

COMMERCIAL LEASING: ANTICIPATING ISSUES AND AVOIDING PROBLEMS

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April 2009

- I. Overview – the Lease is both a contract and a conveyance of an interest in property. Contractual provisions can override common law rights and remedies. The resulting document is often lengthy and complex.
 - A. A lease is also a financial vehicle. The tenant can be the primary credit behind a transaction, and certainly in most deals, the tenants provide the cash flow to operate the project.
 - B. The goal is to be skilled at negotiating a win for three parties to the lease:
 1. Landlord
 2. Tenant
 3. Lender
 - a. The lender is the silent third-party to most transactions and the lease, especially if it is a “key tenant” lease (one involving a credit tenant or large square footage), should be geared toward acceptance by the lender
- II. Common Law and Statutory Presumptions
 - A. The right to possession is one of the bundle of rights which make up “property.” An owner can grant the right of possession to another in several ways:
 1. By license or contractual right, which are terminable in accordance with the terms of the license or contract, generally, with little or no prior notice. These create a lower status right to possession than that which is created by a lease.
 2. By lease, which creates more rights in favor of the tenant than a license.
 3. The term “usufruct” is sometimes used to describe the right to enjoy the benefits of the property of another, without actually having any of the interest in the property itself. A usufruct is “[T]he right of using and enjoying and receiving the profits of property that belongs to another, and a ‘usufructuary’ is a person who has the usufruct or right of enjoying anything in which he has no property interest.” *Marshall v. Marshal*, Tex.App., 735 S.W.2d 587.

- a. One practical effect of being the owner of a usufruct and not the owner of a tenancy is that if the holder of the usufruct is denied possession because a former tenant has held over the premises, then the holder of the usufruct is dependent upon the landowner to pursue an action against the holdover tenant, and the holder of the usufruct has no standing to sue the holdover tenant.
- B. If a landowner grants to another the right to possess property for a period of time, then there is a presumption that a tenancy is created. The tenancy may be one for a period of time, or may be one at will. If the period of time is less than five years, then the presumption under Georgia law is that tenant obtains a mere usufruct, which is neither transferable nor taxable, and which technically is not considered part of the landlord's estate.
- C. If a landowner grants to another the right to possess property for a period of time, then there is a presumption that a tenancy is created. The tenancy may be one for a period of time, or may be one at will.
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§ 44-7-1. Creation of landlord and tenant relationship; rights of tenant; construction of lease for less than five years

(a) The relationship of landlord and tenant is created when the owner of real estate grants to another person, who accepts such grant, the right simply to possess and enjoy the use of such real estate either for a fixed time or at the will of the grantor. In such a case, no estate passes out of the landlord and the tenant has only a usufruct which may not be conveyed except by the landlord's consent and which is not subject to levy and sale.

(b) All renting or leasing of real estate for a period of time less than five years shall be held to convey only the right to possess and enjoy such real estate, to pass no estate out of the landlord, and to give only the usufruct unless the contrary is agreed upon by the parties to the contract and is so stated in the contract.

- 2. The practical difference between a usufruct and lease is generally eliminated by the inclusion in the lease of many contractual provisions which supersede a statutory presumptions regarding usufructs, such as specific assignment clauses.
 - a. The distinction between a usufruct and a tenancy or estate for years is crucial because there are certain obligations which under common law a landlord was responsible under a usufruct which were transferred by virtue of the creation of an estate for years. **O.C.G.A. §44-6-105** provides that "A tenant for years is liable for all repairs or other expenses

which are necessary for the preservation and protection of the property.”

- b. This language seems to contradict **O.C.G.A. §44-7-13** which provides that “The landlord must keep the premises in repair. He shall be liable for all substantial improvements placed upon the premises by his consent.” This language has been interpreted to mean that a tenant would not be required to repair major casualty damage despite the language of **O.C.G.A. §44-6-105**) which provides: ‘A tenant for years is bound for all repairs or other expense necessary for the preservation and protection of the property. *W. E. Alwood, Jr. v. Commercial Union Assurance Company, Ltd.* (1963) (107 Ga.App. 797, 131 S.E.2d 594).

D. The basic tenancies are:

- 1. Estate for years or specified time period – tenancies for less than one year may be oral, but for one year or more, must be in writing
- 2. Tenancies at will, or periodic tenancies – if no time period is specified for the lease, then the presumption is that the tenancy is at will. **O.C.G.A. §44-7-6**
 - a. Tenancies at will may be terminated by the landlord upon 60 days prior notice and by the tenant upon 30 days prior notice. **O.C.G.A. §44-7-7.**
- 3. Tenancies at sufferance. These are tenancies that convey no rights – they are less than a tenancy at will and no advance notice is required to terminate them.

