

10-2013

Leasing Space in New York City: A Practical Guide for Technology Start-Ups

New York Law School

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Recommended Citation

New York Law School, "Leasing Space in New York City: A Practical Guide for Technology Start-Ups" (2013). *Center for Real Estate Studies*. Book 1.
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Leasing Space in New York City:
A Practical Guide for Technology Start-Ups

October 2013

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Overview: How to Use this Guide

Who is this Guide for?

This Guide is written to assist growth-stage technology companies entering negotiations with landlords to lease office space in New York City. Growth-stage technology companies are typically one to two years old, have approximately one to two million dollars in funding, may generate revenue, and have ten or more employees. These companies often want to transition from incubator space to traditional office space, but struggle to obtain affordable, short-term leases that accommodate growth and flexibility.

This Guide is divided into three main sections – each section relates to the major issues that growth-stage technology companies face in typical lease negotiations. In addition, this Guide provides practical advice on how to solve those issues, suggests strategies for negotiating and drafting the lease, and includes sample lease provisions.

Organization

The three major sections of this Guide relate to Cost, Space and Long-Term Planning & Flexibility.

Section 1: Cost

- Identifies the significant economic costs of leasing space.
- Describes major lease provisions relating to those costs.
- Provides practical advice on how to reduce and effectively manage the total cost of leasing space.

Section 2: Space

- Addresses how tenant can use its space and protect its ability to conduct its business during the **lease term**.
- Discusses how landlord and tenant can work together to prepare the space before tenant moves in.

Section 3: Long-Term Planning & Flexibility

- Describes how tenant can design a lease that aligns with its business strategy.
- Suggests ways to negotiate a lease that is flexible and conducive to long-term business and financial planning, and also allows for the possibility of future growth and/or contraction.

Tenant's Team of Professionals

This non-exhaustive list suggests various professionals that tenants may choose to engage during the leasing process and the circumstances under which to involve them.

Documents to Negotiate

This is a list of documents that tenants can expect to negotiate during the leasing process.

Glossary

This Guide also includes a glossary of terms and a list of external references and resources. Terms that appear in the glossary will appear in bold throughout the text.

DISCLAIMER

This publication is designed as an overview and introduction only and does not purport to be a complete or exhaustive treatment of each topic. It is intended to promote thought and discussion. This publication is not intended to be nor should it be construed as legal or professional advice. The information and views expressed in this publication may not apply to individual readers or to their businesses or to any particular specific facts or circumstances.

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1. COST

The most important issue for a prospective tenant is the “true” cost of leasing space. This section will discuss the material items that affect the “true” cost: (a) rent (including **escalations** and taxes); (b) **security deposit**; (c) **Good Guy Guaranty**; (d) electricity; and (e) landlord services. Each subsection will analyze these considerations and propose strategies to reduce costs.

A. RENT

While it is important to achieve the lowest rent per square foot, there are also many additional costs in a commercial lease that affect tenant’s ability to make the most cost-effective decision.

At a Glance - Rent

- Compare space alternatives based on the cost per usable (or “carpetable”) sq. ft., *not* based on gross rentable sq. ft.
- Although it varies by building, the rentable sq. ft. provided by landlord is typically 10-30% larger than the usable area due to **loss factor**.
- Compare space alternatives based on the total aggregate cost of all rent, **escalations**, electric charges and other charges.

Rentable Space vs. Usable Space

When advertising space for lease, landlords will usually list the **rentable space** (expressed in square feet) and the rent per square foot. The **rentable space** is the total usable area of the **premises** and a portion of the common areas. These common areas may include the lobby, public corridors, shared restrooms, stairwells, etc. Therefore, tenants must keep in mind that they are also paying for space outside of tenant’s **premises** as part of the stated rent per square foot. The percentage difference between rentable and usable space of the **premises** is commonly known as the **loss factor**, and will vary from space to space and building to building. For example, **loss factor** is typically greater in older buildings than in more modern buildings that typically have larger floor plates and are designed more efficiently. Additionally, **loss factors** are typically greater on divided floors than on full floors. Tenants and their real estate brokers should take the **loss factor** into account when evaluating potential spaces in order to compare the **net effective rent** of each space. A basic illustration of **loss factor** is provided below:

	Space A (10 th floor of building constructed in 1920)	Space B (10 th floor of building constructed in 2010)
<i>Rentable Space</i>	6,000 sq. ft.	6,000 sq. ft.
<i>Usable Space</i>	4,500 sq. ft.	5,400 sq. ft.
<i>Loss Factor</i>	25%	10%
<i>Fixed Rent</i>	\$50 psf.	\$55 psf.
<i>Gross Rent</i>	\$300,000	\$330,000
<i>Net Effective Rent</i>	\$67 psf.	\$61 psf.

SECTION 1: COST

The example above demonstrates the effect of **loss factor** on the **net effective rent** of two 6,000 square foot spaces in different buildings. Although the fixed rent per square foot of Space B is higher than the fixed rent of Space A, the **net effective rent** of Space B is significantly lower once **loss factor** is taken into consideration.

How to Determine Rent in the Lease

Landlord's Perspective

From landlord's perspective, rent is an income stream that determines landlord's profit after payment for various costs, such as: (i) debt service on any mortgage secured by the building; (ii) real estate taxes; and (iii) **operating expenses**. Given the long term relationship established by the lease and in order to protect against the time value of money, landlord seeks to maintain its profit margin and ability to maintain the building in working order through one of the following methods:

Method	Explanation
1.) Fixed base rent with fixed escalation	Base rent is expressed per square foot. The annual escalation is a percentage of the fixed base rent (usually between 2-3%).
2.) Fixed base rent with fixed escalation plus percentage of taxes	The same as method #1 and tenant also pays its proportionate share of certain increases in real estate taxes.
3.) Fixed base rent with percentage of operating expenses plus percentage of taxes	The same as method #2 and tenant also pays its proportionate share of increases in operating expenses .
4.) Triple Net	Typically used when tenant is renting an entire building and pays for <i>all</i> expenses of the building (operating expenses , insurance and taxes).

Escalations (Operating Expenses & Real Estate Taxes)

Typically, the definition of **operating expenses (OpEx)** includes such items as utilities, trash removal, janitorial expenses, security, landlord's insurance premiums, management fees, repairs and maintenance or other costs associated directly with the operation of the property. The definition of **operating expenses** within the lease will typically exclude certain items such as capital improvements, management expenses, mortgage and ground lease payments made by landlord.

Practice Point: To fully understand tenant's financial obligations under the lease, it should work with its attorney and/or broker to carefully review the definition of **operating expenses**.

Below is a non-exhaustive list of types of **escalations**.

SECTION 1: COST

Types of Escalations	
Real Estate Taxes and Assessments	When expressly required, tenant is obligated to pay the taxes due for its proportionate share of the property. These taxes are calculated over the base year .
Water and Sewer Expenses	Tenant may have to pay a pro rata share of landlord's cost of providing water and/or a share of the city's sewer charges or meter.
Landlord's Insurance Premiums	The cost of landlord's insurance is included as an operating expense. Landlord maintains insurance to rebuild if there is a fire or other casualty.
Common Area Expenses	Tenant may be obligated to pay a pro rata share of landlord's cost of maintaining the common areas of the premises . Some common area expenses are: <ul style="list-style-type: none"> • Supplying heating, ventilation, and air conditioning (HVAC); • Electricity usage for common areas; and • Cleaning, landscaping, and repairing the common areas of the property.
Utilities	Utilities may include electricity, heat, and hot water production. It is common for tenant to pay the cost of operating utilities and landlord to pay the cost of installing and repairing them.

The **escalation** provision allows landlord to pass on future increases in real estate taxes and **operating expenses** to tenant. Tenant pays for its proportionate share of increases in taxes and **operating expenses** over an agreed-upon **base year**. Although the **base year** is open to negotiation, the **base year** is typically the calendar year or tax year of the lease's execution or the calendar year or tax year following lease execution. The proportionate share is a percentage of tenant's occupancy of the building; it is typically determined by landlord and calculated as follows: Tenant's Proportionate Share = Tenant's Rentable Square Feet / Total Rentable Square Feet in Building.

Costs Typically Excluded from Operating Expenses
<ul style="list-style-type: none"> • Ground lease payments; • Depreciation; • Interest and principal payments on mortgages; • Expenses arising from negligence of landlord or another tenant; • Capital improvements (unless such improvements reduce operating expenses); • Costs of marketing and advertising space in the building.

SECTION 1: COST

Depending on a building's occupancy during an agreed upon **base year**, the **base year operating expenses** may not accurately reflect the **operating expenses** in future years. For example, if a building has substantial vacancy during tenant's **base year**, the **base year operating expenses** may be artificially low. As a result, tenant could potentially see a sharp increase in its **operating expenses** if the building achieves high occupancy in the future. To prevent tenant from being blindsided by this increase, it is common to **gross up** the numbers during tenant's **base year** to reflect full (or nearly full) occupancy. While the exact **gross up** percentage will be negotiated between the parties, it will typically reflect between 95-100% occupancy.

Another **escalation** that is common, but has fallen out of favor, is the **Porter's Wage Escalation** (or **PWE**). The **PWE** follows the hourly wages of the Porter's Union (Local 32 B-J) – the union for maintenance and janitorial staff in New York City's commercial buildings. The **PWE** reflects any increase in the Porter's Union wages that is negotiated between the union and Realty Advisory Board. Typically, the method used to calculate this **escalation** is known as "penny for penny," whereby for every one cent increase in the Porter Union's wages above the **base year**, tenant will incur a one cent increase in rent per square foot. For example, if the "penny for penny" formula is used for a 10,000 square foot space, and the Porter's Union wages increase \$0.50 per hour over the **base year**, tenant's rent would increase \$0.50 per square foot (10,000 sq. ft. x \$0.50 = \$5,000). In landlord friendly market, the **PWE** calculation might be increased to a penny and one-half for one penny.

