DRAFTING AND NEGOTIATING WINNING LEASES:

a. Defining Rent, Costs & Taxes

i. Gross Lease/Full Service Lease: Rent includes operating expenses, insurance, utilities and taxes.

ii. Modified Gross Lease: In addition to fixed rent, the tenant pay certain specified building expenses – for example, utilities, or the lease provides the tenant will pay the amount certain building expenses (taxes, insurance, operating expenses) increase over a base year.

iii Triple-Net Lease: The tenant is typically responsible for all costs associated with the tenant's pro-rata share of the property in a triple-net lease including taxes, insurance, maintenance and utility costs. Even in a triple net lease the tenant may require the landlord undertake certain structural repairs/replacement of capitalized items. Commercial brokers may designate a leases which provides the landlord maintains the obligation to make major repairs/replacements but passes thru other obligations to the tenants as "double-net" rather than "triple-net leases".

iv. Rent Increases:

A. The fixed (base) rent may be the same amount throughout the lease term (less common) or may at set intervals be adjusted to either a set amount or to reflect an adjustment based upon economic factors (for example, an increase proportionate to an increase in the Consumer Price Index).

B. An additional method of adjusting rent is through the use of percentage rent. Percentage rent is rent that is determined from the sales of the tenant's business. Generally used in retail (including restaurant leases), having percentage rent as a component in determining the rent has the advantage of allowing a tenant to negotiate a lower fixed rent rate while providing the landlord with a share of the tenant's business success. A lease with percentage rent component constituting a substantial part of the rent paid by the tenant is not as attractive to a landlord's lender as a fixed rent amount. In negotiating percentage lease provisions, issues to be addressed include:

- sales break point
- rate of percentage rent
- definition of year percentage rent is payable
- definition of gross sales
- payment schedule
- audit rights
- obligations of continuous operations/implied sales; and
- restrictions on competing operations.

C. The Consumer Price Index is a cost of living indicator computed and issued monthly by the U.S. Bureau of Labor Statistics which tracks the price level of a group of goods and services purchased by average consumers.

- The BLS publishes CPI's for two general types of consumer groups:

  The CPI for Urban Wage Earners and Clerical Workers (CPI-W) which covers households of wage earners and clerical workers that comprise approximately 32 percent of the total population; and

  The CPI for All Urban Consumers (CPI-U) which covers wage earners and clerical workers households, professional, managerial, technical workers, self-employed, short-term workers, the unemployed and some unemployed consumers.

- CPI's are published for four separate U.S. geographic regions.

- CPI-U (1982-1984 base year) is the most commonly used index.

v. **CAM/Operating Expense Additional Rent Provisions.**

A. Common Area Maintenance ("CAM") expense pass-thru provisions are contained in both net and modified gross rent leases and allow the landlord require the tenant reimburse the landlord for certain specified operating expenses the landlord has incurred in connection with the management, operation and maintenance of the building and/or project in which the tenant's premises are located.

B. The tenant's payment of CAM (also called "operating expenses") is often referred to as "additional rent" in commercial leases and is paid by a tenant in addition to the base (fixed) rent.

C. In a triple net lease, a landlord will attempt to include in the lease's CAM provisions a recapture of all the costs incurred by the landlord in owning, operating, maintaining, repairing and replacing components of the common areas of the project. A landlord may include administrative overhead charges and management fees, costs of tax contests, advertising costs (shopping centers) and certain types of capital expenditures. Items typically excluded from CAM charged to tenants are leasing commissions, tenant improvements for an individual tenant's space, mechanicals and equipment serving only one tenant, landlord's attorneys' fees incurred in lease negotiations, landlord's debt service payments and certain capital expenditures. A tenants may attempt to negotiate revisions to the items included in the CAM charges to eliminate or cap the administrative fee charged to the tenant (for example, eliminate any fee assessed on the portion of the CAM charges allocated to tax and utility payments), specify the type of capital expenditures the tenant will agree to reimburse – for example, the parking lot can be repaved no more often than every 7 years, and provide that the tenant will not reimburse the landlord for environmental remediation not required by the tenant's activities.

D. A lease may also include a cap on the total amount of CAM charges to be paid by the tenant. That cap on CAM expenses may be: (i) a set dollar amount (ii) based on increases in CAM over a base year; and/or, (iii) limit annual increases to a set percentage over the preceding lease year. Generally, if the landlord agrees to a cap on CAM, the landlord requires that the cap does not apply to expenses the landlord can not reasonably control - utility expenses, snowplowing, taxes and insurance.

E. CAM charges are typically assessed to tenants on a pro-rata basis. A tenant's pro-rata share is the leasable area of the tenant's premises divided by the leasable area of the building/project of which the tenant's premises are a part. A tenants will want to delete from the calculation of the leasable area of the tenant's premises portions of the tenant's space that contains mechanicals or is not usable by tenant for its business (for example, attic, mezzanine or basement space). A landlord may attempt to exclude certain shopping center space from the calculation including the landlord's office space, or specified anchor or outparcel users.

vi. Taxes.

