

JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

V. INDUSTRY SEMINARS AND SPEECHES - SHORT TERM

I. Other Presentations In Which Either The Date And /
Or Sponsoring Organization Is Missing

3. Development Topics

- p. Two speech outlines "Commercial Leases",
"Office Leases", and two lease check
lists, no dates

COMMERCIAL LEASES

- I. For the developer of commercial structures it is difficult to say which comes first, the building or the lease. (speaking of multi-tenant projects)
- A. The Bockl Building Saga
 - B. Not only do lenders want leases first; they wish these leases to conform to their idea of what is best security for their loan. Therefore negotiation of a lease involves at least three parties - the tenant, the developer, and the eventual mortgage holder (as distinguished from the construction money man.)
 - C. Ignoring detail provisions of insurance, etc. Lease negotiations are concerned with the ability of the tenant to pay the rent and the strength of the obligation to pay the rent.
 - 1. Capacity to pay is a matter of credit and character and need not concern us here other than to point out AAA tenant leases can serve as collateral more readily than "local risks", a questionable practice as many lenders have found.
 - 2. Legal strength of the obligation in regard to rent collection, lease cancellation, and status in event of mortgage foreclosure or insurance loss.
 - D. AAA tenants can sometimes push for sly cancellation provision in event there is a shift in their market area etc. In addition fire damage etc. may provide the tenant the option of cancelling the lease, and finally financial with the landlord may permit modification or cancellation. In the case of leases to professional persons, death or disability may cancel a lease; for other organizations the landlord may be required to provide expansion space or forfeit the lease. Therefore a 20 year lease may only be good for one year. Indeed, federal bankruptcy laws permit cancellation of a long term lease by a bankrupt by payment of no more than 1 years rent as damages.
 - E. Next the lender is concerned with the effect of foreclosure on the lease. If the lease is made after the mortgage it is subordinate to the mortgage and extinguished should the mortgagee start foreclosure action.

The mortgagee may not want to give the tenant an opportunity to break a lease favorable to the landlord, or conversely, may wish to bargain a new lease at more favorable rent from a given tenant. Each lease must be negotiated as to whether it is superior or inferior to the lease. The wise tenant who values his location and his rental terms will insist on a dominant lease and/or a provision for quiet and undisturbed possession of the premises for the life of the lease.

rent

II. Of course the lender is also concerned with the term of the lease in years, the amount of ~~rent~~ in relation to area and sales volume, and provisions for renewal. ~~XXXXXXXXXXXXXXXBUILDING~~

- A. Lease term for building should be staggered. Not all tenants can move at the same time. Moreover a long term lessee may want room to expand in the future so that his immediate neighbors will be given short term leases. At the same time the lender wants to see a certain proportion of leases which will maintain the cash flow with some degree of stability and a point above the break even point.
- B. For example, if the break even point is 60% and you have leased 60% of rentable area to AAA tenants, they will extend you a loan in anticipation that you will receive some income from local risks for the balance of the property. Solid leases also reduce the vacancy allowance and possibly the cap rate selective. For example if one solid tenant takes 50% of the building, and those renting to local risks face a 10% vacancy ratio, you should expect a vacancy rate of only 5%.
- C. Most commercial leases run for 5 or 10 years and carry options to renew for 10 or 20 years more. As a result commercial loans tend to be 10 or 15 years in duration, with interest ranging from 5 3/4% to 6 1/2%.
- D. The value of percentage leases depends on estimated changes in demand for tenant goods and services over the period of the lease. To the degree that land and building contribute to improvement of earnings, the landlord is entitled to share in the additional earnings there is always the problem of defining and isolating the sales figures to be used and gaining access to the records to audit these figures for the landlord. It is not unknown for a chain store to credit sales to one location rather than another because of lower rent requirements.
- E. Finally we have a long group of lease provisions to pin point the responsibilities of each party in regard to a variety of questions. The object of the lease is to answer as many questions as possible which may arise in the future. Since it not likely to be clairvoyant, the more comprehensive the lease the better. These details would include:

- | | |
|---|---|
| 1. Name under which business is to be conducted | 10. Percentage differentials for varying types of merchandise |
| 2. Prior possession | 11. Off premises sales |
| 3. Continued occupancy | 12. Allowances to tenant for capital improvements |
| 4. Manner of conducting business | 13. Recapture clauses |
| 5. Restriction against other outlets | 14. Escalator clauses |
| 6. Tenant advertising | 15. Condition clauses |
| 7. Subleasing | 16. Purchase options |
| 8. Exclusives | 17. Insurance |
| 9. Differential between wholesale and retail stores | |

OFFICE LEASES

I. Introduction

- A. A lease is a risk management device which is designed to stabilize the set of assumptions which might have been implicit in the minds of the party at the time the contract was made.

