduate School Real Estate Institute in courses dealing with real estate valuation and commercial lease negotiation.

## COMMON REAL ESTATE TERMS

**Abatement of Rent or Additional Rent** – Delayed commencement of rentals or relief for periods of time of the obligation to pay rentals such as during the initial preparation of leased space or during a fire or casualty or loss of use.

**Acceleration of Rent Obligations** – A contractual remedy for failure to perform by a tenant or purchaser when in default of obligations or as a condition event agreed to by the parties when future obligations to pay rent and possibly additional rentals become immediately payable.

**Additional Rentals** – Additional payment obligations in addition to the Fixed or Base or Annual Rent specified in the Lease. Additional rents or other charges called additional rentals may be payments to reimburse the landlord for costs to prepare the leased premises, operate the property or leased space or such costs as insurance and taxes.

**All-in Costs** - Common usage is for planning or budgeting and conveys the understanding that all costs, including "soft costs", "planning and design costs", "hard costs" or rather materials and equipment and fixturing" as opposed to labor or professional costs, and generally any other expenditure when all added together with the items anticipated fulfill the delivery of the property or commissioning thereof into intended use. Additional costs include construction terms of art such as "supervision", "overhead" and "contractors or managers profit" and landlord's add on assessments sometimes referred to as "loads".

**Alterations** – Any changes to property or space. These can be repairs, additions, replacements or improvements. Alterations can be cosmetic, decorations or significant additions or demolitions and reconfiguration to property. Alterations can be structural which means changing certain load bearing components of the building structure. Alterations can not only change the appearance and structure but can also impact on a particular use or character of planning or zoning regulation of the building or improvement causing legal and regulatory impacts and compliance with building and use laws as well as fire and safety laws. Allocation – The formulation of attributing a portion of an amount, payment, cost or expense to different categories, benefits or persons or properties.





**Area, Floor Area, Carpetable Area, Allocable Area, Rentable or Rented Area and Usable Area** – these are easy terms to adopt to compare and differentiate space being purchased or leased in a transaction. Other than the term "Floor Area" which is a zoning and architectural term of art (meaning area counted as space on a floor for purposes of bulk and height building and construction regulation and limitation), the other terms help in the analysis of the financial and operational efficiencies and economies of scale of space when comparing needs to costs and to other comparable candidate properties. For instance "Rentable Area" can be defined to mean the agreed to measurement of the square foot area to be paid for and it may be a fictional or designated area or one "deemed to be" for purposes of applying rental rates. The actual "Rentable Area" might well be the space demised to the tenant or purchased by the buyer when measured under agreed to space measurement protocols or prevailing methodology standards of computation in the region of the property or space. "Carpetable Area" might be considered by some to be the portion of the "Rentable Area" that can be actually stood upon or walked upon and carpeted. "Usable Area" may be the "Carpetable Area" plus areas like shelf space over setbacks of buildings which can not be walked on but maybe cables, wiring or even books can be placed upon. Areas that benefit the space leased for instance but found elsewhere in a property rather than within the leased space may be allocated to the leased property as providing a service or benefit to that leased space along with the costs associated with that "Allocable Area" and even rent costs applied to such space. Breaking down and understanding the various areas and measurements of space in a property for purchase or lease is very helpful to do and dangerous to ignore when comparing candidate properties for occupancy and needs of operation or financial or operational suitability or feasibility.

**Arbitration** – An alternative method of dispute resolution mechanism in a forum other than a governmental judicial system or court. Also sometimes referred to as ADR or alternative dispute resolution.

**"As-Is" "Where-Is"** – The conceptual disclaimer of representa- tions with respect to condition or legal compliance of the leased space or property for sale and all contained in it. The concept of "as-is" is generally taken to mean "as you see it" or "as it exists at a given time whether seen or discoverable" or rather a disclaimer of responsibility by the seller or lessor for the general operation status or condition of the item. The concept of "whereis" when coupled with "as-is" is particularly dangerous to a purchaser or lessee of property since it implies the possibility of location non-conformity or non-compliance with legal requirements as well as disclaimer of general condition of the improvement, fixture or contents of the property or leased

space. It can also be a disclaimer of the legality of the entire building or structures in relation to other structures, land placement and even to the general area such as a use which was allowed or a location of fixtures which were allowed by laws no longer applicable and even in violation of newer laws.

**Assignment** – The transfer of the rights to the lease or property or contract by the possessor of the rights. The transfer does not necessarily relieve the transferring party of its contractual obligations nor confer all benefits to the transferee.

