TEN KEY INSIGHTS FOR HEALTHCARE LEASE NEGOTIATIONS

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This article will look at several key negotiating points for tenants in triple net healthcare leases. It will also offer suggestions for certain lease provisions that will protect tenants from overreaching and unfair expenses, overly burdensome obligations, and ambiguous terms with respect to the rights and responsibilities of the parties. These suggestions are intended to result in efficient lease negotiations and favorable lease terms from a tenant's perspective.

1. INITIAL AND RENEWAL TERMS

Initial terms and renewal terms are important components in health care lease negotiations for both tenants and landlords. The length of an initial term, as well as of subsequent renewal terms, provides the parties with security, predictability, negotiating power, and market flexibility.

When deciding between a longer or shorter initial term length, a health care tenant should compare the benefits of each. A longer initial term gives a tenant security in knowing it will not have to incur costs and business interruptions in connection with relocating and negotiating a new lease in the near future. Longer initial terms also allow tenants predictability in rental costs and leverage to negotiate other key lease points. In exchange for the assurance of having a long-term tenant in place, landlords will often offer improvement allowances, rent concessions, and other opportunities for tenants to improve their lease terms. For example, a health care tenant may be offered a tenant improvement allowance by its landlord to build out its practice space in exchange for agreeing to a longer initial lease term. However, shorter initial lease terms offer tenants flexibility in uncertain markets to potentially take advantage of better space in different geographical locations or markets. In addition, if a tenant is a new business just entering the market, it may want a shorter initial term with renewal options to allow time to grow the business with an exit strategy if that business does not grow as projected.

From a health care tenant's point of view, renewal terms in a lease offer additional security in knowing they can continue their business for a certain

period of time in the same location and market and avoid the disruptions in business operations and costs of negotiating a new lease for relocation space. It is beneficial for a health care facility that has created visibility in a specific market to be able to continue its business in such a market and location.

From a landlord's point of view, renewal terms provide a dependable forecast of revenue on which the landlord can rely. Based on this forecast, a landlord can mitigate risks and costs associated with vacancies and locating replacement tenants. Most renewal terms include pre-negotiated annual escalations which provide both the landlord and tenant with predictability with respect to their future financial obligations and revenues.

Renewal terms are typically based on changing markets and market rentals. Many times, renewal term rental rates will be based on current fair market value. This allows a landlord to maximize the benefit of rising property values when adjusting rental rate terms upon renewal. For health care tenants, negotiating shorter renewal periods (e.g., two renewal terms of three to five years each) allows the tenant to reevaluate market conditions periodically and the option and flexibility to secure more favorable lease terms elsewhere.

Overall, initial terms and renewal terms are critical clauses in health care leases. They provide stability, predictability, and mutual benefits to landlords and tenants.

2. OPERATING EXPENSE PROVISIONS

Many times, health care tenants will enter into triple net leases, which place full responsibility on the tenant for payment of all costs relating to the property being leased. When entering into a triple net lease for medical office space, health care tenants should pay special attention to negotiating operating expense provisions. These provisions. which determine which operating expenses the landlord will pass through to the tenant, can have a significant impact on a tenant's financial responsibility over the term of a lease. Tenants can limit their operating expense obligations by negotiating the following terms (preferably in advance in a letter of intent (LOI)).

Carveouts from Operating Expenses

Operating expense clauses generally cover any and all costs of operating, maintaining, and repairing the building or center in which the leased premises are located. These clauses are broad and pass through costs for real estate taxes; the landlord's insurance; management fees (which should be limited to four to five percent of total operating expenses for the building); salaries of employees; and maintenance, repairs, and replacements to the common areas (including repairs and replacements of sidewalks, parking lots and roofs, and services such as snow removal and janitorial).

It is customary for tenants to negotiate that certain items be excluded from the definition of operating expenses. Exclusions tenants should push for include costs relating to marketing and leasing of other space in the building; costs for which the landlord is reimbursed by insurance proceeds or otherwise; legal fees and related expenses arising due to the gross negligence or misconduct of landlord or its agents; fines due to the landlord's failure to comply with applicable laws; late fees and penalties due to the landlord's failure to timely pay bills; reserves for future expenses; costs of services furnished to other tenants and not to all tenants of the building (including renovations or alterations for other tenants); costs arising from the potential or actual presence of adverse environmental conditions occurring by reason of the landlord's or another tenant's introduction thereof in violation of any applicable environmental laws; costs of correcting defects in the construction of the building; and depreciation, interest, and other financing charges.

