

Outline for COMMERCIAL LEASES

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Introduction

While the seminar and this outline are oriented to be most informative and useful to professionals involved in major commercial leases where greater negotiating flexibility is available based on the size of the transaction and its desirability to the Landlord, it will also be extremely helpful in enhancing the knowledge of other professionals involved in minor leases where most of the same issues exist, except on a smaller scale and certainly for those who need to understand the Lease as a “hybrid document” and as the building blocks of value of real estate, for lending and for institutional management and investing in real property. The items covered by the outline and seminar are those topics the lecturer deems to be the most important areas to be understood in major commercial leasing, but in no event should it be viewed as all-inclusive and certainly is not topically exhaustive. The order of this course will follow the appearance of issues in standard forms of office and retail leases. Additionally the mandatory course textbook referenced at the back of this Syllabus, *Navigating the Dangerous Shoals of a Commercial Lease*, follows the same outline structure and order and should be read in advance of the review in class of the lease sections. For your first class, please have read the first 6 chapters of *Navigating the Dangerous Shoals of a Commercial Lease* and the corresponding topical chapters in the treatise *Negotiating and Drafting Office Leases*, which must be ordered promptly as set forth at the end of this syllabus or from the NYU Bookstore upon enrolling in order to have it in time for the first class. *Navigating the Dangerous Shoals of a Commercial Lease* is a free downloadable handbook for facilities directors and can be downloaded as set forth at the end of this syllabus. One other thing is important to note. While everyone loves to be able to negotiate a commercial lease, this course is designed not as a negotiation workshop, but an in depth study of the economic, quantitative and risk shifting concepts dealt with in a complex typical commercial lease; with the emphasis being: “that if you know the impacts on finances, risk, operations and services” of all the sections of a typical sophisticated commercial lease and you understand the needs of your company tenant, negotiation is simply a default condition. So, the sections in the syllabus which layout “negotiation” issues and positions, will

be for students to practice out of class the negotiations and bring their experiences and questions back to class for discussion and elaboration.

Lastly, this will be a graded course. The grade will be a subjectively weighted average of attendance, participation in class and completion of the “project” described at the end of the syllabus appearing along with the mandatory and optional course texts and workbooks.

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A. LEASING IN GENERAL

1. THE HISTORY AND TITLE/NATURE OF THE LEASE DOCUMENT

- a. License, occupancy agreement, Indenture and now demising
- b. How land and improvements treated in Common Law
- c. Readings on evolution of the grant/demise
- d. The major purposes of a Lease: Early Cash Flow, Transfer of Obligations, Shifting of Costs & Responsibility/Compliance and Creditworthiness/Durability

2. INDENTURE, CONVEYANCE, DEMISE OR CONTRACT?

- a. Term of years, Present Demising, grant with covenants/run with land: Title, Superior Interests, Lease Priority and Durability/Priority of Encumbrance
- b. Conditions of limitation, precedent or subsequent
- c. Hell or High Water Financing Instrument
- d. Executory Interval and Contract Interval and delayed demise
- e. Regulation of ownership/shares and operations of tenant entity
- f. Regulation of use, exclusives, exclusions and products/operations

3. LEASE FORMS: 1950s, 1970s and "KILLER" forms of 1980s

- a. Shifting of risk, hidden costs, imbedded profits
- b. Transfer of responsibilities, compliance with laws, repairs and maintenance
- c. Absolutely Net
- d. Pyramiding and layering of definitions
- e. Duties of disclosure or "fiduciary duty" and fair dealing (NY vs. Maryland)
- f. The emergence of the "Work Letter", "Work Fund" and "TI"
- g. Landlord builds TI and assumes time, delivery condition and compliance risks
- h. Tenant builds TI and assumes delivery condition, compliance, strikes and fire
- i. "As is", "Where is" and delivery conditions and latent defects of space or building and permits, plans filing and inspections: whose responsibility and shifting and time and costs

4. TERM SHEET, LETTER OF INTENT: COVERAGE/BINDING OR NOT

5. LEASE COVENANTS, WARRANTIES AND REPRESENTATIONS

6. STATUTORY PROVISIONS AND OVERLAY (REASONABLENESS?)

7. THE SPACE, AREA, SKETCH, MEASUREMENT OF "DEEMED TO BE"

- a. Carpetable, usable, FAR, allocable
- b. Cross-hatch responsibilities and demising-the cross-hatching trap

- c. Econometrics of the use of commencement Dates
- d. The “as-of” dating and moving trigger dates in jurisdictions
- e. Common Law of Building, Land and Common Elements and rights to use

8. USE, RIGHTS, COVENANTS (IMPLIED OR EXPRESS), REPRESENTATIONS, AND THE CERTIFICATE OF OCCUPANCY/ZONING

- a. No warranty of suitability-some states limited warranty of habitability
- b. No warranty of use or right to use/zoning
- c. NY law, w/o warranty and covenant, pay even though no use allowed

B. SITE SELECTION (the “Balancing Act”)

The factors to be considered are as follows:

1. BASIC REQUIREMENTS: (in order of importance)

- a) Will possession conform to time constraints?
(Remember Murphy’s Law).
- b) Total price tag (rental escalations, Tenant improvements, rent concessions, tax structure, capital improvements necessary).
- c) Landlord’s reputation (stable landlord, financing in place, etc.).
- d) Location of building (transportation, ancillary services, surrounding area).
- e) Term available (options possible?). Title superiority-ground leasehold?
- f) Size of floors (layout and loss factors).
TYPICAL LOSS 20% - FULL FLOOR VARIATION 15% - 30%
FOR SUBDIVISION.
- g) Availability of future expansion.
- h) Facilities (zoned HVAC, power supply, security, computerized environment, elevators, amenities, storage available? restaurant? banking?).

