



## How to Negotiate a Lease to Protect Your Business: Top 10 Tips for Retail Tenants

05.12.2017

Below is a key list of 10 tips that retail tenants should consider when negotiating their commercial lease agreements.

### **(1) Hire a Broker**

Other than consulting an attorney, hiring a knowledgeable commercial real estate broker is probably the most important item a retail tenant can do to protect its interest. A broker will ask the tenant the important questions to make sure the tenant has picked the best location, agreed to the appropriate length of the lease term, and settled on the correct rental rate. A broker may also be instrumental in assisting the tenant with the premises upfit and review of the upfit work letter. The broker will help negotiate the letter of intent with the landlord setting forth the key business terms. A broker will let the tenant know what is reasonable regarding rent and location. A broker will also know what is typical in the market regarding free rents, allowances, tenant upfits, concessions, and annual caps on common area maintenance fees. The broker's fee is usually paid by the landlord or the landlord's broker, so that the tenant often does not even have to pay for the broker's services.

### **(2) Talk to Your Bank/Franchisor**

If a tenant is going to take out a loan or if a tenant will be a franchisee, it is imperative that the tenant talk to its banker or franchisor early in the leasing process. Often lenders and franchisors will have conditions that will require the consent of the tenant's landlord. It is best to provide the landlord with such conditions at the beginning of the lease negotiation process rather than after the lease agreement is signed. A lender or a franchisor may require a landlord to sign a landlord's lien waiver whereby the landlord waives or subordinates any rights the landlord may have in the tenant's inventory, equipment, or other personal property. A lender or franchisor may also require a landlord to sign a collateral assignment whereby such lender or franchisor can step into the shoes of the tenant (as the tenant) in the event the tenant defaults under the tenant's loan agreement or franchise agreement. Negotiating these terms up front (when the tenant has a little more bargaining power) is much easier than negotiating these terms after a lease agreement has been signed (when the landlord has much more bargaining power).

### **(3) Consult an Attorney**

Commercial tenants should hire an attorney at the beginning of the leasing process. The best time to start the attorney's engagement is before the letter of intent is signed. If the tenant agrees to key business terms in the letter of intent, it is often difficult to renegotiate these terms during the lease drafting and reviewing process. An attorney will review the lease agreement to confirm that the business terms the parties have agreed upon (as reflected in the letter of intent) are properly reflected in the final lease agreement. The attorney will review the legal items in the lease agreement and help protect the tenant through lease negotiations with the landlord. If the attorney is unsuccessful in negotiating certain key lease terms, the attorney will inform the tenant of the risks associated with such key lease terms either being included or not included in the final lease agreement. The attorney affords the tenant more protection and allows the tenant to make a fully informed decision on whether to move forward and ultimately sign the final lease agreement.

### **(4) Discuss Term and Renewal Options**

A tenant should have a long-term plan at the beginning of the lease negotiating process. If the tenant hopes to be in the same location for 10 years, the tenant should have a right under the lease agreement to be in the premises for at least 10 years. For tenants, it is always best to have a shorter initial term (for example, 3 years) with options to renew the term of the lease at tenant's sole discretion (for example, 3 options to extend the term for 2 years each). That way, if the tenant's business is not as successful as planned in the short run, the tenant will only be liable under the lease for a shorter term (i.e., 3 years). When discussing the renewal options, the lease agreement will sometimes fix the rent during the renewal term or state that the rent during the renewal term will be at the "market rate." If the "market rate" provision is used, it is important to set forth a clear and specific understanding of how the "market rate" will be determined if the landlord and the tenant cannot agree upon the rent for any of the renewal terms. Otherwise, the whole renewal option may be deemed unenforceable if the "market rate" cannot be calculated.

### **(5) Protect Yourself from Early Lease Termination**

In some jurisdictions, a memorandum of lease may need to be recorded to protect a tenant in the event of a sale of the premises or a foreclosure by the landlord's lender. A memorandum of lease is a short form lease which sets forth the name of the landlord, the name of the tenant, a description of the premises, and the length of the lease term (including renewal options). The memorandum of lease will then be recorded in the county register of deeds' office or with the clerk of court. In certain jurisdictions, if a memorandum of lease has not been recorded in the public records, and the premises are sold or foreclosed by the landlord's lender, the new buyer of the premises or the bank could refuse to honor the tenant's existing lease agreement and force the tenant to vacate the premises, even if a significant portion of the lease term remains. With the memorandum of lease recorded, a tenant will be protected in certain situations. In addition, a tenant should request that the landlord's current lender execute a subordination, non-disturbance, and attornment agreement ("SNDA") upon lease signing. Under an SNDA, the lender agrees to honor the tenant's lease agreement in the event of a foreclosure so long as the tenant continues to pay rent and perform its other obligations under the lease and is not otherwise in default. If an SNDA is not signed by the landlord's lender, in certain jurisdictions the landlord's lender may refuse to honor the tenant's lease agreement and force the tenant to vacate the premises upon foreclosure.

