COMMERCIAL REAL ESTATE POCKET GUIDE

FIRST EDITION

WAGONHEIM LAW

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WAGONHEIM LAW DIFFERENCE

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WAGONHEIM LAW

In the late 1990's, one could hardly turn around without seeing an article about the death of commercial real estate. The argument went that online storefronts such as Amazon and the craze of the virtual office had eclipsed the usefulness of actual brick and mortar stores.

Physical retail was dead. Traditional office space was dying. And the simultaneous rise of the internet and gas prices meant that "location, location, location" was nothing more than the swan song of a bypassed industry.

But a funny thing happened on the way to the funeral – commercial real estate refused to die. Despite a recession that has wreaked havoc on virtually everything in its path, commercial real estate has survived. And while tight across-the-board credit threatens no industry more, companies are still seeking their perfect locations, land is still being developed, and credit is still there to be had…if the deal is right.

This Pocket Guide is dedicated to those – whether developer, lender, landlord, tenant, seller or purchaser – who continue to fuel the engine of our economy with their initiative, ambition, business acumen and yes, even bravery, by travelling what lately has seemed a very steep, uphill climb. It is our hope that this Guide provides some assistance, a map, and a few checkpoints along the way.

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The largest obstacle to a clear line of communication between client and counsel is the prospect of being nickeled and dimed to death under a billable hour system. As a result, many times, clients simply choose not to call.

The cost of that reluctance is enormous. Without the proper guidance, small issues can quickly blossom into big problems. Every day, clients call us for guidance on virtually every issue facing their businesses. Here are just a few examples:

- "Can my landlord charge me for this?"
- "Can I use the parking lot next door?"
- "We're thinking about subleasing space; what do we need to consider?"
- "What can I do about the big increase in my real estate tax bill?"

With all that, our concern is about the calls we're not getting. I suspect we're not being used as a resource by front-line personnel such as A/R clerks, on-site project managers, or supervisors, perhaps because they lack the authority to start the lawyer's meter running. So we both lose out. Our firm loses the chance to deepen relationships; and our client loses an opportunity for advice often when it would be most effective – before the problem actually arises.

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We can't say "we value relationships" unless we've built our business model around proving it. Wagonheim Law offers a wide variety of flat fee and blended options, but our flagship program is EHP. EHP eliminates the roadblock to client communication by taking the billable hour out of the equation. For less than the amount many attorneys charge for an hour of their time, a client can gain unlimited access to our attorneys for an entire month.

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	EHP	EHP Plus
Unlimited phone calls	√	√
Unlimited e-mails and correspondence	√	√
Unlimited demand letters	√	√
Annual, unlimited good standing review	√	√
1 monthly contract review and analysis	√	√
Free copies of Pocket Guides and publications	√	√
Free WL mobile applications with updates	√	√
Reduced fees for seminars and workshops	√	√
3 monthly contractual reviews and analyses		√
Free Mechanic's Lien Notices		√
Annual updated corporate minutes		√
Annual audit response letter		√
Monthly in-person conference		√
Contingency fee for District Court collection matters		√
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PART ONE: THE COMMERCIAL LEASE

INTRODUCTION

Some contracts give lawyers a bad name. They're long, filled with sometimes impenetrable legalese, and formed from sentences long enough to earn failing grades in English 101. Commercial leases are like that. In fact, a Commercial Lease Agreement is one of the most complex legal documents a business owner will ever encounter.

A commercial lease includes many separate agreements which, taken alone, are complex in and of themselves. For example, commercial leases usually include a construction contract, a security agreement, a subordination agreement, a release and indemnification agreement, restrictive covenants, rights of first refusal, and other agreements.

Each of these agreements alone could be the subject of extensive negotiation. In a lease, these agreements are mixed in with other difficult issues such as operating expense pass-throughs, landlord services, assignment and subletting, repair and maintenance of the premises, insurance and default and remedies.

> Bill Gates once said "success is a lousy teacher; it convinces successful people that they cannot fail."

Many business owners fall into this trap. Because their businesses are successful, they become convinced that they know everything they need to know about negotiating a lease. After all, they know how long the lease should last and what the rent should be. What else is there?

TYPES OF LEASES

Triple Net Lease

A "triple net lease" (NNN), or "net lease" derives its name from the fact that the rent quoted the tenant is net of taxes, insurance, and repairs and maintenance – meaning that the tenant must pay for those items in addition to its base rent.

A triple net lease is the most commonly used leasing arrangement. In it, the tenant pays a fixed rent plus some or all of the property expenses, including taxes, insurance and maintenance, repairs, utilities and other predetermined items. In a triple net lease, the property owner will receive the rent "totally net" after the expenses passed through the tenants are all paid.

The exact items that are to be paid by the tenant are usually specified in the written lease before the lease is signed. In certain properties such as a multi-tenant office building or a strip mall, the lease expenses that are passed along to the tenants are usually prorated to the tenants based on the size or square footage of the area occupied by that individual tenant.

Only one of many commercial leasing options, the triple net lease is sometimes called a true net lease, because the landlord often has very few responsibilities related to building upkeep. For this reason, many commercial landlords favor triple net leasing options. The building can generate a high level of income while the tenant keeps it in good condition, generally making improvements to the property as well.

For its part the tenant has many of the advantages of ownership, including control over the property, without having the substantial capital investment that acquiring a property represents.

A triple net lease is not without risk to a landlord. Some tenants may not be able to pay fees, or may allow the building to fall into disrepair. In some extreme instances, a tenant may deliberately cause damage to a building to collect insurance money. For this reason, some triple net leases include a reserve fund whereby the tenant makes regular payments into the reserve fund, which can be used to cover essential repairs in the event of an emergency.

Gross Lease

In a "gross lease" arrangement, the tenant pays a gross amount of rent, which the landlord then uses to pay the expenses. In many ways, it is the exact opposite of a triple net lease. This type of lease is not usually favored by landlords due to the inability to pass expenses through to the tenant.

Modified Gross Lease

A modified gross lease is a lease in which the rent includes building expenses like a gross lease, but the landlord recaptures expense increases via a pass-through provision such as an operating expense, tax, or utility escalation. Modified gross leases are commonly found in multi-tenant office environments.

Hybrid Lease

Hybrid leases mix the features of gross, modified gross, and net leases. In this type of lease, some expenses are passed on 100% to the tenant while others are included in the rent on a gross or modified basis. For example, utilities and cleaning may be charged to the tenants on a net basis (fully charged to the tenant), while operating expenses and taxes are handled on a modified gross basis (base amount included in the rent, with a pass-through of increases).

Green Lease

The use of a “green lease,” as opposed to traditional lease, is essential to any commercial green building operation. Green leases are becoming more common as sophisticated real estate operators clearly see the benefit of making sustainability a part of their investment strategy.

Commercial green leases have a more positive effect on net operating income than traditional commercial leases.

Why?

Because requiring both the landlord and tenant to act responsibly in terms of the most efficient use of materials and resources, regardless of the cost of energy, results in lower operating costs for both parties. Commercial leases are a long-term commitment as it is often difficult to predict energy costs from year to year.

To develop an effective, well-considered green building lease, a landlord must preemptively create a lease structure that contains negotiable and non-negotiable items that are designed to meet a building's energy and environmental goals.

<u>Ground Lease</u>

A ground lease is a long-term lease of land that usually is suited for credit tenants or certain franchises. Examples of typical situations involving ground leases include the stand-alone pad sites in a shopping center, national chain stores, and certain restaurants. In a ground lease, the landlord (the Ground Lessor) leases land to the tenant (the Ground Lessee) under a long-term lease. The ground lease usually allows the Ground Lessee to construct one or more buildings, make improvements on the land and enter into leases with other tenants, all without the Ground Lessor's consent. While this is a lease structure, the Ground Lessee has greater rights and obligations than the typical commercial tenant. The Ground Lessee's rights include the ability to mortgage its leasehold interest in the property and protest tax assessments.

COMMON LEASE DEFINITIONS

Additional Rent - Any amounts due under a lease that are in addition to base rent, such as operating expenses, taxes, insurance, and maintenance.

Allowance - A set dollar amount provided by the landlord under a lease to be used by the tenant for a specific purpose. Examples include allowances for tenant improvements, moving expenses, design fees, etc. If the expense exceeds the allowance amount, such excess is the tenant's responsibility. If the expense is less than the allowance, the savings are retained by the landlord unless their agreement specifies otherwise.

Amortization - Payment of debt in regular, periodic installments of principal and interest, as opposed to interest only payments. This may also be used in a lease where the landlord incurs costs for additional tenant improvements which are effectively treated as a debt and repaid by tenant over the term of the lease.

Assignment - A transfer to another of any property, real or personal, or any rights in said property. Common assignments are of leases, mortgages, and deeds of trust, although the general term encompasses all transfers of title.

Base Rent - A specific amount used as the minimum rent onto which may be added other items (often termed "additional rent") such as added expenses, taxes, CAM charges, or other additions as specified in the lease.

Base Year - The 12 month period upon which a direct expense escalation of rent is based. Typically, the calendar year the lease begins.

BOMA - Building Owners and Managers Association. BOMA publishes the definition of rentable and useable area, which is used to determine the square footage leased in most commercial office buildings.

CAM Charges - Common Area Maintenance charges. Those charges levied on or the expenses incurred in maintaining the common areas of a building.

Class - Class is usually used in conjunction with an office property and refers to the quality of property. Class definitions fall within the following guidelines. Class A+: Landmark quality, high rise building with prime central business district location (the best of the Class A buildings). Class A: Generally 100,000 square feet or larger (five or more floors), concrete and steel construction, built since 1980, business/support amenities, strong identifiable location/access. Class B: Renovated and in good locations. Newer building is smaller in size, wood frame construction, and/or in non-prime location. Class C: Older, unrenovated of any size in average to fair condition.

Commencement Date - The date on which a lease begins. This is typically, but not always, the day on which the tenant takes possession of the leased space, which usually occurs upon substantial completion of the tenant improvements. (See Occupancy Date below.)

Common Area - Common area is the area used in common by multiple tenants. Typical common areas include building and elevator lobbies, rest rooms, and the corridor leading from an elevator lobby to a tenant space in an office building and include parking lots, entrances, and open areas at multi-tenant retail malls and strip centers.

Demised Area - The walled off and secured area of a leased space, separated from spaces leased to others (by a "demising" wall).

Discount Rate - The rate of interest used in a present value analysis representing the "time value of money."

Escalation - A clause in a lease providing for an increased rent at a future time. Escalation may be accomplished by several types of clauses, such as: (1) fixed increases - a clause which calls for a definite, periodic rental increase; (2) cost of living - a clause which ties the rent to a government cost of living index, with periodic adjustments as the index changes; (3) direct expense - the rent adjusted according to changes in the expenses of the property paid by the landlord, such as tax increases, increased maintenance costs, etc.