2. BUILDING UNDER CONSTRUCTION

Advantages

Disadvantages

- a) Discounts for pioneers

- a) Timing treacherous
(strikes, etc.)

Advantages

- b) Maximum flexibility available for special needs
- c) Landlord needs you for credibility – negotiations easier.
- d) Long planning time frame

Disadvantages

- b) Getting what you don't see
- c) The Landlord in trouble trouble syndrome (renegotiations as necessity)
- d) No discussion with existing tenants.
- e) No track record for assessing escalation factors

3. EXISTING BUILDINGS:

Advantages

- a) Timing usually controllable
- b) Getting what you see
- c) Completion generally assured
- d) Discussion with existing tenants
- e) Escalation easier to determine

Disadvantages

- a) Price tag generally higher except in bad market
- b) Loss of flexibility (space expansion, HVAC, electricity, needs, staircases)
- c) Landlord generally more difficult - negotiation harder (unless vacancy rate is high)
- d) Shorter time frame to plan

C. IMPORTANT LEASE CLAUSES (EARLY RESOLUTION VARIETY)

While the following clauses are of significant importance, they are usually agreed upon between the parties before the Lease is drawn. There is usually very little dispute because the solutions are either dictated by the Landlord or the Tenant and, unless the solutions are acceptable to the other side, the transaction aborts.

1. THE LEASED PREMISES:

- a) Size of premises and individual floors (necessary for planning and operations).

- b) Location of premises (high floors or low floors).
- c) Availability of contiguous expansion space (if expansion is contemplated).
- d) Storage space.
- e) Usable vs. rentable

2. LENGTH OF TERM OF LEASE:

- a) Original term (usually minimum of 10 years)
- b) Renewals (one or two-five year renewals at fair market value or agreed rent).

3. BASIC RENTAL

- a) How computed (usually \$ per square foot but sq. footage is misleading - rentable or usable - loss factor).
- b) Rent concessions (subject to negotiation - if successful should cover all rent and additional rent).

4. POSSESSION - BUILDING BEING CONSTRUCTED:

- a) Concept of ready for occupancy (i.e. Landlord's work substantially completed, all HVAC elevators, lobby areas, utilities in and operative).
- b) Concept of outside dates (minimum and maximum, remedies of Tenant). IS CANCELLATION REALLY A REMEDY?

5. POSSESSION - EXISTING BUILDING

- a) Concept of ready for occupancy still applies, but limited to work in Tenant's space.
- b) Outside dates - (less critical since completion in time is probable).

D. LEASE CLAUSES INVOLVING DIFFICULT AND TIME CONSUMING NEGOTIATION

The important lease clauses which are potential deal-breakers consist of those which are primarily monetary and those which are primarily non-monetary at lease signing, but could later have monetary implications. The ultimate resolution of these clauses depends on several factors such as (a) the site (b) the time frame (c) size of tenancy (d) Landlord's desire to deal (e) desirability of building, etc.

Monetary Clauses ("Deal Breakers")

- 1. Tax increases
- 2. Porters' wage increases
- 3. Operating expense increases
- 4. Utility charge increases

5. Electricity clauses
6. Consumer Price Index (“CPI”)
7. Rent concessions
8. Landlord’s contributions - work allowances,
Tenant improvements (“TI”)

Non-Monetary Clauses (“Deal Breakers”)

9. Assignment - subletting
10. Options (renewal, expansion, cancellation contraction, rights of offer or refusal)
11. Agreements with lenders
12. Building operation and security
13. Limitations of liability
14. Financial capability security deposits - guarantees
15. Insurance
16. Resolution of disputes
17. Improvements, alterations and repairs
18. Compliance with laws (environmental or otherwise).