III. Property Types and Particular Lease Concerns

- A. **Retail spaces**, found in strip centers, malls and sometimes in office or residential towers or stand-alone buildings.
 - 1. Generally, retail leases provide that the landlord maintains the building structure, but that a large majority of maintenance is the tenant’s responsibility. Negotiation may arise over underground or exterior utilities or otherwise inaccessible mechanical systems. HVAC should serve only one unit.
 - 2. Unique lease requirements and concerns are:
 - a. Wanting flexible use clauses. The presence of exclusive use clauses in favor of other tenants of the center may prohibit uses desired by the new tenant. If a use clause is too broad, then the potential (or later actual use) might conflict with an exclusive use granted to another tenant.
 - b. “Free rent” period, which is time granted to the tenant after the commencement date to allow for tenant buildout, usually 30 to 60 days. Some tenants are concerned about

- their ability to obtain construction permits, especially on a stand-alone location (i.e. CVS or Walgreen).
- c. Exclusive use clause in favor of the tenant, prohibiting other tenants from infringing on their business. Minor or ancillary uses that are not another tenant's key business might be permitted. The definition of the "shopping center" must be broad enough to include all of the property, even out parcels, and sometimes, even property owned by the landlord or affiliates in the vicinity of the property.
 - d. Co-tenancy or "going dark" provisions that allow the tenant to terminate, or pay only percentage rent, in the event that an anchor or key tenant "goes dark" (closes its store). The anchor is usually a draw for a large portion the shop space tenant's customers.
 - e. "Radius" clauses prohibiting tenant from opening up a competing store in the general vicinity of the shopping center, so as to maximize traffic and percentage rent.
 - e. Hours of operation may be unique and a form lease may require that the tenant continuously operate, even at times when it would generally not be open.
 - f. Grand opening banners and signs help create a buzz, but may be prohibited by the form lease.
 - g. Parking is key for any retail tenant, and if spaces are not conveniently located, business suffers.
 - h. Relocation clauses allow the landlord to relocate the tenant to be flexible if new tenants need to consolidate space or require a particular or unique position in the center. Relocation may be negotiable and is generally objectionable from a tenant's perspective. The landlord should be required, at a minimum, to provide substantially similar space, with identical buildout.
 - i. Guaranties may be initially required, but can "burn off" (i.e. be reduced) over time based on performance.
 - j. CAM or operating costs often contain components that might be objectionable, but landlord's are reluctant to change because of the need for uniformity when calculating costs of the Center to pass through to each tenant. One of the more objectionable components is capital costs (unless amortized). Sometimes tenants are happy with a cap on increases. Landlords typically will only cap increases in "controllable" costs (not insurance, taxes or utilities).
 - k. Franchisor rights to assignment (and reassignment to new franchisees), and ownership of trademarks and signage often arises. The landlord will not want to pre-approve a transfer to a low credit-worthy tenant. Some franchisors are low or no-asset entities, which presents a credit issue

also. Franchisors frequently want notices of default and cure rights. The cure should be a condition to any assignment. Not all franchisors agree on these points.

- l. Occupancy or “continuous operations” clauses, requiring that the tenant be in possession and open for business continuously.
- m. Visibility of premises often conflicts with the landlord’s desire to retain full right to alter the shopping center with future development

- B. **Office spaces** are found in office buildings, towers, and stand-alone buildings. They have pass-through expenses similar to retail leasing. Structural maintenance is generally the landlord’s and day-to-day maintenance is the tenant’s. Important issues include:
 1. Expansion and right of first refusals on adjacent space.
 2. Services provided by the landlord are important: hours of operation, elevators, cleaning services, security, after-hours needs.
 3. Building standard allowance for tenant improvements (is the allowance sufficient for constructing even the minimum needed improvements? Excess is paid by the tenant).
- C. **Residential leases**, as in apartments, condo units or single-family homes or duplexes, is beyond the scope of this paper, as being generally form driven and subject to statutory intervention with regard to security deposits and rights and remedies.
- D. **Industrial leases**, comprising “big box” leases, or carve-ups of space in an large industrial building, having a small office component and a large warehouse/distribution center component.
 1. Maintenance is similar to shopping center leases. In stand-alone buildings, we may have a lease requiring all maintenance to be handled by the tenant, even structure (roof, exterior walls and floor).
 2. Pass-throughs for CAM, taxes and insurance.
- E. **Rent components**
 1. Sometimes rent is “net,” meaning there is base rent and additional rent for the pass-throughs.
 2. Sometimes rent is “gross,” meaning that base rent includes the amount of all pass-throughs.
 3. Sometimes leases are drafted as “modified gross” leases, meaning that the base rent includes “base year” pass-throughs.
 4. Percentage rent is rent based on a percentage of revenue derived from the location, usually over a “breakeven” or base amount. A “natural” breakpoint is the volume of gross sales a tenant must generate to pay the fixed minimum rent, at a rate equal to

