

Ten Key Issues in Commercial Leases for Retail Space from the Tenant Perspective

By Nancy Lanard, Lanard & Associates, P.C.

The commercial lease can have a significant impact on the performance of a franchised business. Among other things, lease costs, restrictions on the tenant's business, and the rights and uses that are specified in the lease can affect whether the business will be successful or not at a particular location. In this article, we discuss ten frequently negotiated lease terms and offer strategies for approaching these terms from the perspective of the tenant/franchisee looking for a retail location.

1. Personal Guaranty

The personal guaranty is often a hot-button issue in commercial lease negotiations. Having been burned badly during the recession, and having their own lenders to whom they must answer, landlords prefer strong personal guarantees. However, negotiation by tenant's counsel to limit guarantees is still imperative. For example, a tenant may attempt to limit the personal guaranty to no greater than twelve months of rent (or less, if the landlord will agree) that lasts through only the initial term of the lease (or only the first several years of the lease). This means that the personal guarantor will only be liable for at most twelve months of future rent and additional rent (taxes, insurance and operating expenses) plus all past rent due.

In order to have the most leverage in the negotiation of the personal guaranty, the tenant should address the topic at the pre-lease stage, during its negotiation of the letter of intent ("LOI"). LOIs are non-binding but landlords typically remain faithful to their terms through a lease negotiation, and they expect the same from the tenant. Sometimes, tenants will sign an LOI before they have retained counsel. While landlords may be quite reluctant to reopen the negotiations on the guaranty, tenant counsel can attempt to revisit the issue by explaining that the tenant did not have a full understanding of the implications of the personal guaranty.



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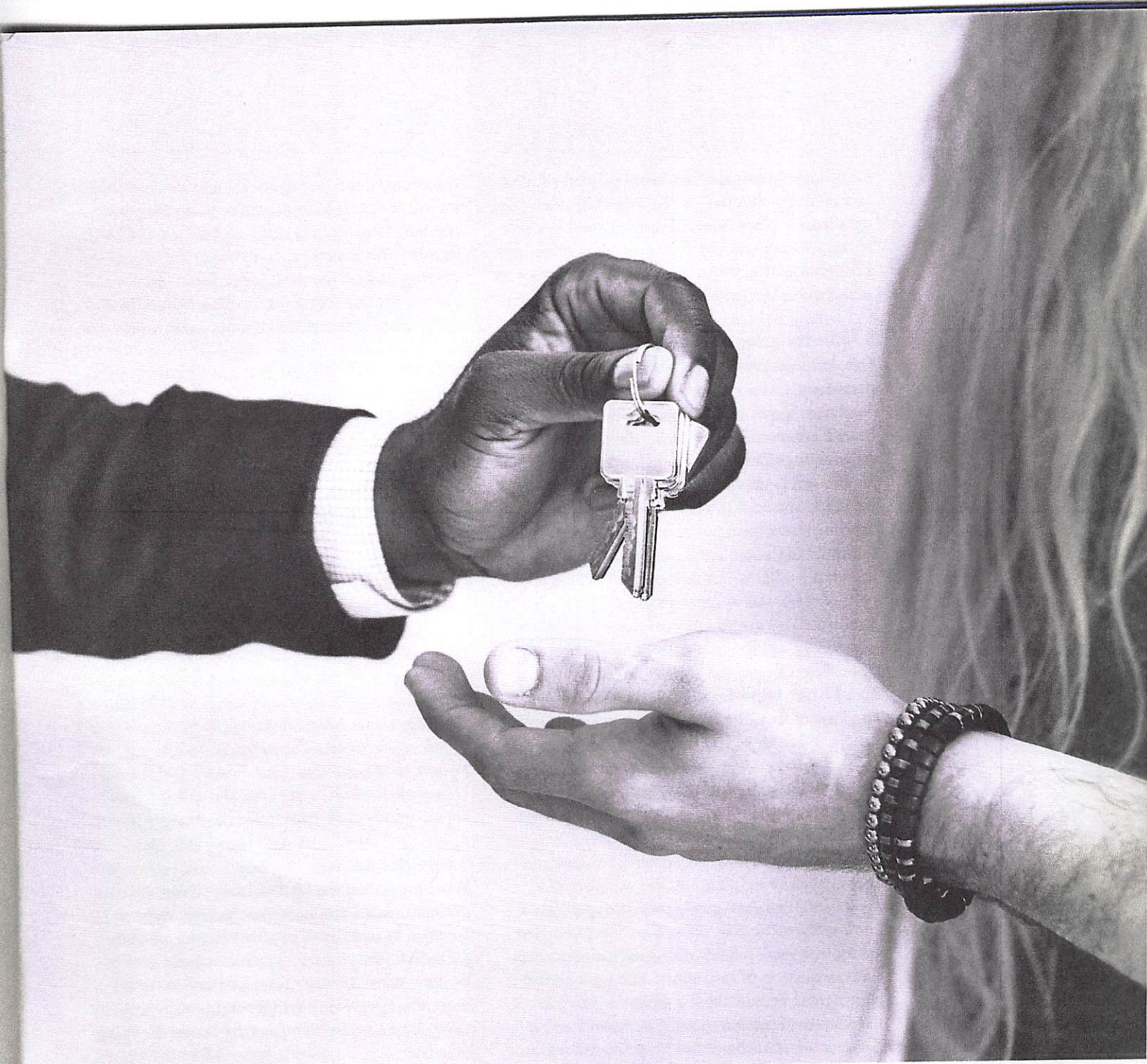
2. Release Upon Assignment