Real Estate Taxes & Assessments

Real estate taxes are annual expenses charged by the city and state for ownership of land. In contrast, when the local government makes a capital improvement which benefits the landowner (e.g., a sidewalk, or new sewer line), the government assesses the landowner for this benefit. If the lease agreement expressly requires tenant to contribute to the cost of future increases of real estate taxes and assessments, the lease should stipulate tenant's exact percentage share.

Possible Calculations of Real Estate Taxes for Tenants
<ol style="list-style-type: none">1. All of the real estate taxes;2. A portion of the real estate taxes;3. Any increases in the real estate taxes over a specified amount of time;4. A portion of the tax increases listed above; or5. Any increases in the real estate taxes attributable to tenant's work.

SECTION 1: COST

It is important to consider how tenant's pro rata share of the building's **operating expenses** will be calculated. Tenant wants its share to be the ratio between the total square footage of tenant's leased space and the total square footage of the rented or occupied building space. Therefore, it is critical for tenants to factor in the vacant space of a building when calculating the building's total square footage. This will ensure that tenant is not obligated to pay for real estate taxes apportioned to the unoccupied space.

B. SECURITY DEPOSIT

Generally, commercial landlords will require a prospective tenant to provide a **security deposit** in the form of cash or a **letter of credit** when the lease is signed. The **security deposit** lowers landlord's financial exposure and helps ensure that tenant will meet its lease obligations (e.g., payment of rent, compliance with the **assignment/sublease** provision, repair obligations, delivery of vacant **premises** at expiration of **lease term**). If, at the end of the term, tenant has performed all of its obligations under the lease, landlord will return the **security deposit** to tenant.

At a Glance – Security Deposit

- If the **security deposit** is large, try to negotiate a **burn-down** provision.
- Consider providing a **letter of credit** or investment options in lieu of up-front cash.

Calculating the Security Deposit

Usually, the **security deposit** is calculated as a certain percentage of tenant's **fixed annual rent** and/or based on landlord's financial commitment to tenant improvements or up-front investment to prepare the space for occupancy (commonly known as **build-out**). The **security deposit** is typically expressed as a negotiated amount of months' rent. The **security deposit** correlates with landlord's assessment of tenant as a financial risk. Some factors that landlords typically use to assess risk are: the strength of tenant's balance sheet; tenant's credit history; the presence of a guarantor; and a thorough review of tenant's business financials. If landlord believes tenant poses a higher financial risk, it might require tenant to provide a higher **security deposit** (e.g., up to a full year's rent).

Ensuring the Return of the Full Security Deposit

If tenant complies with the lease for the full **lease term**, landlord will return the **security deposit** in full. However, many events can frustrate tenant's ability to have its **security deposit** returned. For example, ownership of the building could change, landlord could default on the building's mortgage, or the management company could fail to properly account for the money.

Tenants should protect against these events in the lease:

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Potential Landlord Action	Suggested Lease Provision
1. Landlord sells the building.	Upon any transfer of landlord’s interest, the security deposit will be transferred to the new owner/landlord. Tenant will be expressly notified of any transfer of landlord’s interest.
2. Landlord sells the building and fails to give security deposit to new landlord.	Landlord will provide a corresponding rent reduction to compensate for the loss of the security deposit .
3. Landlord fails to return the security deposit to tenant at the end of the lease term .	Except where withheld due to tenant default, landlord will return the security deposit upon tenant’s surrender of the premises at the expiration of the lease term .

Practice Point: To help ensure the return of the full deposit, tenants may require landlord to hold the deposit in an **interest-bearing escrow account** separate from landlord’s general funds.

Reducing the Security Deposit Up-Front and Over the Term

Tenants that are required to provide a **security deposit** larger than four to six months’ rent may negotiate for a **security deposit** reduction provision (called a **burn-down provision**) in the lease. Landlords are often willing to provide this **burn-down** provision in exchange for a larger **security deposit**. This provision provides that, as long as tenant is not in default, the **security deposit** will be reduced and returned to tenant in equal portions throughout an agreed-upon timeframe. For example, if the initial **security deposit** equals 8 months’ rent, at the first anniversary of the lease, the **security deposit** could be reduced to 6 months’ rent. At the second anniversary, the **security deposit** could then be reduced to four months’ rent, and so on. This allows for tenant to recoup some of the initial **security deposit**, provided it complies with the terms of the lease. Landlord will always want some **security deposit** on reserve (2 to 4 months’ rent is typically reasonable) should tenant default on the lease. Suggested language follows:

*So long as tenant is not in material default of the lease, landlord shall return [a negotiated percentage of the **security deposit**] to tenant on each anniversary of the lease **commencement date** until the **security deposit** equals [a negotiated amount].*

Landlords understand that the **security deposit** can be a burdensome financial outlay for new businesses. As a result, landlord may allow its tenants to post a **letter of credit** instead of cash. A **letter of credit** is an agreement delivered by a bank, which pledges its credit to landlord as tenant’s **security deposit**. Typically, banks are willing to issue **letters of credit** to ongoing customers in exchange for an annual fee (usually 1-3%). For example, a **letter of credit** for a \$100,000 **security deposit** that is issued by the bank for an annual fee of 2% would cost tenant \$2,000. **Letters of credit** are particularly useful for small businesses since it preserves cash

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resources. Landlords may also prefer a **letter of credit** because it is outside of the “automatic stay” in a Bankruptcy proceeding. Tenants should compare the required **security deposit** with the annual administrative fee for a **letter of credit** when determining how to cover the **security deposit**.

C. GOOD GUY GUARANTY

Since the recent recession, landlords have been requiring more than a **security deposit** to ensure tenant’s compliance with the lease. In addition to the **security deposit**, many landlords now require a limited guaranty, known as a **Good Guy Guaranty**.

At a Glance – Good Guy Guaranty

- Make sure the **Good Guy Guaranty** terminates when tenant surrenders the **premises**.
- Request that the guarantor be released from all obligations in the event of an **assignment** of the lease and a replacement **Good Guy Guaranty** by the guarantor of the new tenant.

What is a Good Guy Guaranty?

A **Good Guy Guaranty** is a limited guaranty in which the guarantor promises to be a “good guy” and surrender the **premises** to landlord if tenant defaults on the rent. In exchange, the guarantor will be released from any liability for rent or any other obligations under the lease after surrender. Typically, under a **Good Guy Guaranty**, tenant must pay all rent from the date of default to the date tenant surrenders the **premises** and leave the space in “broom clean” condition in order to avoid liability under the guaranty. Suggested language follows:

*Landlord shall not enforce its rights to damages or remedies under this guaranty agreement, so long as (i) tenant has vacated the **premises** and (ii) all rent, due and payable, has been paid through the date tenant surrenders **premises**. The guarantor’s obligation shall not cover any rent that is accelerated as a result of default.*

*In the event of a **sublease** or an **assignment** of the lease with landlord’s consent, the guarantor shall be released provided the **assignee** or **lessee** executes a guaranty agreement in the same form and nature as this guaranty that is reasonably acceptable to landlord.*

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How is the Guarantor Released from Liability Under the Good Guy Guaranty If Tenant Defaults?	
Situation	Tenant defaults on the lease by not paying the rent or failing to fulfill another material obligation under the lease.
Step 1	Tenant notifies landlord and agrees to pay all rent and additional rent due, including all arrears through a certain agreed upon date.
Step 2	At that time, tenant delivers the space vacant and in “broom clean” condition, removes its personal items, clears any liens on the property created by tenant, and delivers the keys back to landlord.
Result	Upon tenant’s surrender of the property, landlord will provide the guarantor with a guaranty release , releasing the guarantor from liability.

Who Provides the **Good Guy Guaranty**?

Most often, the guarantor will be tenant’s principal, major investor or, where applicable, its parent company. Usually, smaller tenants will have the principal of the company provide the **Good Guy Guaranty**. Major investors, however, may also be willing to offer a guaranty in exchange for additional investment opportunities or other special rights.

In contrast to the **Good Guy Guaranty**, some landlords require a **personal guaranty** by tenant’s principal. The difference between a **personal guaranty** and **Good Guy Guaranty**, is that the **personal guaranty** is not limited – the guarantor is fully liable for all amounts due under the lease in the event of tenant default.

D. ELECTRICITY

The cost of electricity usage is passed through to tenant either as a rent inclusion or **additional rent**. Landlords are reasonably concerned with proper use of the building’s electrical system, and often expressly require that tenants not overload it. To ensure it does not overpay and that its electrical needs are met, tenant should clarify in the lease exactly how much electricity it may use and how the cost will be calculated.

At a Glance - Electricity

- Negotiate to have the cost of energy explicitly defined in the lease.
- Sub-metering offers an opportunity for tenant to precisely measure its individual energy use.
- Estimate how much power will be needed for operation *before* negotiating.
- If tenant works nontraditional business hours, try to negotiate for after-hours electricity to be provided at normal, business day rates.

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Electricity Delivery Methods

The chart below describes and compares the most common approaches to electricity delivery:

Method	Description	Benefits	Drawbacks
<i>Direct</i>	Tenant buys electricity directly from the utility company and a meter measures tenant's consumption.	1) There is no markup. 2) Tenants can deal directly with the utility company.	1) Many older buildings do not have the proper wiring to support this method. 2) Utility companies may charge a higher rate to tenant than that offered to landlord since landlords sometimes are entitled to a "bulk" discount rate.
<i>Sub-meter</i>	Landlord buys electricity directly from the utility company and distributes it to its tenants. A sub-meter measures tenant's use, and tenant pays based on its consumption.	Tenant knows exactly how much electricity it is using. This is a good compromise if direct metering is not available.	Tenant will not know the rate charged, so it should ask to be charged the same rate as landlord. Landlords often mark up the cost by as much as 10%.
<i>Rent Inclusion</i>	Tenant pays a fixed charge that is added to the rent (often \$3 psf). The amount is set forth in the lease and may be increased if tenant's use increases.	Tenant knows how much it will pay for electricity—this provides certainty.	1) Landlord has the right to monitor the electricity consumption and adjust for extra usage. 2) Tenant does not have control over the amount paid because it is based on tenant's square footage, not actual use. Therefore, tenant is locked into paying for electricity that may be more than the cost of tenant's actual electricity use.