percentage to be used for percentage-rent calculations (Divide fixed base rent by percentage used for calculating the percentage-rent). A lower percentage results in a higher natural breakpoint.

IV. Specific Lease Provisions

A. **Rent**

1. Base rent, sometimes called “fixed minimum rent”
2. Pass-throughs for taxes, insurance, operating expenses (CAM)
3. Percentage rent
4. Late charges, default charges, costs incurred by landlord in curing tenant defaults. The lease should contain a provision whereby all such charges are deemed “additional rent” so that failure to pay by the tenant will be grounds for eviction based on non-payment of rent as opposed to merely grounds for an action for breach of contract.
5. Specify “without offset or deduction *except as expressly provided herein*” (sometimes with reference to the particular provisions allowing offset or abatement) so that payment of rent is a separate covenant not contingent on any performance by the landlord, allowing the landlord to sue for rent notwithstanding the landlord’s breach under other sections of the lease
 - a. Might refer to a tenant self-help provision or a casualty provision
6. Specify to whom paid, when and where:

“Tenant shall pay to Landlord at _____ Peachtree Road, Atlanta, Georgia 30303, or to such other address as Landlord may from time to time designate by written notice to Tenant, promptly on the first (1st) day of each month, in advance, during the term of this Lease, in lawful money of the United States of America, without offset or deduction [optional: except as expressly provided herein], and without any prior notice and demand, rental (the “Base Rental”) as follows:”

7. Consider a savings clause:

“No receipt by Landlord of an amount less than Tenant’s full amount due will be deemed to be other than payment “on account”, nor will any endorsement or statement on any check or any accompanying letter effect or evidence an accord and satisfaction. Landlord may accept such check or payment without prejudice to Landlord’s right to recover the balance or pursue any right of Landlord. No payments by Tenant to Landlord after the expiration or other termination of the Term or after the giving of any notice (other than a demand for payment of money) by Landlord to Tenant will reinstate, continue or extend the term or make ineffective any notice given to Tenant prior to such payment. After notice or commencement of a suit, or after final judgment granting Landlord possession of the Premises, Landlord may receive and collect any sums of rent due under this Lease, and such receipt will not void any notice or in any manner affect any pending suit or any judgment obtained.”

8. Consider a “clawback” on rent abatement or other inducements in the event of default whereby these landlord concessions become repayable by the tenant upon the occurrence of a default.
- B. **Security deposits** are obtained by landlords to guaranty performance by tenants. In the commercial context, they are typically not segregated from other landlord’s funds, and interest is usually not paid.
1. Specify that the funds are for security of tenant’s performance and any used funds must be restored.
 2. Tenants want assurances that the funds will be transferred to a purchaser on a sale of the premises, and that the funds will be restored promptly upon lease expiration. Tenants may negotiate a return of the security deposit following performance without default over a period of time (i.e. two years).
 3. Use of letters of credit as security were thought to offer better protection to a landlord in bankruptcy as they are outside of the bankruptcy estate. However, bankruptcy cases limit applicability of Letters of Credit to capped damages under 11 U.S.C. §502(b)(6) and treat them essentially the same as a security deposit (*In re PPI Enterprises, Inc.*, 324 F.3rd 197 (3rd Cir. 2003 which focused on language in lease describing the letter of credit to be *in lieu of* security deposit; See *In re Mayan Networks Corporation*, 306 B.R. 295 (9th Cir. BAP 2004) in which the letter of credit is described as “securing” tenant lease obligations, thereby allowing treatment as security deposit). Draws are likely subject to bankruptcy stay, even though the letter of credit is supposedly independent See, e.g. *Faulkner v. EOP-Colonnade of Dallas, L.P. (In re Stonebridge Technologies, Inc.)*, 291 B.R. 63 (Bankr. N.D. Tex. 2003).
 - a. The tenant will have to pay an annual fee to its lender to maintain the letter of credit. It should be issued by a financial institution in the vicinity of the premises or landlord, so that drawing upon it does not impose a travel obligation.
 - b. Unique feature of letter of credit as security:
 - (i) Expiration of letter of credit necessitates that renewal will be needed prior to expiration date;
 - (ii) Drawing upon the letter of credit reduces available amount to be further drawn, thereby necessitating restoration of the letter of credit to original face amount;
 - (iii) The letter of credit must be transferable without a fee so that upon a sale of the building, it can be transferred to the purchaser
- C. **Construction of initial premises**