Estoppel Certificate - An instrument which prevents individuals from later asserting facts different from those contained in the document. The tenant and landlord both sign the estoppel certificate, confirming the lease and pertinent facts thereto. Thereafter, neither party may make claims to the contrary as of the date of the estoppel certificate.

Extension Option - An agreed continuation of the lease or occupancy under the same conditions, as opposed to a renewal, which implies new terms or conditions. In a lease, it is a right granted by the landlord to the tenant whereby the tenant has the option to extend the lease for an additional period of time. An extension option differs from a renewal, which implies new terms or conditions.

Gross Up - An adjustment made to operating expenses to account for the occupancy level in a building. When operating expenses are "grossed up," it means that the building's variable expenses have been adjusted upwards to the level that those expenses would be incurred if the building were fully occupied (typically 95%).

Ground Lease - A lease of land only (either vacant or exclusive of any buildings on it). Usually a net lease on a long-term basis (30 years+). Ground rent should not be charged back to the tenant as an operating expense.

HVAC - Heating, Ventilation, Air Conditioning. A general term encompassing any system designed to heat and cool a building in its entirety, as opposed to a space heater.

Landlord (Lessor) - The party (usually the owner) who gives the lease (right to possession) in return for a consideration (rent).

Lease Term - The specific period of time in which the landlord grants to the tenant the right to possession of real estate.

Lease Year - a year as defined in the Lease. The first Lease Year is often longer than 12 months, running, for example from May 13th when the lease is signed to the following May 31st. Subsequent Lease Years are usually 12 months from a specified date, such as June 1st to the following May 31st.

Letter of Intent - There are several possible uses of this term. Generally, a written statement that two parties to a prospective transaction (buyer/seller or landlord/tenant) intend to proceed to a final agreement in good faith on stated principal business terms of the transaction. This meaning applies when executed by both parties. Alternatively, such a document may be signed only by one party and is then an indication of a willingness to enter into agreement on the stated terms and conditions. To avoid legal issues regarding offer and acceptance and thus formation of a binding contract, care should be taken to include in the letter of intent a clause stating that there is not a specific offer and no intent to be a legally binding obligation. However, an obligation to continue to negotiate in good faith to conclusion can be created.

Master Lease - A lease controlling subsequent leases. A master lease may cover more property than subsequent leases. For example: "A" leases an office building, containing ten offices, to "B." "B" subsequently subleases the ten offices individually. The ten subleases from "B" as sublessor are controlled by the lease from "A" to "B" (master lease).

Net Present Value (NPV) - The calculation of NPV takes into account both the netting of costs and benefits and the time value of money. (See Present Value below.)

Net Rentable Area or Rentable Area - The area (square footage) for which rent can be charged. Generally, it is the gross area of the full floor less the area of all vertical penetrations (elevator shafts, stairwells, mechanical shafts, etc.). Rentable area can be measured in many ways, but the most common measurement for office buildings is according to BOMA standards. Net rentable area includes the tenant's premises plus an allocation of the common area directly benefiting the tenant, such as restrooms, common corridors, mechanical and janitor's rooms and the elevator lobby on the tenant's floor.

Nondisturbance - So long as a lease is not in default, the tenants occupancy rights under the lease will not be disturbed by the landlord or its successors or assigns.

Occupancy Date - Unless specifically stated otherwise in the lease, it is the date on which the tenant takes possession of its leased premises. (See also Commencement Date above.)

Operating Expenses - The cost of operating a commercial property, such as janitorial, management fees, utilities, snow removal, and similar day-to-day expenses, as well as taxes, insurance, and a reserve for replacement of items which periodically wear out. Operating expenses should not include capital expenses such as roof replacement nor expenses associated with the production of income such as leasing commissions and legal fees.

Pass Throughs - Operating expenses over the base year amount that are billed to the tenant as additional rent.

Premises - Typically the entire rentable area leased by tenant. Sometimes used to designate solely the useable area leased by tenant, i.e., where the tenant has exclusive occupancy as opposed to the common areas.

Present Value - The present value is the amount that must be invested now to produce a known future value. For any sum invested at a given interest rate, the amount one would receive at the end of the period can be determined by taking the investment times one (1) plus the interest rate of the period to the power of the period. For example, if $10 is invested in an interest rate of 10% for one year, the investment would grow to $11 at the end of the year. It follows, then, that $11 one year from now is worth $10 today; that is $10 is the present value of $11.

Renewal Option - The right of a tenant to renew (extend the term of) a lease for a stated period of time at a rent to be determined (i.e., 95% of "fair market rent and/or on terms that differ from the original lease term").

Rent - Consideration paid for the occupancy and use of real property. Also a general term covering anything of value (covenants and agreements).

Rental Rate - The amount of rent paid for the occupancy and use of real property. Typically, stated on a per square foot per month or per year basis.

Request For Proposal (RFP) - A document typically issued by a tenant's agent to landlords of real property, inviting the owner(s) to submit a proposal to the tenant for the leasing of a vacant space. The RFP sets forth the specific areas of concern to the tenant, such as the space in question, the lease term, expansion and renewal options, rental rate, tenant improvements and other allowances to be provided by the owner.

Right of First Offer or First Opportunity - A right, usually given by a landlord to a tenant, which gives the tenant a first chance to buy the property or lease a portion of the property if the landlord decides to sell or lease. Unlike under a Right of First Refusal (see below), the landlord is not required to have a legitimate offer which the tenant can then match or refuse. If the tenant refuses to make an offer or if the parties cannot agree on terms, the landlord can sell or lease the property to a third party free and clear of the tenant's right of first offer or first opportunity.

Right of First Refusal - A right, usually given by a landlord to a tenant, which gives the tenant a first chance to buy the property or lease a portion of the property if the landlord decides to sell or lease. The landlord must have a legitimate offer, which the tenant can match or refuse. If the tenant refuses, the property can then be sold or leased to the offeror.

Right of Offset - A specific clause in a lease where the tenant has the right to deduct from the rent certain costs which are due to the tenant from the landlord. Included may be the costs incurred by tenant to cure defaults of the landlord, after notice and failure by landlord to cure the defaults. The tenants curative acts are called "self help."

Sublease - A lease under which the sublandlord is the tenant of a prior lease of the same property. The sublease may be different in terms from the original lease, but cannot contain a greater property interest. Example: "A" leases to "B" for five years. "B" may sublease to "C" for three years, but not for six years. (Rent can be greater or less than that in the prior lease.)

Subordination - To make subject or junior to something else, such as the rights of an outside lender. Usually the tenant's rights under a lease are subordinate to the rights of the landlord's tender.

Substantial Completion - Generally used in reference to the construction of tenant improvements (TIs). The tenant's premises is typically deemed to be substantially completed when all of the TIs for the premises have been completed in accordance with plans and specifications previously approved by the tenant. Substantial completion is sometimes used to define the Commencement Date of a lease.

Subtenant – A tenant under a Sublease.

Tenant (Lessee) - A holder of an interest in property for a specific term under a lease or other rental agreement (generally a right to occupancy and use).

Tenant Improvements (TIs) - Improvements to land or buildings to meet the needs of tenants. TIs may be new improvements or remodeling and be paid for by the landlord, tenant, or shared by them.

Triple Net - A lease requiring the tenant to pay in addition to a fixed rental, the expenses of the property leases, such as taxes, insurance, maintenance, utilities, cleaning, etc. The terms "net net," "net net net," "triple net," and other such repetitions are used.

PART TWO: BUYING OR RENTING: WHAT EVERY BUSINESS OWNER NEEDS TO KNOW

MAKING THE DECISION

Most everyone has experienced the joy, stress and anticipation of looking for a new home. Whether that home was a first apartment, a starter house, a dream home, or something in between, many of the same questions were involved in the decision-making processes:

- Should I lease or buy?
- How much can I afford?
- How long do I plan to stay?
- What are my priorities (e.g., neighborhood, housing style, proximity to work, home)?

Finding the right home for your business involves many of the same questions, issues, and decisions. The most common options for having your business are leasing or buying and, as you might expect, there are advantages and disadvantages to each.

Leasing Advantages	Leasing Disadvantages
Lower initial cash requirements – usually a security deposit and one or two months of rent upon signing the lease, and possibly tenant improvement costs.	You will not build equity over time.
Lower maintenance costs – usually limited to interior elements and plate glass (no roof, parking areas or structural elements).	You may be compelled to contribute to maintenance expenses, marketing expenses and other common expenses that do not directly benefit your business.
Greater flexibility to expand or contract as needed at the end of a lease term.	The landlord may require you to move at the end of the lease, even if you like the space.
Rent is a deductible business expense.	Some leases may require the tenant to vacate the premises or move within a building or complex during the term of the lease if the space is needed by a larger tenant.
	Easier to react to future space needs by expansion or contraction, with the right lease.

Buying Advantages	Buying Disadvantages
Mortgage interest and depreciation are deductible for income tax purposes.	Higher initial cash requirements – usually 10 to 20 percent of the purchase price.
There is an opportunity to build equity over time, which can improve your personal and professional financial position.	Higher maintenance costs – the owner is responsible for maintaining the property and paying the maintenance costs. Time spent on maintenance issues also takes away from time available to dedicate to your business.
Having more control over the property and the ability to make alterations and improvements to suit your needs and desires.	Unlike a lease, it is more difficult to just “walk away” from a property that you own.
Having the option of leasing excess space to others.	Expansion may become cost-prohibitive and/or operationally cumbersome.

Which option is right for you and your business depends on various considerations. The considerations can vary widely depending on the nature of your business. Cash is always a factor – for a smaller business or one that is just starting, leasing may make sense because the initial cash requirements are lower. For a growing business, size and room for growth may be big concerns. Location can be a principal consideration, especially if your business serves a specific market or demographic. Zoning also affects your decision – commercially-zoned property generally is more abundant than property that is zoned for heavy industrial uses.

Deciding whether to lease or buy starts with a close examination of your business’ needs and wants in relation to current market conditions, available properties, budget constraints and the future plans for your business.

SECTION 1031 EXCHANGES

A variation on buying real estate is a tax-deferred exchange. Exchanges are commonly known as "1031 Exchanges" or "Section 1031 Exchanges" because Section 1031 of the Internal Revenue Code authorizes a seller of investment property to defer some or all of the gain on the sale of the property if the owner re-invests the net sale proceeds in similar investment property. Tax-deferred exchanges also can be used in cases involving condemnation or insurance proceeds, although different Code provisions apply.

In the most simple exchange, a seller and a buyer simply transfer their properties to each other. Most exchanges are not this simple. Unlike such a "straight exchange" or swap of properties, an exchange may require the use of a "straw party." In this scenario, the property owner (Exchangor) enters into a contract for the sale of property (the Relinquished Property) with a third-party buyer. The Exchangor then assigns the contract to the straw party (the Qualified Intermediary), which becomes entitled to receive the net sale proceeds at closing on the sale to the buyer. At closing, the Qualified Intermediary instructs the Exchangor to transfer the property to the buyer, and the Qualified Intermediary receives the sale proceeds to hold for the benefit of the Exchangor's use in acquiring other, similar investment property.