Carveouts from Real Estate Taxes

Tenants should also push to include carveouts from the definition of real estate taxes that are passed through to the tenant. Typical exclusions include municipal, state, or federal income taxes; interest; late fees and penalties imposed as a result of the

landlord's failure to pay tax bills in a timely manner; inheritance; estate; succession; transfer; franchise; corporation; net income; profit; or capital gains taxes imposed on the landlord in connection with the sale of the property; and any taxes which are determined based upon the landlord's net income or net worth.

Controllable Operating Expenses

Since landlords have control over many of the costs that are passed through to tenants as operating expenses, tenants should request an annual cap on controllable operating expenses. These include operating expenses that landlords have control over and typically exclude utilities, snow removal, insurance costs, and real estate taxes. These provisions force landlords to run their operations efficiently and not pass poor-management costs along to tenants.

Reconciliation

Tenants should ensure that landlords are obligated to provide estimated statements of each tenant's proportionate share of operating expenses before the beginning of each calendar year, and to provide actual reconciliation statements within a reasonable time (generally 60 to 90 days) after the beginning of each subsequent calendar year. Clear language should be included that any underpayments or overpayments will be adjusted between the parties within 30 days of the date of the actual statement and that any funds due back to the tenant for an overpayment may be credited to the next due and owing base rent or additional rent.

Sunset Clause

This clause provides that a landlord must invoice a tenant for additional rent (to the extent additional rent is payable through an invoice) within a certain time period (usually 18 to 24 months) of the month in which charges are incurred. This forces a landlord to promptly notify tenants of any additional rent that is not a recurring monthly charge which would be reconciled each calendar year and protects tenants from receiving an invoice for charges that were incurred years prior and for which adequate records may no longer be available.

Audit Rights

Tenants should always have an express right to audit their landlord's accounting of operating expenses. It is reasonable for this right to be limited to once per calendar year, to be actionable upon advance written notice to the landlord, to take place within a certain time period of tenant's receipt of landlord's year-end reconciliation statement, and to be undertaken by an accounting firm that is not paid on a contingency basis. Any overpayments or underpayments revealed by an audit should be adjusted between the parties. Tenants should push to include language that if the landlord has overcharged tenant by more than a certain percentage (typically five percent) of a tenant's proportionate share of the operating expenses, the landlord will pay the costs of the audit. In all other cases, tenants usually bear the cost of any audits.

Other Tenant Provisions

Tenants should add language to operating expense provisions to clarify that if any operating expenses passed through to the tenant are capital improvements (e.g., replacement of roof), such expenses will be amortized over the useful life of such capital improvements (using generally accepted accounting principles) with the tenant's obligation limited to the term of the lease.

Most times, regardless of whether a landlord passes janitorial costs through to a tenant as part of operating expenses, the removal of medical waste will be a direct cost that tenant is obligated to contract and pay for directly.

Tenants should make sure that the cost of improvements necessary to keep the premises or building compliant with laws, including the Americans with Disabilities Act, should be excluded from operating expenses.

Negotiation of any of these provisions is crucial in a triple net lease and can have a significant economic

impact on a tenant throughout a lease term. As with any highly negotiated lease terms, by addressing these provisions in detail in advance in the LOI, the parties can avoid protracted negotiations and can more efficiently negotiate and finalize their leases.

3. ASSIGNMENT AND SUBLETTING PROVISIONS

It is imperative for a commercial tenant, particularly a private equity-owned health care tenant, to include provisions in a lease which allow the tenant the flexibility to assign and sublease the commercial space without having to obtain the landlord's consent and/or to meet burdensome landlord conditions.