#### **(6) Safeguard Your Location**

Tenants should ask for an exclusivity clause in their lease agreements. The exclusivity clause will simply state that, so long as the tenant is not in default under its lease agreement and is open for business, the landlord will agree not to lease any other space in the shopping center to another tenant who is engaged in the same business as the tenant. The exclusivity clause will help assure the tenant that no other businesses in the shopping center will directly compete with the tenant. A tenant should also request that any relocation clauses be removed from its lease, especially if the location where the tenant's premises is positioned is important to the tenant's business. Relocation clauses usually provide that the landlord, at its option, may cause the tenant to relocate to another space in the shopping center, which affords the landlord additional flexibility in accommodating the expansion needs of other tenants or in carving out space for a new tenant. If the landlord refuses to remove a relocation clause, then the tenant should at least negotiate the relocation clause to help protect the tenant as much as possible (for example, either allowing the tenant to terminate the lease agreement, or requiring the landlord to provide for a similar location together with a reimbursement of all of tenant's relocation costs).

#### **(7) Understand "As Is"**

If the tenant accepts the premises in “as is” condition and there are no other provisions in the lease agreement requiring the landlord to perform any work or warranty any portion of the premises, the tenant will be responsible for the maintenance, repair, and replacement of all portions of the premises. Tenants should try to negotiate for a warranty by the landlord that certain items are in good working order as of the commencement date of the lease term (e.g., electrical, plumbing, roof, HVAC, etc.). A tenant should also try to negotiate a cost-sharing mechanism for the HVAC units whereby the tenant will be responsible for a portion of the cost of maintenance and repair of the HVAC (per lease year) and the landlord will be responsible for the remainder of such cost (including replacement costs) over some agreed upon amount.

#### **(8) Ask for Notice and Cure Provisions**

In many form lease agreements suggested by landlords, a failure by the tenant to timely pay rent when due will constitute an immediate default, and, sometimes, a failure by the tenant to comply with any other non-monetary obligations under the lease agreement will also constitute an immediate default. In such instances, the landlord can immediately exercise all of its rights and remedies under the lease agreement, often including an acceleration of rent and termination of the lease. Landlords frequently will agree to provide a tenant with a notice and cure period upon the occurrence of a monetary or non-monetary default under the lease. Tenants should ask for more than a grace period to pay rent. Tenants should always ask for at least one written notice of rent payment default per lease year (with an opportunity to cure) prior to being deemed in default under the lease agreement. Tenants should also ask for a notice and cure period for non-monetary obligations. The notice and cure period for monetary obligations is often shorter (3-10 days is typical) than the notice and cure period for non-monetary obligations (15-45 days is typical).

#### **(9) Know Your Rights When Your Landlord Defaults**

In most jurisdictions, unless the lease agreement states otherwise, the only right a tenant has if the landlord defaults under the lease agreement is to sue the landlord for breach of contract, unless the landlord's default wrongfully evicts the tenant. Therefore, a tenant should try to negotiate certain rights and remedies into the lease agreement. Tenants are sometimes successful in negotiating for cure rights (for example, if the landlord is required to perform some duty under the lease agreement and fails to do so, the tenant can cure the landlord's default and perform that duty). The next step is negotiating whether the tenant would then bill the landlord for the costs associated with the curing of the landlord's default or whether the tenant could withhold rent (or a portion of rent) to offset the costs of such cure. An extreme remedy for a landlord default would be permitting the tenant the option to terminate the lease agreement. The termination right is rarely granted; provided that a termination right is sometimes negotiated for a breach by a landlord of a tenant exclusivity clause or for an anchor tenant vacating the shopping center.

#### **(10) Negotiate Your Guaranty.**

Since many commercial tenants are legal entities (often corporations or limited liability companies), landlords will often require the principals of the tenant to execute a guaranty agreement when the lease

is signed. Under the guaranty agreement, the individual principals (“Guarantors”) guaranty the tenant’s rental and other obligations under the lease agreement. Therefore, if the tenant defaults, the Guarantors will be responsible to the landlord for such obligations. The guaranty agreement imposes liabilities on the Guarantors (in the event of a tenant default) just like the lease agreement imposes liabilities on the tenant. Two types of guaranty agreements are used to guaranty leases: (i) a guaranty of payment and (ii) a guaranty of collection. A guaranty of payment (which permits a landlord to simultaneously pursue the obligations of the tenant and the Guarantor) is more common than a guaranty of collection (which only permits a landlord to pursue collection against the Guarantor after exhausting all efforts to collect from the tenant). For these reasons, a Guarantor should attempt to negotiate a guaranty of collection rather than a guaranty of payment. In addition, Guarantors should try to limit their liability under the guaranty agreement. Guarantors should push back if a landlord attempts to require that a principal’s spouse sign the guaranty agreement. Such a guaranty requirement may violate the federal Equal Credit Opportunity Act. If the spouse signs, the landlord may then have recourse against any joint assets of both the principal and his or her spouse. Guarantors should try to negotiate a monetary limit to their guaranty (for example, only guarantying payment for a period of 1 year or up to a certain dollar amount rather than an unlimited guaranty). Guarantors should further try to negotiate an early expiration of the guaranty agreement (for example, provided the tenant has not defaulted under the lease agreement for a period of 1 year, the guaranty agreement will expire and become null and void).

## **Related People**

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