1. In shopping centers, the landlord delivers the tenant a “white box” and the tenant generally handles the tenant improvements. A landlord may provide either free rent and/or a tenant allowance (actual cash) to help finance the cost of the tenant improvements.
 - a. Disbursement of the allowance may be conditioned upon lien waivers, satisfactory completion of the work (or portions thereof if draws are contemplated), acceptance of the premises by the tenant, evidence of no lien filings (by title update or endorsement).
 - b. An addendum to the lease, sometimes called a “work letter” details particulars about construction, such as selection of materials, architectural drawings, selection of the contractor, and adhering to the schedule for completion.
 - c. The landlord has an interest in having the tenant open its business expeditiously so that the shopping center has activity. Dead space does not attract shopping center customers.
2. Office building tenant improvements may also be the tenant’s responsibility, but more often, the landlord controls construction and pays an allowance either by directly contracting with the contractor, or mandating that the tenant use an approved contractor.
 - a. Completion on time is important, but since space is not generally visible from the exterior, completion is not as crucial except from the standpoint of establishing an early rent commencement date and satisfying the tenant’s need to vacate former space (without holding over).
3. Industrial tenant improvements are generally handled entirely by the landlord, and there is generally no allowance, but the construction costs are factored into the base rent.
4. Often, there is an “anticipated commencement date” followed by an “outside commencement date” and if completion of construction is not achieved prior to the outside completion date, the tenant will have a termination right.
 - a. The outside completion date will be subject to “tenant delays.” Force majeure is also a factor, but at some point, even force majeure cannot be an excuse for failure of the landlord to complete construction.
5. In the retail context, the commencement date may be conditioned to a specific time of the year (the holiday season or spring) and the tenant may not be required to take possession, or pay rent, except during those busy economic seasons.
6. Construction will be required to be in compliance with all applicable laws, ordinances, rules and regulations. If the tenant is doing the construction, the tenant will be required to obtain the certificate of occupancy.

7. The tenant will have a right to “walk through” the space prior to accepting delivery, and to prepare a punchlist of incomplete items. Cosmetic items should not be grounds for refusing acceptance.
8. The lease commencement date should be memorialized with a commencement date memorandum or lease amendment, which specifies acceptance of the premises by the tenant and the date of commencement.
9. Second generation space is usually leased “as is, where is.” Conversely, tenants can usually negotiate a warranty of landlord’s work on newly constructed premises.

D. Lease term, renewal, holdover and early termination

1. The lease term is usually measured from the “Commencement Date” or specified by date and year. The tenant is usually required to surrender the premises upon the end of the term in the same condition as when leased, natural wear and tear accepted. Broom clean condition may be specified (trash is frequently part of the vacating process).
 - a. Holding over beyond the end of the term can upset subsequent tenants plans for a new lease at the premises. Holdover clauses should specify that the tenant holding over is a tenant at sufferance (basically, a licensee), and that rent is nonetheless due at an exorbitant rate (i.e. 200% of usual rent). It is also a good idea to have the tenant indemnify the landlord for all damages arising from the holdover, such as might be involved by the delay caused to the subsequent tenant.
2. Renewals with specified rent rates rarely benefit a landlord. If the renewal occurs in a falling rent market, the tenant will not exercise the renewal at the higher specified rate and will renegotiate. If the renewal occurs in a rising rent market, the tenant will exercise the renewal, and the landlord loses the ability to charge the higher market rate. The landlord wants exercise or non-exercise of the renewal well in advance of the lease expiration date so it can react to a non-exercise by advertising the space “for lease” by other tenants.
 - a. Renewals specified at “market rate” without any mechanism for determining the market rate if the parties cannot agree, such as having an appraisal process, is nothing more than an “agreement to agree” at a later date and therefor, generally not enforceable. This may work to the landlord’s advantage. To avoid a circumstance whereby a lawsuit to enforce the provision paralyzes a property, require that the market rate be agreed upon well in advance of the lease expiration date, failing which, the renewal becomes void and of no effect.