Most leases prohibit transfers by assignment and subletting or require a landlord's prior written consent subject to meeting certain burdensome conditions. In addition, landlords often include a "change of control" provision which provides that sale of a controlling interest is deemed a transfer requiring landlord consent. A health care tenant looking for flexibility for reorganization or internal transfer subject to private equity control will want to push back on change of control provisions and will want to ensure that their lease allows for certain permitted transfers that do not require landlord consent. Permitted transfers customarily include transfers to: (i) an affiliate of the named tenant under the lease (e.g., any entity, directly or indirectly, which controls, is controlled by, or is under common control with tenant); (ii) a successor entity created by merger, consolidation, or reorganization of tenant; or (iii) an entity which shall purchase all or substantially all of the assets or a controlling interest in the stock or membership of tenant. If the tenant is a management services organization (MSO), the lease should also include explicit landlord permission for a sublease between the MSO and the provider that will occupy the leased premises.

Landlords may accept the concept of permitted transfers but often seek to impose conditions to allowing them. Certain conditions on permitted transfers are reasonable, such as requirements for advance notice, that the proposed permitted transferee assume all obligations under the lease, that the permitted transferee operate only for the permitted use set forth in the lease, and that a copy of the transfer document be provided to the landlord. However, other conditions, such as requiring a net worth test for the assignee or financial reporting, can be burdensome and serve to undermine the concept of permitted transfers without landlord consent.

Other common assignment and subletting provisions should expressly not apply to permitted transfers. These include recapture provisions which allow a landlord to terminate the lease and recapture the space, excess profit provisions which provide that any excess profits realized as the result of a transfer will be shared between landlord and tenant, and administrative fees and reimbursements to the landlord which are often charged to tenants in connection with an assignment or subletting request. Restrictions on transfers should not apply to guarantor entities. Often with private equity, the guarantor is the parent entity and cannot be restricted by a landlord as to transfer, restructuring, or reorganization at the top of its organization.

In the case of transfers that do not fall within the definition of permitted transfers and require landlord consent, a tenant will want to include language that landlord will not unreasonably withhold, condition, or delay such consent. Other tenant protections should also be considered, including a cap on administrative and review fees reimbursable by tenant to landlord, a reasonably short time period (e.g., 30 days) for the landlord to approve or disapprove a request or be deemed to have approved, a reasonably short time period for landlord to exercise recapture rights or be deemed to have approved, and a provision that excess profits will be shared equally rather than all belonging to landlord.

Negotiation of assignment and subletting terms is critical for tenants, particularly with respect to private equity-owned health care tenants. The goal for tenants in negotiating these points is to provide flexibility for addressing future financial and operational needs. As with other highly negotiated lease terms, addressing assignment and subletting provisions in detail in advance in the LOI clarifies expectations of

the parties clear, saves time and money by avoiding protracted negotiations, and results in an overall efficient lease negotiation process.

4. MAINTENANCE, REPAIR, AND REPLACEMENT OBLIGATIONS

Landlords will often place responsibility for repairing, maintaining, and replacing mechanical systems (e.g., HVAC, electrical, and plumbing systems) that exclusively serve the leased premises on tenants. This can result in a tenant spending a significant amount of money on system repairs which they may not get the full benefit of if their lease is nearing the end of its term. Therefore, it is crucial for tenants to shift responsibility for such repairs onto the landlord, particularly with respect to replacements.

A good starting point for negotiation is for a tenant to have the mechanical systems exclusively serving the leased premises inspected prior to entering into the lease. Tenants should also seek a landlord representation in the lease that all such systems are in good working order and condition as of the lease commencement date. Tenants should further negotiate a warranty by landlord for a certain period of time following lease commencement. For example, a tenant may negotiate that if a major system requires repair or replacement during the first year of the term, the landlord will be fully responsible for all costs to repair or replace the system, and thereafter, tenant's obligations for repair and replacement costs will be capped at a certain dollar amount per year or even that tenant's responsibility for repairs will be capped and all replacements costs will be on the landlord. Language should also be included to clarify that a determination as to whether repair or replacement is needed will be determined by a mutually acceptable contractor. Tenants will likely be required to maintain service contracts for those mechanical systems exclusively serving the leased premises, which is reasonable. However, if the parties agree that the tenant will be responsible for all costs of repairs and replacements, a tenant should push for language in the lease that requires the landlord to assign any warranties and for the landlord to agree that tenant may enforce such warranties directly during the lease term.