After closing on the sale of the Relinquished Property, the Exchangor must identify other property (the Replacement Property) that the Exchangor wants to acquire in exchange for the Relinquished Property. Typically, the Exchangor signs a contract to buy the Replacement Property and then assigns the Replacement Property contract to the Qualified Intermediary. The Qualified Intermediary disburses the money that it held from the sale of the Relinquished Property directly to the seller of the Replacement Property, who deeds the Replacement Property to the Exchangor. While this may seem like a lot of effort, it can be worthwhile, especially if you have a significant gain on the sale of the Relinquished Property.

WHAT EVERY COMMERCIAL TENANT SHOULD KNOW

TYPICAL TENANT RESPONSIBILITIES

While your lease agreement is the ultimate guide as to your obligations as a tenant, the following are common commercial tenant responsibilities which you should anticipate the landlord will expect from you (at a minimum):

- Duty to pay rent when due;
- Duty to provide the landlord notice of any needed repairs that are the landlord's responsibility;
- Duty to make repairs that are the tenant's responsibility;
- Duty to give notice of any major changes in the tenancy, including subleases and property modifications; and
- Duty to continuously occupy the premises throughout the lease term so that the appearance of the landlord's building or shopping center is not compromised by a dark space.

You have found what you think is the perfect space for your new business. This Section provides you with a laundry list of issues and options to discuss with your landlord… as well as a description of traps for the unwary. Keep in mind that a commercial lease is a long, dense, and complicated legal document. Considering that it is something you will likely have to live with for quite a few years, you should carefully consider the value of discussing your approach, as well as the finer points, with an experienced real estate attorney.

As you approach the prospect of negotiating a lease, you should consider the following:

Basic Lease Cost:

Lease costs are determined in two steps:

The monthly cost is determined by multiplying the square footage by the cost per square foot, which gives you the annual cost, then dividing by 12 for the monthly cost. For an office space of 5000 square feet at $25 a square foot, the monthly cost would be $10,416.67.

Then the common area maintenance (CAM) costs are added on. If you are leasing a portion of a building, the CAM costs are those "general" building areas like walkways, driveways, hallways, and, in some cases, restrooms.

In order to determine the true cost of a Lease, it may be helpful to complete the worksheet on the following page.

CALCULATING RENT

Annual Rent:	$_______________
Annual Operating Expenses:	
Property Taxes	$_______________
Insurance	$_______________
Electricity	$_______________
Gas	$_______________
Oil	$_______________
Water	$_______________
Sewer	$_______________
Trash	$_______________
Snow Removal/Lawn Mowing	$_______________
Mechanical Systems (Repairs/Maintenance)	$_______________
Structural/Roof Repairs & Maintenance	$_______________
Non-structural Repairs & Maintenance	$_______________
Driveway, sidewalk, parking lot repairs	$_______________
Other:	$_______________
Total	$_______________
Total Annual Rent and Operating Expenses: *(add)*	$_______________
Total Amount divided by 12 months for Monthly Rent and Operating Expenses: *(divide)*	$_______________
CAM (not including the above items):	$_______________

Extra Costs Included in the Lease:

It is imperitive that you discuss with the landlord what is included in the lease as well as the mechanics of payment. In some cases, the landlord will pay CAM costs as part of the base rent amount; in other cases, the landlord will want to pay these costs and pass them on to you. You will ultimately have to pay these costs; it is just a question of paying them yourself or having the landlord pay them. Examples of typical costs associated with a commercial lease are:

- Property taxes (pro-rated on the percentage of the building included in the leased space)
- Snow removal, lawn mowing, and landscaping
- Utilities (electricity, gas, sewer, water)
- Refuse collection
- Insurance on the property (pro-rated among the tenants)

You should negotiate these issues with the landlord to determine how many of these items are included in the base rent payment, and how many you will need to pay yourself. If not, be sure to clarify with the landlord so that once you sign the lease, you are not surprised. You may hear terms such as "gross lease" and "triple net" lease during the lease negotiations. Although these are common terms, it is best to specifically ask the landlord what is included in the base rent payment. Sometimes, the landlord may have a different understanding of these terms than you.

Repairs and Improvements:

Not a week goes by without our receipt of a call asking whether the landlord is responsible for X or the tenant is responsible for Y. The answer, invariably, is "it depends on what the lease says."

The question of who is responsible for what is probably the most common issue that arises between landlord and tenant during the course of a lease. The issue presents itself at the outset of the relationship, depending upon any changes (reconfiguration, painting, carpeting, upgrades, etc.) you need made to the leased space before you can occupy it.

Tenants often find it more cost effective to do the work themselves or hire their own contractors. Landlords, however, take the opposite view – akin to an insistence you may have about retaining control over the people doing work on your own house.

It is not uncommon for roof leaks, an HVAC outage, parking lot issues, snow removal, broken windows, or other issues to crop up during the term of the lease. In fact, it is the rare lease term in which at least one of these issues does not arise.

Wherever possible, these issues should be negotiated in advance of occupancy and spelled out in the lease while both sides are still working to persuade the other to make a deal.

Equally as important, you, as the Tenant, have the right to ask for clauses to protect your rights in a commercial lease agreement. You can seek clauses to hold the landlord responsible in case the building is not repaired and include a clause which states that you can make repairs and discount the cost of repairs from rent if you give the landlord adequate notice of the repairs. Another provision that can protect you is to state that your rent will be reduced if your business is impacted by disrepair of the building. The landlord only has a right to whatever agreement you come to mutually.

Unless otherwise negotiated, most repairs generally become the responsibility of the tenant. Equally as important, if the landlord fails to meet its repair obligations and it impacts your business, generally you are out of luck. A commercial landlord has limited duties.

One way to remedy this situation is to pay for repairs and take the repairs out of your rent, as long as the lease allows this remedy or the landlord agrees to it in writing. If you make repairs and offset the cost of repairs from the rent payment that would otherwise be due, and the landlord has not agreed to this, expect your landlord to hold you responsible for rent in addition to the repairs. It is best to do everything possible to avoid litigation, so negotiate with the intention of coming to an amicable way of resolving the situation. The landlord is usually also absolved of all liability for any adverse impact of these conditions on your business, no matter how severe.

Note that you are normally prohibited from taking any action on your own to repair the defective conditions or make any other improvements which is sometimes referred to as “self help.” The tenant who excersises self help without authority to do so risks eviction. Some leases also require the tenant to continue paying the rent where the premises have not even been completed for occupancy, or have been destroyed by fire.

You should take care to address the following issues: driveway, sidewalk, parking lot repairs and maintenance, structural and roof repairs and replacements, non-structural repairs and maintenance, as well as mechanical system repairs, maintenance, and replacements.

Term of the Lease:

Generally, landlords like long-term tenants, so the longer the lease you will accept, the more concessions you may be able to negotiate in terms of the rental rate, build-out or other costs. Many businesses find it advantageous to negotiate one or more options to extend the lease, provided they are not in default, to add more stability in the event the space turns out to be a good fit for the business.

Indemnities, Insurance, Releases, Waivers, Subordination, Assignment & Subletting

> These are the terms that can make the eyes of even the most calloused real estate professional glaze over. (In fact, we recommend that you bookmark this section to revisit as a sleep-aid.)
>
> Of course, the fact that so many people gloss over these provision is what makes these provisions so dangerous.
>
> So buckle up, sip your energy drink, and read on….

How the lease treats third party claims and indemnities can have a direct and substantial impact on your wallet. Here's what the terms mean and what to watch out for.

Third-Party Claims. The landlord and tenant each are at risk for claims by third parties arising out of the acts of the other party. An example would be a slip and fall in the parking lot. These claims could be for personal injury or property damage. These cases usually result in both the landlord and the tenant being sued. Each party could look to its own insurance. However, claims may exceed insurance limits, policies may have substantial deductibles, or a party may be self insured, and claims of this nature will impact future premiums. Therefore, most leases provide that if the acts of the tenant or its invitees caused the loss, the tenant will indemnify the landlord. Such a one-way indemnity is not reasonable or fair to the tenant.

Indemnities. An "indemnity" is basically that condition under which you become someone else's insurance company. When you "indemnify" someone for a certain activity or risk, that person has the right to come back to you if they are damaged in some way. Their expectation will be that you will "make them whole," meaning that you will reimburse them for any losses or damages.

Indemnification provisions vary widely in their definitions of: (1) the risk; (2) the type of damages; (3) the method by which those damages are determined; and (4) the time at which reimbursement must be made.

Watch out for broadly drafted tenant indemnity clauses that cover anything happening on the premises (or sometimes even within the entire building or project) and/or work only in favor of the landlord. The indemnity should be a cross-indemnity, not just one-way from the tenant to the landlord (except possibly in a single-tenant, triple-net lease of a commercial building, where a one-way indemnity may arguably be appropriate).

The indemnities should be limited to claims by third parties and should not cover claims by the landlord or tenant against each other (which would properly be the subject of a release, not an indemnity). The cross indemnities should cover any acts of the indemnifying party that cause loss or damage to the other party, and should not be limited to negligent acts. If the cross indemnities are narrowly drawn to cover only third-party claims arising from the indemnifying party's own acts or omissions, it should not be necessary to exclude the indemnified party's negligence. The indemnities should address the effect of liability insurance coverage and survive the expiration of the lease term.

Liability Insurance. The amounts of insurance coverage are dependent on the financial strength of the parties and the nature of the tenant's business. Often the lease will require the tenant to have the landlord (and its lender) named as an additional insured on the tenant's liability insurance policy.

Self Insurance. All insurance has a degree of self insurance through deductibles. The extent of self insurance allowed will depend on the financial strength of the parties and may be limited by the lease.

Releases and Waivers of Claims by Landlord and Tenant. As discussed above, indemnification should be limited to third-party claims, and claims by the landlord and tenant should be dealt with by releases or waivers of claims. In most leases, it is appropriate for the landlord and tenant to waive claims against each other for damage to their respective property. Each party should be expected to look to its own property insurance for recovery on these claims.

Most landlord lease forms provide that the tenant waives claims against the landlord, but there is no waiver by the landlord in favor of the tenant. A waiver by the landlord is appropriate, especially since the tenant generally pays for a portion of the landlord's property insurance through the operating expense "pass-through" provisions.

The waiver generally should extend only to property damage and not personal injury. The argument that each party should look to its own insurance does not apply in the case of personal injuries which are not covered by such insurance.

The waiver should not purport to include damage to the property of third-parties, since the landlord and tenant cannot waive claims of third parties. The waiver should include claims against the other party's employees, agents, and contractors.

There should be no exception for "negligence," since in almost all cases, the property damage will be the result of someone's negligence. That is, the whole point or purpose of the waiver is to waive claims for property damage caused by negligence.

The only exception to mutual waivers will be a "triple-net" lease of an entire building in a lease where the tenant agrees to carry all the property insurance and agrees to rebuild the building in the event of a fire or other casualty.

