

***NEGOTIATING THE MAJOR OFFICE LEASE***

*Article contributed by:*

*Andrew L. Herz and Russell G. Wohl of  
Patterson Belknap Webb & Tyler LLP*

As published by  
**BLOOMBERG LAW REPORTS**<sup>®</sup>  
in  
July 2008  
**Real & Personal Property**  
**Vol. 1, No. 1**

## **NEGOTIATING THE MAJOR OFFICE LEASE**

*Article contributed by:*

*Andrew L. Herz and Russell G. Wohl of Patterson Belknap Webb & Tyler LLP*

Negotiating a major office lease follows the same basic format as negotiating a typical office lease but, just as flying a jumbo jet is inherently the same as flying a two engine prop plane, in many respects that is where the similarities end. When a large tenant seeks to occupy a substantial portion of a large office building, the leasing exercise by its very nature becomes significantly more complex and time consuming and the consequences impact more people and more dollars. Beyond utilizing a comprehensive checklist of items in evaluating any lease,<sup>1</sup> even otherwise routine issues take on a more significant role since the stakes for both the landlord and the tenant are far greater.

By virtue of the size of the space alone, the financial commitment of the parties is greatly increased. Often, this may result in a major office tenant having more negotiating leverage, but as weather and the length of the runway impact the flight plan for a jumbo jet and small planes in different ways, so too do the financial climate, construction periods, relative vacancy rates and the like, such that the opposite may be true and a landlord may be reluctant or unwilling to entertain any of the tenant rights and options discussed in this Article. Because of a major office tenant's size requirements, large contiguous and unencumbered blocks of space may be limited, or, as is often the case in a tight market, all of the space that it needs may not be available either in its entirety or may also require that the major office tenant or landlord negotiate with an existing tenant to surrender or relocate space or that the major office tenant sublease some of the needed space in connection with a contemporaneous direct lease from the landlord. In such a case, creative direct and subletting structures may be necessary to create the block of space that the major tenant requires.<sup>2</sup>

This Article will address some of the common (and not so common) rights and options that a major tenant may seek in its negotiations with a landlord and also set forth some of the general concerns that a landlord may have under

such circumstances. We do not propose to set forth what either party "is entitled" to receive as that depends entirely upon the particular circumstances and the relative bargaining strength and sophistication of the parties.

In a major office lease transaction, the magnitude of the dollars involved increases the stakes and literally magnifies what otherwise would be relatively minor expenses for a tenant. For example, often a landlord will seek to charge a tenant a supervisory fee if the tenant performs any alterations, including cosmetic changes such as carpeting within the premises based upon the total cost of the alteration. For a small tenant, often such an expense does not seem worth fighting about. After all, the landlord may have to coordinate use of the service elevator, review the contractor's insurance certificate, coordinate the contractor's deliveries, etc. However, for a multi-floor tenant, the expense could be quite substantial. Usually both the landlord and the tenant and their respective counsel will understand these distinctions and landlords will factor this into the rent. Of course, this is often a source of pure profit for the landlord and it may waive such a fee for an initial build-out but resist waiving such a fee for future alterations or decorations.

For the landlord also, the stakes are much greater. A landlord willing to lease a single block of substantial space in its building to a major tenant is making a bet on the financial viability and continued good reputation of such tenant. If the block of space that the tenant is leasing is large, the ability of the landlord to finance its building may be significantly impacted by the credit worthiness of the major tenant and, not infrequently, the lender will want to receive financial information from and about the major tenant. While this might not seem problematic if the tenant is a public corporation, the possibility of an assignment of the lease or a going private transaction must be considered in a major long-term lease. Often, private companies are reluctant to provide financial statements even when the landlord offers to sign a confidentiality agreement.

