

Are You a Commercial Tenant?

Better Exercise Caution in Today's Real Estate Market

Current economic conditions have lower occupancy rates—and that means cash flow is down for many commercial landlords. As a result, some landlords are having difficulty meeting their lease obligations with respect to repairs and upkeep.

State laws usually provide that a tenant's obligation to pay rent is independent of a landlord's maintenance obligations. Absent a specific lease provision, a tenant would be legally required to continue to pay rent even after a landlord default.

If you're a commercial tenant about to renew or enter into a new lease, what should you do?

SAFEGUARD AGAINST LANDLORD DEFAULTS

One solution is to negotiate lease provisions that allow you to correct the landlord default and offset those expenses incurred against your rent. Landlords and their lenders are usually reluctant to agree to cure-and-offset rights. However, they may compromise with you by allowing setoffs following some form of independent verification—judicial or other—that you properly exercised your cure right. But be careful. Though a right to cure is fine if the fix is a relatively minor matter, it's not much of a solution for major repairs where costs exceed your remaining rent obligations.

A struggling landlord may also delay performing repair and maintenance obligations by invoking the lease's "force majeure" clause, which allows for delays resulting from an event that is outside of its control. Because this provision can leave a tenant with little recourse, tenants often request a limited force majeure clause that doesn't allow a landlord to delay repairs due to financial difficulties.

SAFEGUARD AGAINST FORECLOSURE

In these tough times, a lender's increased vigilance over landlords can affect tenants. Most leases require tenants to execute two legal forms—estoppel letters and subordination, non-disturbance agreements (SNDAs)—which govern their rights as to the lender. Prior to signing a lease, a tenant should carefully review the terms of these documents to determine the impact of any foreclosure.

REVIEW GROSS-UP AND OTHER PROVISIONS

Any tenant whose lease will require the payment of additional rents for variable common area charges above the base year will want to make certain the base year's costs are grossed up to reflect any current vacancies. Otherwise, when vacancies are filled and the landlord's variable costs increase, a tenant may be obligated to pay a greater share of those operating expenses.



Unfortunately, the shared costs for common areas, insurance, or tax liabilities can be overstated. Be sure your lease requires your landlord to provide an annual reconciliation statement, documentation of costs, and the right to audit the landlord's records.

Because commercial property values—especially those with high vacancy rates—have fallen significantly, tenants should ensure that the taxable value of their premises has been appropriately adjusted. If you are the building's sole tenant, include a right to contest the local assessor's tax valuation. If you lease less than 100% of the property, you may need to employ more creative means to reach a fair arrangement.

It's the wise tenant who enters a lease with eyes wide open and all the fine points nailed down. If you would like some assistance reviewing your commercial real estate agreements, please give us a call.

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