- b. Renewal should be conditioned upon no default by the tenant at the time of exercise or the time of renewal. Other conditions may be that the tenant has not assigned the lease, or that the assignee have equal to or better credit than the original tenant. A sample renewal clause is:

“Tenant shall have the right to renew the term of this Lease for one additional five (5) year period by delivering written notice thereof to Landlord no later than the one hundred eightieth (180th) calendar day preceding the date of expiration of the original, and so long as (x) Tenant is not in default hereunder beyond applicable cure periods as of the date of delivery of such written notice and (y) Tenant is not in default hereunder beyond applicable notice and cure periods as of the date of commencement of such renewal term. In the event of any such renewal, the terms and provisions set forth herein shall remain in full force and effect in accordance with their terms, provided that the rental payable by Tenant to Landlord for such renewal term shall be the Market Rate (as defined below). For purposes of this Lease, the term "Market Rate" shall mean the rental rate being quoted by owners of equivalent first class office/warehouse space in the greater Metropolitan Atlanta, Georgia area similar in quality and interior improvements to the Premises without considering the effects of any free rent, allowances or other concessions offered by such owner. If Tenant and Landlord are unable to reach agreement on a "Market Rate" for the Premises within ninety (90) days of Landlord's receipt of Tenant's written notice of renewal, then Landlord shall be deemed to have fulfilled its obligations hereunder and this Option to Renew shall be rendered null and void.”

- 3. Early termination clauses should be conditioned on no default by the tenant on the date of notice and on the date of termination.
 - a. In particular, surrender of the premises in accordance with the lease terms (i.e. broom clean) is difficult to enforce once the tenant vacates, so if the landlord can void the termination, it has a strong hand to mandate tenant compliance. The landlord should try retain the security deposit until surrender of the premises by the tenant in accordance with the lease terms.
 - b. Early termination clauses generally require that the tenant pay a termination fee. Care should taken so that the fee is phrased in terms of liquidate damages to compensate the landlord for reasonably estimated damages arising from early termination and may be equal several months rental or more. The termination fee may include unamortized costs associated with the lease, such as broker's commissions, tenant allowances, tenant inducements and construction costs. "Amortization" of these costs is in many ways a misnomer because landlords generally have an internal rate of return on investment which they hope to achieve throughout the lease term, and if the term is shortened, then the expected return will not exist. In other

words, the costs are analogous to loaned funds, but are different because the expected internal rate of return is not a published rate and generally remains private. The termination fee, coupled with advance notice, gives the landlord both cash flow and time needed to re-lease the premises.

(i) Failure to properly phrase the fee as liquidated damages may indicate that the fee is an unenforceable penalty.

c. Sometimes landlords include termination clauses to take effect upon the sale of the property (for redevelopment purposes).

E. **Square footage calculations.** If rent payable on a square footage basis, measurement of the square footage can be important. Typical measurements are from the interior of exterior walls and to the center of demising walls. “Unusable” areas, such as pillars, may be excluded. The tenant may want the right to verify square footage, which should be limited to the initial month or so of the lease term to avoid uncertainty. If measurements turn out to be incorrect, and years have passed, the landlord might owe a substantial amount to the tenant.

1. In an office lease, rental may be “grossed up” to include the percentage of the building which is generally not usable, such as elevator shafts, bathrooms and storage areas, so that each tenant bears a proportionate amount and therefor, the landlord will receive an effective rent rate for the entire building, and not just the usable area.

F. **Maintenance and Pass-Through Issues.**

1. The so-called “triple net” lease imposes all but the structural maintenance components upon the tenant, and costs incurred for taxes and operating the property, including insurance, are passed through to the tenant. In the typical shopping center and industrial lease, the landlord’s maintenance obligations are limited to roof, exterior walls (excluding doors and windows), and floor. Sometimes “structural elements” are broadly included, which might mean those areas of the building that provide structural support, like certain beams or joists. HVAC and other mechanical systems may be negotiated, but initially, the tenant will be responsible. Responsibility for exterior utilities, or those which are not easily exposed, may be shifted to the landlord. Repairs rendered necessary by the acts or negligence of the tenant will be the tenant’s responsibility.

a. Waiver of subrogation and rights of recovery clauses typically provide that insurance shall cover any property damage losses. This is a “risk shifting” inclusion in most