Some health care tenants may require additional system capacity, such as additional HVAC units, emergency generators, or additional electricity capacity. Tenants should negotiate the installation of these types of requirements in the LOI so that the landlord has a clear picture of the tenant's operational requirements in advance. Tenants do not want to get to the negotiation point of a lease only to have a landlord reject the installation of additional systems. Tenants will typically be responsible for any additional costs of repair, maintenance, and replacements of additional systems and for removal of such additional systems at expiration of the lease term.

By accepting delivery of leased premises, tenants typically accept the premises in as-is condition, unless expressly stated otherwise. Therefore, it is important to include a carveout for latent defects in or affecting the premises which may not be discovered until after lease commencement. For example, mold not readily detectable upon visual inspection may be discovered at some point during the term or during the course of any tenant work. Language should be included in the lease that such latent defects will be remediated at landlord's sole cost and expense.

Maintenance, repair, and replacement of foundations, walls, other structural components of the building, parking lots, sidewalks, and roofs are most often the landlord's responsibility. To the extent possible, a tenant should negotiate affirmative language stating that such costs will not be passed through to the tenant as operating expenses, particularly in a single-tenant building where all such costs would fall on one tenant. Mechanical systems that jointly serve the leased premises and other parts of the building or common areas, are customarily passed through as operating expenses as well, which is why negotiating limitations on operating expenses and amortization of any capital improvements included in operating expenses is so important.

Negotiation of maintenance, repair, and replacement obligations is essential in order to protect tenants. Tenants should consider the term of the lease and the potential for repairs and replacements to major systems which could result in significant costs and burdensome obligations. As with other key lease terms, responsibility of the parties for maintenance, repairs, and replacements to the leased premises should be set out in detail in a LOI in order to make expectations of the parties clear, to save time and money by avoiding protracted negotiations, and to achieve an overall efficient lease negotiation process for both parties.

5. HOLDOVER PROVISIONS

Holdover provisions should be carefully negotiated in order to limit a tenant's liability for expenses arising from unforeseen circumstances.

What happens if a tenant does not vacate on lease expiration without having negotiated a renewal or a new lease? Circumstances may arise which interfere with a tenant's ability to vacate the premises in a timely manner, such as delayed or terminated negotiations with respect to a lease for an intended new space or delays in the new space being ready for occupancy.

Most commercial leases provide that tenants in holdover will be month-to-month tenants or tenants at sufferance and will pay a holdover rental rate which is usually 150 percent to 200 percent of the monthly base rent payable during the month prior to lease expiration. Sometimes landlords include in the lease extraordinarily high holdover rental rates and/or seek to make the holdover rental rate apply to additional rent as well as base rent. Tenants should push back in these instances and negotiate to obtain a reasonable holdover rental rate that only increases the base rental obligation, while the obligation to pay additional rent remains as provided for in the lease prior to expiration.

Tenants also may want to push for a grace period during which base rental remains the same as during the last month of the term before the holdover rate kicks in, after which a moderate increase occurs for another specified period before the full holdover rate applies. For example, the first three months after expiration of the lease term would remain at the prior base rent, after which the holdover rental rate would take effect.

Landlords also routinely seek to hold tenants responsible for all damages that the landlord may incur as a result of the tenant's holdover, including lost rent from a potential new tenant. Tenants should try to limit exposure to such damages by negotiating that the holdover rental rate is landlord's exclusive remedy or that responsibility for such damages will not apply until holdover has continued beyond a certain length of time.

Negotiation of holdover provisions is important in order to limit tenant exposure to high penalties and costs, particularly in situations where a tenant may not have the ability to vacate for reasons beyond its control. As with other key lease terms, we recommend detailing the basic understanding of the parties with respect to holdover in a term sheet in order to clarify expectations of the parties, which will save time and money by streamlining negotiations and ideally achieve an overall efficient lease negotiation process.

6. SURRENDER PROVISIONS

Tenants should understand and negotiate their obligations for removal of alterations, equipment, and other personal property, and the condition in which leased premises must be surrendered at the expiration or earlier termination of the lease term. Failure to do so could result in delays in a tenant's ability to vacate the leased premises as well as unforeseen significant costs.