Minor Clauses (Not “Deal Breakers”)

19. Damage and destruction
20. Liens
21. Personal property
22. Bankruptcy
23. Tenant defaults

E. IN-DEPTH ANALYSIS OF THE MONETARY “DEAL BREAKERS”

1. Rent Adjustments Based on Increases in Real Estate Taxes
(Typically found in all leases in excess of 2 years)
 - a) The Importance of This Clause To The Landlord:
 - (i) Stabilization of Landlord’s cash flow during term of lease.
 - (ii) Provides Landlord with funds to pay real estate taxes when due.
 - (iii) Provides lenders assurance that their security will not be impaired.
 - b) The Importance of This Clause To The Tenant:
 - (i) Creates additional rental liability.
 - (ii) Creates additional rent and occupancy tax liability.
 - c) The Component Parts of The Clause:
 - (i) Definition of Taxes
 - a. real estate
 - b. income
 - c. BIDS
 - (ii) Exclusions

- (iii) Tax base (deferrals and abatements and reductions during term)
 - (iv) Computation of Tenant's proportionate share.
 - (v) Timing of taxes due.
 - (vi) Certiorari proceedings.
 - (vii) Refunds for overpayments.
- d) What Tenant Really Needs
- (i) A reasonable tax base.
 - (ii) Protection against distortion by sale, etc.
 - (iii) Fair proportionate share.
 - (iv) Certiorari proceedings.
- e) What Landlord Really Needs
- (i) A reasonable tax base.
 - (ii) Timely payment of tax share.
- f) Acceptable Resolutions
- (i) Dollar amount only if it equals or exceeds actual taxes.
 - (ii) Protection against distortion by sale, etc.
 - (iii) Monthly payments.
 - (iv) Adjustment if tax increase varies from norm for comparable buildings.

2. Porters' Wage Increases

- a) The Importance of This Clause to The Landlord
- (i) Provides protection against increased expenses and inflation.
 - (ii) Simple Formula.
- b) The Importance of This Clause To The Tenant
- (i) Provides for increase in rent, which is based on an artificial index (i.e. wages of employees in office buildings).
 - (ii) Creates additional rent and occupancy tax liability.
- c) The Component Parts of The Clause
- (i) Definition of wages (with/without fringe benefits).
 - (ii) Rate of increase (1¢ - 1¢ or 1.5¢ - 1¢).
 - (iii) Base wage rate.
 - (iv) Payment schedule.
- d) What Tenant Really Needs
- (i) Replacement with an operating expense clause, if possible.
 - (ii) "Cap" on annual increases
- e) What Landlord Really Needs
- (i) Right to flip to operating expenses formula.
 - (ii) Protection against distortion (wages vs. expenses).

- f) Acceptable Resolutions
 - (i) Use clause only for short term leases (i.e. 3 years or less).
 - (ii) Get a “cap” on increases.
 - (iii) Use other indices (expense increases - CPI, etc.) as basis for adjustment.
 - (iv) Eliminate fringes as basis of computation.

3. Operating Expense Increases

- a) The Importance of This Clause to The Landlord
 - (i) Stabilization of cash flow.
 - (ii) Provides lenders assurance that their security will not be impaired.
 - (iii) Uniformity.
- b) The Importance of This Clause To The Tenant
 - (i) Creates additional rental liability.
 - (ii) Creates additional rent and occupancy tax liability.
- c) The Component Parts of The Clause
 - (i) Base rate.
 - (ii) Definition of “operating expenses”.
 - (iii) Exclusions.
 - a. capital expenditures
 - b. management fees
 - c. overhead costs
 - d. insurance deductibles
 - e. retail space
 - (iv) Proportionate share.
 - (v) Statements.
 - (vi) Payments (how computed).
 - (vii) Annual adjustments (refunds or underpayments).
- d) What Tenant Really Needs
 - (i) Fair base rate (adjustable for new services).
 - (ii) Fair proportionate share.
 - (iii) Qualification of “capital improvements”.
 - (iv) Right of review.
 - (v) “Standards” for expenses.
 - (vi) Protection vs overcharges.
 - (vii) Good “exclusions”.
 - (viii) SUNSET CLAUSE
- e) What Landlord Really Needs
 - (i) Protection against increases in cost of building operations.
 - (ii) Protection against items of expense not in Landlord’s control.
 - (iii) **Binding and conclusive clause**

- f) Acceptable Resolutions
 - (i) Representative base rate adjusted for occupancy.
 - (ii) Proportionate share based on true ratio of space to size of building.
 - (iii) Capital improvements required by future laws may be considered proper part of “expenses” but amortized over useful life.
 - (iv) Projected share of payments based on actual increases or penalty if Landlord overcharges.
 - (v) Right of review and audit.

4. Electricity Clauses

- a) Direct Electric – Simplicity
- b) Submetering
 - (i) Pay according to usage
 - (ii) Rate schedule (1970 rate schedule)
 - (iii) Administrative charge
 - (iv) Initial cost to submeter
- c) Rent Inclusion
 - (i) Increases vs. decreases
 - (ii) Profit center
 - (iii) Survey – subjective
 - (iv) No equipment costs
- d) Electric Capacity
- e) Interruptions in Service

5. Consumer Price Index (“CPI”)

- a) The Importance of This Clause to The Landlord
 - (i) Hedge against inflation in long term leases.
- b) The Importance of This Clause To The Tenant
 - (i) Adds to rental cost.
 - (ii) Increases rent and occupancy tax.
 - (iii) **Artificial indices – does not reflect real estate market.**
- c) The Component Parts of The Clause
 - (i) Base year.
 - (ii) Type of index used.
 - (iii) Method of calculation.
 - (iv) Method of payment.
- d) What Tenant Really Needs
 - (i) Fair base year.
 - (ii) Reasonable index.
 - (iii) Based on portion of rent which is Landlord’s return.
 - (iv) “Cap” on increases.