Since the recession of 2008-2010, landlords have commonly required the original guarantors of a lease to remain jointly and severally liable for the tenant's performance under the lease even after the lease has been assigned to a new tenant (for example, on the sale of the business). In weaker real estate markets, tenants may be able to negotiate this requirement out of an assignment provision in the lease. The current trend, however, is for landlords to be reluctant to negotiate a release. Prior to signing a lease, the tenant may attempt to negotiate for a release if the assignment of the lease is to the franchisor or to another franchisee of the franchise system that has a substantially similar or stronger net worth as the assignor.

3. Relocation

In shopping centers, landlords often want the flexibility throughout the term of the lease to move a tenant to another area within the center. For example, a landlord may want to move a smaller tenant to a different location so that two or more spaces can be combined for a larger prospective tenant.

Relocation can be highly detrimental to the tenant's business. If the tenant cannot eliminate the landlord's rights to relocate the tenant altogether, then the tenant should attempt to negotiate appropriate limitations on the landlord's rights to relocate. Potential limitations and protections include: (i) limiting the times of year or days of the week a relocation is permitted.; (ii) designating areas within the center to which the landlord cannot relocate the tenant to preserve visibility and accessibility for the tenant; (iii) requiring the landlord to pay all costs of the relocation and reimbursing tenant for profits lost as result of the business interruption; and (iv) limiting the duration it takes to relocate the tenant to minimize the impact on the tenant's business. Additionally, base rent and additional rent should abate during any period of time that



the tenant is closed for business. Lastly, it should be specified that if the landlord delivers a larger space, the rent and additional rent should not be increased, but if the new space is smaller, then the rent should be reduced to reflect the smaller square footage.

4. Operating Expenses

Most shopping center and single tenant leases are triple net leases. This means that a tenant pays, in addition to base rent, additional rent that represents its share of the landlord's costs for insurance, taxes and operating expenses (also known as Common Area Maintenance charges or "CAM"). The CAM

charges should be negotiated so that they are limited thereby reducing tenant's costs.

A tenant should consider negotiating the exclusion of the following items from CAM: (i) capital expenditures; (ii) depreciation on the building or the shopping center; (iii) landlord's legal fees in collecting overdue rent; (iv) damage or repairs that are covered by insurance; (v) damage or repairs caused by other tenants; (vi) damage or repairs caused by agents of the landlord; (vii) interest or penalties charged to the landlord for landlord's failure to timely pay obligations; (viii) taxes related to rental income;

(ix) property management fees in excess of 5%; and (x) costs incurred to test or survey or clean up any hazardous substances not caused by tenant. Tenants should also consider negotiating a limitation on CAM to a certain percentage over each year of the lease.

5. Maintenance Obligations

One common issue in a commercial lease is maintenance of the heating, ventilation and air conditioning system ("HVAC") and which party bears the responsibility. It is important when representing a tenant/franchisee that the tenant require that landlord represent and warrant that the HVAC system is in good working order at the time the tenant takes possession of the premises. A tenant should also attempt to negotiate a twelve-month period in which the landlord will pay for all costs of repair that are over and above the cost of standard HVAC maintenance service or replacement of the HVAC system, especially if the system is old. If the tenant learns after signing the LOI that the HVAC is old then there should be further negotiated concessions from the landlord to compensate for this, such as a larger improvement allowance or the installation of a new HVAC system prior to delivery of the premises.

6. Permits

Every tenant will need construction and use permits before building out the premises that are leased. Permitting issues can be complex and highly variable between municipalities. For example, a municipality may have a moratorium on construction of restrooms. Having a permit contingency would allow a tenant to extricate itself from a lease when the cost or time to get permits is out of the ordinary. In the current market, landlords will be reluctant to give tenants permit contingencies, or if they do, the contingency period is likely to be quite short. As a result, tenants should conduct as much diligence as possible, including meeting with architects, contractors and local authorities, before signing a lease.

7. Signage

Signs are important to every business. Most commercial landlords, as well as local municipalities, require approval of any signs to be displayed. To avoid signage issues, tenants should attempt to get pre-approval of the franchisor's signage requirements prior to signing the lease. Similar to the permit contingency, a signage

contingency can be negotiated into the lease to protect the tenant if it is unable to obtain sign approval from all governing authorities. Lastly, for many businesses, it is critical to negotiate a right to be on the shopping center pylon or monument, including the location and the size of the display on the pylon or monument.