Sources of Electrical Costs

Uses: Typically, tenants use electricity for lighting and to power its office equipment (e.g., computers, printers, etc.). However, tenants that have a large computer server room, supplemental A/C, use three-dimensional printers or other heavy machinery, may use a large amount of electricity. Landlords want to keep their electricity costs low and generally try to limit their obligation to provide electricity to uses in connection with typical office use (e.g., lighting and normal office equipment.)

Practice Point: Tenants that plan on using more electricity than traditionally needed in an average office should negotiate for a broader use provision in the lease. The use provision should set a minimum amount of electricity that landlord must provide.

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Rent Inclusion Method: If tenant uses the rent inclusion method, landlord may require tenant to make a pro-rata payment for the electricity it uses. This means tenant pays its share of the electrical consumption of the building. This is a reasonable request and if tenant expects to use more electricity, tenant should expect to pay for the extra consumption. Suggested language follows:

Landlord shall provide, at its own expense, all electricity at a capacity of not less than ten watts per rentable square foot.

*Tenant may use electricity provided to the **premises** by landlord as needed in the ordinary course of its business, including lighting, equipment use, supplemental HVAC, etc.*

Servers: The use of servers is an example of extra electrical use. Tenants that wish to operate their own servers should anticipate this extra electrical use during the lease negotiation. Tenants should ask landlord to set aside capacity for the additional electricity needed to power the server, and should provide the estimated cost of that additional electricity. This will eliminate any surprise to tenant about the cost.

Telecommunications, Fiber Optics, and Cable Services: Tenants should confirm whether landlord's telecommunications, fiber optics and cable providers meet their needs before choosing to work with a particular service provider. If tenant chooses to work with landlord's provider, landlords will typically pay the provider directly, thereby eliminating the necessity of negotiating with a third party. Also, since landlord has an existing relationship with the provider, it may be able to secure a better price. If tenant chooses to use its own provider, tenant must ensure the building is wired properly and should consult with landlord and the proposed provider before making such an arrangement.

Practice Point: Tenants should require landlord to provide prior notice before changing service providers. This way, tenant has time to change providers if the new service does not meet its needs.

Quantity of Electricity Delivered and Used

Tenants should calculate their average electricity usage in the course of business so that they are not bound by the amount that may be pre-set under the lease.

Landlord's Proposed Term	Tenant's Recommended Drafting	Effect
Landlord shall provide electricity at landlord's expense at a set capacity no less than [x] watts per rentable square foot.	<i>Landlord shall provide electricity at landlord's expense in an amount that is customarily used by tenant to conduct of its business.</i>	Landlord's provision gives landlord control over how much electricity tenant may use. The recommended drafting lets tenant dictate how much electricity it is permitted to use based on need.

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When Electricity is Provided

If tenant anticipates it will use the space during weekends and holidays, it must negotiate for this use ahead of time. Typically, the lease will include an hourly rate for regular business hours and increased hourly rates for “after hours” service.

Landlords generally reserve the right to discontinue providing electricity to the building. If landlord does so, tenant will still have to pay rent or risk default. To protect against this, tenant could ask for at least 45 days’ notice before landlord shuts off service so tenant can find alternate service. Tenants should also negotiate for landlord to provide electricity service until tenant can make alternate plans, at no extra expense to tenant. Suggested language follows:

*Landlord shall provide at least 45 days’ notice to tenant if landlord decides to discontinue providing electricity services to the **premises**. Landlord shall, at landlord’s sole expense, furnish and install any equipment (including meters) required for tenant to obtain electric current directly from a utility or other supplier. Tenant shall not be required to pay to landlord any charge for electricity usage from the date that tenant obtains electric current from a provider other than landlord.*

E. LANDLORD SERVICES

Landlords traditionally provide a number of services to a building, such as: water; **heating, ventilation, and air conditioning (HVAC)**; cleaning; utilities; and elevator service. There is no exhaustive or standard list of services; each lease will have a specific list of services that landlord will provide. Tenants should review this list of services and understand what services are included and which will cause tenant to incur additional costs. The cost of these services is built into the **base rent** in most instances, but any overtime charges associated with these services are billed to tenant separately. Landlord and tenant must negotiate what services will be provided, the quality of those services, and when the services will be provided.

At a Glance - Landlord Services

- Be specific about **HVAC** needs.
- The cost of ordinary water usage (drinking fountains, pantry and lavatory use) is included in rent. Landlord may install a meter and charge tenant extra for use beyond what is deemed ordinary.
- Ask for water to be delivered to the space for **HVAC** and water chiller systems.

Tenant Access to Premises

The lease should expressly provide that tenant will have access to its space 24 hours a day, 7 days a week. Landlords always provide water, and generally provide elevator service, during normal business hours; however, landlords of smaller buildings may not operate the elevator on weekends or holidays. In order to ensure convenient access to the space, tenants should ask for passenger elevator service 24 hours a day, 7 days a week. For weekends, it is

SECTION 1: COST

reasonable for tenants to ask landlord to provide at least one passenger elevator at all times other than business days. Suggested language follows:

Landlord may change the manner of operation of any of the elevators, but shall not reduce the hours of operation provided herein (unless required by law).

This language will provide flexibility for landlord to operate the elevators as it deems necessary, without denying tenant access to its space. Additionally, tenants may reasonably request free use of freight elevators on regular business days during business hours to ensure prompt receipt of deliveries and freight elevator service upon request at other times.

Practice Point: Tenants should include a definition for “business day” and “business hours” in the Defined Terms section within the lease. Additionally, the lease should include an enumerated list of holidays.

Services

HVAC: Landlords generally provide **HVAC** to the space, but **HVAC** is normally restricted to business days and during business hours. In New York City, heat is normally provided from November 1st to April 15th. Air conditioning is also provided seasonally. Tenants should be as specific about needs as possible in order to ensure that the space is comfortable and that landlord’s attempts to keep costs low do not interfere with business operation. Suggested language follows:

*Landlord shall provide **HVAC** in accordance with tenant’s plans and specifications for the comfortable occupancy of the **premises** during the hours from 8:00 AM to 6:00 PM, Monday through Friday, and from 8:00 AM to 1:00 PM on Saturdays {or other preferred timing}. Comfortable occupancy shall mean temperatures of 70 to 74 degrees F, 50% relative humidity, with fresh air of not less than 0.25 cubic feet per minute for each square foot of usable area in the **premises**, throughout the **premises** on a year-round basis, regardless of outside temperatures.*

To avoid overpaying for **HVAC** during non-business hours, tenants should ask that the charge be pro-rated. Suggested language follows:

***HVAC** supplied to the **premises** at other times (other than business hours) at the request of tenant shall be supplied at tenant’s own expense. The cost of after-hours **HVAC** shall be pro-rated at an hourly rate equal to landlord’s actual cost without profit or markup and in no event more than [X% of total cost of service]. Landlord agrees that the afterhours cost for **HVAC** will be reduced to the extent that any other tenant uses same, with the overall cost to be pro-rated.*

Tenants are generally responsible for **HVAC** distribution within the space. However, tenants can request that landlord operate **HVAC** in conformance with specific design criteria, such as certain architectural or engineering needs. For example, server rooms need to be kept at a certain temperature. Tenant can require landlord to deliver air conditioning to the server room as

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part of its design criteria (which is typically included as an exhibit to the lease). Suggested language follows:

*Landlord shall ensure that its provision of **HVAC** to the **premises** conforms to the design criteria of the system and the normal operation of the system.*

Cleaning: While under no statutory or legal obligation, most landlords will provide cleaning services after business hours, every business day. These cleaning services are typically provided for free and are standard throughout the building; however, it is common for tenants to pay an additional fee when additional services are rendered (e.g., the cost of removing tenant's trash in excess of normal wastebasket refuse and rubbish). Tenants should make sure that the additional amount paid is limited to the difference between normal waste removal and extra waste removal. Suggested language follows:

*Following tenant's receipt of a bill, tenant shall pay to landlord or landlord's cleaning contractor, the cost of removing tenant's refuse and rubbish from the **premises** and the building to the extent it exceeds normal waste basket refuse and rubbish.*

However, if landlord charges for cleaning and trash removal, tenants should negotiate for a *specific charge per month* to be set forth in the lease to prevent uncertainty. Suggested language follows:

Tenant shall pay landlord \$[X] per month for ordinary office trash collection.

Water: Generally, landlords will provide water for ordinary lavatory purposes at no charge. If tenant is using water in excess of ordinary lavatory purposes, landlord may reserve the right to install a meter to measure and charge for tenant's water consumption. Tenants that anticipate excess water usage should request that landlord at least provide water for ordinary uses and purposes. Suggested language follows:

*Landlord shall, at its own cost and expense, provide to the **premises** domestic water for ordinary drinking, pantry and lavatory purposes.*

2. SPACE

After the basic considerations of cost, size and location are met, tenant must also resolve a variety of issues in connection with its rights to use and modify its space. Specifically, this section will discuss: (a) landlord access; (b) **build-out**; (c) alterations; (d) building rules and regulations; and (e) tenant's permitted use of the space.