Waiver of Subrogation. A waiver of subrogation prohibits the insurer from attempting to come after a third party who causes any kind of loss to the insured. For example, a landlord may agree that it will not hold the tenant liable for any type of damage to the rental unit. If damage occurs, the landlord would file a claim against the insurance company. If the landlord has to come out of pocket, it could, absent a waiver of subrogation, pursue reimbursement from the tenant.

A waiver of subrogation is frequently confused with a waiver of claims. A waiver of subrogation can be made only by the insurance company; the landlord and tenant have no power to do so.

It is essential for a lease to contain a waiver of claims and not just a waiver of subrogation because (1) if there is no waiver of claims, the damaged party could elect to sue the other party rather than make an insurance claim (and thus the waiver of subrogation would never come into play); and (2) one of the parties may be wholly or partly self insured.

Notice and Opportunity to Cure. Most landlord-friendly leases do not provide for notice of default and opportunity to cure in favor of the tenant. Landlords typically will resist notice as to monetary defaults, but most landlords will agree to give notice as to non-monetary defaults. In many situations, however, even a requirement for notice of monetary defaults can be obtained. Some landlords will agree to a "grace period" for late payments (such as five days) in lieu of notice.

Many landlord lease forms contain a remedy which allows the landlord to "accelerate" rents if the tenant defaults. This remedy is unreasonable in a lease where the landlord also recovers possession of the premises. A tenant should try to avoid such an acceleration clause in a lease, but take note: landlords rarely agree to delete them.

Subordination of Landlord's Lien. Most landlord lease forms provide for a contractual landlord's lien covering all personal property located in the premises. These liens often conflict with a tenant's normal bank financing and equipment acquisition financing. Accordingly, it is desirable to have the landlord agree in the lease to subordinate or waive its liens in favor of certain types or classes of lenders, such as a tenant's inventory lender or a lender providing "purchase money" financing for the purchase of new equipment.

Assignment and Subletting. All landlord lease forms prohibit assignment or subletting without the landlord's consent. Many leases also go further by defining any change in ownership of the tenant as an assignment or subletting. Legitimate concerns for the tenant include (a) corporate re-structuring, such as formation of a subsidiary or related company, (b) transfers by death, gift, or divorce, and (c) the sale of the entire company. A tenant also will not want to be in default under a lease if a shareholder dies, gets divorced, or gives shares of stock to his or her children. A tenant will not want to be precluded from forming a subsidiary or otherwise reorganizing its business structure because of a lease prohibition. Most importantly, however, if the tenant wants to sell its entire business in a corporate acquisition, the tenant needs to be sure that it can transfer its location as well as its other assets to the buyer.

Other Aspects of the Lease

You should also discuss issues such as:

- Restrictions on signage;
- Exclusive and non-exclusive parking;
- A right to relocate to one of the landlord's other properties if you outgrow the space; and
- Early termination for start-ups/capping exposure by agreeing to a "buy-out" of the remaining lease term.

MANAGING THE BUILD OUT

Many landlords offer "turn-key" construction of leasehold improvements. That is, the landlord provides space planning and construction through architects and contractors selected by the landlord. Some landlords will permit the tenant to engage its own architect and contractor, subject to the landlord's approval. In either case, there is a construction "allowance" which is generally available to the tenant. In a "turn-key" job, the landlord agrees to perform certain specified work with anything above that work being considered an "extra" at the tenant's expense. When the tenant builds out its own space, the landlord will generally pay a specified amount of money toward the construction. It is the tenant's responsibility to bring in the job on budget or pay for any items which exceed the landlord's allowance.

Most commercial office building leases call for "turn-key" construction, whereas retail and industrial leases may tend toward the tenant having the work done. The tenant may want to have its own construction work done if the tenant believes it can get a better financial deal negotiating with its own contractor or if the tenant has an ongoing relationship with a particular contractor who, for example, has built out other locations for the tenant. However, in most cases tenants will opt for a turn-key job.

Where the landlord is responsible for the build-out, the tenant will have three primary concerns: (a) getting the most work it can out of the landlord, (b) getting the landlord to stand behind its work with some sort of warranty obligation, and (c) achieving completion on time and budget. Many landlord lease forms provide that the commencement date of the lease may be extended without penalty to the landlord for as long as it takes the landlord to complete the premises. Additionally, many landlord lease forms provide that taking possession by the tenant will be deemed acceptance of the premises by the tenant and will waive any claims against the landlord for defects or delays.

Tenant Improvement Problems

Where substantial tenant improvements must be done before your space will be ready to occupy, you have a set of special problems to address.

The lease should include diagrams of what will be done and specific lists of items to be accomplished. All work should be done to code and by licensed contractors under permits, where required by law. Exact measurements should be provided. A schedule of what will be done is important, particularly if the landlord's portion of the tenant improvements needs to dovetail with your portion. If you left something out, you will pay for it, one way or the other.

Whatever you attach to the building as a tenant improvement, except for "trade fixtures," becomes the landlord's property – even if you paid for it and considered it your property. There is no clear rule as to what type of attachment is sufficient to make personal property part of the real property, nor is the line clearly drawn for what constitutes a "trade fixture," although some features, such as signage, would obviously be trade fixtures. If you remove an attached item, and the landlord wins in a suit against you for it, you could end up paying the landlord to replace the item.

You should avoid the entire problem by specifying those items which you will attach and be entitled to remove when you leave. The landlord's only legitimate concern is that the premises are not unreasonably damaged by the removal of improvements. Restoring the premises to their original condition, or patching over and painting any holes from such attachments might be the practical term to include in the lease, so that you have the full rights to remove and take with you those things you intend to keep. At the very least, it gives you room to bargain when you go, if the landlord wants to buy the improvements from you.

Is it always "better late than never"?

Your lease is signed in March, your Commencement Date for the lease is June 1, and your rent starts in August. You begin construction of the tenant improvements, but problems arise. Subcontractors don't show up on time. The Building Inspector requires the electrical to be re-done. You forgot handicapped access bathrooms. The rain has stalled the new roof repair. Those delays have a ripple effect that postpones later work, and now it's August. Your rent is due, and you are nowhere near ready to pay it, let alone open the doors to customers whose money you were planning to use to pay the rent. It happens all the time.

All that was missing was a clause that postponed the other lease dates by the amount of time by which the stated construction deadline was exceeded for reasons beyond the parties' control. The lease should include a "punch list" step, where anything specified in the tenant improvement which has not been done, or has been done incorrectly, can be identified and completed. There should be adequate remedies to complete the construction, if not done in timely fashion, such as the tenant advancing the money and deducting that amount from future rent.

TRAPS FOR THE UNWARY

In spite of the complexity of commercial leases, many business owners tend to think of a lease as a rather simple, "standard" document. Often they do not consult an attorney before signing a landlord's lease form. It is only later, when a problem arises, that an attorney is consulted. Once they do, they are often shocked at what they find.

"What do you mean *'I have to move out'*?"

Many leases contain a Relocation Provision under which the landlord retains the right to move tenants to a new space, even during the term of the lease, in order to manage the building in the most efficient manner or even simply to placate a larger, expanding tenant.

Relocation can be expensive – even if that relocation is only to another suite in the same building. Four of the most common expenses involve new stationery, revised marketing materials, new furniture (especially built-ins), and the move itself. Depending upon how the provision is written, the landlord may not be obligated to reimburse the tenant for some (or even any) of these out-of-pocket costs.

As this is a negotiated term, many options exist, including removing the landlord's right entirely, making the landlord responsible for every expense incurred by the business in moving, or limiting the exercise of that right to the first year or two of the lease.

"Will somebody *please* turn up the heat?!"

Standard commercial leases make the landlord responsible for providing utilities and other services to the premises.

Unfortunately for tenants, what the lease giveth, the lease often taketh away. Even while conferring this obligation on the landlord, some leases also provide that the tenant waives all claims against the landlord and waives any right to vacate the space before the end of the term. Hence, depending upon how the lease is drafted, the obligation may be difficult to enforce.

The Impact

Broken air conditioning or heating can make the premises unbearable to work in, so that neither customers nor employees want to remain there. Leaky roofs can destroy inventory, customer files, and electronic equipment. Defective wiring endangers your business.

If you lose customers and staff to these conditions, how will you pay your rent? It is still due, and you could be evicted for nonpayment of rent, and then be held liable for the rest of the money due under the lease if you fail to pay the rent.

Your desperate calls to the landlord to "please do something" have no legal impact, if a written notice is required. Your business could be completely destroyed in 30 days, before the landlord even has to start taking action, and meanwhile your hands are tied. This kind of situation happens every day.

The Solution

The only way to protect yourself from such consequences is to negotiate into the lease special provisions that: (1) permit you to repair and deduct the costs from rent after reasonable advance oral or written notice, (2) make the landlord liable for any adverse impact on your business, and (3) expressly reduce rent for the period of time that the defective conditions remain, so that the landlord is not encouraged to delay repairs. Even low rent cannot make up for the losses you could suffer.

"I'll pay rent when I get full use of my space."

> "Because the mail never stops. It just keeps coming and coming and coming, there's never a let-up. It's relentless."
>
> Newman's answer to Jerry's question as to why it is always the postal workers who go crazy.
>
> -- Seinfeld: The Old Man

Rent is the same way. It is relentless. There are many things that can cause a business interruption. But unless you provide otherwise, the obligation to pay rent never stops. Your lease must anticipate the causes for business interruption – from a leaky roof or a malfunctioning HVAC system to a widening of the street that consumes half the parking lot or a build-up of snow making access to your business all but impossible.

A well-drafted lease will leave no doubt as to the allocation of responsibility and the times at which rent may be suspended or the lease may be terminated.

A judgment is nothing but a hunting license

If for some reason the tenant can find an unreleased claim against the landlord, that claim can usually only be satisfied out of the landlord's interest in the building (which is often heavily mortgaged). The tenant on the other hand, is fully liable, has pledged all its personal property to secure its obligations, and the principal owner of the tenant has probably personally guaranteed the lease. Thus, the lease is effectively nonrecourse to the landlord, but full recourse and secured as to the tenant. Obviously, if push comes to shove, the tenant will find itself in a rather difficult bargaining position in its dispute with the landlord.

<u>"Have I got a deal for you!" (or "the evil of two Lessors")</u>*

So, the worst has happened and you can't pay your rent. The lease has you on the hook for three more years, making impossible an already precarious financial situation. Left as it is, the landlord will have a claim against you for thirty-six times the monthly rent – all of which he can now claim as due under the Acceleration Clause in the lease.

There is, however, a glimmer of light at the end of the tunnel in the form of another business which you believe stands ready to take over all or some of your space. The new tenant's rental stream for your space will automatically lower your liability to the landlord. All you have to do is get that new tenant installed in the space and you're off the hook.

Well…maybe.

Depending upon how the lease is written, the landlord may have the unfettered right to refuse to accept the new tenant. Other possibilities include the landlord's insistence that the new tenant sign as a Subtenant, keeping you liable on the primary lease if the subtenant defaults. How these scenarios play out is almost entirely a function of the original lease.