Most commercial leases provide that alterations and improvements made by or on behalf of a tenant become the property of the landlord and must be surrendered with the leased premises upon expiration or earlier termination of the lease unless the landlord requires removal. Tenants should request language in the lease requiring landlord to advise at the time it consents to such alterations and improvements whether or not the same must be removed,

rather than the landlord having the right pursuant to the terms of the lease to demand removal at the time of expiration or earlier termination. Having such a term in place eliminates the element of surprise and provides the tenant with certainty as to which alterations and improvements it is required to remove. Tenants may also want to limit the removal requirement so that any alterations or improvements that cannot be removed without significant damage are to remain in the leased premises upon expiration of the lease term.

Health care tenants often have unique needs and require specialty alterations and equipment, such as raised flooring systems, emergency generators, supplemental HVAC systems, oxygen and medical gas systems, and related cabling, wiring, and piping. A health care tenant may try to negotiate that specialty alterations and equipment do not have to be removed at all, as this can be especially burdensome, time consuming, and costly. However, the landlord will likely push back and insist upon the right to require removal. As a back-up position, as with any other non-specialty alterations, tenants may want to negotiate that the landlord is required to advise whether or not removal is required at the time the landlord consents to installation of any such specialty alterations and that the same need not be removed if removal would result in significant damage. Tenants should also insist upon a clear definition of what constitutes "specialty alterations and equipment" and push for certain exclusions such as vaults (including vaults which encompass radiation treatment areas and equipment), reinforced floors, structural reinforcements, drainage holes in floors, and other medical equipment and installations routinely used in medical offices.

Negotiation of surrender provisions is important in order to limit a tenant's exposure to costs associated with removal of certain alterations and equipment and to allow a tenant to plan and budget accordingly at the lease outset and as the need for such alterations and equipment arises during the lease term. As with other key lease terms, the basic understanding of the parties with respect to surrender obligations should be detailed in a term sheet in order to clarify expectations of the parties, save time and money by streamlining negotiations, and achieve an overall efficient lease negotiation process.

7. TENANT IMPROVEMENT ALLOWANCE PROVISIONS

A tenant should negotiate for the landlord to provide a tenant improvement allowance to prepare the leased premises for the tenant's occupancy. Important factors include the amount of the tenant improvement allowance, whether the tenant or the landlord will complete the work, and how and when the tenant improvement allowance will be paid.

Landlords often incentivize a desirable tenant by providing a tenant improvement allowance which provides a tenant with certain funds to pay for the costs in preparing the leased premises for the tenant's occupancy. When negotiating the amount of a tenant improvement allowance, the parties generally consider the type of space needed for the tenant's purpose and how the premises will be used, the length of the lease term, and the square footage of the premises.

Tenants will want the lease to specify that the tenant improvement allowance can be used for hard costs directly related to construction (such as labor, materials, and major systems such as HVAC) as well as intangible soft costs not directly related to construction (such as permitting, architectural and engineering fees, and feasibility studies). Leases often provide that any tenant improvement allowance amount not used within a certain time frame will be forfeited. Tenants will therefore want to ensure that time periods are clearly stated and long enough to account for potential delays and to include a carve-out for force majeure events. Language that would allow tenants to apply any unused tenant improvement allowance amount to payment of future rent is also beneficial to tenant.

The parties will also negotiate who will complete the work. If the landlord is completing the work, the tenant should require that all plans and specifications be subject to the tenant's approval and that timelines for approval and substantial completion

are clearly delineated. Specific dates and time periods should be used rather than vague language such as "within a reasonable time" or "promptly." The landlord will routinely include provisions for "tenant delays" which often advance the rent commencement date. Tenants should negotiate a fair definition of this term, which should not include situations outside of the tenant's reasonable control such as certain selected materials being delayed or unavailable.

The tenant will also want to include a penalty for a landlord's delay in delivery, such as an extended free rent period or day-for-day rent credit and, eventually, a termination right and reimbursement for all costs incurred by the tenant in connection with the lease. Any landlord work should be substantially completed prior to delivery to tenant, meaning that landlord has completed its work to the point that tenant can commence its work (if any) and that landlord's work is complete subject only to minor punch-list items. Minor punch-list items are those which do not interfere with the tenant conducting any work or with tenant's use and occupancy of the leased premises for the permitted use, and the lease should provide that landlord will address such items within 30 days following delivery. If the landlord is completing the work, it is often helpful to the tenant to have early access for pre-commencement activities such as installing IT equipment, wiring, and cabling, and taking measurements to prepare for the tenant's work (if any). As long as such early access does not interfere with the landlord's work, and the tenant produces evidence of insurance, landlords often agree to such early access.