II. The office lease.

A. Identification of parties

B. Description of premises and optional areas

C. Definition of rent

1. Base rent
2. Escalator clause
3. Escalator index year and audit
4. Service charges

D. Term of lease and renewals

1. Date of occupancy
2. Conditions of occupancy and penalties
3. Overstay and automatic renewal
4. Prior written notice
5. Use of calendar dates rather than ordinate numbers
6. Subleasing and assignment

E. Conditions of termination

1. In event of casualty loss
2. In event of eminent domain
3. Death or disability of tenant
4. Change of conditions clause for tenant
5. Penalties for tenant as liquidated damages
6. Bankruptcy of either party

F. Performance standards for landlord

1. Failure to perform - Abatement or optional right to terminate
2. Specification as to utility capacity
3. Specification for air temperature and humidity control
4. Specification for window washing, including venetian blinds, etc.
5. Specification for wall-washing and repainting
6. Specification of janitorial services, security systems, hours of elevator service, etc.

G. Insurance Agreements

1. Hold harmless clauses
2. Public liability responsibilities of tenant
3. Fire liability of tenant
4. Insurance of tenant improvements

H. Sign, window, and display controls (including curtains)

I. Constraints on use and tenant selection

1. Restraints on use of tenant space - broadly or narrowly defined
2. Tenant wishes relative to approval of other tenants in the building
3. Remedies

J. Special features and responsibilities

1. Reservation of parking stalls
2. Use of name on building or on tenant directory in lobby
3. Right of landlord to relocate tenant
4. Responsibility for commercial lease insurance
5. Responsibility for legal costs

K. Tenant improvement allowance from landlord

1. Design fees
2. Partitioning
3. Ceiling system
4. Floor system
5. Special utilities
6. Interior decorating
7. Moving expenses
8. Commissions to be paid

L. Subordinations

7. Use - Add "demonstration of lessee's products" and "any other lawful purpose" if using their form.
 - a) If manufacturing is planned, include it in list.

8. Rent -
 - a) A gross rent (i.e. includes utilities and janitor) is most desirable.
 - b) We will not covenant for a security deposit or rental prepayment.
 - c) Rent escalation is undesirable.
 - d) Tax and insurance escalator clause is agreeable after strong resistance.
 - e) Base year should be late in our term, i.e. third year, and apply to renewal periods.
 - f) Do not accept first year base escalator.
 - g) Write clause so that we audit any escalator and concur before any increase is due or payable.
 - h) State rental in annual and monthly terms.

9. Expansion Options -
 - a) Ninety days is normal for giving notice.
 - b) State day and calendar year notice must be given by to renew exercise option whenever possible. For example, "June 1, 1967", not "60 days prior to". This helps to make lease terms more clear.
 - c) Obtain expansion options for additional space if you feel they are a possibility. We move more often for lack of expansion space than for any other single reason.
 - d) Outline expansion areas in green on Exhibit "A" and refer to them.
 - e) State exact square footage, rental rate (same terms and conditions), and calendar date to give notice, etc.
 - f) Be sure to include who does partitioning and who pays for it. (lessor) A dollar limit for improvements might be required.
 - g) Try to get cancellation option at no penalty if expansion space promised cannot be provided.

- h) Try to get repainting for all leased space if take expansion space.
- i) Try for rent reduction if we become major tenant.

10. Renewal Options - a) Renewal options are extremely desirable.

- b) Give exact calendar date of notice due requirements.
- c) Insist on same terms and conditions (or decreases).
- d) A series of many short (1 or 2 year) renewals is desirable.
- e) You may have to agree to tax and insurance escalation.
- f) Try to establish a repainting schedule if we renew.