- e) What Landlord Really Needs
 - (i) Fair base year.
 - (ii) Reasonable index.
 - (iii) Cover loss of buying power on Landlord's profit.
 - (iv) Adjustment at reasonable intervals.

- f) Acceptable Resolutions
 - (i) **Exchange for periodic fixed rent increases (i.e. 10%-20% every 5 years).**
 - (ii) Use of C.P.I. (Northeast-all wage earners).
 - (iii) Computation on fraction of rent not otherwise covered by escalation clauses (exclude electricity cost, operating expenses, taxes, debt service, etc.) – **Applies to all fixed increases also**

6. Rent Concessions

- a) The Importance of This Clause To The Landlord
 - (i) Major inducement to Tenants.
 - (ii) Shows higher rent to lenders and purchasers.
 - (iii) Higher rent for renewals, increases and CPI adjustments.
 - (iv) Reduces immediate cash flow.

- b) The Importance of This Clause To The Tenant
 - (i) Substantial short term savings.
 - (ii) Appropriate timing (i.e. big expenses at lease commencement).

- c) The Component parts Of The Clause
 - (i) Size of concession.
 - (ii) What it covers.
 - (iii) When it takes effect – **Don't want fixed dates.**

- d) What Tenant Really Needs
 - (i) Protection against loss of concessions (lender's approval).
 - (ii) Coverage of all rental items.
 - (iii) Real concession - **not effective until occupancy.**

- e) What Landlord Really Needs
 - (i) Financially stable Tenant.
 - (ii) Enough other benefits to warrant granting rent concession.

- f) Acceptable Resolutions
 - (i) Concession covers all rent but not cost of electricity.
 - (ii) Staggered concession over period of years.

7. Landlord's Contributions - Work Allowances
Tenant Improvements ("TI")

- a) Distinguish between Landlord's work and Tenant Fund
 - (i) Turn key.
 - (ii) Work allowances.
 - a. Control over contractors
 - b. Control over payment
 - (iii) Landlord's work subject to cap – competitive bidding.
- b) The Importance of This Clause to The Landlord
 - (i) Major outlay - often non-recapturable when Tenant vacates.
 - (ii) Control of installations, improvements and timing.
- c) The Importance of This Clause to The Tenant
 - (i) Minimizes cost of occupancy.
 - (ii) Ability to determine nature of installation and use of funds.
- d) The Component Parts of The Clause
 - (i) Landlord's basic work.
 - (ii) "Tenant's Work" - Who does it? - How and when paid for?
 - (iii) Permitted use of Landlord's funds.
- e) What Tenant Really Needs
 - (i) Protection that funds are available when needed.
 - (ii) Right to use excess funds as concessions or soft costs or for Tenant furnishings and moving expenses
 - (iii) Right of competitive bidding.
- f) What Landlord Really Needs
 - (i) Some control over type of installation.
 - (ii) Protection against default – Letter of credit, Bond, Personal Guaranty.
- g) Acceptable Resolutions
 - (i) Landlord has limited right to review installations. Quick decision making essential.
 - (ii) Tenant has right of competitive bidding
(should Landlord have right to bid with its general contractor?)
 - (iii) Availability of funds on pro-rata basis.
 - (iv) Excess funds available to Tenant (but not in cash).

F. LET'S MAKE A DEAL – The Instructor and Class Members will all participate in a deal making negotiation and review of a "Workletter"(handout).

G. IN-DEPTH ANALYSIS OF THE NON-MONETARY "DEAL BREAKERS"

1. Assignment - Subletting

- a) Legal framework
 - (i) Legal distinctions between assignment and subletting
 - (ii) The Importance of This Clause to The Landlord
 - (iii) Protects flexibility in occupancy requirements (recapture rights).
 - (iv) Protects integrity of tenants (type of tenant and number)
 - (v) Elimination of renting competition.
 - (vi) Source of additional income (important for “down-market” lease)
 - (vii) Original Tenant not released

- b) The Importance of This Clause to The Tenant
 - (i) Flexibility for change in operations (growing).
 - (ii) Cost-savings by space reduction (“down-market” assignment subletting).
 - (iii) Source of profits (“up-market” assignment/subletting).
 - (iv) Landlord has no obligation to mitigate damages.

- c) The Component Parts of The Clause
 - (i) Initial prohibition vs. assignment/subletting.
 - (ii) Procedure for Landlord’s consent (notification, time frame).
 - (iii) Restrictions as to prospective tenants.
 - (iv) Landlord’s recapture rights (types of recapture, termination, assignment and subleasing i.e sandwich).
 - (v) When to recapture, notice of intention, term sheets and signed deal.
 - (vi) Who pays for demising?
 - (vii) Recission right.
 - (viii) Recapture for all of the space and for all of the term.
 - (ix) Who gets profits? (What are “profits”?)
 - a. Net vs. Gross – broker’s fees. attorneys fees, work contribution, free rent and downtime original costs.