* Despite not having been emphasized in bold font, we are extremely proud of this pun.

“Missed it by that much.”

One of the touchier aspects of a lease to negotiate concerns late fees. Obviously, no landlord wants a tenant who is habitually late with the rent; and no prospective tenant wants to signal to the landlord that it expects to miss the lease’s most important deadline. Nevertheless, it is important for the tenant to build in a grace period within which the landlord will not charge a late fee. After all, sometimes the old “it must have gotten lost in the mail” actually turns out to be the truth.

“The Disappearing Option”

Tenants often like to build renewal options into their leases in order to maintain their right to stay in a space that works for them. Landlords are generally in agreement with the concept of keeping a stable and good-paying tenant, **as long as it is a tenant they want to keep**.

Options, therefore, typically require certain standards to be met before they can be exercised by the tenant. There is a big difference between “the Tenant can exercise the option if it is not currently in default” and “the Tenant can exercise the option if it has not been in default during the term of the lease.” The first clause is much more tenant-friendly. Accept the second alternative, and you may find yourself packing up when you had every intention of staying…all because of one slightly overdue payment three years earlier.

EVICTION

No Guide of this sort (if there are any others) would be complete without a discussion of that most unpleasant of subjects – eviction.

Eviction is a devastating event to the commercial tenant. The costs of moving and setting up again, amid the disruption and loss of normal business, the potentially unsatisfactory new location, and the liability for rent through the end of the lease, all present a terrible price for what might be a trivial event gone ballistic.

If you see that you are getting into a conflict with your landlord, consult a landlord-tenant attorney immediately. Much can be done to help your position before the conflict goes to court, and the time with an attorney is well spent.

> "Attorneys can actually help fix problems before they get to court. If you think that the only use for an attorney is in litigation...you're wrong."

Commercial tenants are often shocked at the reactions of the courts. They may have believed that the judges would back the small businessperson and apply a reasonable solution that avoids forfeiture of the entire business through an eviction. Unfortunately, the courts may not be sympathetic. Even a sympathetic judge's hands may be tied by the language of the lease.

Settle When You Can

As with other lawsuits, it is possible that the eviction case can be settled. Your bargaining power is directly related to the strength of your case. However, since your downside risk of going through the eviction is severe, including owing future rents, a "best-case" resolution might enable you to just move out and owe nothing.

MOVING ON AND MOVING OUT

Typically, your lease will require that the premises be left in clean condition. If you have toxic substances that you use in your business (waste oil, chemicals, etc.), your lease may require that you remove them and certify that the premises are free of such toxic threat.

A smooth transition can also benefit you through good future references and referrals of customers to your new location. Equally as important, a smooth transition can speed up return of your security deposit and eliminate the threat of litigation from a landlord who may already be unhappy that you're leaving.

WHAT EVERY REAL ESTATE PURCHASER SHOULD KNOW

WHO IS THE BUYER AND WHY?

There is a big difference between John Smith, John Smith, Inc. and John Smith, LLC. Having decided to buy real estate, your next big decision is "what will the actual buyer look like?" What follows is a brief discussion of issues that should be on your radar screen.

> Shameless Self-Promotion: Refer to our Business Owner's Pocket Guide and/or our own mobile application, BizRx, for a full (and excellent) discussion on the pros and cons of different corporate structures.

Form of Ownership

If you decide that buying property is the right choice for your business, the next question becomes how to hold title. As with selecting the right ownership structure for your operating company, determining the structure for your real estate interests requires an analysis of the tax considerations, exposure to liability, and exit strategies.

Tax Considerations

Sole proprietorships, limited liability companies, S corporations, and partnerships are "pass-through" entities for income tax purposes. The profits and losses of these entities are taxed at a personal level for the owners. Other entities are subject to different tax treatment.

Exposure to Liability

When thinking about limiting your exposure to liability in the context of owning real estate, two factors should be considered. First, real estate can be an extremely valuable asset that can add to your bottom line. If the real estate adds value for you, though, it also can add value for creditors. To protect your real estate asset from creditors of your operating company (other than lenders who loan money for the purchase or improvement of the real estate), it may be advisable to hold title to real estate in an entity that is separate from your operating company.

The second factor to consider is liability protection. If you own real property in your own name, you may have exposure to liability for injuries or losses that others sustain on your property. Insurance is the first line of defense in this context. However, owning real estate in the name of a business entity also helps to shield the entity's principals from personal exposure for injuries and losses on the property.

LETTERS OF INTENT

Before investing the time and money to prepare a real estate purchase contract, many prospective buyers find it beneficial to negotiate a letter of intent which sets forth the major business terms of the purchase. While letters of intent can help sellers and buyers to determine that they are in agreement as to the major business terms before spending the time and money to draft a contract, they also can have unintended consequences. If a letter of intent shows the parties' intent to be bound and contains sufficiently definite terms, it may rise to the level of a contract and be enforceable against the parties.

Drafted correctly, a letter of intent can ensure that the parties are literally on the same page before they spend too much money on lawyers and due diligence. Drafted poorly or without proper thought, a letter of intent will, at best, be a waste of effort and, at worst, can have long-term and expensive unintended consequences.

A typical letter of intent will spell out the following terms:

- The property being purchased
- The purchase price
- The Closing Date
- The study or due diligence period
- The Buyer's prerequisites to Closing (e.g., obtaining financing, a clean environmental report, a satisfactory title report, zoning or construction approval, the issuance of permits)

- Exclusivity (meaning the Seller takes the property off the market while the Buyer conducts due diligence)
- Division of costs, taxes, and fees
- Termination provisions
- Other material or "deal-breaking must-haves" for both sides

SALE & PURCHASE CONTRACT

While a Seller will generally want a short, clean contract that provides the most expeditious route to closing, a Buyer will be more interested in guaranteeing enough time to evaluate the property and protect against any unexpected or inherited problems.

Typical Provisions

Generally, agreements that affect real property must be in writing and signed by the parties to be enforceable. There is no specific form of written agreement, but the contract should be clearly and accurately written to confirm the parties' intentions. Every sale and purchase contract must contain certain terms. While the following list is neither all-inclusive nor limited to the bare bones, a good contract should include provisions addressing the following:

- the correct legal name of each party to the contract and any third parties who are involved in the transaction, such as an escrow agent or settlement agent;

- an accurate and sufficient description of the property that is included in the sale. If any personal property is included in the sale price, the purchase price should be allocated between the real and personal property;

- the purchase price, the amount and timing of deposits, the manner of payment of the purchase price at closing, and the disposition of the deposits if the contract is terminated;
- a description of any study period, including the nature of the Buyer's studies and inspections, the Buyer's rights of entry, and any limitations on the Buyer's rights (such as the days and/or times during which inspections may be conducted, allowing Seller's representatives to be present, limiting discussions with some or all of the seller's tenants);
- the date of closing or a clear method for determining the date of closing;
- prorations of the income and expenses of the property, including rents, utility bills, real property taxes, and the allocation of transfer and recordation taxes;
- representations and warranties; and
- default and remedy provisions to address what can happen if either party to the contract fails to perform.

Additional provisions should be included to address the particulars of each transaction and any special conditions and agreements between the parties.

The Buyer's Key Considerations

Representations and warranties are key factors for the buyer. The Buyer wants the representations and warranties to be as broad as possible and to survive closing. How long the representations and warranties survive is often a point of negotiation. How long (or short) the survival period is depends, in part, on the character of the property (residential, commercial or industrial), the nature of the uses that have been conducted on the property, and the nature of the Buyer's intended use.

Contingencies are another key factor for Buyers. Contingencies help to define when the Buyer's obligation to close arises and ensure that certain conditions have been satisfied or knowingly waived by the Buyer. Typical contingencies include financing, appraisal, and satisfactory results of environmental, title, survey, and other studies of the property. Depending on the nature of the property and the Buyer's business, other contingencies may include approval by a franchisor, approvals from local government, and/or a transfer of licenses or permits.

Due Diligence

Due diligence refers to the process of investigating, examining, inspecting, and analyzing the property that is the subject of the contract to determine whether the property suits the Buyer's needs or intended purpose. Because the doctrine of *caveat emptor* ("let the buyer beware") is alive and well in commercial property transactions, it is essential for a Buyer to learn as much about the property as is feasible in light of time and budgetary constraints. The scope and extent of a Buyer's investigation and analysis of the property hinges on several factors, including the Buyer's familiarity with the property at the outset of the transaction, the nature and intended use of the property, the representations and warranties that the seller is willing to make, and the lender's requirements.

At a minimum, every Buyer should investigate certain aspects of the property, including:

Financial Feasibility	How much does the property cost in terms of the purchase price, financing costs, and operating costs, and do the income or benefits of owning the property justify the investment?
Title	Does the seller have good and marketable title free and clear of any unacceptable liens and encumbrances? A title search to the property also should reveal any recorded covenants, conditions, and restrictions that may affect the use of the property. Your attorney or title company also should search corporate records, court filings, bankruptcy proceedings, and lien records.
Survey	A survey is a plat or map, prepared by a licensed surveyor or engineer after an inspection of the property, that shows the property in varying degrees of detail. At a minimum, a survey should show the property boundaries, the location and dimensions of any improvements, access to and from the property and a public road, observable evidence of easements (utility poles, manhole covers), and encroachments by or on neighboring properties.
Zoning & Code Compliance	Zoning affects what uses can be made of property and any public restrictions on permitted uses, such as building height limits, parking requirements, and setbacks. The buyer should confirm that the buyer's intended use can be conducted on the property in compliance with applicable limitations and restrictions. The buyer also should verify that there are no pending or threatened code (building, zoning, etc.) violations.
Property Condition	As with the purchase of a home, a buyer should consider having the property and any improvements inspected to verify their condition and to evaluate the need for repairs or improvements. Property inspections also include investigations and assessments of any environmental conditions or pollution that may affect the property.
Operating Costs	Buyers should review copies of real and personal (if applicable) property assessments, tax bills, maintenance records, income and expense reports, and any other books and records of the seller pertaining to the property to assess the cost of operating the property.
Leases	If you are buying property that is occupied by tenants, you want to review the leases and any other agreements that the seller has with those tenants. You also want to know who your tenants are, including whether they are financially sound and what their mid- to long-term need is for the space that you are thinking about buying.

Once you have reviewed the due diligence materials, what do you do with the information? In the absence of contract provisions to the contrary, the options are as diverse as the materials. Buyers can use due diligence information to try negotiating a lower purchase price, to support a request for a repair escrow, to cause the seller to make certain repairs prior to closing, or to terminate the contract and walk away from the deal with the earnest money deposit in hand.

FINANCING THE TRANSACTION: WHAT EVERY BORROWER NEEDS TO KNOW

Finding the right property, negotiating a contract or a lease that protects your interests, and confirming that the property suits your intended use mean nothing unless you can close the deal. Most commercial real estate transactions, whether purchases or leases, have some financing component. In the case of a purchase, there is usually a purchase money loan. For leased premises, there is usually a loan or other financing arrangement for the expenses of preparing the premises for occupancy, including tenant improvements, inventory and fixtures, furniture, and equipment. The costs of obtaining financing and paying the loan are a driving force in your real estate search, so the earlier you can get a firm grasp on them, the better your chances of closing the deal.