A. LANDLORD ACCESS TO PREMISES

Landlords will always reserve the right to enter tenant's space in case of an emergency, to monitor and maintain the safety and integrity of the building, to make repairs, to maintain structural components of the building, to ensure the building is safe for all tenants, and to show the space to potential tenants when the **lease term** is about to expire. Landlord will want this right of access in both emergency situations and at other reasonable times. While this is typical, tenants should consider how landlord's access affects the space itself and tenant's privacy and security. Landlord and tenant can balance their competing interests with careful lease drafting.

At a Glance - Landlord Access to Premises

- Require landlord to give notice before entering the **premises**, except in an emergency.
- Safeguard property before landlord begins any construction or repair work.
- Require landlord to be responsible for loss or damage to tenant's property resulting from landlord's access.

Prior Notice

To avoid the element of surprise and to safeguard privacy and property, tenants should require landlords to give notice prior to its entry to tenant's space. This way, tenant will have enough time to prepare for landlord's arrival. By custom, tenants typically only receive oral notice since it is often impractical for landlord to provide written notice. Furthermore, landlords will insist on the right to enter in an emergency without any notice (e.g., to repair a leaking pipe, etc.). This emergency entry is reasonable and customary.

Practice Point: Tenants should negotiate for the right to have its representatives present during landlord's access to the space in a non-emergency.

Restricting the Reason for Entry

There are certain customary reasons that justify landlords' right to enter a space, and tenants should expect to be bound by these rights. In general, landlords will seek the right to access the space for the broadest possible purposes, which may include the maintenance of structural portions of the space, replacement and erection of pipes, ducts, and conduits in the space, or showing the space to prospective tenants. Suggested language follows:

*Landlord shall have the right to enter the **premises** to maintain and repair, with*

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*minimal disruption: (1) the foundation, walls, structural support columns in the **premises**, (2) the plumbing, **HVAC** system, sprinkler, telecommunications risers, or any equipment or infrastructure that passes through or serves the **premises**, and (3) all other necessary repairs except those tenant is required to make.*

To Counterbalance Landlord's Right to Enter:

Repairs

Tenant should require landlord to be responsible for loss or damage to tenant's property resulting from landlord's entry. This helps tenant protect against property loss caused by landlord's work. Suggested language follows:

*Landlord shall be solely responsible for all costs and expenses of such repairs and maintenance. Landlord shall be solely responsible for any loss or damage negligently, recklessly, or intentionally caused by landlord or its agents or employees during such repair and maintenance of the **premises**, including the theft of tenant's property.*

Showing Space

Landlords also need to show the space to prospective tenants when the current tenant's term is about to end. Suggested language follows:

*Should tenant, its agents or employees, not be present or available to permit access to the premises during the 18 month period prior to the expiration of the **lease term**, landlord or its agents may enter using a master key.*

B. BUILD-OUT

Unless the space is being leased "**as-is**" (because it was previously built out and/or tenant does not want to make any modifications), the space must undergo construction. This process is called **build-out**. **Build-outs** can vary in complexity from minor alterations to a major construction project in the case of raw space. Raw space is also referred to as a "shell" or "white box." Although there is no precise legal definition, "shell" typically refers to a concrete slab floor with no walls other than drywall covering the inside of the exterior walls of the space, and no ceiling. It is not ready for tenant to use as an office.

Landlord and tenant must negotiate who will **build-out** the space, the scope and design of the improvements, who will pay, and who will bear other risks. **Build-out** is heavily negotiated and carefully planned. Generally, the terms of the **build-out** are set forth in an exhibit to the lease, referred to as a **work letter**. Work letters generally come in two varieties: 1) tenant or landlord **build-out**, with or without **TI Allowance**; and 2) landlord **build-out** and delivery of a completed space, also known as **turnkey**. **Turnkey** refers to when landlord completes all of the construction and delivers tenant a "key" to the completed space.

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At a Glance - Build Out

- The **work letter** outlines which party will conduct **build-out**, the scope and design of the improvements, which party will bear the cost of construction, and allocates the risks involved.
- Include a schedule of construction deadlines and a move-in date for tenant.
- Ensure that any benefit from **free rent** is not lost as a result of delays.
- Always include an **outside date** so that tenant may terminate the lease if the space is not delivered prior to the **outside date**. This protects tenant from excessive delays caused by landlord's failure to deliver the space.

Landlord Incentives for Tenant Build-Out

When negotiating **build-out**, landlord is concerned with encouraging tenant to lease the space, the costs landlord will incur, and landlord's ability to lease the space after tenant vacates. Depending on the current condition of the space and the strength of the leasing market, landlord may offer incentives to tenant to **build-out** the space. There are two primary incentives:

1. **Tenant Improvement Allowance (TI Allowance):** **TI Allowance** is a negotiated amount, typically calculated as a set dollar amount multiplied by the square footage of the space. With a **TI Allowance**, tenant **builds-out** the space itself but is reimbursed through improvement requests submitted by tenant. Any costs in excess of **TI Allowance** are borne by tenant.
2. **Free Rent or Rent Abatement:** Also called rent concessions, these are periods (usually at the beginning of the **lease term**) where tenant occupies the space without paying rent and taxes.

Build-Out and the Work Letter

Tenant Build-Out and TI Allowance: Some landlords may be willing to allow tenant to perform a **build-out**; however, this is a significant undertaking that landlord often wants to control. Tenants managing **build-out** will require an architect, engineer, and other construction professionals to assist in creating plans and a budget. Tenant also assumes the risk of something going wrong during the **build-out** process. If landlord is willing to let tenant perform the **build-out**, it may also provide **TI Allowance** to help cover some or all of the cost. Landlord recoups **TI Allowance** through rent increases over the term of the lease. If landlord does not provide **TI Allowance**, it may offer tenants other incentives, such as **free rent** for a number of months at the beginning of the **lease term**. Like **TI Allowance**, **free rent** is recouped through increased rent over the **lease term**.

Turnkey Work Letter: In a **turnkey work letter**, landlord pays for and manages **build-out** to make the space move-in ready based on plans mutually agreed upon by landlord and tenant. A **turnkey work letter** is desirable for tenants that do not want to bear the responsibility of **build-out**, and are not seeking a high quality or custom **build-out**. Landlords will generally perform this work as cheaply and quickly as possible, and the completed space will likely be plain and generic. If tenant desires a more personalized look, or requires specific modifications to operate its business, landlord will require tenant to restore the **premises** to its pre-built condition or tenant will need to convince landlord that the plans will not interfere with landlord's ability to rent the space to subsequent tenants.

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Pre-Built Space: Landlord may also offer the space in its “pre-built” or “**as-is**” condition, and perform little to no work for a new tenant. The layout of pre-built space may reflect the needs of the prior tenant, but it will typically suit basic office needs. It may contain several private offices, cubicles, a storage space, and a copy room. Such spaces may be useful for smaller start-up companies looking to move in as soon as possible and to avoid the complexity of managing a construction project.

Negotiating Build-Out and Drafting the Work Letter

Paying Landlord for Build-Out Through Rent: When landlord provides **TI Allowance** or **free rent**, it will recoup these up-front costs from tenant through increases in rent over the **lease term**. Therefore, tenants must ensure they do not end up overpaying landlord. The best way for tenant to do this is to separate rent payments from **build-out** payments. If the two are added together and treated as rent, rent **escalations** will apply to the **build-out** payments as well, unnecessarily increasing tenant’s costs (see Section 1: RENT for more details). The portion of rent used to cover **build-out** will depend on the monthly rent and the cost of **build-out** – there is no standard figure. However, **build-out** costs can range from a few dollars per square foot to well over a hundred dollars per square foot.

What’s in a Work Letter?
1. Current condition of the space and existing services.
2. Tenant’s responsibilities to provide build-out plans for landlord review.
3. Landlord’s responsibilities for performing build-out and pricing for anticipated work.
4. Penalties in case of delay.
5. Condition of the space when delivered to tenant.
6. Tenant’s work allowance, if any.
7. How tenant may apply or spend work allowance.

Timing & Critical Path Schedule: A **work letter** should provide a schedule of how the **build-out** will progress, including the date tenant may take possession, penalties that will be imposed for delay, and remedies available to the party that suffers from the delay. It should also include a **critical path schedule** outlining specific construction deadlines and the anticipated date of **substantial completion**. This schedule lets the parties plan for delays or time consuming tasks. Tenants performing work should ensure that delays out of their control do not trigger a penalty. For example, tenant should negotiate for an automatic extension in the event of delays encountered in obtaining government permits.

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Practice Point: Define **substantial completion** within the lease. For example, **substantial completion** typically means all work is completed except for the punch list and minor unsubstantial items that do not interfere with tenant's use and occupancy of the **premises**.

Tenant's Outside Date: **Work letters** should always include an **outside date**. This is the date at which tenant can terminate the lease without penalty because landlord has failed to complete the **build-out** on schedule. This provides an opportunity for tenant to walk away from the lease in the event of excessive delays in construction.

C. **ALTERATIONS**

Once tenant has moved into the space and started conducting business, it may decide to make additional changes, or alterations, to the space. Depending on its needs, tenant may choose to make minor decorative or **non-structural alterations**, or in some rare cases, major construction improvements. Landlords seek to restrict alterations of any kind, especially if tenant has a shorter **lease term**. If necessary, tenant should anticipate the alterations it will need to make and ensure that the lease does not heavily restrict them.

At a Glance - Alterations

- Anticipate whether the space will require minor decorations, **non-structural alterations**, or major alterations.
- Be aware of which types of alterations require landlord's consent.
- Ensure that the lease requires landlord consent within a reasonable time and prevents landlord from unreasonably withholding consent.

Typical Alterations Provision

A typical alterations provision will require tenant to obtain written consent from landlord for any alteration except for decorative alterations (e.g., paint, wall and floor coverings). However, landlords will generally agree not to unreasonably withhold its consent unless the alteration is substantial, or exceeds a dollar amount agreed to by the parties. Once tenant obtains landlord's consent, tenant will be subject to additional restrictions and obligations such as obtaining government approvals and restrictions on hiring contractors.