**Audit Rights** – Rights of a party to review and confirm costs or expenditures of another party. In many jurisdictions the tenant or purchaser does not have the audit right or right to confirm the costs and expenditures or even investments in the property of the other party unless granted expressly and completely in the contractual document.

**Brokerage Article or Provision** – A provision in a contract of sale or lease representing the parties dealing with or employment of a real estate broker or salesperson and the assignment of the obligations to pay such brokers. The provision generally contains a representation by each or just one of the parties that there have been no other dealings or employments of others than the listed broker and an undertaking or indemnity to protect the other from other brokerage claims for compensation with respect to the sale or leasing transaction. The indemnity can be for reimbursement for duplicate commissions or fees as well as legal defense costs or loss of transaction impacts. These are very serious and dangerous clauses and must be reviewed carefully and understood.

**"Build to Suit" or "Turnkey"** – is the general term of art for delivery condition of a property or leased space in conformity with specifications of functionality, physical and operational performance and legal compliance. The parties generally in many jurisdictions intend to have a seller or landlord construct or alter a property or space so completely to the needs and specifications of the purchaser or lessee so that the purchaser or tenant can literally "turn the key in the lock" and move in to a property or space that fits the needs of the occupant and functions as required and is permitted and legal in all respects specified in the lease or contract of sale.

**Business Interruption and Rent Insurance** – relates with insurance for loss of use of a property or space and the impact on the occupants operations and income with respect to the business interruption insurance and the loss of rental income for a lessor with respect to the owners rent insurance coverage.





**Common Area Maintenance or CAM** – charges or expenditures for maintaining, repairing, operating and in some cases improving areas of a property used in common by all occupants.

**Capital Costs and Disbursements** – Disbursements of funds for or relating to a building structure or its major systems serving the building, such as elevators, heating and cooling systems, ventilation systems, wiring, electrical, communication and monitoring systems, fire and safety systems, plumbing and sewer and piping systems. Capital disbursements are an accounting characterization of funds disbursed for long term alterations or additions to improvements and properties which are materially large in amount and for items which have a life of benefit to the property exceeding the current annual period. Generally these disbursements better or improve a property or , if a repair or replacement, are of significant enough amount or scope as to be a reconditioning of the component of the property. These types of costs are considered in the accounting community by those without bias towards the benefit of an owner, seller or landlord, to be ownership responsibility costs of the owner/seller or landlord and not undertaken or reimbursed as rentals or otherwise by purchasers or tenants.

**Cash Flow, Accrual and Tax Analysis** – Different methods of evaluating the funding and timing of payment of costs of property and operations and the impacts on the financial condition and balance sheet reflection thereof. These different types of timing and impact analyses of a real estate purchase or lease are customary for brokerage and institutional management firms to provide and critical for the through understanding of any transaction and for the comparison of alternative candidate transactions and properties over various holding and operation periods.

**"Caveat Emptor"** - Latin phrase meaning "Let the Buyer Beware." When considered in relation to applicability to a purchase of property or lease of space and the resulting "papering or documenting of the transaction" a party must be aware that they in many jurisdictions can not rely on any "as-is" or "where-is" conditions being proper, legal or even suitable and that the other party to the transaction may not be under any obligation to provide any information or representations with respect to any aspect of the property. It is also important to understand that the "papering of the transaction" is itself a term of art in many jurisdictions to imply that one of the parties, such as the landlord in a lease and seller in a sale transaction, will document the deal in a light most favorable to itself and its position. It is not uncommon to receive documents for an intended transaction containing all of the rights and benefits conceivable for the benefit of the party "papering" the deal and issuing the documents

and few of the benefits and rights of the other party as requested by that party during negotiations. It being the duty and responsibility of the other party to protect its needs through careful review and alteration of the documents for its benefit.

**Certificate of Occupancy** – a certification , temporary or permanent, of a governmental regulatory entity authorizing the particular use, floor loads and types of operations and density of a building, improvement, land and/or leased space. The permit or certificate to occupy a building, land or space had different effects if each jurisdiction and may be required to be obtained or applied for by an owner in one jurisdiction, an occupier or a tenant or lessee, depending on the legislation, regulation or statute. Architects are the best to review the certificates of occupancy (the "C of O") and advise the attorney and company of the suitability, legality and alteration ability with respect to the property under consideration. There should be no assumptions make during the feasibility or due diligence review and discovery of the property by the purchaser or lessee since this permitability or suitability and legality of the status of the property can not be assumed or relied upon for candidate properties.