Each month, the landlord needs the major tenant to pay its rent or the landlord may suffer severe consequences. Unlike some other types of continuing real estate transactions, such as secured loans, leases generally do

not have continuing financial covenants. However, financial covenants are often important conditions to the continuing waiver by the landlord (if the lease so provides) of such customary rights, such as:

- the right to have no or a relatively small lease security deposit or a burn-down in the amount thereof during the term;
- the waiver of a requirement for additional deposits when undertaking major capital improvements or legal contests; and
- limitations on the obligation to carry insurance or permitting self-insurance.<sup>3</sup>

So too, do landlords attempt to condition extraordinary or additional rights, such as rights of first refusal and expansion rights, on the financial strength of the tenant; although, typically, the required condition precedent is limited to the tenant (and its affiliates) actually occupying and paying rent for a substantial block of the space and not being in material default.

Another wrinkle in the flight plan for a major office lease for both the landlord and tenant is that the time period to negotiate and consummate the transaction can be significantly longer than the typical smaller office lease. This is true in part because of the logistics involved and the need for advance planning. Unlike the small office lease, many consultants will normally be involved in the move, and hopefully, in the planning process. These consultants often include the whole range of professional services firms including: architects, structural and mechanical engineers, IT and communications consultants, a move consultant, and an insurance consultant. Although the input of these consultants is invaluable, their activities need to be coordinated either through the broker or a project manager. Timing also can be a critical aspect of planning, as the tenant is most likely moving out of one of more locations and no tenant wants to be paying rent for the same employees in more than one location for other than a very short time.

Plans and specifications take a significant amount of time to develop; not just because it takes time to prepare the actual drawings but because the tenant has to develop a

sophisticated program for how it is going to use the space. For a major office tenant, the timing of obtaining landlord's consents and the ability to have the landlord approve plans in various stages keeps the process moving smoothly. As may be the case in smaller transactions with sophisticated parties, landlords often will agree to a deemed approval mechanism and/or an expedited arbitration procedure to break any impasses in the approval process.

Inherent in the major office lease is the complexity of the actual construction. Multi-floor occupancies may require internal staircases and other vertical transportation methods and often specialized uses such as cafeterias, fitness centers, laboratories, executive dining rooms and libraries. Often overlooked is how the construction workers are afforded access to the building, the tenant's space and related staging areas. All of these complexities should be addressed at the negotiation stage and be included in the final lease documentation. The input of the various consultants discussed above is critical to address practical concerns and issues. These complexities and practical concerns and issues may require:

- the use or construction of a dedicated hoist on the exterior of the building;
- the granting of a "staging area" on the ground and/or lobby to facilitate delivery of materials and storage until loaded onto the floors;
- the right to have a construction shed;
- preferential use of or a dedicated freight elevator;
- provision of temporary power;
- use of space on a floor outside of the premises for tool storage and project management;
- use of elevators for move-in and move-out;
- the right to determine how much of the existing premises needs to be demolished and what should remain;
- provision of security during construction; and
- addressing the impact and responsibility for jurisdictional labor costs.

As a result of the foregoing, it is not uncommon for the "work letter" provisions of a lease for a major tenant to be as long, if not longer than, the entire lease for a typical office lease. Additionally, in granting any of the rights

described above, a landlord needs to be sensitive, regardless of the size of the tenant, to the appearance of the building after completion of the construction and the impact upon how customers and clients of a tenant gain access to the building and the tenant's space.

Beyond the actual construction and related work letter considerations, the lease document is a "living document" that must address a relationship that can continue for at least fifteen or twenty years. Customary provisions in a landlord's form lease are frequently modified for the large office tenant to streamline and avoid turbulence in the long term landlord/tenant relationship. The provisions that a major tenant will often seek to negotiate and modify from the typical form (or first draft) provisions include, but are certainly not limited to:

- alterations
  - no consent for non-structural and decorative alterations;
  - advance consent for certain structural alterations (including floor reinforcement, installing raised flooring and internal staircases and the like);
  - deemed approval rights;
  - tenant's right to select contractors (and limitations on a landlord's right to change approved contractors, especially after contracts are awarded);
  - no obligation to restore the premises at the end of the lease term or very limited removal obligations (landlords often want so called "specialty alterations" removed, but major tenants will attempt to limit such an obligation if a succeeding tenant uses the same);
  - the right to shaft and riser space and cooking ducts and vents; and
  - the right to have private lavatories, cafeterias and a gym.
- tax escalations and related tax provisions
  - waiver of monthly deposit amounts;
  - rights to participate in tax certiorari proceedings;
- landlord's obligation to cooperate in tenant seeking benefits under tax and other incentive programs; and
- limitations on the landlord's right to change tax escalation due to a reduction in a base year taxes as a result of a successful tax certiorari proceeding.
- operating expense escalation provisions
  - expanded list of items excluded from operating expenses;
  - protection against additional operating expenses due to changes in insurance companies or coverages and building management; and
  - expanded audit rights for tenant.
- use
  - greater flexibility and fewer restrictions to prevent "gotcha" scenarios in sublettings and assignments.
- legal compliance
  - waiver of any requirement to post security deposits;
  - rights to contest applicability of laws; and
  - obligation of the landlord to comply with ADA in public areas.
- services
  - right of tenant to have its own contractors or employees perform services;
  - tenant to have voice or ability to replace cleaning contractor;
  - the right of use of dedicated exclusive elevators and installation of private elevators between floors;
  - right to specified levels of actual service performance, such as elevators wait time and speed, HVAC and supplemental systems specifications; and
  - back-up generator specifications, allocations and priority of usage and shedding.

- electricity
  - right of the tenant to bring additional service into building;
  - reallocation of power among the leased floors; and
  - the right of tenant to have usage directly metered.
- repairs
  - self-help rights of the tenant; and
  - obligation of the landlord to use overtime labor, including, at the landlord's cost, due to circumstances preventing access to the building.
- access/landlord changes
  - restrictions on when the landlord can enter the leased premises and protection of "secured areas"; and
  - limitations on the landlord's ability to reconfigure public spaces or reduce usable area of the leased premises or the ceiling height thereof.
- insurance
  - higher deductibles;
  - self-insurance rights for the tenant; and
  - requirement that the landlord be obligated to maintain casualty and liability insurance.
- casualty
  - greater termination rights for the tenant based on estimates and actual restoration time; and
  - expanded abatement period after the landlord's restoration is completed.
- assignment and subletting
  - limited or no recapture of sublet space;
  - limited or no termination right if the tenant assigns the lease;
  - no right of the landlord to backlease space proposed to be sublet;
  - lock-out periods if the landlord will not agree to waive all recapture or backleasing rights;
  - the right to have permitted desk sharers;
- fewer restrictions and conditions to the landlord's approval;
- shorter approval periods for the landlord;
- deemed approvals;
- limited or no profit sharing on tenant transfers, expanded items included in permitted expenses for tenant profit sharing calculations, including unamortized cost of the tenant's build-out and deemed expense for downtown;
- tenant profit sharing with the landlord if the landlord recaptures or backleases;
- greater rights for affiliates and related parties of the tenant to use the leased premises without the landlord's consent;
- the obligation of the landlord to recognize eligible subtenants;
- permitted sub-subtenant rights; and
- the right of tenant to lease from other tenants in the building where there otherwise is a restriction.
- default
  - better notice and cure rights.
- security
  - waiver or letter of credit rights;
  - reduction of the security deposit during the term; and
  - permitted non-cash security.
- holdover
  - more graduated holdover rental rates;
  - limits on consequential damages; and
  - rights to surrender parts of the premises held over to reduce liability.
- consents
  - all not to be unreasonably withheld or delayed; and
  - expedited arbitration in the event of a dispute.
- recourse
  - greater limitations on recourse;
  - release of assignee; and
  - release of deceased and departing partners.

- miscellaneous
  - right to have a recorded memorandum of lease (especially if the building is under construction);
  - protection against obstruction of views;
  - expanded abatement rights in the event of an interruption of service; and
  - many more, depending on the particular needs of the parties.