8. Tenant's Right to Review Landlord's Books and Records

Because the landlord passes its costs through to the tenant in the form of additional rent, it is crucial for the tenant to have the right to review the books and records of the landlord related to those charges that are passed through to the tenant. A tenant should negotiate for this right. If the audit shows those charges are incorrect by a certain percent (often 3-5%) or more in landlord's favor, then landlord should pay the cost of the audit. The lease should require the landlord to provide reconciliation statements annually, within a reasonable time after the close of its fiscal year, that itemize landlord's actual taxes, insurance premiums and permissible operating expenses. The tenant should negotiate to have unrestricted access to the landlord's copies of all invoices, tax bills and other supporting documentation for the charges shown.

9. Landlord Repairs

What happens if the landlord fails to make needed repairs? The lease should require the landlord to make such repairs within a short period of time after being given written notice by the tenant. Failure of the landlord to timely make those repairs should result in tenant's ability to abate rent until the repairs are made. If tenant can abate rent, it typically lights a fire under the landlord to get the repairs completed quickly. It is important to also ask for an emergency self-help clause in which the tenant can remedy the issue itself after 24 hours if the landlord has not responded. In that situation the landlord then must reimburse the tenant for the costs of the repair or replacement within fifteen days of receiving the invoice from the tenant for it.

10. Exclusive Use

As a tenant and a franchisee, it is often advantageous for the tenant to be the only business of its type in the shopping center. Negotiating an exclusive use provision, granting the tenant the exclusive rights to its type of business in the shopping center, can be critical to

the success of tenant's business. It is important when negotiating the exclusive use clause that there be clear definitions in the lease of tenant's rights that are broad enough to protect the tenant from competitors opening in the shopping center. If the landlord violates the exclusive use clause, there should be a penalty for doing so that results in tenant's severely reduced rent (for example, the base rent is abated by 50% or 75% of the normal amount or tenant is only required to pay additional rent, and not base rent) until the violation has been remedied by the landlord. This usually motivates the landlord to be careful not to violate the exclusive use provision. Often, the landlord wants to limit the

time of rent abatement to a twelve-month period, for example, after which the tenant will have to decide to pay full rent or terminate the lease.

Conclusion

In many situations, leases are extremely negotiable documents. The list of items discussed in this article is just the tip of the iceberg in terms of the types of negotiated changes a tenant can seek. Leases for franchised businesses should be carefully negotiated by attorneys who have experience in understanding both the commercial landlord-tenant and the franchise relationship in order to protect the interests of the franchisee/tenant. ■

Message from the Chair

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we cannot rest on these accomplishments. We must continue to find ways to deliver better and better programs and networking opportunities for our members. For these reasons, we have decided to engage in a top-to-bottom review of every aspect of the operation of the Annual Forum. A committee has been formed to undertake this project, chaired by Will Woods. Other members of the review committee include Karen Satterlee, Dawn Newton, Mike Gray, Beata Krakus, Joe Fittante, Jennifer Palmer (our new outside meeting planner) and me. The committee expects to seek input from every constituency and stakeholder within the Forum on Franchising, actively seeking comments, suggestions and criticisms from every member. The goal will be to make the Annual Forum an even better experience than it has been which keeps pace with member expectations and technological advances.

How can you help? First, please take the time to fill out the survey for the 41st Annual Forum on Franchising in Nashville. These surveys are a vital part of the planning process, and your responses this year will help shape next year's meeting in Denver, Colorado at the Hyatt Regency Convention Center. (Mark your electronic calendar entries now for October 16-18, 2019). But they will also give the review committee the benefit of very recent feedback and impressions. Second, you can email any specific suggestions you may have directly to Will Woods at Will.Woods@bakermckenzie.com or to me at

ekarp@wkwrlaw.com. Third, you can respond when members of the review committee reach out through FranList or other means.

In keeping with the theme of our Transparency Initiative, a summary of the results and recommendations of this review of the Annual Forum will be shared with you in a Message from the Chair in this space.

New Books from the Forum on Franchising

We are delighted to be introducing three new books at this year's Forum.

Our first ever *Bankruptcy Handbook* was edited by Jason Binford and Daniel M. Eliades. Chapter authors include (in order of appearance in the book) David Neff, Frances A. Smith, Lynette J. Gladdis, Daniel M. Eliades, Marcus A. Banks, Joel Buckberg, David S. Catuogno, Sharon Z. Weiss, Craig K. Schuenemann, Aaron Kaufman, John Vernon, Christina Stephenson, David Gurnick, Eric C. Peterson, Ryan Hardy, Jason B. Binford, Matthew Gruenberg, Jan S. Gilbert, Craig R. Tractenberg, Michael Conway, Michelle Shriro, Rakhee V. Patel and Nicole S. Zellweger.

The FTC Rule, 3rd Edition was edited by Susan Gruenberg, Ann Hurwitz and Alexander Tuneski. Chapters were written by (in order of appearance in the book) Warren Lee Lewis, Leonard D. Vines, Jan S. Gilbert, Christian Thompson, Kenneth R. Costello, Christine E. Connelly, Maral Kilejian, Joseph J.