Sources of Funding

Your lender and financial advisor are key players on the team that assists you in consummating a successful transaction, and it is almost never too early to talk with them about your plans. The bank with whom your business deals on a regular basis is a good place to start, especially if you have a close working relationship with a loan officer or other representative of the bank. If your bank knows you and your business, it is in a good position to discuss your plans and financing options.

Other lenders also may be interested in earning your business, so developing new banking relationships is another alternative. Insurance companies and private investors also are willing to make loans or take an ownership interest in certain real estate purchase transactions. In an economic climate where lenders are hesitant to make the loan, some motivated sellers and landlords also may agree to finance a portion of the purchase price or improvement costs.

When you and your lender reach agreement regarding general terms, the lender usually will issue a written commitment. This loan commitment outlines and defines the general terms of the loan. The commitment also contains the conditions on which the lender is agreeing to make the loan. While each transaction is unique, all lenders condition their obligation to make the loan on the satisfaction of certain conditions.

What a Lender will want to know

Just as you want to study the property to confirm that it suits your needs at the right price, your lender will want to perform certain due diligence as part of the underwriting process. "Underwriting" refers to the process by which a lender evaluates the borrower, the property, and the documentation requirements to decide whether or not the lender should make the loan. Your lender is just as concerned about the value and condition of the property as you are, in part, because it wants you, the borrower, to succeed, but also because the lender could end up owning the property if a loan default occurs. In addition to examining the value and physical condition of the property, your lender will want to study the ability of the borrower (you and/or your business) to repay the loan. These studies include an examination of financial information regarding the borrower, any guarantors, the property, and any major tenants at the property.

Lender's Studies of the Property

As far as the property is concerned, your lender will have many of the same questions and concerns as you. Your lender will almost certainly want a consultant to review the environmental condition of the property because of the risks associated with environmental contamination. Your lender also will want to verify that you are acquiring good and marketable title to the real estate because the lender does not want any liens that are senior to its loan. Your lender may want the owner (you, unless the Seller agrees) to escrow funds for repairs and replacements, especially if a property condition report reveals the need for repairs. While lenders generally do not want to take ownership of properties, it does happen when borrowers default, so the lenders need to know about the condition of the property.

Lender's Examination of the Loan and the Lender's Risk

Regardless of how well you get along with your banker, sooner or later, your proposed transaction is going to come down to a question of underwriting – in other words "what is the bank's risk?" The following are a few key indicators examined by lending committees in order to make a decision as to whether or not lending you the money for your purchase is a risk the bank is willing to take.

The Loan-to-Value Ratio

As far as the financial aspects of the loan, lenders concentrate on three ratios when deciding whether to approve a commercial loan. The first ratio is the Loan-to-Value Ratio. The Loan-to-Value Ratio is a percentage that is calculated by dividing the amount of the loan(s) on the property by the value of the property. For example, if the purchase money loan is $400,000, and the appraised value of the property is $500,000, the Loan-to-Value Ratio is 80% ($400,000/$500,000). Generally, commercial lenders want the Loan-to-Value Ratio to be in the range of 70% to 80%, although there are small business loans and other options for financing commercial properties with higher Loan-to-Value Ratios.

The Debt Service Coverage Ratio or Debt Coverage Ratio

The Debt Service Coverage Ratio allows the lender to estimate the cash flow that is available to meet the annual principal and interest payments on the loan. How much cash is available is a factor of the net operating income. Net operating income is determined by subtracting the expenses of owning and operating the property from income (rent) that the property generates. Debt service is equal to the payments of principal and interest required to pay the loan over a given period. This ratio enables the lender to be sure that there is enough income generated from the property to repay the loan.

The Debt to Income Ratio

Another factor that many lenders use is the Debt to Income Ratio, which is determined by dividing the borrower's monthly debt obligations by the borrower's gross monthly income. Unlike a residential loan, commercial lenders emphasize the ability of the property to pay for itself by the income it generates.

Documenting the Loan

When the lender is satisfied with the results of its studies of the property and the borrower's ability to repay the loan, the lender or its attorney will begin preparing the loan documents. While each loan is different and different documents may be required to address unique circumstances of certain loans, most loans share the following document requirements.

The Loan Agreement

The loan commitment broadly describes the loan transaction. The Loan Agreement is a more detailed agreement between the lender, the borrower, and any others who have a role in the loan transaction, such as guarantors. In the Loan Agreement, the lender agrees to fund a loan at closing or to make funds available for future draws on certain terms (interest rate, maturity date, prepayment rights, etc.). In consideration of the lender's agreement to make the loan, the borrower and guarantor agree to the terms and conditions and agree to repay the loan per those terms and conditions.

Payment Terms

The borrower's and guarantor's obligations to repay the loan are usually set forth in the Loan Agreement and in separate documents. As the document's name suggests, a Promissory Note is the borrower's promise to repay the loan. The form and specific content of Promissory Notes can range from simple one-or two-page documents to much more detailed and complicated documents. If the lender requires other individuals or companies to guaranty the borrower's promise to pay, the lender will require one or more written Guaranties. The Guaranties document the guarantor's promise to repay the loan if the borrower fails or is unable to repay the loan.

Pledges of Collateral

Collateral gives the lender security in the event that neither the borrower nor the Guarantor repays the loan. Collateral is usually the lender's last resort. In the event of a default, the lender has the ability to retake and sell the collateral to pay down the Promissary Note. When the collateral is real estate, the lender derives its right to retake and sell the property in a Mortgage, Deed of Trust, or Indemnity Deed of Trust. For other, non-real estate collateral, the lender derives its rights from a Security Agreement and a Financing Statement. These documents are recorded among the Land Records and/or filed in other public records in the jurisdiction where the collateral is located. Lenders also can require that the owners of the borrower pledge their stock (or other ownership interests) in the borrower, which would allow the lender to take over control of the borrowing entity if a default occurs.

Other Documents

The Commitment, Loan Agreement, Promissory Note, Guaranty, and Pledge Documents are the basic documents for any loan transaction. For commercial or income-producing properties, other aspects of the loan are addressed in various other documents. Because of lenders' concerns regarding environmental matters, lenders often require an environmental indemnity agreement whereby the Borrower agrees to defend and protect the lender against any claims or expenses arising from environmental hazards or contamination.

If the property is occupied by one or more tenants, the lender will require one or more of the following:

- An Assignment of Leases and Rents. Through this document, the Borrower conditionally assigns its rights as the landlord so that the Lender can assume the role of the landlord and receive rent from the tenants if a loan default occurs.

- A Tenant Estoppel Certificate. The Tenant Estoppel Certificate is a document that tenants sign to acknowledge the terms of the lease, to confirm that the Borrower (landlord) has satisfied its obligations under the lease, and to verify that the tenant is paying rent.
- A Subordination Agreement. If the lender is making a loan to a tenant whose landlord has a security interest in the tenant's property, the lender will want the landlord to agree that the lender's lien and the lender's rights in the tenant's property are superior to the lien and the rights of the landlord. A subordination agreement constitutes the landlord's acknowledgment that its rights are subordinate (or less than) the rights of the lender.
- An Escrow Agreement. If funds are held back from the loan or if funds from the Borrower's monthly loan payment are held by the lender for a specific purpose, such as paying real property taxes, insurance premiums, repairs, or tenant improvements, they will be paid into an escrow account. An escrow agreement will be used to specify the amount of the escrow and the circumstances in which funds will be released.
- An Opinion Letter. Many lenders require the borrower and guarantor to deliver an opinion letter from their lawyer. Opinion letters are intended to give the lender additional assurances regarding specific legal aspects of the loan. Lenders rely on opinion letters to confirm that the borrower and guarantor are bound by the loan documents and have the authority to make the loan.

CLOSING AND POST-CLOSING

Closing

As a junior associate working on my first complex transaction, I realized that closing was like a dinner party. Someone has to host the party, and that person is responsible for coordinating all of the details. The host must invite the right guests (seller, buyer, lender, settlement agent, broker, etc.). The host ensures that each guest brings the right dish to pass – the seller has the deed, the buyer brings his checkbook, the lender brings the loan proceeds, and so on.

At the conclusion of a successful closing, the seller walks away with the net sale proceeds, and the buyer has title to the property. Also, the lender has made a loan and the buyer/borrower has received the loan proceeds and agreed to repay the loan.

"Closing" refers to the process of consummating the loan. At closing, the seller signs the documents to convey the asset (typically a deed in the case of real property or a bill of sale in the case of personal property); the buyer accepts the transfer documents; the borrower, the guarantor and the lender sign all of the loan documents; the security documents are released for recording; and money starts flowing. Many of us remember closings where the parties and their attorneys and advisors sat on opposite sides of long conference room tables while the parties signed their respective documents, the Notary Public stamped and sealed the documents, and the office assistants frantically made copies and assembled closing packages. While in-person closings still occur, many more closings close "in escrow."

In an escrow closing, the parties sign and notarize their documents in the comfort of their offices and then send the documents to a settlement agent with specific instructions concerning the settlement agent's duties. The settlement agent collects all of the funds and documents, confirms with the parties when all of the conditions for closing have been satisfied, and then delivers the documents and the money to the parties who are entitled to receive them.

The nature of a closing tends to mirror the nature and complexity of the transaction. In smaller, more straight-forward commercial transactions, closings are relatively easy to coordinate; while more complex commercial transactions involving multiple assets, adversarial proceedings, and/or multiple layers of financing have more "moving parts" that need to be coordinated.

Post-Closing

Now that you have consummated closing on the purchase and loan, you might think that the only thing left to do is make the monthly payments to your lender. In some cases this may be true. In many other cases, however, the borrower has additional obligations with respect to the lender. In the Loan Agreement, the borrower usually agrees to give the lender certain reports and financial information on a regular (monthly, quarterly or annual) basis. It is important for the borrower to have a system in place to meet these reporting requirements because the failure to meet them may constitute an event of default.

In addition to financial reporting, the loan documents usually obligate the borrower to report other issues affecting the property. In the Assignment of Leases and Rents, for example, the borrower may have promised not to terminate or modify any leases that were in effect as of closing and/or not to enter into new leases without giving notice to or receiving approval from the lender.

Other issues that usually require the borrower to give notice to the lender and/or receive the lender's consent include any transfers of the property, transfers of ownership interests in the borrower (if the borrower is a business entity), condemnation proceedings, and casualties such as fires, floods, or other damage to the property.

Because the failure to give the lender notice or obtain the lender's consent as and when required by the loan documents may have adverse effects on the loan, borrowers need to have a good understanding of the loan documents and their non-monetary obligations.