Practice Point: Enumerate the **non-structural alterations** that tenant is permitted to make within the body of the lease.

Obligations and Restrictions Commonly Included In Alterations Provisions

1. Tenant may only make **non-structural alterations** that do not interfere with building systems.
2. Tenant is prohibited from making any alteration that affects buildings systems such as plumbing, electricity, sprinkler systems, or telecommunications. The new **build-out** may not harm or affect the structural integrity of the building.
3. Tenant must use contractors approved by landlord and must require them to maintain insurance that is satisfactory to landlord.
4. Tenant must obtain all necessary government approvals prior to performing the work.
5. Any fixture or installation put in the space becomes property of landlord, unless landlord explicitly agrees otherwise.
6. When tenant vacates the space, it must restore the space to the condition it was in before the alteration was made, at tenant's own cost.

Types of Alterations

Minor, Decorative Alterations: Some tenants only wish to make minor alterations like painting the walls and hanging pictures. Often, minor alterations are addressed in a separate section of the lease called “rules and regulations” (more detailed information about this section can be found in Part D. RULES & REGULATIONS). The rules and regulations may prohibit tenant from marking, painting, or drilling into walls without prior written consent from landlord. Tenants should negotiate for the right to make certain minor alterations without landlord consent, or provide that landlord’s consent cannot be unreasonably withheld for specified minor alterations. Suggested language follows:

*Tenant shall make no changes in or to the demised **premises** of any nature without landlord’s prior written consent. However, landlord’s prior written consent is not required for (1) the painting of any walls within the demised **premises**, as long as the color is not black or navy, (2) drilling into the walls when the drilling is for the purpose of installing an item on the wall that weighs less than 50 pounds, (3) any other minor, decorative alteration that does not affect the floor slab or affix anything to the floor slab, and (4) any alteration not requiring permits from any governmental authority, that does not impact the quality of the demised **premises** or impact building systems.*

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*Landlord's consent shall not be unreasonably withheld for **non-structural alterations** within the demised **premises**. Landlord shall respond to any written request by tenant for a **non-structural alteration** within seven (7) business days.*

By prohibiting landlord from “unreasonably withholding consent,” the lease ensures that landlord’s denial of consent is for good cause. Establishing a specific timeframe for when landlord must respond prevents unnecessary delay of tenant’s proposed alterations. In all cases, tenant should be aware of the duty to restore the **premises** to its original condition at the end of the lease, required by most landlords.

Practice Point: Tenants should also be mindful that leases typically obligate tenant to comply with all relevant laws when making alterations, for example the New York City Building Code, the New York City Fire Code, and the Americans with Disabilities Act.

Non-Structural Alterations: Landlords may allow tenants to make **non-structural alterations** without prior approval, as long as the changes do not impact the outside appearance of the building and do not impact building systems (e.g., electricity, **HVAC**, plumbing, etc.). In these circumstances, landlord will typically require tenant to provide plans and specifications once the work is finished. Landlord will then inspect the plans to ensure that the alteration will not adversely impact the building.

What are Structural Alterations?
Alterations are structural if they: <ul style="list-style-type: none">• Are extraordinary in scope and/or expense.• Change the appearance of the building.• Change the space’s purpose or use• Affect a substantial portion of the building.• Impact building systems.

Major, Structural Alterations: In every lease, landlord will prohibit tenant’s ability to make major, **structural alterations** without its prior consent and significant involvement. For example, before proceeding with any alteration, landlord will usually require tenant to submit architectural and engineering plans and specifications for approval. Landlord wants to ensure that:

- 1) the structural integrity of the building is not compromised;
- 2) other tenants in the building are not disturbed by construction;
- 3) the quality of work performed is satisfactory; and
- 4) landlord is able to re-let the space at the end of the term without excessive cost or delay.

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Examples of Major Structural Alterations

1. Installation of a stairway connecting floors of the building within the office suite; and
2. Installation of a server room.

Practice Point: If tenant anticipates it will need to make major **structural alterations**, it should plan for these in the **work letter** and include these alterations in the initial **build-out**. If not, tenant should negotiate for these specific alterations in the lease and provide preliminary designs as an exhibit.

D. RULES & REGULATIONS

In addition to requiring tenants to comply with the lease, landlords also require tenants to abide by the rules and regulations of the building. Rules and regulations, typically a separate section of a lease, are created by landlord to govern things like use of the freight elevator, office hours, pets, and smoking and may be changed as landlord sees fit. These rules are generally reasonable and intended to provide a uniform quality for all building users and occupiers. However, some rules have the potential to interfere with tenant's business. In examining the rules and regulations of the building, tenant should consider whether any rules are unreasonable, discriminatory, or overly restrictive.

At a Glance - Rules & Regulations

- Rules and regulations should be imposed and enforced equally among all tenants.
- Ensure the right to review and approve any new rules.
- New rules should be reasonable and customary for similar buildings.
- Bicycles and animals are often prohibited; tenants should get prior approval.

Ensuring that Rules are Applied Fairly

To ensure that landlord applies the rules and regulations of the building fairly, tenant should include non-discriminatory language in the lease. Suggested language follows:

Tenant shall comply with existing and any future rules and regulations of the building the owner may adopt, so long as these rules and regulations do not materially or adversely affect tenant's rights under this lease or impose any material financial responsibility on tenant. Although landlord is not required to enforce these regulations against all tenants, landlord shall not enforce them upon tenant in a discriminatory way.

Bicycles

Many landlords have strict regulations about bringing bicycles into the space. The New York City Bicycle Access to Office Buildings Law¹ allows tenant to make a written request to landlord at any time during the **lease term** to allow tenant to bring and store bicycles in the building. When tenant makes this request, landlord must then design and implement a Bicycle Access Plan allowing access and storage for bicycles, or request an exemption from the City. Landlord will be granted an exemption if it can show that either (1) the building's freight elevator is not equipped for bicycle use for safety reasons; or (2) free, indoor bicycle parking is available on the **premises** or within three blocks or seven hundred fifty feet of the building (whichever is less). Bicycle access and storage will depend on the building's size and characteristics.

Pets

Most commercial leases prohibit tenants from bringing pets into the space, with exception of service animals (e.g., guide dogs). In the unlikely event that pets are permitted, landlords generally require tenants to use the freight elevator to bring pets in and out of the building.

E. USE OF PREMISES

The use provision of a lease limits how tenant may use and occupy its space. The lease generally lists specific permissible uses of the space (e.g., office use). If tenant violates the use provision, landlord may seek to terminate the lease and obtain money damages.

At a Glance - Use of Premises

- Define use as broadly as possible (e.g., "any lawful use").
- Make sure the lease allows for necessary installations for tenant's business operations.
- Think about the future, including **subleases** and **assignments**. An overly restrictive use provision can make a space hard to market.

Use Should be Flexible to Accommodate Future Plans

The use provision not only affects tenant's use of the space, but also affects tenant's ability to **assign** or **sublease** the space in the future. If the use provision is too narrow, an **assignee** or **subtenant** will have to conform to the use of the original tenant. To ensure the use provision does not conflict with tenant's future business plans, tenant could ask for the lease to allow "any lawful use" or "any lawful *office* use" of the space. This language would protect any use of the space that is not illegal or outside of typical office activities. However, landlords rarely consent to a use provision that broad. Instead, tenants often attempt to broaden the use provision by adding the language "and any uses incidental thereto." Suggested language follows:

¹ N.Y.C. Admin. Code §28-504

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The premises shall be used and occupied for executive, general and administrative office use only, together with all incidental uses related thereto, and for no other purpose.

Tenant should not agree to a use provision that requires it to operate or stay open during certain days or hours. Additionally, the lease should also allow tenant to: 1) enjoy use the building's common facilities, 2) specify how tenant's employees, guests, or customers may use the space, 3) dictate its own minimum operating hours, 4) permit 24 hour, 365 day a year access, and 5) state the standards and costs for such uses.

Practice Point: The use provision will also be limited by the building's Certificate of Occupancy, local building and health codes and applicable zoning laws.

3. LEASE TERM FLEXIBILITY & FUTURE PLANNING

Whether tenant's business grows, contracts, or dissolves, the lease should provide ways for tenant to modify its responsibilities accordingly. In particular, the lease should contain exit strategies tenant may employ to move to a larger or smaller space within the building, to modify the size of its existing space, or to leave the space altogether. Tenants should consider the **sublease**, **assignment** and **lease term** in its "exit strategy." By the same logic, lease renewals and expansion rights are part of tenant's on-site "growth strategy."

A. Assignment & Sublease Provision

The **assignment** and **sublease** provision provides tenant with an exit strategy from the lease by allowing tenant to transfer its rights to the space to a new tenant during the **lease term**. Landlords are understandably wary of tenants they do not know and whose financials they have not verified. Thus, landlords attempt to restrict the right to **assign** and **sublease** in several ways, including:

- Requiring landlord's approval of an **assignment** or **sublease**;
- Expanding the types of transactions that require approval (e.g., **change of control**, stock transfer, merger);
- Giving landlord the right to withhold approval for any reason;
- Securing landlord's right to **recapture** the space if approval is not given; and
- Allowing landlord to profit from any approved transfer.

At a Glance - Assignment & Sublease

- Know the difference between an **assignment** and a **sublease**. Consider both exit strategies.
- Set up a timeline for obtaining landlord's consent and ensure landlord's consent cannot be withheld unreasonably.
- If tenant anticipates an initial public offering during the **lease term**, make sure the definition of **assignment** specifically excludes anticipated business transactions, such as a stock sale, merger or a **change of control** that results from an IPO.
- Avoid provisions that require minimum net worth thresholds for **assignees** or **subtenants**.