- modern leases. These provisions conflict with maintenance provisions requiring that the tenant be responsible for its negligence, and ambiguity should be avoided.
- b. In the office lease context, despite language in the lease to the contrary, nearly all repairs are made by the landlord.
 - c. Language imposing liability arising out of a repair that is not reported on the tenant reflects a contractual effort to further shift liability for the premises to the tenant. In “triple net” leases, the tenant is generally in control of the premises, the landlord does not want to be charged, explicitly or implicitly, with an obligation to inspect the premises for repairs. If the landlord has a duty to inspect, it may more easily be liable for injuries or damages resulting therefrom.
2. In the triple net lease, taxes, assessments and other governmental or other charges upon the land are charged to tenant, pro rata, based upon the size of the tenant’s space to the space of the entire building structure. The definition of taxes should be broad enough to encompass all possible taxes on the property. Taxes on rent sometimes are an issue, but not applicable currently in Georgia.
- a. Assessments under declarations or other title encumbrances need to be specifically included since they are non-governmental.
 - b. Tenants should require that assessments which are payable in installments be paid in allowable installments. If a lease terminates before the assessments would otherwise be amortized, the landlord is getting the benefit of the improvements constructed with the assessments but the tenant is paying the price.
 - c. Landlords often contest taxes. Tenants may want the right to participate, but any participation must be cooperative and not adverse to the landlord’s efforts. If the building is a single tenant building, the tenant has a compelling interest in being involved and sometimes initiating a tax contest. Savings, net of costs of the contest, should benefit the tenant.
3. The calculation of the pro rata share may exclude certain areas of the improvements, such as anchor space or out parcels. The general ratio is that of leased area of the premises (excluding exterior or mezzanine space) to the leasable area of the building.
4. Operating costs, or common area maintenance, may be broadly defined to cover all costs incurred in operating the project. Insurance may be separately stated or may be included in the definition. Administrative fees are often added, usually as a percentage of costs.

- a. Shopping center anchor tenants sometimes do not pay operating costs, but do cover these costs in another fashion, either by maintaining their own pad site, or pursuant to a declaration or operating agreement which assigns responsibility for work and allocates the costs.
- b. Certain costs may be excluded from operating costs:
 - i. commissions payable to any real estate broker(s) for the leasing of space in the development;
 - ii. the cost of any work done by the landlord for and at the expense of any particular tenant(s) in the development or for which the landlord is entitled to reimbursement from a third party;
 - iii. legal fees paid to enforce the obligations of any other tenant; auditing or other professional fees and professional expenses incurred by the landlord;
 - iv. interest or penalties for overdue payments of taxes;
 - v. the cost above the deductible level to the landlord of repairs made, or the work done, by the landlord as a result of fire, windstorm or other insurable casualty or by the exercise of eminent domain, provided, however, that this exclusion for eminent domain is limited to the amount of the condemnation award received by the landlord in compensation for such repairs or other work;
 - vi. attorneys fees and court costs and other such expenses incurred by the landlord in connection with the negotiation of disputes with existing or prospective tenants or occupants of the development;
 - vii. amounts for which reimbursement has been made to the landlord by tenants or other occupants of the development;
 - viii. costs incurred by the landlord due to the violation by the landlord or any tenant of the terms or conditions of any lease for space in the development;
 - ix. mortgage financing; interest on debt or amortization payments on any mortgages and rental under any ground lease or underlying leases covering the landlord's property;
 - x. compensation paid by the landlord to persons engaged in commercial concessions operated by the landlord (and not be a third party) on the landlord's property (e.g. a newspaper stand or shoeshine service or valet parking);

- xi. expenses paid by the landlord for the advertising and promotion of space for rent in the development;
 - xii. salaries, wages and benefits of the landlord's employees above the level of "Property Manager;"
 - xiii. costs and fees in connection with the acts or omissions of other tenants;
 - xiv. painting or repainting any tenant's premises (unless painting is general exterior painting not paid for by any tenant);
 - xv. costs in excess of [\$250] incurred by the landlord for the purchase of objects of art or decoration for the landlord's property; and
 - xvi. costs or expenses of a capital nature [unless amortized over the expected useful life of the improvement].
- c. Landlords do not like to make too many changes to their definition of operating costs because they would rather uniformly bill all tenants.
 - d. Audit rights are sometimes granted to tenants, for a limited period of time. Auditor which are paid a percentage of savings should be excluded.
6. Insurance costs are sometimes contained in a separate provision. The landlord's right to reimbursement should be broad enough to encompass all insurance that a prudent landlord would require, and that which a nasty lender will require. Generally these coverages are for:
- a. Casualty or so-called extended coverage, which may include terrorism, earthquake and boiler insurance;
 - b. General commercial liability;
 - c. Automobile and workers compensation; and
 - d. Dramshop or "liquor liability" coverage.
7. In retail leases, tenants usually pay monthly estimates and "true up" at the end of the year. Industrial leases generally provide for billing periodically when costs are incurred. Office leases are usually in the form of "modified gross" leases whereby base rent includes the estimated pass-through costs for the first lease year, and tenants pay the deficiency at the end of the year, which sets a new standard for monthly rent going forward.
- G. Use clauses and assignment rights:** The permitted use clause can restrict or expand the tenant's rights in the premises, and impacts the tenant's ability to assign the lease by increasing or decreasing the pool of potential assignees. A use clause that permits "any lawful use" will give the tenant great flexibility. Most landlords prefer to restrict use to those within its expectations. For instance, any "business office use" might provide a great deal of flexibility in the office context, but it also protects the