- d) What Tenant Really Needs
 - (i) Right to assign/sublet to “affiliates” and sell business without Landlord’s consent, recapture or profit sharing.
 - (ii) Quick approvals by Landlord in all other cases (not to be unreasonably withheld).
 - (iii) Effective right of redress (expedited arbitration).
 - (iv) Protection of flexibility (protection of term, nature of subtenant, alterations, etc.)
 - (v) Right to keep reasonable share of profits.
 - (vi) Reasonable flexibility.
 - (vii) Desk space
 - (viii) Subtenant non-disturbance
 - (ix) Further subletting.
 - (x) Use alterations and signage controls.

- e) What Landlord Really Needs
 - (i) Right of recapture if Tenant assigns lease or sublets for balance of term.
 - (ii) Reasonable profit-sharing.
 - (iii) Reasonable protection vs. competition (exclusion of existing tenants and actively negotiating parties).
 - (iv) No money damages for failure to withhold, Bad Faith exception.
 - (v) Criteria for withholding consent – use, financial worth, and meet standards of the building.
 - (vi) Dividing up floor.
 - (vii) Market rent; and
 - (viii) Landlord’s agent as exclusive broker.
 - (ix) Control marketing and advertisements.

- f) Acceptable Resolutions
 - (i) No Landlord’s consent for assignment/subletting to “affiliates”.
 - (ii) 30 day right of first offer to Landlord; 10 days thereafter.
 - (iii) No solicitation of existing tenants(possible exception if Landlord does not have comparable space available within reasonable time (i.e. 6 months).
 - (iv) No solicitation of parties with whom Landlord is actively negotiating.
 - (v) 50%-50% split of profits (expenses come off the top; profits when received not “receivable” and should not be amortized).
 - (vi) Recapture okay if assignment or sublet for balance of term, provided Tenant’s share of “profits” are protected.
 - (vii) “Excepted Space” concept - reasonable space not subject to Landlord’s rights.

- g) Mock Negotiation of an Assignment/Subletting Clause

2. Tenant Options Generally

- a) The Importance of These Clauses to The Landlord
 - (i) Affects ability to deal with all space in building.
 - (ii) Creates difficult timing problems.
 - (iii) Limits long range planning.
- b) The Importance of These Clauses to The Tenant
 - (i) Creates flexibility as to term and needs **(if you can get them, take them)**.
 - (ii) Helps with monetary planning.
 - (iii) May become a “bargaining chip”.
- c) The Component Parts of The Clause
 - (i) Definition of the option.
 - (ii) Time of exercise.
 - (iii) Procedure for exercise.

- d) What Tenant Really Needs
 - (i) Options that meet most important needs.

- (ii) Effective timing and procedures.
- (iii) Fair treatment if option is exercised or not.

- e) What Landlord Really Needs
 - (i) Minimization of adverse impact on planning.
 - (ii) Minimization of income loss.
 - (iii) Quick decision-making by Tenant
 - (iv) Conditions, same tenant, financial criteria, payment history.

3. Renewal Option (fixed rental)

- a) Time of exercise - usually 1 year before term expires (“time is of the essence).
- b) Forgetting.
- c) Known cost to both parties.
- d) Usually not less than the then existing rent.
- e) May be part of space only (also applies to 2.2)
 - (i) Protect contiguity.
 - (ii) Appropriate reduction of rental.
 - (iii) Revision of proportionate share and any other provision based on square footage.

4. Renewal Option (fair market value or percentage thereof)

- a) Time of exercise usually 1 year but rent determined as of 6 months prior to expiration.
- b) Disputes usually settled by arbitration
 - (i) (i) Three arbitrators (third arbitrator picked by other two).
 - (ii) (ii) “Baseball” arbitration.
- c) “Bail-out” provision (good or bad?).
- d) Determination of “fair rental value”
 - (i) Limit to term of renewal.
 - (ii) Space considered “as is”.
 - (iii) Adjustment for then market concessions
 - (iv) Deduction for renting commissions.
 - (v) Floor of then escalated rent
 - (vi) Base years.
- e) Determination of “fair market value” of property (only used when Tenant occupies entire building)
 - (i) (i) Property valued as if vacant, unimproved and unencumbered.
 - (ii) (ii) Highest and best use.
 - (iii) (iii) Specified rate of return.

5. Cancellation Option by (Tenant)
 - a) Time of exercise usually not available until the passage of several years and the usual one-year notice required (depending on size of space).
 - b) **May be only part of total premises otherwise know as a Shedding or Contraction option.**
 - c) Negotiated penalty representing loss of deal.
 - d) Quantifies Tenant's cost of vacating.

6. Cancellation or Relocation Option (by Landlord)
 - a) Time of exercise may be short if Tenant is relocated.
 - b) All relocation at Landlord's expense – comparable space.
 - c) If Tenant gives up space - received negotiated penalty for loss of deal.
 - d) Grants Landlord degree of flexibility in leasing plans.
 - e) Demolition

7. Right of Expansion (not required taking by Tenant)
 - a) Right to take space at given time in future.
 - b) Rent may be at Tenant's then rent or fair market value.
 - c) Tenant improvements and concessions should be considered – **prorate concessions.**
 - d) Sliding timeframe if earlier or later possession occurs.
 - e) Be sure expansion space is included in all other options.