Assignment vs. Sublease

There are generally two ways for tenant to transfer its leasehold interest to a third party and be released from some or all of its obligations under the lease. Tenant can: 1) **sublease** the space to a new tenant (**subtenant**) for a period of time shorter than the full **lease term**; or 2) **assign** the entire space to a new tenant (**assignee**). In either case, the original tenant is not released from its obligations under the lease unless landlord specifically releases tenant.

Sublease: In a **sublease** arrangement, the **subtenant** will pay rent to the original tenant under the **sublease**. The original tenant will, in turn, pay the rent due under the original lease to landlord. For example, if a space is \$50 per square foot under the lease and tenant **subleases** the

SECTION 3: LEASE TERM FLEXIBILITY & FUTURE PLANNING

space for \$45 per square foot to a **subtenant**, the original tenant still pays \$50 per square foot to landlord. Because the original tenant still has the primary responsibility to pay under the lease, it must ensure that the **subtenant** abides by all of the provisions and rules and regulations under the lease.

Assignment: In an **assignment** arrangement, the **assignee** will pay rent directly to landlord. This relieves some pressure from the current tenant, as the **assignee** becomes primarily responsible for all of the obligations under the original lease. However, landlord can still sue the current tenant for any unpaid rent under the lease unless tenant is released.

Practice Point: Tenants should consider both **assignment** and **sublease** as part of their exit strategy under the lease and negotiate for reasonable flexibility in either method.

Scenarios Where Sublease Is Preferable:	Scenarios Where Assignment Is Preferable:
<ul style="list-style-type: none"> • Tenant is a seasonal business. • Tenant wants to suspend its business for a short time and eventually return to the space. • Tenant’s parent company wants to sublease its space to an affiliate or subsidiary. • Tenant wants to reduce its rent and does not need the whole space, <i>and wants the option to expand later on.</i> 	<ul style="list-style-type: none"> • Tenant does not want to return to the space. • Tenant no longer wants to do the administrative work that comes with leasing space. • Tenant wants to reduce its rent and does not need the whole space, <i>and does not need an option to expand later on.</i>

Landlord’s Response to Tenant’s Proposal: When tenant proposes an **assignment** or **sublease** to landlord, landlord can respond in three primary ways:

- 1) Cancel the lease;
- 2) Approve the **sublease** or **assignment** proposed by tenant; or
- 3) Refuse to approve the **assignment** or **sublease** and maintain the lease for the rest of the term in its current form.

How to Obtain Landlord’s Consent

Leases usually require that tenant obtain landlord’s consent for any proposed **assignment** or **sublease**. As often drafted, this consent can be withheld for any reason whatsoever, whether reasonable or not, and can be given at any time, in any way. As a new business, tenant’s financial plan may be uncertain. For example, tenant may have 10 employees one month and 50 the next. Or, tenant may want to sell the majority of its stock to a new investor on short notice. Therefore, allowing landlord to have such broad authority to refuse a transfer of the lease (without reason or warning), can impair tenant’s ability to plan for such changes. To prevent this, tenants should negotiate for specific, detailed procedures for obtaining landlord’s consent.

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Suggested Procedures for Obtaining Landlord's Consent

1. Tenant's proposal for an **assignment** or **sublease** should be provided to landlord in writing at least 30 days before the proposed transfer.
2. Tenant's proposal should include:
 - a. Financial information about the assignee or subtenant;
 - b. Proposed terms of sublease or assignment;
 - c. Any other reasonable information requested by landlord.
3. Ask landlord to give notice of consent or refusal within ten (10) days of receiving tenant's proposal.

This method can be used for either **subleases** or **assignments**. Tenant should insist that landlord's consent be provided *prior* to a **sublease** or **assignment** agreement.

Ensure Landlord is "Reasonable" in Withholding Consent: In most commercial leases, landlords can typically refuse consent for any reason whatsoever, unless the lease expressly requires that their refusal be "reasonable." It is in tenant's best interest to provide a list of reasons for which landlord could *reasonably* refuse consent. This will at least force a larger discussion between the parties about the types of new tenants landlord might approve. Suggested language follows:

*Landlord may reasonably refuse consent where it reasonably determines that tenant's proposed **assignment** or **sublease** of the space is burdensome, involves a **subtenant** or **assignee** that cannot meet the financial obligations under the lease, or the nature of the proposed use of the **premises** might disturb other tenants in the building.*

The Form of Landlord's Consent: Tenants should always require that landlord's consent be made in writing.

Practice Point: Tenants should read landlord's consent carefully. Some landlords may try to change the terms of tenant's proposed **assignment** or **sublease** by including modified terms along with its consent.

Prohibitions on Parties Becoming Assignees or Subtenants: Some leases restrict to whom tenant can transfer the lease by listing prohibited new tenants. These restrictions protect landlord from having to lease to unwanted tenants (like those with whom landlord is engaged in litigation) and tenants with whom landlord might negotiate a higher price (like current or prospective building tenants).

Practice Point: Tenant may be able to reduce these restrictions by offering landlord an option to profit from the transfer. For example, tenant may agree to share the profits from increased rents under the **sublease** with landlord.

How Assignment Can Interfere with Business Transactions

Definition of Assignment: Depending on how **assignment** is defined within the lease, common business transactions like stock sales, mergers, leveraged buyouts, and other transactions resulting in a **change of control** of tenant may be treated as an **assignment**. Definitions of **assignment** that include all of these scenarios without limit can interfere with tenant's business plans. For example, if a new investor purchases a significant amount of stock in tenant's company, but less than a majority. Under a lease where **assignment** is defined as "the transfer of the majority of interest or stock of tenant entity," the transfer to the new investor will not require landlord's consent. However, under a lease that defines an **assignment** as "any **change of control** of tenant," the transfer will require consent.

Ideally, the lease should allow tenant to enter into the following transactions without landlord's consent: stock transfers (including initial public offerings), recapitalizations, mergers, dissolution, and transfers to a "related entity" (entities that control or are controlled by tenant).

Practice Point: If tenant plans to eventually go public, it might also want to make specific exceptions for a **change of control** that results from an initial public offering, or excludes publicly traded companies.

Assignments to Successors & Net Worth: Leases often allow landlord to refuse consent to a proposed transfer to a company that takes over tenant's business (tenant's **successor** entity) if its net worth is not equal to or greater than that of the current tenant on the date of the transfer (no matter how positive the projections are for tenant's future growth). This can prevent tenant from engaging in certain business transactions, like leveraged buyouts.

Tenant should try to remove the net worth provision from the lease entirely. If landlord is reluctant to remove it, tenant might try offering to pay a higher **security deposit**. At the very least, tenant should try to limit consent of the net worth requirement to **successor** entities that are *unrelated* to the original tenant (e.g., do *not* have the same personnel, name, and business purpose as the original tenant). Suggested language follows:

*Tenant may **sublease** the **premises** to any entity that, at the time of making such **sublease**, is an **affiliate** of tenant without landlord's consent. Tenant may **assign** the lease to any entity that, at the time of making such **assignment**, comprises substantially all of the same personnel and has the same business purpose as the original tenant, without landlord's consent. Landlord's consent to an **assignment** to an *unrelated* entity will not be unreasonably withheld, provided that the net worth of the **assignee** is at least equal to that of tenant on the date of signing this lease.*

Practice Point: In the example above, it is important to define the term "**affiliate**" within the lease in order to clarify to whom tenant may **sublease** without obtaining landlord's consent. (See additional discussion below under "Exceptions for **Successors** and **Affiliates**.")

Assignment, Subleasing, & Profit Sharing: The lease may also provide ways for landlord to profit from an approved **assignment** or **sublease**. Landlord can do this by requiring that tenant pay landlord any excess rent it receives from a transfer. Often, the lease will provide for a 50/50 split on

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any net profits resulting from the **assignment** or **sublease**.

Landlord's Ability to Take Back the Space

A lease will almost always allow landlord to **recapture** (or take back) the space if tenant proposes an **assignment** or **sublease** that landlord does not want to approve. If landlord **recaptures**, tenant must leave the space immediately and pay any remaining rent. Because **recapture** rights are landlord's strongest position in controlling the lease, it is unlikely that tenant will be able to remove it from the lease entirely.

Notice Periods: Tenant can ask landlord to give advance notice of its intent to **recapture** the space so that tenant has enough time to find new space. For example, the lease could provide that landlord must decide whether to exercise its **recapture** rights within 10 or 20 days of the proposed transfer. If landlord decides not to **recapture** the space, tenant should have at least 6 months to negotiate the **assignment** or **sublease**. If landlord decides to cancel the lease, then tenant should have several months to find new space.

Exceptions for Successors and Affiliates: Tenants should negotiate for a right to **assign** or **sublease** to **affiliates** or related companies *without* triggering landlord's right of **recapture**. Suggested language follows:

*Tenant's option to **assign** its rights under the lease to an **affiliate** or related **successor** entity shall not be deemed an offer from tenant to landlord in the manner set forth in Section [provision allowing **recapture**]. In the event that tenant effectuates any of the aforementioned transfers, landlord may not exercise an option to terminate the lease or force an **assignment** or **sublease** to it or its **affiliate** or designee.*

Tenant's Right to Withdraw: Tenants can also negotiate for a right to withdraw a proposed **assignment** or **sublease** if landlord elects to **recapture** the space. For example:

*If landlord chooses to terminate the lease, tenant may withdraw tenant's offer notice within fifteen (15) days of receiving landlord's notice to terminate. Withdrawal of tenant's offer notice will result in a return to the original status of the lease whereby tenant will be entitled to remain in the **premises** for the remainder of the term.*

B. Lease Term & Renewal Options

For a small to medium-sized business, committing to a long **lease term** can be a risky endeavor. Many commercial **lease terms** are for 7 to 10 years and it is often difficult for growth-stage businesses to plan that far in the future.