If the tenant is completing the work, the tenant should be sure to include reasonable and specific time periods for the landlord's approval of contractors, plans, specifications, and the tenant's completion of the work. The lease should specifically state that the landlord's approvals shall not be unreasonably withheld, conditioned, or delayed. A landlord's failure to approve or disapprove of plans within the specified time periods should result in the plans being deemed approved by the landlord to avoid delaying construction deadlines. The tenant's obligation to complete construction within the specified time period should also be subject to force majeure events.

Another important factor to negotiate if the tenant is completing the work is the timing of payment of the tenant improvement allowance. The tenant will often front the improvement costs and will be reimbursed by the landlord upon completion of the work as certified by tenant's architect and production of final lien waivers. Depending on the size of the project, tenants may want to push for staggered disbursements in two or more phases or monthly disbursements. Tenants should also look for any supervision and management fees that landlords may attempt to include in the tenant improvement allowance. Finally, tenants should ensure that if the work is completed earlier than anticipated, the tenant can commence operating in the premises, but the rent will not commence until the specified rent commencement date so that tenant gets the full benefit of any negotiated free rent period.

8. EXCLUSIVITY, EXPANSION, AND RELOCATION PROVISIONS

Exclusivity provisions protect a tenant's interest in leased premises by restricting landlords from leasing space in the same building or shopping center for a similar permitted use. These provisions are not only important for retail tenants but should be negotiated for by healthcare tenants as well. For example, a tenant that operates a dermatology practice in a shopping center may want to restrict its landlord from leasing space to other tenants who provide many of the same services. It is also important to define what a tenant's recourse is if the landlord breaches the exclusivity provision or if another tenant operates outside of its permitted use in violation of the exclusivity provision. Recourse may include a reduction in rent for a certain period of time while landlord attempts to resolve the violation and, eventually, a termination right if landlord is unable to cause the rogue tenant to cease the violation.

Expansion provisions allow tenants the flexibility to expand into additional space that may become

available for lease by landlord during the lease term, usually contiguous space or other space in the same building. Tenants should push for a right of first offer if such space should become available, even if the tenant is uncertain of what its future needs may be during the term. Negotiated rent and coterminous terms should be included in the lease.

Relocation rights on the part of a landlord allow the landlord to relocate a tenant to a similar space in other areas of the shopping center of building. Tenants should push for no relocation right on the part of landlord, especially if the leased space has been built out by or for tenant to meet specific needs of tenant's business. A relocation at any time during the term would likely result in an interruption to a tenant's business and, in the case of healthcare tenants, inconvenience to patients. If a landlord will not agree to remove a relocation right, tenants should push for the right to occur only once during the term and only after the first several years so as to give the tenant time to get its business running in the space. In all cases, tenants should ensure that these provisions define the relocation space as comparable in size and location (such as proximity to elevators and lobbies) and that the landlord is responsible for building out the new space to the same condition as the original space at landlord's sole cost and expense.

The landlord should also be expressly responsible for the costs of any updates to the tenant's stationary, signage, and other incidental costs as a result of the relocation. A landlord's responsibility for costs in connection with a relocation should not be capped at any particular amount. A tenant should also reserve a termination right if the relocation space identified by the landlord is not reasonably satisfactory to the tenant, in which case the landlord should be responsible to reimburse the tenant for the unamortized portion of any improvements to the premises paid for by the tenant.

9. DEFAULT PROVISIONS

A tenant should carefully negotiate default provisions to limit its exposure in the event of default, which may occur as a result of numerous unforeseen factors often outside of a tenant's control such as market trends, financial stability, and force majeure events.