8. Right of First Refusal
 - a) Right to match a deal about to be made.
 - b) Refusal or acceptance based on existing documents.
 - c) Hinders making deal with other party.

9. Right of First Offer
 - a) Preliminary offer without a deal.
 - b) Right to accept (in which event papers are drawn).
 - c) If offer is rejected, deal may be made with third party upon terms no worse than preliminary offer.
 - d) Revised offer if terms change - short-fuse.
 - e) Not a hindrance to dealing with third party.

10. Resolution of Disputes
 - a) The Importance of This Clause to Both Parties
 - (i) Fair, quick method of resolution needed.
 - (ii) Picking proper parties to solve disputes.
 - (iii) Avoids costly legal fees.

- b) The Component Parts of The Clause
 - (i) Number and qualifications of arbitrators and appraisers (should they be impartial?).
 - (ii) Procedure for resolution of dispute (AAA?).
 - (iii) (iii)Time frame from beginning to conclusion.
 - (iv) (iv)Binding decision.
 - (v) (v) Who pays fees? (usually split).
- c) Acceptable Resolutions
 - (i) (i) Short resolution of consent to subletting or assignment, alterations, legal content of documents (one named qualified party acceptable to both Landlord and Tenant).
 - (ii) (ii) Any other dispute can be resolved by arbitration or appraisal. Landlord picks one - Tenant picks one - then the two pick the third arbitrator. (a) AAA rules are acceptable.
- d) Right to call witnesses and submit documents.

11. Limitation of Liability Provisions

- a) Landlord's Liability
 - (i) Generally limited to equity in building.
 - (ii) Necessity to get offset and guarantee of dollars needed for Tenant improvements, takeover
- b) Liability of Corporate Tenant
 - (i) Usually unlimited liability to Landlord.
 - (ii) "Dummy corporation" concept.
 - (iii) Requirements to maintain net worth as basis of default.
- c) Liability of Partnership Tenant
 - (i) Usually unlimited liability to Landlord.
 - (ii) "Law firm rebellion" (partnership assets vs. partners assets).
 - (iii) Minimum net worth concept for release of partners.
- d) LLPs and LLCs

12. Security Deposit

- a) Cash Security
 - (i) Deposit in interest-bearing account.
 - (ii) Interest paid annually (1% fee to Landlord).
 - (iii) Periodic reductions in security tied to reduction in term of lease. (Burn offs)
 - (iv) Reduction tied to no deficits and net worth of Tenant.
- b) Letters of Credit
 - (i) What are they?
 - (ii) Advantages to Tenant.

- Cost (usually ½% to 1%)
- Frees cash tied up as security.
- Utilization of banking relationship.
- (iii) Advantage to Landlord's (bankruptcy)
- (iv) Draw down procedures.
- (v) Duration (usually limited to one year).
- (vi) Effect of non-renewal or draw down.
- (vii) May be automatically reduced or extended. (Evergreen)

13. Improvements and Repairs

- a) Landlord's Obligations For Repairs
 - (i) All common areas.
 - (ii) Plumbing, HVAC, electricity and all systems.
 - (iii) Structural repairs of all kinds.
 - (iv) Roof and exterior repairs.
 - (v) Windows.
- b) Tenant's Obligations for Repairs
 - (i) Non-structural interior repairs.
 - (ii) All repairs to Tenant's fixtures, furnishings and equipment.
 - (iii) All repairs caused by Tenant's negligence.
 - (iv) Private facilities (elevators, toilets, etc.).
- c) Improvements and Alterations Requiring Landlord's Consent.
 - (i) All structural improvements.
 - (ii) All exterior improvements.
 - (iii) Improvements affecting HVAC and other building systems.
 - (iv) Dollar threshold for consent.
- d) Improvements Without Landlord's Consent
 - (i) All cosmetic improvements.
 - (ii) All non-structural interior improvements below threshold.
- e) Restoration Obligations
 - (i) Lease language usually grants Landlord option to require removal or not of alterations (pin Landlord down at time of consent).
 - (ii) Tenant usually required to remove all fixtures, furnishings and equipment.
 - (iii) Tenant obligated to repair damage caused by removal of property.

14. Disturbance and Subordination Agreements

- a) What are they?
 - (i) Total recognition.
 - (ii) Partial recognition (exclusion for concessions, Tenant improvements, dollar advances, etc.)

- b) Who needs them? (how important?)
- c) How obtainable? (variations of rental or term)
 - (i) From Landlord in case of subletting.
 - (ii) From Landlord's lenders.
 - (iii) From land owner in ground lease transaction.
- d) When are they obtained and remedies for not obtaining
- e) Covenants to obtain reasonable efforts/best efforts.