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At a Glance - Lease Term & Renewal Options

- Negotiate for a shorter initial term with renewal options.
- Consider complexity and timing of **build-out** when adjusting the **commencement date** of the **lease term**.
- Determine the most favorable way to calculate the renewal rent.

Lease Term

The **lease term** defines the period during which the lease is in effect. On average, landlords ask for terms ranging from 7 to 10 years. It is often difficult to find a shorter **lease term** in New York City because many landlords perceive greater risk with shorter terms. As a result, some landlords may offer shorter terms only in exchange for a higher **security deposit** or other financial concessions by tenant.

Start & End Dates of the Term: Precise start and end dates are not always possible, and there are a variety of reasons why tenant may prefer a flexible start date, called the **commencement date**. For example, tenant may want flexibility if the space has to undergo extensive **build-out** or renovations. Landlords and tenants will often agree to use the completion of **build-out** as the effective **commencement date** or provide optional extensions if the **commencement date** is delayed (see Section 2, B. **BUILD-OUT** for more details).

Potential Reasons for a Delayed Commencement Date
<ul style="list-style-type: none">• Lag time in gaining government approvals required for build-out.• Build-out construction is not complete.• A prior tenant refuses to move out of the space (e.g., a holdover tenant).

Tenants should protect themselves from any potential delays of the **commencement date** in the lease. Although landlords have an enormous incentive to ensure that the lease starts on time, delays may be caused by forces outside of landlord's control. As such, landlords often insist on wide latitude in setting and modifying the **commencement date**. Therefore, tenants should specifically negotiate for the right to terminate. Suggested language follows:

*The **commencement date** shall begin on the [month][day],[year], unless landlord or landlord's agent shall not have **substantially completed** work on the **premises** or obtained all legal documents necessary for occupation by tenant. Landlord or landlord's agent shall be given until [month][day],[year] (the "**outside date**") to **substantially complete** work and turn over possession of the **premises** to tenant. If for any reason landlord has not **substantially completed** the work by the **outside date**, then for a period of ten (10) business days after the **outside date**, tenant shall have the unilateral right to terminate this lease by written notice to landlord.*

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Renewal Options

Landlords generally prefer a longer **lease term** without fixed renewal options. However, it is often in tenant’s best interest to enter into the shortest **lease term** that landlord will agree to, while simultaneously retaining the right to extend the **lease term** in relatively short increments. Under this model, at the end of each renewal term, tenant will have the option to renew or walk away from the lease entirely.

Elements of a Typical Renewal Term		
TYPE	PURPOSE	NEGOTIATION & DRAFTING POINTS
<i>Length & Number of Renewal Terms</i>	Defines the length of each term and the number of renewal terms that tenant may take advantage of under the lease.	Tenant should think about the longest amount of time it hopes to be in the space and divide the renewals accordingly. Each renewal period is a set number of years.
<i>Notice</i>	Provides whether, how, and when tenant must give landlord notice that it will be exercising a renewal option.	Tenants may have to notify landlord several months in advance. The lease will specify either: 1) that the lease automatically renews without notice from tenant; or 2) that the lease will expire <i>unless</i> tenant gives notice that it wants to renew. Suggested language follows: <i>The option shall be exercised by written notice given to landlord not less than [ordinal number] [days/months] prior to the expiration of each lease term. If tenant does not give notice in the manner provided above, this renewal option shall expire.</i>
<i>Rent</i>	Calculates the amount of rent that will be charged to tenant under each renewal term.	There are generally three methods to negotiate the new rent: 1) Predetermined in the lease; 2) Percentage of fair rental value (FRV) at the beginning of each term; or 3) Increased/decreased by a pre-selected index of inflation. Method 1) may be favorable to tenant if landlord agrees to a below-market rate. If it is higher than market rate, tenant may be able to renegotiate an amount that conforms to the market rate when tenant renews. Methods 2) and 3) may also be favorable because they balance extreme increases in the market rate and allow tenant to benefit from any decreases in the market rate.

Calculating the **FRV** of the Renewal Rent: If the **FRV** method is used to calculate the renewal rent, it should be clearly defined in the lease. Landlords will often require that the parties engage in either **baseball arbitration** or the **three appraisal technique** to settle any disputes between the parties about the rent calculation. Suggested language follows:

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Provided that tenant is not in default of this lease, tenant shall have [ordinal number] option(s) to renew the lease for an additional term of [ordinal number] [year(s)/month(s)/day(s)] beginning at the expiration of the initial lease term. All of the terms and conditions of the lease shall apply during the renewal term except that the annual rent shall be [the sum of \$_____][calculated according to the attached Rent Schedule].

Baseball Arbitration vs. Three Appraisal Technique	
Baseball Arbitration	This method requires that both landlord and tenant engage a neutral third party to calculate a renewal rent amount. The arbitrator (third party neutral) must choose one of the two proposed numbers. Because the arbitrator must choose one of the proposed amounts, the parties are motivated to pick a fair, realistic number.
Three Appraisal Technique	Landlord and tenant mutually select three different appraisers to evaluate the market value of the renewal. Once the appraisals have been made, the lease will set the renewal rent as the average of the three appraisal values.

Early Termination Rights: **Early termination rights** give tenant the ability to cancel the lease early with written notice to landlord. Typically, tenant must give 6 to 12 months’ notice of cancellation. However, it is very rare for landlord to agree to an **early termination right** because of its obligations to the bank holding the building’s mortgage. If tenant succeeds in obtaining an early termination option, it will likely have to give additional concessions, such as paying landlord for its **build-out** costs, other fees and expenses.

TENANT'S TEAM OF PROFESSIONALS

Tenant's Team of Professionals

Entering into a commercial lease is complicated. As a result, tenant often has to hire many different types of professionals during the leasing process. Some of the following professionals tenant will be working with for the first time, while others tenant may already have a professional relationship with, or already have on its staff.

Attorney – A real estate attorney experienced in commercial leasing will assist in negotiating lease provisions. An attorney can advise on leasing strategies that consider the leasing tenant's current needs as well as its future business plans. Additionally, the attorney will review the lease and explain the implications of various provisions as well as the obligations of both landlord and tenant under the lease.

Broker (Tenant Representative) – A licensed real estate broker will guide tenant through the leasing process. Tenant's broker will assist tenant in finding a space suitable to tenant's needs and negotiate the business terms of the lease with landlord. Additionally, the broker should be knowledgeable about the various government incentives available to qualifying leases and buildings, including: tax breaks; financing programs (e.g., grants, bonds); and utility and energy benefits. Tenant should hire its own broker and should not rely on landlord's broker when negotiating the lease provisions. It is customary for landlord to pay the broker commission. Still, tenants should clearly define the scope of its relationship with a broker in writing and be careful not to enter into an agreement without fully understanding the terms of the representation, exclusivity, and fees involved.

Engineer/Architect/Contractor – When tenant **builds out** its space, it will need to consult with a combination of engineers, architects and contractors. These professionals will help design a **build-out** plan to suit tenant's needs, comply with applicable building codes, and fit tenant's budget and timeframe.

Information Technology Consultant – An IT expert will assess the capabilities and capacity of a building's server and make recommendations as to whether the configuration meets tenant's needs.

Insurance Agent – An insurance agent will assess tenant's potential liabilities and any indemnification requirements under the lease to determine its insurance needs. The agent will also help tenant compare coverage under various policies, and procure the policy that will best suit tenant's needs.

Banker – In instances where landlord requires a **letter of credit** in lieu of a traditional **security deposit**, the bank will issue that **letter of credit** on behalf of tenant based on considerations such as tenant's financial statements, tax returns, credit history, cash flow, and business projections.

Accountant – An accountant will consult with tenant about determining a leasing budget. Additionally, an accountant can advise about tax considerations and whether certain leases qualify for various tax incentive programs.

Documents Tenant Should Expect to Negotiate

The following is a list of documents that tenants can expect to negotiate during the leasing process.

1. **Letter of Intent (LOI) or Term Sheet** – Prior to lease execution, landlords and tenants will often draft a non-binding letter of intent to memorialize the parties' intention to execute a lease agreement for the space. The LOI sets forth the proposed essential lease terms (e.g., the parties, **lease term, base rent**, etc.) and may also include additional key terms (e.g., exit strategies, renewal options, etc.) if either party requires a specific term or condition.
2. **Lease** – Tenants should expect to negotiate the terms of its office lease with the assistance of its broker/tenant representative and attorney.
3. **Rider** – Typically used with a form office lease, a lease rider will set forth an additional set of terms and conditions to supplement the **form lease**. New York City landlords will often use the Standard Form of Office Lease published by the Real Estate Board of New York (REBNY) along with multiple lengthy lease riders containing additional terms and conditions. The REBNY form and riders need to be read together in order to fully understand the lease obligations.
4. **Work Letter** – Usually attached as an exhibit to the lease, a **work letter** provides the design and layout specifications of **build-out**, and allocates the cost, construction and liability responsibilities between the parties.