**Commencement** – the beginning or operative coming into existence of a right, obligation or measurement period under a transaction document. There are many commencements in transaction documents. For instance, commencement of the rental payment obligation, commencement of the erosion of the abatement of rent period, commencement of the obligations and duration thereof and commencement of the insurance of obligations or application of impacts on the terms themselves by other commencements. Some commencements are difficult to appreciate and even gauge, like the beginning of the life of a contract or lease that states it is "made" or effective at or on an "as-of" date. This may be a date other than the actual day and time that the document(s) is signed. The "as-of" date can relate to a previous period prior to the execution day of the documents and affect the parties obligations even prior to the time they begin negotiations. The results being early erosion of an abatement period, an early payment of rent, an early increase in an obligation or change in term and a responsibility of a party to a transaction for a condition or obligation with respect to the property which was not intended. Commencements of all types in purchase and sale contracts and leases should be carefully analyzed and drawn on a time line so as to ascertain the effect and impact on the party's obligations and timing of discharging them or funding them.

**Compliance Article** – a provision of a contract or lease which sets forth the status or obligations of the parties with respect to the condition of a property with respect to legal and regulatory requirements and the responsibility for the continued or





preexisting compliance or non-compliance of the property or occupancy at and use of the property. Obligations and rights usually dealt with in such clauses include certificates of occupancy, structural and alterations legal, fire and safety compliance, zoning, types and manner of occupancy and use of the property and environmental issues. These clauses and articles should be fully understood and also sketched on the time line of commencements in order to fully understand the various respon- sibilities and obligations /rights with respect to the property and space.

**Connectable Load** - In calculating electrical surcharge expenses, the amount of appliances and machines that are on Premises that can be connected and can consume whether or not these appliances or machines are operational.

**Connected Load** – the calculation of the electrical energy being needed by the electric consuming appliances and equipment wired or plugged into the electrical system at a space or property. The connected load or consumption can be a variable measurement based on the running, startup or idling needs and use of the connected consuming device. Connectable load is different and sometimes is referred to as the amount of load that can be connected based on capacity of the wiring to deliver or sometimes is used to mean all devices in the space or at the property if working and connected and functioning within specifications of variable operation and use periods. These are terms for engineers to address and to be discovered prior to purchasing the property or leasing the space. Basically it is important to know what can be plugged in or connected or wired to the electrical system of the building within the systems capacity to legally and safely furnish the energy load. "Incremental Connectable Load" is an unusual hybrid of the two definitions and has an extremely unfair utilization and cost impact on a tenant when a survey is done annually of the electric consuming devices found in space and priced by the landlord for additional rent to be paid by the tenant.

**Construction Fund, Tenant Fund, Tenant Improvement Fund ("TI Fund") or Allowance(s)** – the funds to be provided, utilized or applied by one or more of the parties to the property transaction usually for compliance with a delivery condition or the alteration of the space for the initial occupation of the property by the user. There is no implied or understood expectation by the providing party that the particular fund or allowance is sufficient to accomplish the needed result and such funds and conditions of the property must be understood by the party with the intended needs.

**Delivery Condition** – the legal, physical, qualitative, quantita- tive and status of compliance condition of the real property or title or use right with respect to the

interest or right in property being delivered or granted. This includes observable and hidden conditions as well.

**Ejusdem Generis** – a legal or judicial standard or rule of reading and interpretation of writings that provides that "where general words follow an enumeration of persons or things, by words of a particular and specific meaning, such general words are not to be construed in their widest extent, but are to be held as applying only to persons or things of the same general kind or class as those specifically mentioned" or where words later following which are more specific and detailed may be construed to modify or control the earlier more general text. Leases and contracts of sale can be 100s of pages long and have exhibits, schedules and related rules and regulations which control them or are controlled by them. Transaction deal terms can be set forth in one location of a document or in another document altogether and be modified or delineated intentionally or by accident. All documents must be read and reviewed to work together to effect the intended result.

**Escalations** – additional rentals or charges found in a lease which can be increases in amounts by formulae or periods or can be amounts when compared with previous similar amounts from periods to periods. Such as the real estate taxes for the first year of a property lease when compared with tax amounts to be paid for later years. Common charges for operating and maintaining a property when compared year to year can escalate and the increases charged as additional rent operating expenses. "Passthrough" escalations is in many jurisdictions intended to imply that the landlord is just passing through the actual increases in operating costs from the beginning of the measurement period to be defrayed or reimbursed by the tenant. The implication is that the pass-through is calculated comparably from year to year under fair standards and does not include duplicative charges, hidden profits or other fees or benefits to the landlord. In many jurisdictions the implication will not protect the tenant and document language must be included to do so.