15. Guarantees of Performance

- a) Unlimited Guaranty of Lease Performance By Tenant
 - (i) Individual guaranty.
 - (ii) Corporate guaranty (must be financial relationship).
- b) Limited Guarantees
 - (i) Time limitation.
 - (ii) Dollar limitation.
 - (iii) Payment and not performance
 - (iv) Prompt surrender guaranty with rent current.
 - (v) Prompt surrender guaranty no liability for accrued rent.
 - (vi) Construction guaranty.

16. Miscellaneous Trouble Areas

- a) Delivery of Possession of Premises Where Landlord Has Work to Complete
 - (i) Effect of Landlord's notices stating when premises will be delivered with work "substantially complete" (Tenant needs right to dispute).
What is substantially complete?
 - (A) Lobby area and all common facilities
 - (B) HVAC and all building systems operating
 - (C) Unrestricted normal access to premises
 - (D) Temporary certificate of occupancy
 - (E) All construction materials removed from premises
 - (F) No restriction vs normal usage by Tenant
 - (G) **Delays and changes by Tenant**
- b) Overtime HVAC Service By Landlord
 - (i) Overtime HVAC (usually at fixed dollar per hour rate but excessive).
 - (ii) Fix Landlord's cost plus 5%-10% as basis for charge (escalation of landlord's costs okay if items of expense are initially specified).
 - (iii) Get benefit of cost-sharing when service is used concurrently with other tenants.
 - (iv) Individual Units
- c) Creating Operational Standards for the Building

- (i) General standards (i.e. first-class office building).
 - (ii) Elevators (usage and number)
 - (iii) HVAC specifications
 - (iv) Access to premises
 - (v) Cleaning specifications
 - (vi) Security procedures
- d) Consents and Approvals Generally
- (i) “Not to be unreasonably withheld or delayed”.
 - (ii) Realistic time-frame for response.
 - (iii) Objections should be specific.
 - (iv) Failure to object timely should equate to approval.
 - (v) Costs should be reasonable.
- e) Abatement of Rents Generally
- (i) Event of a casualty (get waiver of subrogation provision).
 - (ii) Unavailability of an essential service.
 - (iii) Offsets plus interest (Landlord’s contribution).
- f) Compliance With Laws
- (i) Tenant should be obligated only to comply with laws to extent of non-structural changes arising out of Tenant’s particular use of premises as distinguished from “general Office use”.
 - (ii) Total compliance is Tenant’s obligation as to subsequent alterations by Tenant during term.
 - (iii) ADA requirements - who is liable for compliance?
 - (iv) Asbestos removal - who is liable for compliance?
 - (v) Environmental laws - who is liable for compliance?
- g) Insurance Provisions
- (i) Fire and extended risk insurance - what it covers and who pays for it?
 - (ii) Liability insurance - what it covers and who pays for it?
 - (iii) Rent insurance - what it covers and who pays for it?
 - (iv) Plate glass insurance - what it covers and who pays for it?
 - (v) Blanket policies
 - (vi) Catastrophe insurance – War and Terrorism Impact on Operating Expenses
 - (vii) Deductible provision
 - (viii) Waiver of subrogation clause
 - What is it?
 - Why is it necessary?
 - Should it be mutual?

MATERIALS:

REQUIRED TEXT: NEGOTIATING AND DRAFTING OFFICE LEASES, LAW JOURNAL SEMINARS PRESS (Library of Congress ISBN 1-58852-061-7, 1995), Two volume Treatise (2000 pages) , updated 2 times per year, can be obtained by calling American Lawyer Media: (800) 603-6571 or (212) 313-9300 and ask for your student 40% Discount for NYU Students. The current cost is about \$300 without discount and should run about \$150 with the NYU Student Discount. Please email me, jbwood@tklaw.com if you run into any difficulty obtaining the Treatise.

QUANTITATIVE ANALYSIS: NAVIGATING THE DANGEROUS SHOALS OF A COMMERCIAL LEASE: Download for Free the Facilities Director's Handbook from www.officeleasingusa.com, under the tab "Additional Resources" (approximately 100+ pages in pdf format). This handbook was utilized by the NYU Graduate School as a course text for real estate valuation courses in 1992-1996 and was published then by NYU. It is an econometric treatment of leases as financial instruments and will complement the regular course materials and lectures.

THIS WILL BE A GRADED COURSE: Grading will be based on attendance, class participation and a course end project. I will discuss on the first night and the last night the project you will need to present to me within one week after the last class. The report must be in writing (MSWord, WordPerfect or Lotus WordPro) and emailed to me. The file name must contain you name. It will be no longer than 3 pages long, double spaced, 12 point times roman font and with 1 inch margins on 8X11 inch paper, one sided. The project paper will be in two parts, as follows:

I. What in your opinion are the 10 most important financial, operation and risk areas of a commercial lease and if you were to represent a tenant, how would you wish to have them dealt with in a lease? Not the language, but the concepts. For instance, one could be the shifting of the fit-out or initial installation and preparation of the space for the tenant, who should do it, what risks and costs and time impacts would be accommodated if you got your best tenant language.