11. Cancellation - a) A cancellation is a valuable option, insist on it.

- b) Especially if we can get lower rental rate for longer term lease.
- c) The penalty dollar amount must be reasonable.
- d) One or two months' rent is normal.
- e) Try for a clause "or improvement costs for a new tenant, whichever amount is less". This could save many dollars for us.
- f) Lessor usually wants the unamortized portion of his improvement costs as a penalty. This cost must be looked at closely to discount items such as floor tile, ceiling, light fixtures, corridor doors, drapes or improvements that do not need to be replaced for a new tenant if we leave. Or, at least, not fully replaced.
- g) Try for ninety-day notice to cancel, but may have to give more time.

12. Sublet - Must have opportunity to sublet with lessor's approval within 30 days. Try to establish a time limit for lessor's approval or "not to be unreasonably withheld".

13. Alterations - a) Alterations should be allowed with lessor's approval "which shall not be unreasonably withheld."
 - b) We should have the right to remove our alterations at our expense. If not removed, they become the property of lessor.

14. Computer - Installation must be allowed (with specific permission if necessary).

15. Liens - A provision to place a lien on our furniture, fixtures and property is undesirable. Under no circumstances may a lien be placed on our computer.

16. Insurance - A waiver of subrogation must be granted by the lessor. We do not wish to provide certificate of liability insurance. There is usually no direct cost for this waiver to lessor.

17. Parking - a) Ask if rent is reduced if we take no parking.
 - b) If rent is lower, we must take it.
 - c) Be sure if it is building standard by checking other tenants if necessary.
 - d) One space per 300 square feet leased is reasonable to expect. (Rule of thumb)
 - e) The company will not pay extra or rent for parking.
 - f) If no parking, try to secure a reduced rate for our personnel.
 - g) State exact number and nature of parking, i.e. off-street, reserved, assigned, etc.

18. Janitor - Normal five-day janitorial service should be specified or assured, except in very small offices where less frequent service may be adequate.

19. Partitioning - a) At lessor's expense.
 - b) Rule of thumb is ten linear feet per 100 square foot rental.

- c) Cost \$15-\$30 linear feet for fixed.
- d) Cost \$15-\$30 linear feet for moveable.
- e) Fancy partitions with walnut panels, etc. can be used only as per company policy unless the building standard requires it; otherwise we pay for it in rent or cancellation penaltys.
- f) Electric receptacles usually one per 85-100 square feet of leased space.

20. Air Conditioning - a) Necessary for comfort and computers.
- b) Some lessors charge extra for after normal hour use, watch out for this.
 - c) If we are a major tenant, consider specifying temperature range, e.g. 72° F. and 55% relative humidity.
21. Repairs - We will repair minor items in premises (e.g. glass). Lessor makes structural repairs and maintains building (e.g. paint).
22. Damage - If complete, rent abates immediately and an opportunity at lessee's option to terminate the lease should be allowed within 30 days. If partial, rent is pro-rated and repairs must begin soon and must be completed within 90 days. You may have to extend the time for delays caused by acts of God, etc.
23. Litigation - We will not pay lessor's attorneys fees.
24. Lessee Default - We insist on lessor serving notice and a minimum of ten days to correct our default (e.g. omission of rent).
25. Subordination - a) The lease is subordinate to existing mortgages, but our leasehold interest cannot be distrubed if we are not in default.
- b) On subsequent mortgages, our lease will be subordinate if new mortgagee covenants not to disturb our leasehold interest unless we are in default. Lessor is responsible to obtain this covenant in his mortgage agreement.
26. Notices - Should be sent by registered or certified mail to 8100 - 34th Avenue South, Minneapolis, Minnesota 55420 and not to leasehold premises.

26. Notices Cont.

Can be sent to leased premises, but if so, must also be sent to Minneapolis.

27. Termination - Automatic renewal is to be avoided in all cases; we will serve notice of renewal.

28. Overstaying - Any penalty for overstaying is undesirable; if necessary, it should not exceed ten percent of rent.

29. Exhibits - a) Should be labeled "A", "B", etc.

b) Need not be initiated if they are written into lease "attached to and made a part of this lease agreement".

c) Exhibits should show land area if appropriate, office space in relation to other space on that floor, and the approved floor plan.