ONGOING ISSUES

Permits and Licenses

Before getting back to business, you need to consider what permits, licenses, and approvals you may need as a property owner. Hopefully, this was considered and addressed early in the transaction. The need for such permits, licenses, and approvals varies widely with each governing jurisdiction. Many jurisdictions require property owners to obtain a use and occupancy permit or a certificate of occupancy before opening for business. Local governments use these permits to ensure that properties are being used in compliance with applicable zoning restrictions. By examining the zoning requirements and the time and expense associated with obtaining necessary permits as part of the due diligence, you can hopefully minimize or avoid delays.

In addition to use and occupancy permits, some uses require additional licenses. For example, if you are buying a pub, liquor store, or a club that sells alcoholic beverages, the local liquor board will have to approve the transfer of the seller's liquor license to the buyer. Having all necessary governmental approvals in place is critical to ensuring a smooth transition of an ongoing business.

Private covenants also can affect your intended use of the property. If the property is in a commercial or industrial development, you may need to obtain approval from a property owner's association or the developer before adding structures (signs) or changing the use or exterior appearance of the property. You should double-check the need for any private approvals before ordering new signage to advertise your new building.

Vendor Contracts

Now that you are in the business of owning and operating income-producing property, you may be surprised at the number of contracts that need to be signed. Not many property owners are totally self-sufficient, so they need to purchase goods and services from others pursuant to vendor contracts or service agreements. Services that many commercial properties need include lawn maintenance, snow removal, heating, ventilating and air conditioning maintenance, elevator maintenance, and janitorial service.

When negotiating contracts for goods or services, certain terms are critical. Each contract should clearly define the scope of work or the nature of the service that the vendor intends to provide. The time for the vendor's performance and the owner's payments also are important terms. The property owner also may want the ability to terminate the contract on short notice; while the vendor may want automatic renewal provisions that guaranty the vendor a long-term relationship.

If the building has multiple tenants, the owner may want to hire an agent to manage the building's operations. The property management agreement outlines the agent's obligations with respect to the operation of the building, including maintenance, insurance, lease renewals, and rent collections. Property managers usually charge a percentage of rents as a standard fee and then offer additional services at set hourly rates or flat fees. As the owner of the building, you want to be able to terminate the property management agreement in the event of a default, and you may want to require the property manager to have fidelity bonds and/or errors and omissions insurance to protect your interests.

Property Tax Assessment Appeals

Real property is subject to tax based on its assessed value. Generally, the state's assessment is intended to reflect the fair market value of the property. How "fair market value" is defined, however, is open to interpretation.

In Maryland, real estate is re-assessed by the State every three years. You have the right to appeal each re-assessment by filing an appeal soon after you receive notice of a new assessment. You also may have the right to appeal the current assessment within a short period after closing. Finally, you may appeal by January 1st of any year during the 3-year cycle if events occur which you believe merit a reduction in the assessed value. Filing an appeal cannot result in an increase in the assessed value, but a successful appeal can result in a reduction of the assessment with a corresponding reduction in the real estate taxes.

Easements, Licenses and Other Agreements Affecting Real Estate

During the time that you own real estate, the need may arise for other agreements that affect your business. Easements, licenses, and other agreements can be used to give someone rights to use your property or to receive rights in the property of another. These agreements are often used to memorialize rights to enter onto or use another's property. Between and among commercial property owners, these agreements often confirm the right of one owner's employees and customers to park or cross on a neighbor's property. These agreements also can be used for signage, utilities, storm water management, and other purposes involved in the development or use of commercial real estate.

EXIT STRATEGIES

Generally, commercial real estate is an asset that owners intend to hold for a relatively long period, especially if the real estate is to be a home for your principal business. By keeping the real estate separate from your operating company, you create opportunities to establish long-term growth opportunities which can be combined with the long-term plans for yourself and your business. On the sale of your business, you can also sell the real estate; alternatively, you could keep the real estate and lease it to your business or other tenants following the sale of the business.

Special attention should be given to the selection of the state law that governs the real estate entity's form of existence. In Maryland, foreign (non-Maryland) entities are subject to withholding on the sale of real property that is located in Maryland. For example, if you form a Delaware limited liability company to own real property in Maryland, that entity may be subject to a withholding tax when it sells the real property. In 2010, the rate of withholding was equal to 8.25% of the total payment to the Delaware LLC. That withholding would not be payable if the real estate had been owned by a Maryland limited liability company or if the Deaware LLC had been registered to do business in Maryland prior to closing on the sale.

You should also consider how transfer and recordation taxes effect your exit strategy. Maryland has both state and local transfer taxes and a state-level recordation tax. Generally, transfers of a controlling interest in the real estate entity are subject to tax; however, there are exemptions for certain transfers. Considering these factors at the time of purchase can help to facilitate a smooth and less costly transfer when it comes time to sell the real property or the entity which owns it.

PART THREE: WHAT EVERY COMMERCIAL LANDLORD NEEDS TO KNOW

Landlords tend to be simple creatures. They really only want these five things out of life:

1. To collect the maximum amount of rent;

2. To obtain and maintain a stable, long-term rent roll;

3. To maximize the value and appeal of its property;

4. To minimize its responsibility for significant out-of-pocket expenses during the lease term; and

5. To maximize its chances of collecting its money in the event of a tenant default.

All of these goals can be accomplished through the lease, and all tend to be necessary, to one extent or another, for keeping the landlord's lender happy.

NEGOTIATING THE LEASE

First and foremost, the landlord must decide what type of lease it wants to offer. Part I of this Guide offers a detailed look at different types of leases and the situations to which they may be applicable.

Once the landlord has made its decision as to the type of lease, there are other key decisions which must be made. Typical issues are:

Lease Term. Landlords often have to strike a balance between the desire for stability through a longer lease term and a desire for flexibility where the property is concerned.

As an extreme example, it is doubtful that many landlords would want to sign a 100 year lease. Sure, it would be nice to secure the revenue stream (assuming the tenant could be counted on to stay around that long), but few landlords would want to tie up their properties for that long. There may, for example, come a time when the landlord wants to put the property to other use, perhaps in combination with other property, which would be effectively out of the question if its hands were tied by an long-term lease.

Renewal Options. If everything is going well, both parties have an incentive to keep the arrangement intact for as long as possible. Renewal options, however, can be one-sided in the tenant's favor unless they are negotiated and drafted properly. A landlord must ensure that the only tenant that can exercise an option to extend is a tenant that landlord wants to keep.

Rent & Rent Escalation. These are the business issues at the heart of every lease.

- How much is the tenant going to pay year-in-and-year-out?
- Will the lease remain the same throughout the term or will it increase from year-to-year? If so, by how much?
- What amounts are to be charged over and above base rent? Considerations include common area maintenance, taxes, snow removal, and a host of other possible out-of-pocket expenses.

Repairs and Maintenance. This is the flip side to the discussion in Part Two. While we need not repeat each issue here, suffice it to say that the Landlord has every incentive to minimize its expenditures – particularly those for which it is not going to secure reimbursement from the tenant – while preserving the utility, appearance, and value of the property.

Typically, a commercial lease that is not truly triple net makes the landlord responsible for repairing the roof, exterior walls, and utilities (plumbing and electricity), and makes the tenant responsible for everything else. The tenant is usually required to give written notice to the landlord of the defective condition, and the landlord then has 30 days to start resolving the problem, with no deadline for solving it.

Note, however, that some landlords err on the side of taking on more expenses so that they can be assured of quality repairs and upkeep – even within tenant spaces. Others prefer a less hands-on approach.

Regardless of which approach the landlord intends to take, it is absolutely critical that the lease is carefully drafted so that the landlord's intention makes its way, unaltered, into the legal document.

ENFORCEMENT

This is often where the rubber meets the road. A lease is not worth very much if the landlord is left with few enforcement options in the event of a tenant default.

Events of Default

A well-drafted lease will specify certain events that constitute events of default. When a tenant commits an event of default, it doesn't necessarily mean the tenant is in default. Instead, the commission of an event of default means that the landlord has the right, but not the obligation, to place the tenant in default. Often, the difference between the two lies in the tenant's right (and the landlord's obligation) to provide written notice of the event of default as well as an opportunity to cure.

Events of default come in two flavors: (a) payment; and (b) non-payment.

As you might expect, a payment default arises from the tenant's failure to render payment of rent or other monetary obligations under the lease. Non-payment defaults can include failure to maintain the premises, failure to occupy the premises, improper use of the premises, or the introduction of hazardous materials.

Even if the lease requires the landlord to provide written notice of default in most circumstances, most leases do not place that same burden on the landlord in the event of a payment default. After all, the tenant either knows or is responsible for knowing when it hasn't paid.

Consequences of a default can vary. Leases can reflect a strict or more lenient landlord response. A strict response would be conferring a right of eviction and full acceleration of all monies due under the lease through the end of the term. A more lenient response would entail a grace period, the provision of written notice, and a sufficient opportunity for the tenant to make progress toward a cure.

Consequences of a Default

The landlord has two primary interests in the event of an uncured tenant default: getting the property back and recovering all money due under the lease.

Eviction

The process by which the landlord regains the property is called "eviction." This is very different from "rent court" required for residential leases. The proceedings for a commercial eviction are more formal and less prone to abuse. Leases are often very specific in setting out the procedures the landlord must follow in order to proceed with an eviction.

Importantly, a landlord may have to go through the eviction process even if the tenant is no longer running its business out of the premises. This is especially true if the tenant still has furniture, equipment, inventory, or other possessions in the space.

Monetary Recovery

Getting back the property so it can be re-rented is nice; but the landlord's primary goal will be recovering the money it should have earned under the lease. The first thing attorneys look for in order to evaluate the landlord's chances of success is an Acceleration Clause.

The Acceleration Clause

The Acceleration Clause provides that, upon the landlord putting the tenant in default, all payments which would have been owed by the tenant throughout the term of the lease is due **now**. In other words, the rent which may have been payable over, say, four years, is due all at once in a lump sum.

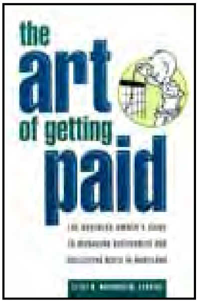
The Acceleration Clause is extremely important to the landlord's interest as it means the difference between the landlord's ability to file suit for all damages all at once or filing suit a number of times throughout what would have been the term of the lease.

As an example, let's say that a tenant defaulted with four years to go to the end of the lease. Rent was set throughout the term at $2,000 per month with no escalation (only because

I'm bad at math). Projected through the end of the lease term, the tenant would owe $96,000 (4 x the annual rent of $24,000).

Without an Acceleration Clause, the landlord would have to wait four years just for the opportunity to sue for the full amount owed. The presence of an Acceleration Clause in the lease would mean that the landlord could file suit for the full amount ***immediately***. This is especially important because a creditor's ability to find and collect money from a debtor is reduced with every passing day. If the landlord had to wait four years before even starting its collection efforts, the money would be as good as gone.

Personal (or other) Guarantees



The first question In The Art of Getting Paid is "Who owes you the money?"