A. In a net lease, real estate taxes and assessments will be passed- thru to the tenant. In determining whether the tax provisions are fair to the tenant, the tenant will want to ensure:

- tenant's share is allocated fairly if the tenant's premises are not separately assessed
- taxes are pro-rated for any year in which the tax period and the lease year do not correspond
- the tenant's right to contest the assessment

For the landlord, the lease provisions relating to payment of taxes may require:

- tenant escrow for taxes
- tenant pay any increase caused by the contest
- tenant pay the increase in assessments caused by tenant's improvements to the premises
- the tenant reimburse the landlord for costs to

contest the taxes

b. Best Practices in Retail Rent.

i. Free Rent Provisions.

A. Definition of Rent Commencement Date. It is common in a retail lease that the tenant will be provided with a period of free rent at the beginning of the lease term. The length of the free rent period may extend until completion of tenant improvements, a set period of time after the tenant accept the premises, opening of business to the general public, or abate until an anchor tenant begins operations. A tenant may further condition rent commencement date by specifying the commencement date is contingent upon landlord's completion of common areas (parking areas completed). In addition to limiting the free rent period, the landlord will often add the recovery of the rent abated as a specific item to be included in damages upon a tenant default.

B. "Black-out" dates. A tenant may specify that it will not accept occupancy of the premises during a set period of the year. Commonly retail department stores will not accept premises if the store can not be open before Thanksgiving until the beginning of the next year. Some retailers have several black-out dates for acceptance of the premises as they want to open new stores in groups for promotional purposes (grand opening sales).

ii. Rent payment obligations.

A. Independent Covenant. Leases drafted on behalf of a landlord will provide that the payment of rent is independent of the landlord's satisfaction of obligations under the lease – the "carefree triple net" lease concept that tenant is obligated to pay rent and expenses regardless of the landlord's performance of lease obligations.

B. Rental Offsets. A provision contained in leases drafted on behalf of a tenant which allow the tenant to withhold rent if landlord has defaulted under an obligation under the lease - for example repair/ maintenance obligation or violation of a tenant exclusive. Provisions allowing the tenant to off-set rent are typically rejected by landlords. If however, a landlord does agree to a tenant's right to off-set rent, the landlord may limit the amount to be offset from each rent payment or limit the time the tenant may off-set rent.

c. **Winning with Options & Expansion Space**.

i. Right of First Refusal.

A lease granting a tenant the right of first refusal to relocate or expand into additional space is triggered by a third party offer to lease. Rent and other terms will be substantially the same as the third party offer for the space.

ii. Option to Expand.

A lease granting a tenant a right to expand into additional space upon a set event – triggering event could be expiration of existing tenant's lease or a notice from the tenant of its desire to expand. A provision granting an option should specify rent for the expansion space, tenant improvements in the expansion space and the extension of the lease term. The lease may require the tenant extend the term of the lease if the tenant desires to exercise an option to expand.

iii. Conditions to Exercise of Rights.

The exercise of the right of first refusal or option may limited by date of exercise or by prohibiting the tenant from exercising an option or right of first refusal if the tenant is in default or if the tenant has assigned the lease.

d. What You Need to Know about Utilities & Common Services.

i. Division of Utility Services.

– common area utilities. Consider separate metering of parking lot lighting if tenant has extended business hours.

- separate metering of premises – who is responsible for the expense of installing separate meters?

-- the lease should be adapted to account for heavy users of utilities – for example, water usage for a laundry or salon – if separate meters are not available.

ii. Landlord Providing Utility Services.

- Many leases grant the landlord the right to provide the utilities and re-bill the tenants for the services. In such a case, the lease should provide that the costs will not exceed those that would be charged by the utility and delete the provision typically inserted by a landlord waiving liability for damage done to the tenant's property or business caused by the interruption of utility service to the premises.

iii. Common Services.

- Not all tenant's use of the common areas justify an allocation based upon square footage.
- Outparcel users may be unfairly assessed for expenses related to internal drives or parking
- In some situations tenants will prefer to undertake their own maintenance of their parcels rather than paying a proportion of the common area expenses of a project

e. Measuring the Space.

i. BOMA (Building Owners and Managers Association) standards. - standardized method of measurement for commercial buildings.

ii. The standard method of determining square footage was originally applied only to office leases but BOMA now provides measurement standards for other types of commercial buildings.

iii. If using BOMA definitions be specific as to year BOMA-96 v. BOMA- 10 since definitions changed.

iv. BOMA 2010 standards created an alternative method to determining load factors – the multiplier applied to a tenant's area to include in the tenant's premises measurement a portion of the common areas. The 2010 method – with its "single load factor" provides for one load factor for the entire building no matter the floor while the "legacy method" of BOMA 1996 allows a calculation of the load factor on a floor by floor basis.

v. BOMA 1996 – the Method A or legacy method results in a floor by floor difference in load factor since floors usually differ as to the amount of common area space. Under Method A floors with higher load factors may be less attractive to tenants.

vi. BOMA 2010 – Method B allocates the same amount of building amenities and service areas to all floors. Method B's single load factor calculation simplify lease calculations and improve the marketability of floors that would have higher load factors if Method A was still used

vii. Usable Area = actual area of a floor or an office suite that can be occupied – measured from the finished surface side of the office side of a corridor and other permanent walls to the center of the partitions that separate the office from adjoining Usable Areas, and to the inside finished surface of the dominant portions of the permanent outer building walls.

viii. Rentable Area – the tenant’s pro-rata share of the entire office floor, excluding elements that penetrate the building from one floor through a floor below.

ix. Load Factor – Rentable Area divided by Usable area(R/U Ratio) - 1