II. What are five very important goals a Landlord has when drafting or designing a form of lease for his or her property to lease to others? Economic, risk, financial and liability are all good candidates to be included and there are of course others. For instance ease of negotiation and fair dealing in order to lower legal fees and shorten the negotiation and start the contract term most quickly would be one example. Shifting of risk, insurance, compliance etc. are some others which you may wish to develop in your paper. Then tell me what the economic impact or benefits are with respect to each.

JOHN BUSEY WOOD

John Busey Wood leads the commercial real estate group at the New York City office of the law firm Thompson & Knight LLP, and advises public and private companies on real estate acquisitions, facilities management, construction and development, brokerage law, commercial leasing, commercial property management and litigation. For over 30 years 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. He has assisted large volume space users in the effective management of their facilities portfolios and in reducing costs and risk. These experiences, coupled with a 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 resulted in his being featured in articles on the impact of commercial leases on companies and being referred to by The Wall Street Journal and other publications as "the father of the modern killer lease." His extensive national experience in developable land, improved property acquisitions, large scale retail and office developments, and leasing and management programs have made him an ideal corporate facilities support resource for companies. He is a noted authority on fair market value determination and valuation of properties as well as rental escalations, expenses, allocations, auditing and litigation/dispute resolution. Among noteworthy projects, Mr. Wood directed the legal team in a national portfolio acquisition with a value in excess of \$2 billion and he participated in the development, leasing and financing of over 4 million square feet of regional shopping malls and retail centers nationwide. In 1998 he negotiated the largest ground/space lease transaction in the history of New York City, containing more than 1.6 million square feet and including "fast-track" rehabilitation, construction lending, permanent financing and options for fee acquisition. In addition, Mr. Wood has advised, directed teams and designed correlated construction contracts for "fast-track" design-build projects, conversions and renovations in New York City, exceeding 8 million square feet, with values greater than \$4 billion. Mr. Wood has also directed large-scale leasing programs for major New York City office towers and mixed use properties. He regularly directs litigation teams in landlord-tenant disputes, construction disputes and retail lease close-outs. His financing, auditing and computer expertise contributed to his uncovering the largest computer-leasing fraud in the United States, the O.P.M. Leasing fraud. Mr. Wood is a licensed Class "A" commercial real estate broker, 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 a member of the Association of the Bar, NYC, New York State Bar Association, American Bar Association ("ABA"), (Vice-Chair of the Commercial Leasing Committee and former Chair of the Office Leasing Subcommittee), and Board of Legal Advisors to the Practising Law Institute ("PLI"). He has been a member of the Board of Directors of the International Association of Corporate Real Estate Executives (NY Chapter), American Institute of Certified Public Accountants ("AICPA"), and American Association of Attorney-CPAs. Mr. Wood served, from 1982 through 1991, as a member of the Associated Builders and Owners of New York, the New York Building Congress and its Board of Legal Advisors, and the Real Estate Board of the City of New York ("REBNY"). Mr. Wood frequently lectures on property acquisition and management, commercial leasing and construction contract techniques, transaction structuring and brokerage law at major real estate brokerage firms in New York City, REBNY, and at the New York University Graduate School and Real Estate Institute. He also

lectures at PLI, where he is the New York and national Chairman of the National Commercial Leasing Seminars, and at the executive and annual meetings of the ABA and AICPA. Mr. Wood has frequently served as a “party selected” and Federal arbitrator and with the A.A.A. in fair market rent valuation and rental/expense/adjustment disputes and audits and he is an American Arbitration Association - National Neutral - Commercial Panelist. He has also served as Assistant Attorney General (Kansas), and as special counsel to Bronxville Board of Zoning Appeals, Planning Board and Board of Trustees and is a member of the Westchester-Putnam Boy Scouts of America Council and the National Eagle Scout Association.

Mr. Wood has presented papers on "Equity Leases" and “Work Letters” to the ABA and on “Accounting and Tax Issues for Work Letters and Allowances” to the AICPA. His article "Trump [Tower] Tenant Finds Turnkey [Construction Agreement] Saves the Day" appeared in the Legal Times of Washington and New York, October 21, 1985. Mr. Wood co-authored, with Alan M. DiSciullo, Esq., the treatise Negotiating and Drafting Office Leases, published by Law Journal Seminars-Press (Library of Congress ISBN 1-58852-061-7, 1995); co-authored "Section V.A, Fire and Casualty Insurance" in the Real Estate Law and Practice Course Handbook , Published by PLI, 1994-2006; co-authored "Building Owner's Assumptions Spark Zoning War", Legal Times of New York, August/September, 1985 and co-authored "Financing Real Estate Development through Participation Leases", Real Estate Review, Volume 20, No. 4, Winter, 1991. He is the author of the book, 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 peer rated by Martindale-Hubbell and was peer-nominated and elected an American Bar Foundation Fellow. Mr. Wood has been Senior Editor of "Real Estate Corner", a monthly article on commercial real estate for corporate professionals published by The Metropolitan Corporate Counsel, Inc. and has appeared on national television speaking on current trends in national real estate.

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