The answer is not as uncomplicated as it sounds. As mentioned earlier in this Guide, there is a big difference between John Smith, John Smith, Inc., and John Smith Limited Partnership. Moreover, whatever the differences, you as the landlord want the right to go after someone (or something) with money. After all, as we mentioned in Part II, a judgment is nothing but a hunting license. If there is nothing to collect, a judgment for $1 billion is worthless.

If the tenant is a new company, does not have an adequate credit history, is unknown to you, and/or presents a credit risk for some other reason, you may want to obtain a personal guaranty of obligations under the lease from one or more of the tenant's principals or even the tenant's parent company (if it has one). Bottom line: the more potential defendants, the greater your chances of finding someone with money to go after.

PART FOUR: WHAT EVERY COMMERCIAL REAL ESTATE SELLER NEEDS TO KNOW

The “sell” side and the “buy” side are two sides of the same coin. The seller is concerned about most every issue described in Part Two as being of importance to the buyer – only the seller takes the opposite view.

Rather than reiterate each issue, we encourage prospective real estate sellers to review Part Two of this Guide to gain a better understanding of the issues that will be front and center in the negotiation of any contract.

GENERAL REPRESENTATIONS AND WARRANTIES

Most sellers want the contract to be “short and sweet.” The seller’s focus usually is on limiting its exposure to liability for any conditions affecting the property and securing protections for the seller in the event of a default by the buyer. A principal focus in limiting the seller’s exposure is limiting the number and scope of representations and warranties. Certain warranties are to be expected, including representations and warranties that:

- the seller has approved the sale contemplated in the contract;
- the person signing the contract on behalf of the seller has the authority to bind the seller; and
- the seller owns good and marketable title to the property.

Unless the letter of intent clearly states otherwise, the buyer will expect the seller to make representations and warranties regarding the general condition of the property, including environmental conditions and hazardous substances. Narrowing the scope and extent of these representations and warranties can be the focus of much negotiation.

Buyers usually want the seller's representations and warranties to survive closing for some period of time. In Maryland, the contract merges into the deed at closing unless the parties agree otherwise. Survival of representations and warranties can work to extend the seller's liability for a breach. Striking the balance between the seller's desire to limit its exposure and the buyer's desire to have some assurances that survive closing is a primary area of negotiating the purchase contract.

A second battle that typically takes place in the negotiation of "reps and warranties" is whether or not each representation in the contract will be "knowledge based." Take a look at the following two statements:

1. The Seller warrants that the improvements on the property comply with all applicable laws.

2. The Seller warrants that, to the best of its knowledge, the improvements on the property comply with all applicable laws.

From a legal standpoint, there is a vast difference between the two.

The first statement is absolute. If, during the survival period, the buyer finds that the building was out of compliance with applicable laws at the time of closing, the seller would be liable for having breached its warranty. Period. No ifs, ands, or buts.

The second statement is conditional. In order to prove that the seller breached its warranty, thereby enabling recovery of resulting damages, the buyer would have to show two things: (a) that the building was out of compliance at closing; and (b) that the seller knew that the building was out of compliance at closing.

The second item of proof – concerning the seller's knowledge – is incredibly difficult to prove.

Buyers always want the Seller's representations and warranties to be absolute. Sellers always want their representations and warranties to be knowledge-based. Which way it winds up being is settled in negotiation.

ENVIRONMENTAL WARRANTIES

Environmental issues can be a nightmare. The State and federal government take an active interest in whether or not there are hazardous materials such as petroleum, oil, asbestos, and/or other toxins on the property. Clean-up is expensive. It is also mandatory, as unchecked hazardous materials could endanger public safety.

Wherever big dollars are at stake, there will always be a battle over who's responsible for payment.

The issue is further complicated by the plethora of federal and state statutes affixing responsibility and mandating a very long statute of limitations.

Sellers, simply put, want to be done with the property. A seller wants to walk away from the closing table with his or her proceeds and be done with the property forever. A buyer does not want to inherit his predecessor's legal issues.

The parties' significant and competing interests on this issue often produces one of the most heavily negotiated facets of the agreement. A buyer will want an absolute environmental representation with a long survival period and unlimited responsibility. A seller will want a knowledge-based representation with a short survival period and a cap on possible damages. Whether or not the parties are able to meet in the middle often depends on the Seller's knowledge of the property, both parties' tolerance for risk, and the buyer's confidence in its due diligence.

REMEDIES

Another area of concern for the seller is ensuring that the seller has adequate remedies if the buyer defaults. Defaults can include the buyer's failure to repair damage done during the study period or the buyer's failure to consummate closing. Having a sufficient earnest money deposit and access to the deposit in the event of default help to protect the seller's interests.

WHAT YOU SHOULD KNOW ABOUT ...
Wagonheim law

WAGONHEIM LAW...

- Offers value-driven, personal attention which combines large firm expertise with small firm economy and responsiveness. We have counseled companies and closed transactions across the country – from Portland, Maine to Seattle, Washington – from our home base right here in Maryland.

- Serves as general counsel to businesses of every size and description, from small, local establishments and large regional enterprises, to some of the most successful and recognized companies in the country.

- Has a track record of excellence in real estate transactions, commercial transactions, construction, and insurance defense litigation in matters ranging from the acquisition and financing of real estate to employment and collection matters, complex fraud, IP, and commercial claims.

- Looks for ways to help its clients grow – at no cost to them – from facilitating timely introductions to strategic vendors and prospective partners, to keeping our clients up-to-date on critical areas of the law.

- Advises our clients on general business issues including succession planning, contractual formation and enforcement, mergers & acquisitions, stockholder issues, employment, collection, and general litigation.

- Is a business law firm rated AV (excellent to preeminent) by Martindale-Hubbell, the country's most prominent and respected law firm rating service.

Scan here to read
Kim's Bio

Kimberly A. Bohle

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- Over 10 years of representing business clients in a full range of commercial matters, including lease review and negotiation, real estate development, mergers and acquisitions, entity formation and modification, and contract review and negotiation.
- Substantial litigation background providing a unique ability to analyze complex transactions from both a litigation and a business viewpoint, resulting in a keen awareness of the potential pitfalls of the various structural and drafting choices that face lawyers at any point in a transaction.
- Member of the Maryland State Bar Association and the Section of Real Property Planning and Zoning, and the National Association of Professional Women.
- Active in numerous other causes, including fundraising for multiple sclerosis research and working with non-profits that assist women in obtaining job placement; previously served as a member of the Board of Directors for Dress for Success Maryland; volunteers with Pets on Wheels.
- Maryland Super Lawyers Rising Star, 2012.

Scan here to read Bob's Bio

Robert D. Porter

rporter@wagonheim.com

- Represents businesses and their owners in all aspects of commercial real estate transactions, including acquisitions, financing, development, leasing and dispositions.
- Extensive experience in negotiating and drafting complex contracts of sale, development agreements, easements, commercial leases and joint venture agreements.
- Pursues a balanced and results-oriented approach to transactions based on prior, real world experience with the management, operation, use and improvement of residential real estate and years of experience "on both sides of the table," representing both buyers and sellers, landlords and tenants, lenders and borrowers and owners, contractors and subcontractors.
- Over 15 years of military experience, with over 8 years with the Army Reserve Judge Advocate General's Corps, including experience in government contracting and government claims.

Scan here to read Eliot's Bio

Eliot M. Wagonheim

ewagonheim@wagonheim.com

- Admitted to practice in MD and PA,
- Published author and frequent public speaker on construction, development, and general business topics.
- AV-Rated (excellent to preeminent) by Martindale-Hubbell,
- Twenty five years of representing landlords, tenants, lenders, and business owners throughout the mid-Atlantic.
- Duke University (1984), B.A.
- University of Maryland School of Law (1987), J.D.
- Selected as one of SmartCEO's *Legal Elite* in 2011 as one of Baltimore's "Go To" attorneys.
- Selected as a 2012 Maryland Super Lawyer,

DID YOU KNOW…

Wagonheim Law offers more than just legal services. Our firm is the product of decades of experience, relationships and contacts formed throughout the Maryland business community. Every day, we put our Rolodex® to work for clients and friends of the firm.

How can we help you?

- The purchase or sale of real property interest in a company is an excellent opportunity to review your estate planning. Contact us if you'd like a referral to one of our **trusted estate planning advisors.**

- Selecting the type of business entity often has just as much to do with accounting and tax strategies as it does legal protection. Contact us if you'd like a referral to one of our **trusted accounting and tax advisors.**

- One should never sell an interest in a business without appropriate and comprehensive financial planning. Contact us if you'd like a referral to one of our **trusted financial planning advisors.**

- In order to thrive, growing businesses require comprehensive and timely advice from accounting professionals experienced in their particular industry or niche. Contact us if you'd like a referral to one of our **trusted accounting and tax professionals.**

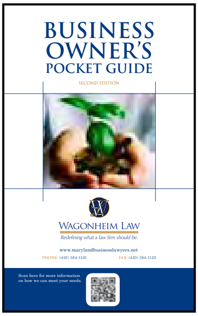
- An experienced commercial banker, knowledgeable about real estate and commercial funding is essential to see the company through the long term. Contact us if you'd like a referral to one of our **trusted banking contacts.**

- Property owners and tenants must manage risk. Experienced and creative insurance advisors are essential to this effort. Contact us if you'd like a referral to one of our **trusted insurance advisors.**

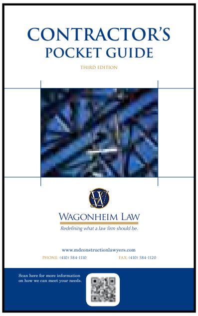
- Buying, selling and leasing property requires more than just sound legal advice. The input of an experienced valuation professional can ensure knowledgeable decision-making no matter what side of the table you're on. Contact us if you'd like a referral to one of our **trusted business valuation professionals.**

- There are numerous other vendors, advisors and service providers (electricians, plumbers, HVAC professionals, builders, elevator maintenance, grounds maintenance, property managers and brokers) whose focus and purpose is to assist property owners and tenants in the operation, maintenance, use, sale, lease and management of property. Contact us if you'd like a **referral to one of our trusted friends, clients, or providers.**

Wagonheim Law Publications



BUSINESS OWNER'S POCKET GUIDE



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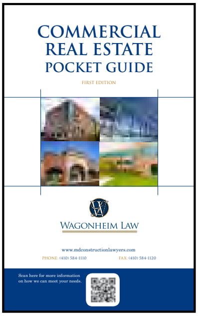

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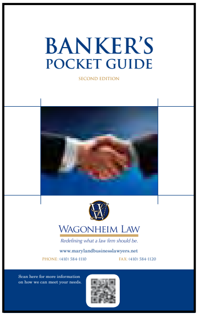

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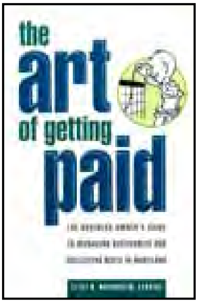

THE ART OF GETTING PAID

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