Tenants should always seek appropriate notice and cure provisions with respect to any lease default. Most landlords will agree to a short cure period of anywhere between three to 10 days for monetary defaults, and tenants can push for a notice requirement as well, at least for two to three late payments in any 12-month period. The cure period for non-monetary defaults should be at least 30 days after written notice from landlord, which should specify the nature of the default and should provide that if a cure cannot reasonably be accomplished within such 30-day period, the tenant will have such longer time as is reasonably necessary as long as tenant commences to cure within the initial 30-day period and diligently pursues the cure to completion.

Tenants should seek protections against accelerated rent provisions. If a landlord will not agree to remove acceleration of rent as a remedy, tenants should push for any accelerated rent to be discounted to present value. Another protection tenants should look for is an affirmative obligation on the landlord to mitigate its damages. Tenants should also push for a self-help remedy in the event of a landlord default beyond notice and cure periods afforded to the landlord.

Tenants should seek to keep late fees and interest to a minimum and even push for a waiver of late fees and interest for the first late payment. Finally, tenants should try to eliminate certain enumerated defaults so that any failure to perform a non-monetary obligation has the benefit of the 30-day notice and cure provision. These include abandonment, failure to sign an estoppel within the specified time period, failure to make a required repair, and failure to use the premises for the permitted use. If a landlord insists on abandonment being an enumerated default, tenants should carve out an exception for temporary closures due to renovations, repairs, or force majeure events such as governmental closures. In addition, tenants can request a "go dark"

provision allowing the tenant to vacate or abandon the premises so long as tenant is continuing to pay rent and perform obligations under the lease.

10. LETTER OF INTENT

While the LOI is usually non-binding, it is an extremely important part of the lease process and a valuable tool to make expectations clear and prevent time-consuming and costly back and forth during lease negotiations. The topics covered previously in this article should be addressed in the LOI, which should serve as a road map for the parties and counsel in drafting and negotiating the lease. By agreeing on these basic terms up front, the parties will significantly reduce the amount of back and forth needed to arrive at a lease both parties find acceptable.

Initial Terms and Renewal Terms

The LOI should detail the length of the original lease term, the number and length of any renewal terms, the required notice period for a tenant to exercise a renewal term, and how base rent will be determined during renewal terms (i.e., a baseball arbitration process to determine FMV whereby both parties hire appraisers to settle on a FMV rental amount or a set amount or increase).

Operating Expenses

The LOI should detail any cap on controllable operating expenses, customary exclusions from operating expenses, any cap on management fees that are passed through to tenant, a tenant audit right, a sunset provision requiring landlord to invoice tenant for any additional rent within a certain period of time, and amortization of any capital improvements included in Operating Expenses.

Assignment and Subletting

The LOI should expressly state any carveouts from the requirement that landlord consent is required for assignments and subleases. It should also set out any landlord criteria for consent, any landlord review fees, landlord recapture rights, and any excess profit sharing.

Maintenance and Repairs Obligations

Obligations of the parties should be included in the LOI, including responsibility for repairs and replacements and any cap on tenant's obligations.

Holdover and Surrender

The holdover rate, any grace period, and any tenant obligation beyond the holdover rental rate should be included. The parties should also address whether tenant improvements must be removed at the expiration of the lease term.

Tenant Improvement Allowances

If any tenant improvements are to be constructed, responsibility for the work, any improvement allowance and the disbursement process, time periods for submission and approval of plans, estimated completion times, and recourse for delays should be addressed.

Exclusivity, Expansion, and Relocation

Any tenant exclusivity provision and the remedy for its violation should be included in the LOI. If a tenant has an expansion right, the expansion space and manner of exercise of the right should be addressed. If the landlord has the right to relocate the tenant, the parameters of the right should be set forth in detail, including responsibility for costs and any limitations on the exercise of the right. If there is no relocation right, the LOI should specify same.

Default

Notice and cure period should be agreed upon in advance, as well as any obligation of the landlord to mitigate damages.

Other provisions the landlord and tenant should address in the LOI include: the permitted use, the square footage and description of the premises, any prohibited uses or restrictions, parking rights and costs, signage rights, and costs. Phrases in the LOI

such as “to be detailed in the lease” or “language to be included in the lease” are not helpful, and the parties should seek to include enough detail in the LOI so as to avoid disagreement on key terms when it comes to negotiation of the form of lease.