landlord from uses that might be permitted by zoning ordinance but are otherwise detrimental to the tenant mix or potentially harmful, such as those involving hazardous materials or loud or noxious uses.

1. **Exclusive use rights or use restrictions.** It is typical for a shopping center to provide for exclusive uses to various tenants to preserve consumer business clientele available for sales. For instance, you might have an exclusive use for a coffee shop (i.e. Starbucks or Caribou) and an exclusive use for a grocery store, but the grocery store will no doubt sell coffee. The coffee exclusive will need to allow sales of coffee from other locations as long as they do not exceed some limited amount. The more broadly stated the exclusive use, the more difficulty the landlord will have avoiding a conflict over future tenants.
2. **Unsavoury Uses.** Many shopping center or outparcel groundleases contain specific restrictions on use, designed to keep out certain uses that severely impact the business operations at the center, such as those with excessive parking (bars and lounges, skating rinks), or unsavoury (massage parlors, adult bookstores).
3. **Assignment rights** give the tenant some comfort that if the business at the premises is not successful, it can either sublease or assign the premises. Landlords want to control their space, and uses within the space, but generally will agree not be unreasonably withhold consent.
 - a. Consent may be conditioned on use, financial ability of the new tenant, reputation and experience of the new tenant, and the existence (or non-existence) of defaults at the time of request. Curing defaults is likely to be a condition of any consent.
 - b. Releases of the original tenant or guarantor may be withheld as part of a consent, and in general, most assignment clauses provide that both the original tenant and the assignee are both primarily liable to the landlord for performance of the lease obligations.
 - c. Any excess rental should be paid to the landlord, which has taken the risk in owning the building and should have the upside. As a practical matter, there usually is not any excess rental.
 - i. Tenants often negotiate the right to recoup leasing costs (commissions and tenant improvements for the new tenant) prior to paying any excess rental to the landlord.
 - d. Recapture provisions, whereby the landlord can terminate the original lease upon receiving a request for assignment, allows the landlord to recapture the space and either lease to the proposed assignee directly (and for more rent), or to another potential user.

- H. **Governmental compliance:** The lease must address changing circumstances arising because of changed laws or building codes (i.e. new sprinkler systems or Americans With Disabilities Act compliance). Most leases contain a blanket provision requiring the tenant to comply with all applicable governmental laws, ordinances, rules and regulations affecting the demised premises. Compliance would then seem to be mandated, regardless of the enactment.
1. It is unfair that the tenant be responsible for making alterations which are required of landlords generally, and not required because of a tenant's specific and unique use of the premises, and most landlord's will agree to such an exclusion. Landlords usually compromise on a specific monetary cost of improvements which the tenant must bear.
 2. Broad environmental indemnities from the tenant are generally required. The tenant will ask for an indemnity from the landlord for liability arising from the landlord's acts, or from the acts of other tenants or third parties.
- I. **Condemnation** can affect a tenant in several ways. A total, permanent condemnation will obviously deprive the tenant of the premises. A temporary condemnation may deprive the tenant of the premises for a limited time period. The length of the time period will be crucial to the tenant's business operations. Other lesser condemnations may also have drastic effects on the tenant, such as a taking involving significant parking spaces or involving access (by taking of curb or median cuts) to the premises. Retail tenants are more concerned than other types of tenants with takings that affect access, parking or visibility. Office/warehouse tenants might be concerned about takings that affect truck courts or turning radius parameters.
1. Tenant damages for takings are generally limited to moving expenses and costs of fixtures and equipment which can not be relocated. Landlords should carefully circumscribe the tenant's right to damages because even if there are separate awards, the practical result of a tenant receiving a greater condemnation award will be to reduce the award available to the landlord. Under Georgia law, the leasehold interest being taken is compensable, as is the fee interest. One contested issue involves compensating the tenant for business which is "lost" as a result of the loss of the premises. Georgia courts have limited tenants' rights to lost profits by significantly restricting the circumstances in which a particular location is considered key for business operations. The usual exception is something akin to a fast food operation located at a busy intersection where passing vehicular traffic constitutes a large portion of business.