Additionally, large office tenants are often given their own bevy of rights which are not generally provided to the ordinary office tenant or, if requested by a smaller tenant, are quickly dismissed by landlords. These include:

- rights to renew the term of the lease for less than all of the leased premises;
- right to cancel lease after rent arbitration if rent unfavorable;
- rights of first refusal on any available space (including space that a landlord may take by recapture) and/or the entire building;
- fixed expansion rights at agreed upon intervals during the term;
- the right to shed space in certain limited amounts at designated times;
- obligation of the landlord to take over existing lease obligation;
- indemnifying the tenant against potential holdover costs in existing space;
- the lease of storage space;
- use of dedicated parking areas;
- the right to use roof and garden space or terrace space;
- the right to use other building amenities such as auditorium;
- the right to install conveyor systems;
- the right to name the building (or restrictions on others having the right to name the building);
- rights to scaffold signage and fees generated in connection therewith;

- rights to lobby and exterior signage (including restrictions on signage by competitors and others);
- signage in other parts of the building complex;
- use of flagpoles;
- rights to have separate entrances;
- separate concierge or lobby directory desk with security in the lobby;
- separate messenger entrance and waiting area;
- rights to have car service parking in front of building;
- rights for the tenant to install its own generator or UPS (uninterrupted power supply) system and install dedicated fuel lines in connection therewith;
- right of the tenant to have own telecom provider and multiple separate points of entry in the building telecom room;
- restrictions on locations of window cleaning rigs to ensure views;
- limitations on costs incurred by landlord for which it seeks reimbursement to actual third party costs without premium incurred by the landlord;
- right of tenant to tie-into the building management systems;
- requirements that the landlord maintain water and air quality to a specified standards and compliance with other green building requirements; and
- a particular favorite of major tenants in situations where it is difficult to figure out what the treatment of the large office tenant should be is that such tenant be granted “most-favored nation” status to insure that better rights are not granted to smaller or other tenants.

A major office tenant often has the leverage to get many of the rights discussed above. However, like any good flight plan, it is critical to have the right attorney pilot the plane to stay on course and not seek rights that are not significant or are without meaning in the context of the transaction or market realities.

*Andrew L. Herz, a partner at Patterson Belknap Webb & Tyler LLP in New York, is a recognized authority and frequent lecturer in the areas of commercial office leasing and mortgage financing. Mr. Herz is a member of the American College of Real Estate Lawyers; included in The Best Lawyers in America; and recommended as a leading lawyer in Chambers USA 2008. He has also been designated as one of only 15 real estate lawyers in the United States to be included in The Best of the Best in Real Estate for 2007 published by Legal Media Group. His clients include major real estate owners and developers, commercial banks, investment banking firms, technology providers, hospitals, professional service companies and other law firms. He also is an active and prominent member of numerous professional organizations focusing on commercial real estate. He may be reached by phone at 212.336.2910 or by e-mail at alherz@pbwt.com.*

*Russell G. Wohl, Counsel at Patterson Belknap Webb & Tyler LLP in New York, has a wide range of experience in all aspects of transactional real estate, including leasing and subleasing (representing both landlords and tenants), ground leasing, acquisitions and mortgage and other security-based financings. He has significant experience in providing advice to companies in connection with the drafting and negotiation of the leasing of major office space throughout the country, including the negotiation of city and state based incentive packages. Mr. Wohl was named a Rising Star in 2007 by Real Estate Weekly for his work in the industry. He may be reached by phone at 212.336.2789 or by e-mail at rgwohl@pbwt.com.*

<sup>1</sup> See S.H. Spencer Compton and Joshua Stein, *Tenant's Checklist of Silent Lease Issues and Landlord's Checklist of Silent Lease Issues*, COMMERCIAL LEASING, New York State Bar Association, Vol. 1, Chapters 3 & 4 (2004).

<sup>2</sup> Although beyond the scope of this Article, see Andrew L. Herz & Russell G. Wohl, *Subleases: The Same Thing as Leases, Only Different*, 35 REAL PROP. PROB & TR. J., 668 (2000), for a discussion and analysis of matters to consider in reviewing and analyzing a sublease transaction.

<sup>3</sup> See Ann Peldo Cargile, Stephen K Cassidy & Arthur E Pape, *Are you Bare or are you Covered? An Examination of Some Key Issues Raised by Self-Insurance*, AMERICAN COLLEGE OF REAL ESTATE LAWYERS ANNUAL MEETING (2002, Los Angeles), 341.