30. Floor plans - a) Follow company policy for office sizes.

b) Allow about 150 gross-maximum or 100 net minimum per resident person halfway out in manpower projection. Working from layout with names and titles of employees is the best approach to determining how much space.

c) Customer engineers need only storage, work area and one table or desk. They are hardly ever in their office.

c) All sales offices need a storage room or library (about 100 square feet).

d) Allow a quiet place for TWX machine.

e) A 250 square foot conference room is usually adequate. Twenty-five square feet per person is comfortable.

f) If a training room is needed, 25 square feet per student is a rule of thumb.

g) Try to set up clerical girls so the receptionist has a back up that can be seen by visitors if possible.

- h) Attempt to have floor plan show all receptacles, drapes, carpets, telephone outlets, etc. to avoid getting charged for them later.
 - i) A square office is best for three men - one man on each wall.
 - j) Allow one receptacle for each possible secretary location.
 - k) Allow for Xerox and other office equipment.
29. Riders - May be added as exhibits or by "paragraphs 30 through 39 following are added to and are a part of this lease agreement".
30. Rules and Regulations - Building rules and regulations may be added, but a clause should be written into the lease that "if any changes, additions or amendments to the rules and regulations as set forth in Exhibit "B" are unreasonable or are inconsistent with the express or implied terms of this lease, the terms of the lease shall govern."
31. Changes - a) Changes may be added to our standard lease by the "Change No. ___" stamp and numbered consecutively.
- b) A paragraph can be added at the end of the lease "Change No. 1 to paragraph 4, etc. are agreed to by both parties to this agreement".
32. Execution - The name and title of those signing should be typed or stamped below the signature line (before requesting signature).
33. Sign Rights - Are important for identification and advertising.
34. Occupancy (for new construction) - Lessor should pay holding over rent or provide acceptable space at no rent to lessee at our option if space is not ready on time.

MORTGAGE BANKERS ASSOCIATION SCHOOL
Commercial Lease Security Checklist
Prepared by
Prof. James A. Graaskamp
University of Wisconsin

I. Definitions

- A. Specific space and location to be leased
- B. Specific business entity as lessor
- C. Specific business entity as lessee
- D. Specific description of real estate elements to be leased
(Definition of shell provided by landlord and finishes provided by tenant)
- E. Specific exemptions of tenant improvements to remain tenant property

II. Conditions for Commencement of Lease

- A. Conditions permitting cancellation by landlord (lessor)
 - 1. Failure to obtain specified financing prior to construction
 - 2. Death or disability prior to a certain date
 - 3. Impossibility of performance due to acts of God, government, regulation, labor conditions, etc.
- B. Conditions permitting cancellation by tenant (lessee)
 - 1. Completion according to specification
 - 2. Completion according to scheduled time
 - 3. Conditions relative to other occupancies
- C. Remedies of landlord
 - 1. Forfeiture of tenant deposits or escrow funds
 - 2. Liquidated damage provisions
 - 3. Guarantees by others
 - 4. Penalty rents, assessments, etc.
- D. Remedies of tenant
 - 1. Postponement of commencement date
 - 2. Rental abatement
 - 3. Cancellation of lease at option of tenant
 - 4. Penalty payments in contract assessed to the landlord
 - 5. No penalties other than suit for damages

III. Conditions for termination of lease

- A. Death or disability at option of lessee estate
- B. Scope of "change in conditions" clause

- C. Guaranteed occupancy and operations clause
- D. Cancellation liquidated damages formula
- E. Bankruptcy receivership of business termination clause
- F. Assignability clause
- G. Implied good faith effort of percentage lease
- H. Permitted uses clause
- I. Casualty loss event
- J. Condemnation events
- K. Specific conditions subsequent explicitly identified as grounds for termination
- L. Subordination position

IV. Rental Formula

- A. Basic minimum rent
- B. Formula for rental adjustment over time
- C. Renewal options, if any, and base rent
- D. Calculation of prominent area charges and tenant participation in same
- E. Real estate tax escalator clause
- F. Insurance premium stop loss clause
- G. Utility expense stop loss clause
- H. General maintenance and replacement assessments for HVAC, parking, lighting, etc.
- I. Audit of sales and overage rents
- J. Conditions for rental abatement due to casualty loss, remodeling, road construction, or business interruption due to riot, strike, civil commotion, or disruption of public services