GLOSSARY

GLOSSARY

1. □ **Additional Rent:** Any amounts under a lease that become due in addition to the **base rent** (i.e. operating expense increases and real estate tax **escalations**).
2. □ **Affiliate:** A business entity that effectively controls or is controlled by another, or is associated with other entities under a common ownership structure. For example, a parent company and its subsidiary are **affiliates**.
3. □ **As-Is:** A term used to describe the state of landlord's delivery of **premises**, and tenant's acceptance of the same **premises**, in its present, unaltered, or improved condition.
4. □ **Assignment:** The conveyance of the entire leased **premises**, including all rights and obligations, from the primary tenant (**assignor**) to a third-party (**assignee**) for the remainder of the **lease term**.
5. □ **Assignor and Assignee:** In a lease **assignment** from the primary tenant to a second tenant, the primary tenant is referred to as the "**assignor**" while the second tenant is referred to as the "**assignee**."
6. □ **Baseball Arbitration:** Method of resolving a dispute in calculating the **fair rental value** of rent for a renewal term. Requires that both landlord and the tenant engage with a neutral third party. Each party then calculates a proposed renewal rent amount and presents it to the arbitrator, who *must* choose one of the two proposed numbers. In theory, since the arbitrator must choose one of the proposed amounts, the parties should be motivated to pick a fair, realistic number.
7. □ **Base Rent:** The minimum fixed, periodic rent due to landlord under the terms of a lease agreement. Tenant is also required to pay **additional rent** based on a specific percentage of tenant's interest in the leased space.
8. □ **Base Year:** The twelve month period upon which a direct operating expense or real estate tax **escalation** is based. The **base year** will typically be the twelve month period preceding the commencement of the **lease term**. Any cost over and above the **base year** will be passed on to tenant on a pro rata basis.
9. □ **Build-Out:** Pre-occupancy improvements to the **premises**, completed by either tenant or landlord, and documented within a **work letter**.
10. □ **Burn-Down:** A provision that provides for the **security deposit** to be reduced in increments over a certain period of years during the **lease term** as long as tenant satisfies all lease requirements.
11. □ **Change of Control:** An event that occurs when the controlling interest in a company changes hands from one person or entity to another resulting in the creation of a **successor**.

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Depending on the language within the lease, a **change in control** may be deemed an **assignment**.

12. **Commencement Date:** The date on which the **lease term** begins. This date is often the day that tenant takes possession of the leased space, usually upon **substantial completion of build-out**.
13. **Consumer Price Index (CPI):** A measurement of economic inflation in relation to the change in the price of a fixed market bundle of goods and services purchased by a population during a "base" period of time. This measurement can be used by landlord to increase **base rent escalations**, protecting his rental stream against inflation.
14. **Critical Path Schedule:** A plan within the **work letter** outlining **build-out** progression, including expected dates of work completion by all professionals performing work on the space. It should include the amount of time each job is supposed to take, as well as an **outside date**.
15. **Early Termination Rights:** Allow tenant to terminate the lease prior to the previously agreed date subject to landlord's approval.
16. **Escalations:** Increases in rent above the **base year** that are typically expressed in a predetermined list of inclusions. **Escalations** are contingent upon external increases in cost to landlord who then transfers the cost to tenant. Tenant pays for a proportional share of increases.
17. **Fair Rental Value (FRV):** A subjective estimate of what a reasonable purchaser would be willing to pay a reasonable seller for a given office space. Typically, a broker will help tenant calculate the **fair rental value** of various offices based on market conditions.
18. **Fixed Annual Rent:** The amount stated in the lease agreement, which remains constant over the **lease term**. Generally, the **fixed annual rent** will be located on the first page of a lease.
19. **Free Rent:** A period during which tenant does not have to pay rent during **build-out**, typically offered as an incentive to tenant to lease the space.
20. **Good Guy Guaranty (GGG):** An agreement whereby a guarantor promises to satisfy tenant's debts and perform tenant's obligations under the lease in the event of tenant default. This guaranty is limited, and provides that the guarantor will be released from its obligations when tenant vacates the space and pays any rent due from the date of the default to the date that tenant surrenders the **premises**. Typically, the guarantor will be tenant's principal or parent company.
21. **Gross Rent:** Tenant's rent based on landlord's quoted price, before taking into account **loss factor, build-out**, and rent concessions. **Gross rent** is usually expressed as a dollar amount per square foot.

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- 22. Gross Up:** A **gross up** provision allows landlord to overstate the **operating expenses** as if the building were fully (or close to fully) occupied. By applying the **gross up**, tenants are required to pay a higher percentage of the expenses. Although this may seem unfair to tenant, it can actually protect tenant from an artificially low **base year** if, for example, the building is still under construction when tenant signs the lease.
- 23. Guaranty Release:** Lease provision that discharges the personal guarantor(s) from the obligations of the guaranty agreement. However, the corporate entity remains “on the hook” for the remainder of the lease term unless otherwise provided by the lease. In a **Good Guy Guaranty**, the guarantor is released if the space is surrendered in “broom clean” condition and all rents are paid from the date of default up to the date of surrender.
- 24. Holdover:** A term used to describe a prior tenant who continues to occupy the **premises** after their **lease term** has ended. A **holdover** tenant can interfere with the ability of a future tenant to move into the **premises** on time.
- 25. Heating, Ventilation and Air Conditioning (HVAC) Systems:** Controls the ambient environment (temperature, humidity, air flow, and air filtering) of a building and must be planned for and operated along with other data center components such as computing hardware, cabling, data storage, fire protection, physical security systems, and power.
- 26. Interest-Bearing Escrow Account:** A designated bank account established at a bank, or financial institution, designed to accrue interest over a certain period of time. This account may be used by landlord to hold tenant’s **security deposit** if specified within the lease.
- 27. Landlord’s Form/Form Lease:** A **form lease** often used as a starting point for lease negotiations. **Form leases** maybe publicly available (i.e.: the **form lease** published by the Real Estate Board of New York, referred to as REBNY) or drafted by landlord himself. Typically, **form leases** are not considered “tenant friendly” and often contain provisions beneficial to landlord.
- 28. Lease Term:** The designated period of time in which landlord grants to tenant the right to possession and use of the **premises**.
- 29. Letter of Credit:** A pledge by a bank or other financial institution that it will honor demands for payment upon full compliance with the conditions specified in the **letter of credit** under the Lease Agreement. Letters of credit are typically used in place of a cash **security deposit** given to landlord in satisfying the **security deposit** clause of a Lease Agreement.
- 30. Loss Factor:** The percentage difference between the rentable and usable areas of a building. “Loss” space includes elevators, stairwells, lobbies, corridors, janitorial rooms, electrical closets, etc. A space’s **loss factor** is calculated as the rentable area less the usable area divided by the rentable area.
- 31. Net Effective Rent:** Tenant’s rent, after taking into account **loss factor**, **build-out**, and rent concessions. **Net effective rent** is usually expressed as a dollar amount per square foot.

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- 32. Non-structural Alterations:** Modifications made to a space that do not affect the physical integrity or any structural elements of a building. **Non-structural alterations** often do not require landlord's consent; however, this will depend on the terms of the lease.
- 33. Operating Expenses (OpEx):** The expenses of maintaining a property (e.g., property taxes, utilities, and insurance); it typically does not include depreciation or the cost of mortgage financing or income taxes.
- 34. Outside Date:** The date at which tenant can terminate the lease as a result of landlord's failure to complete **build out**. The **outside date** is typically included in the **work letter**.
- 35. Personal Guaranty:** The unconditional obligation of a promisor, or guarantor, to answer in case of the failure to pay some debt. If the guarantor is unable to assume the debt monetarily, personal assets or property are relinquished to the creditor.
- 36. Porter's Wage Escalation (PWE):** A formula used to calculate the rate of escalation in **operating expenses** based on the increase in the Porter's Union wages each year.
- 37. Premises:** Specifically identified real property that is to be leased by tenant from landlord.
- 38. Recapture:** Landlord's right to take back possession of the space. A **recapture** right can be triggered by tenant's proposal to **sublease** or **assign** the space.
- 39. Reenter:** Reentry occurs when one party moves into or enters a space at the end of a **lease term**. Landlords **reenter** when the term is over and landlord begins to show the space to new prospective tenants. Tenants can also **reenter** the space at the end of a term of a **sublease**.
- 40. Rent Abatement:** A proportionate reduction in tenant's rent in the event of casualty to the space (e.g., fire, flood, etc.) or some other interference with tenant's use of the space. Note: **free rent** is a type of rent abatement.
- 41. Rentable Space:** The space for which rent can be charged, typically expressed in square footage. This amount usually includes the entire office floor, less the area of vertical shafts (such as elevators, stairwells, and mechanical shafts).
- 42. Security Deposit:** A deposit of cash or a non-cash alternative (**letter of credit**) from tenant to landlord to secure performance of a lease throughout the **lease term**.
- 43. Structural Alterations:** Building modifications that affect a vital and substantial portion of the **premises**. **Structural alterations** may include modifications made to the building's framework or any changes affecting the mechanical, water, electrical, **HVAC**, or underlying structural systems of the building.

GLOSSARY

- 44. Sublease:** A grant of interest in the leased **premises** to a **subtenant** for a term that is less than the primary tenant's lease. The primary tenant retains a reversionary interest in the lease.
- 45. Substantial Completion:** The stage in construction at which the **premises** is considered move-in ready for tenant. The lease and construction agreements should carefully define **substantial completion** to avoid misunderstandings.
- 46. Subtenant/Undertenant:** One who leases all or a portion of the **premises** from the primary tenant.
- 47. Successor:** A person or entity that takes over the role of another after a business transfer or merger. **Successors** can be a related or parent company, or an entirely new entity.
- 48. Three Appraisal Technique:** An alternative method for calculating the **fair rental value** of a renewal rent amount. Landlord and tenant mutually select three different appraisers to evaluate the market value of the renewal. Once the appraisals have been made, the lease will set the renewal rent as the *average* of the three appraisal values.
- 49. Tenant Improvement Allowance (TI Allowance):** Cash reimbursement provided by landlord to tenant for tenant's **build-out** or improvement of a space. **TI Allowance** is generally paid in dollars per square foot. Landlord recoups **TI Allowance** through rent collected over the **lease term**.
- 50. Turnkey:** Refers to a space that is ready for immediate use. Typically, landlord will complete all of the construction and assumes all of the expenses for tenant's initial improvements. In theory, all tenant needs to do is "turn the key" to the **premises** to begin occupancy.
- 51. Work Letter:** A memorandum usually attached as a lease exhibit or letter that explains, in detail, the design and layout of the **premises** and the responsibilities each party undertakes for the construction. The **work letter** should lay out the plans, specifications, and other details of the construction to prevent future discrepancies.

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