2. Most leases contain language to the effect that the landlord is entitled to all condemnation proceeds. An exception is usually made for those awards that the tenant may be awarded separately, sometimes further qualified by allowing the tenant only such award as does not reduce the landlord's award. As mentioned above, this would be a hard standard to prove. Another method is to give the entire award to the landlord except for moving expenses which the tenant may claim.
3. Case law supports the right of the parties to allocate among themselves the condemnation award. Case law further holds that the tenant's interest is not valuable in the absence of the proof that the location is somehow unique to the business.

J. **Casualty and Restoration:** A landlord can be hurt by a poorly drafted casualty or condemnation provision by giving a tenant the right to terminate the lease with minimal cause. A strongly worded provision gives the landlord flexibility on whether or not to restore or repair the premises affected by casualty or condemnation. The landlord will want to consider:

1. The amount of proceeds made available, both by the insurer and by its lender. Most lender's agree that it is in the best interest of the property that it be restored, but several other factors may come into play, including the amount of time left until loan maturity, the length of the leases affecting the property, and the quality of the borrower.
2. The extent of damage and likelihood that the property can be restored to an economically viable unit.
3. The amount of time needed to restore or repair the property.

K. **Subordination and Attornment.** The income stream from tenant leases is ultimately the real security protecting the value of the property. If a lease is subordinate to a security deed, then a foreclosure will automatically and inadvertently terminate the lease. If a lease is superior to a security deed, a devious landlord could protect itself against foreclosure by amending the lease prior to foreclosure to have arbitrarily low rents, thereby lowering the income stream to a point where foreclosure loses its appeal.

1. Most lenders want an option to either have the lease superior, or subordinate, to be determined if and when foreclosure occurs. If the lease does not contain appropriate language, then as a condition to making a new loan, the lender will require a subordination agreement from each tenant.
 - a. Such language reads as follows: "This Lease and all of the rights of LESSEE hereunder are subject and subordinate at all times to any Deed to Secure Debt which now or hereafter affects the real property of which the Premises form a part (the "Property"), and to all renewals, modifications, consolidations,

replacements and extensions thereof. This clause shall be self-operative and no further instrument of subordination shall be required by any holder of a Deed to Secure Debt. In confirmation of such subordination, LESSEE shall execute promptly any certificate that LESSOR may reasonably request related thereto. If LESSOR elects to have this Lease superior to any applicable Deed to Secure Debt and its election is signified in some recorded instrument, then this Lease shall be superior to such Deed to Secure Debt, notwithstanding any other provision hereof.”

2. Attornment is the agreement of the tenant to attorn to (i.e. to acknowledge as being the landlord) the lender, or purchaser at foreclosure, following foreclosure.
3. Subordination, Non-Disturbance and Attornment Agreements are typically required in commercial transactions, further delineating rights and obligations of the tenant to the lender. The tenant wants that its possession and rights of the lease not be disturbed in exchange for subordination of the lease to the loan. If the negotiations become frayed, then the lender can rely on automatic subordination language, if it is contained in the lease. Otherwise, the SNDA may impede a transaction.
 - a. The typical SNDA contains basic exceptions to the lender’s liability after its forecloses and becomes the landlord:
 - i. No liability for the prior landlord’s defaults; If a lender is going to have liability for prior defaults, it will require notice and a right to cure (with sufficient time to mobilize and act on the notice of default – thirty (30) days being the minimum).
 - ii. No offset right by the tenant for prior landlord defaults; Offset rights are distinguished from liability in that they provide the quick and easy settlement of the tenant’s claim against the landlord, and hurt the lender directly and financially. The remedy, if agreed to by the lender, is the same as for clause (a) above
 - iii. No obligation to adhere to lease amendments made without the lender’s consent; A compromise is not imposing liability on the lender for amendments made without prior notice (preferably ten (10) days), thereby allowing the lender to monitor the process prior to having any liability (and to enforce loan covenants prohibiting amendments, if applicable).
 - iv. The lender is not bound by rent payable more than one (1) month in advance; and
 - v. The lender is not personally liable for the landlord’s obligations under the lease, such liability being

limited to its interest in the development of which
the premises are part.