**Estoppels or Estoppel Certificate** – is a document provided required certification of a party, usually a tenant, that certain facts and conditions exist, certain payments have been made and the status of obligations, terms and conditions of the relationship between the landlord and tenant at the time of the issuing of the Estoppel. When issued, the estoppel operates to bind the issuing party and be relied upon by the receiving party and others such as lenders and mortgagees if so provided in the documents and contracts. Estoppels can operate as amendments to existing documents and waivers of rights and terms and therefore are very serious and dangerous certifications.





**Floor Loads** – a measurement or regulatory limitation of weight bearing ability of floors in structures. The measurement may be by "live load" or "dead weight" and can be by impact of dropping an object from altitude as well. It is important to know the limitations of space and property structurally as well as by regulation (such as certificates of occupancy) to assure the ability of the property to safely and legally house and support the operations of the occupant.

**Hazardous Materials and Substances** – substances and materials which are dangerous or toxic to the environment and which are typically regulated by states and municipalities as well as the Federal Government by laws such as the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA), the Clean Water Act, the Solid Waste Disposal Act or the Toxic Substances Control Act and Leaky Underground Storage Tank acts.

**Holdover Article** – deals with the remaining in the leased space or sold property after the right so to do has terminated or expired. These articles and clauses have pricing penalties and indemnification obligations for the defaulting party and must be carefully reviewed.

**HVAC** - Heating, Ventilating, Air Conditioning – systems providing cooling, ventilation, circulation, air quality and filtration, and heating to a space of entire property.

**License Agreement** - a lesser right than a lease and generally for a shorter occupancy or use period and generally terminable by the granter of the license at will. This varies from jurisdiction to jurisdiction.

**Limitation of Liability or Exculpation Article** – a provision which limits a party's liability or directs satisfaction of payment of liabilities from a limited source. Landlords and sellers of properties generally limit their liability for misrepresentation or failure of performance to the property or lease benefits and tenants and purchasers attempt to limit their liability for failure to perform to downpayments, security deposits or entity assets.

**Loss Factor** – the number representing one minus a ratio of the delineated stated size of the rented or rentable area set forth in the lease divided into the carpetable area. Or rather the % of the area stated as being rented that can not be utilized by the occupant. So if a tenant is leasing 1000 rentable square feet as set forth in the lease and can only occupy and walk on 800 square feet, there is a 20% loss factor. Loss factors in New York City for multi-tenanted floors approaches or exceeds at times 50%! Caveat Emptor!

**Nondisturbance, Subordination and Recognition Agreement** – is a document contained relationship among a tenant and those parties with superior rights of title ownership or occupancy to the tenant and the arrangement and contracting for the preservation of the tenant's occupancy and possession of its lease rights during the term of the lease when a landlord, ground lessor or sublessor lose their title rights to the property or space.

**Offset Right or Rent Credit Clause** – the right of a tenant or purchaser to exercise self help to credit against monies it is required to pay or offset against rentals it is required to pay, the payments from the seller or landlord to such purchaser or tenant set forth in the transaction documents to be paid to it or as a remedy or protection of the tenant or purchaser to recover default costs and damages caused to the purchaser or tenant by the non-performing landlord or seller.

**Operations, Continuous Sales and Open for Business Covenants** – are clauses or provisions which require the occupant to be open for business continuously during the prescribed hours and days of operation and conducting the stated use in the space. Sometimes they also specify the amount of area within the space for the type of use.

**Operating Expenses and Provisions** - most fairly stated, operating expenses and provisions for the payment or reimbursement of such, deal with the recording of all disbursements for the maintenance, repair and operations of the property. They can be on a cash flow basis or on an accrual basis and can also include improvements, betterments, additions and renovations and conversions. Care must be given to these clauses for intended financial impact and concern with respect to ownership types of costs.

**Permitted Uses and Mandatory Uses** - the restriction or permission to conduct types of use operations in a space or at a property. These restrictions can be contained in Certificates of Occupancy and in lease provisions. They can be mandatory or permissive, but are rarely a representation of ability to use the property under prevailing laws.

**Pre-existing non-conforming or non-complying** – usually deals with the rights legally to use space or continue to use space for operations when the laws or regulations no longer permit the use. For instance when zoning or building codes change but a certain old use is continuing. The old continuing use is called a "grandfathered use" because it pre-existed the legal change. Sometimes the term is





used to describe a non-compliance with a law or a violation of law which a tenant or purchaser does not wish to be at risk for when the law needs to be complied with such as when a new tenant moves in or when someone wishes to make alterations or obtain permits for the building or space which is non-complying or non-conforming. Pre-existing non-complying issues usually cost a lot of money later and the triggering events must be understood as well as the cost when the event occurs.

