COMMERCIAL REAL ESTATE

Landlords: Don't Give Away the Store!

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COMMERCIAL tenants are currently faced with an abundance of available space and landlords who are ready to make concessions in both business and legal provisions in order to sign up new leases and renewals. Commercial landlords may conclude that these desperate times call for desperate measures, and may be inclined to grant concessions that they have not previously been willing to consider. However, landlords should continue to guard against giving concessions that could impact their ability to sell or refinance their buildings.

Critical Lease Provisions From the Landlord's Perspective

Following is a list of certain important commercial lease provisions that may impact future opportunities to sell or refinance a property:

1. Estoppel provisions
Only allow a short window of time to deliver an estoppel. Consider attaching a comprehensive estoppel form to the lease, and incorporate it as an agreed upon guide for provisions that may be included in future estoppels. Also permit reasonably requested provisions to be included in the estoppel.

2. Subordination and Attornment provisions
Subordination and attornment should be automatic, or the tenant should be obligated to subordinate and attorn.

3. Offset rights
Preserve the income stream from the property. Agree to offset rights only in limited circumstances and with appropriate safeguards.

4. Operating Expense and Property Tax Pass-Throughs
Avoid concessions with an economic effect. Preserve the right to pass-through capital costs resulting from a change in applicable law or arising from the landlord's reasonable attempt to achieve cost savings in its operations. Any cap on the pass-through of operating expenses and any Proposition 13 protection should be sparingly granted.

5. Audit rights
Keep the period for the tenant to exercise audit rights short. Allow the tenant to audit its base year only once early in the lease term. Restrict the tenant's use of auditors paid on a contingency fee basis.

6. Termination rights
Preserve the income stream. If the landlord's existing lender requires minimum term lengths for leases, be wary of circumventing the loan requirements by granting termination rights.

7. Improvement allowances later in the term
Lenders or the tenant may require the landlord to fund the money into an escrow at the beginning of the lease term, or at the time of the landlord's refinance. Consider adjusting the lease rent schedule rather than agreeing to pay improvement allowances later in the lease term.

8. Security deposit
Consider the credit of the tenant and obtain appropriate credit enhancement. When accepting a letter of credit, also consider the creditworthiness of the issuing bank.

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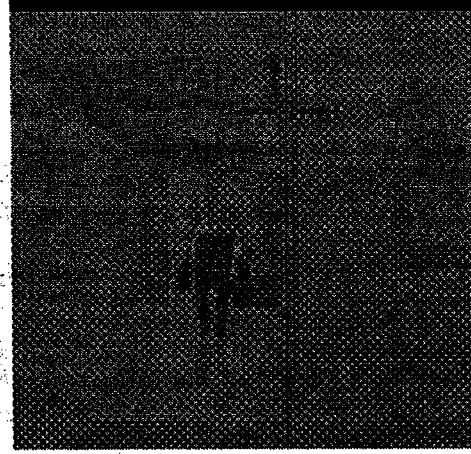

9. Purchase options
Perhaps no lease provision has greater potential to quench a prospective sale. Also, the landlord's loan may prohibit the granting of a purchase option. As an alternative, consider notifying the tenant if the landlord decides to market the project for sale to third parties, but avoid any commitments that could thwart a sale of the project (or the portfolio of which the project is merely a part).

10. Condemnation and insurance proceeds
Lenders typically want to control the proceeds. Lenders will usually agree that the proceeds may be used to rebuild the damaged project, subject to the reasonable terms of the mortgage.

Conclusion

Both lenders and potential buyers of commercial real estate are carefully scrutinizing leases, income streams, tenant credit and potential future liabilities. As in the past, landlords need to think carefully about how to best position their assets to allow for refinancing or sale. The concessions granted by a landlord in these desperate times could have serious long-term consequences on the viability, financability and saleability of the landlord's asset. Landlords should hold fast to landlord favorable positions when negotiating those lease provisions that may have a significant affect on the future of the asset.

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