**Premises or Demised Premises** – a delineation of the space in the lease agreement or contract of sale. It can be very specific and legal or general or by reference such as a sketch or hand drawing attached to the document. Much care must go into the understanding of the actual portion of the property being demised or conveyed and the rights and obligations inferred from the description or drawing. Many unintended results occur when thought is not given to the description of the property or space and the impact on obligations and rights of the parties to that space and areas around it.

**Radius Clause** – a limitation on a party with respect to an area around the property under the transaction agreement. A radius clause can require activity or use in a geographic area or prohibit a use or activity in a geographic area. Commonly these provisions are contained in manufacturing and retail sales documents and reciprocal easement agreements among property owners or tenants.

**Relocation Article or Clause** – a provision that can cause or mandate that a tenant relocate to other space in a building or complex and the election of the landlord and will delineate at which parties cost as well as the time of the relocation. Such clauses can also mandate a continuance of operations at both locations for a period of time or an interruption of operations. These clauses can have major detrimental impact on parties.

**Restoration and End of Term Obligations** – provisions that set forth the condition of the property or space at the surrender or end of the term of the lease or use. Great care and attention to these little clauses found very late in the documents or even in the rules and regulations is recommended. If space or property is leased in a demolished condition, the clause can operate to cause the tenant to give the space back in the same condition. If a structural alteration was effected during the term, that alteration may need to be removed and the property restored at very great expense.

**Signage, Signs and Directory Listings** – rights to have signs on the building, in the building, on the floor, in the elevator , on the door and in a building or complex

directory or sign board or pylon. Signage and sign rights or directory rights are very fundamental and essential to operations and laws of many jurisdictions do not imply a right to signage in excess of that set forth in a transaction agreement or lease. Permission in a document does not imply legal rights to signage under zoning, building codes or landmark regulations.

**Statute of Limitations** – a period within which rights must be enforced under laws. Leases and contracts for sale also have clauses that are referred to as contractual or "mini-statute of limitations" which are contract periods that prescribe when disputes or claims must be made by parties. For instance some clauses state that a bill for additional rent or operating expenses issued by a landlord must be objected to within 20 days or deemed conclusive and correct.

**Survival Obligations and Clauses** – these are the reverse or opposite of the Statute of Limitations clauses and their operation may cause obligations which might ordinarily end with the expiration or termination of a lease of contract of sale to continue for a period of time or indefinitely. These clauses impact considerably on the liabilities and insurability and must be understood.

**Work Letter** – differs from Tenant Allowance, Landlord Fund or Tenant Installation Allowance Fund. A work letter is a customary term of art in many jurisdictions which describes the amount and possibly quality and legal compliance of the delivery condition of the space to be delivered by landlord and finished as set forth in the work letter. The work letter can be described by price or amounts of linear or square or cubic feet of work. A favorite technique of a landlord is to provide a certain number of electrical outlets and doors per number of linear feet of partitions to be provided by landlord under the work letter. Elsewhere in the work letter or rules for construction in the building, the landlord may limit the amount of demising and linear partitions which can be contained in an amount of space or per floor of the building. There have been many times that the work letter when read alone seemed to provide the quality and character of space to meet the operation needs of the tenant only to cause a big surprise when the drawings of the tenant were later submitted for the landlord to lay out and build.





## CHECKLIST OF BROKER SERVICES

- National or international presence and capabilities
- Experience with special use or business needs
- Data on regional resources, workforce, education skills
- Economist on team
- Engineering and architectural staff resources
- Construction expertise and project administration
- Bulk purchasing volume discounts
- Property management expertise and staff
- Financial and capital resources
- Leasing compliance and administration services
- Rentals and additional rentals/escalation audit services
- Retail, manufacturing and other permit experience
- Tax and governmental benefits applications and programs
- Cross-border capabilities and understanding
- Business line understanding
- Financial data and information analyst
- Representations concerning conflicts of interest, competitors, sellers/landlords
- Reputation of loyalty and integrity

## CHECKLIST OF PROPERTY NEEDS

- Special location and transportation needs; 24-hour needs; after hours loading, shipping, receiving
- Use and zoning as of right: manufacturing, assembly, warehouse, retail and sales, public assembly or teaching
- Special floor loads
- Electrical needs Air conditioning special needs
- Ability to alter or make improvements
- Special uses and use districts
- After hours heat and air conditioning
- Building Certificate of Occupancy and use
- Taxes and special district taxes
- Rights for expansion and exit
- Rights for affiliates and related companies and "co-producer" occupancy
- Communication needs
- Landmarks or other limitations on construction and alterations
- Environmental issues
- Truck or railroad delivery and shipping access (side track)
- Highway and trucking access
- Additional land improvement areas and access
- Landlord or seller integrity and reputation for performance