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Proven Strategies to Reduce Occupancy Costs and Risks in Commercial Leases

March, 2013

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Occupancy costs under a commercial lease are typically the second largest expense for any business owner after employee wages and benefits.

Rent reduction in a lease can only be accomplished by negotiating favorable terms with a landlord before the lease is signed, which is when a tenant has maximum leverage. The most important decision a tenant can make towards achieving positive results in the lease negotiation process is the informed choice to retain the services of an experienced, licensed commercial real estate broker. This one decision will have the greatest impact in reducing your rent and improving the overall business terms of your lease. Brokers are accustomed to negotiating lease provisions that can save you money and enhance the value of your lease. Also, the landlord's leasing agent knows that he can't fool a seasoned broker about what is a good deal for the tenant.

A major component of a tenant’s rental obligation in most commercial leases is the monthly payment of common area maintenance charges, real estate taxes and insurance expenses, usually referred to collectively as “CAM Charges.”

CAM Charges are added to your rent each month by the landlord. Basically, the landlord requires the tenant to defray the landlord's expenses in operating the building you occupy by assessing the tenant a pro rata cost per square foot for the CAM Charges. There are three primary factors that will reduce the increase in CAM Charges over the term of your lease. The most important factor is stating in the lease those operating expenses that the landlord cannot charge you. Inappropriate charges by landlords include above market property management fees, landlord's attorney's fees, real estate commissions, income taxes, above market payments to landlord's affiliates and the making of capital improvements to the building such as structural repairs, new HVAC units (and chillers), roof replacements and parking lot resurfacing.

Secondly, it is critical to retain the right in the lease to perform an annual audit of the landlord's accounting records used to calculate the CAM Charges. Having this right to "audit" the landlord's books helps keep the landlord honest and reduces the likelihood of inappropriate CAM Charges by the landlord. It is also a good strategy to add a provision in the lease stating that if your audit uncovers charges prohibited by the lease in excess of a stated percentage of the accurate amount of CAM Charges, such as 5%, the landlord must pay the audit fees you paid to your accountant.

Third, most landlords will agree to a cap in the amount of the annual increase in controllable CAM Charges, which are generally defined as all operating expenses except taxes, insurance and utilities. A cap for controllable operating expenses in the range of 5-8% per year is usually acceptable. This essential provision gives you predictability in controlling the annual increase in your CAM Charges.

Managing the down side risk for any commercial tenant is a fundamental part of protecting the business.

In a free market economy, businesses often suffer and occasionally fail. The following risk factors should be seriously considered while negotiating your lease:

1. Demand the right in the lease to assign or sublet your space to a financially responsible tenant or subtenant. Most landlords will not initially offer you this right, and when they do, they will want to include major restrictions. Avoid any restrictions other than the requirement that you bring to the building a tenant or subtenant in reasonably sound financial condition similar to the other tenants in the building. If a tenant agrees to too many restrictions, the landlord can refuse to accept your proposed tenant or subtenant without a good reason.

2. Require that the landlord deliver you a "subordination, non-disturbance and attornment agreement" ("SNDA"). The SNDA is an agreement between the tenant, the landlord and the landlord's mortgage company. Under Texas law, when a landlord gets foreclosed upon, any leases with tenants that were signed after the landlord secured its mortgage financing (usually when it bought the building) are legally terminated, unless (a) the tenant has an executed SNDA, or (b) the mortgage company subordinated its mortgage to your lease (i.e., made your lease superior to the mortgage). We know from our experience in the recent recession that landlords sometimes end up

in foreclosure. In the event of a foreclosure, the SNDA forces the mortgage company to recognize your lease and to honor its business terms, especially the amount of your rent. Without a SNDA, you put the mortgage company or the purchaser at the foreclosure sale in the powerful position of deciding whether or not you should remain a tenant in the building and at what rental rate. Although the odds are against a foreclosure occurring, the failure to address this issue can be disastrous.

3. Lastly never agree in your lease to allow the landlord to get a lien upon your business and computer records. Under Texas law, if you default on your lease, the landlord has an automatic lien upon all of your personal property in the leased premises, which includes records. If you are forced to relocate your business before the lease term expires, you will be in default of the lease. Tenants can replace furniture and equipment, but business and computer records are irreplaceable. You should draft your lease to exclude these items from the landlord's lien and this can eliminate major headaches.

4. If the landlord requires that you provide a personal guaranty of the tenant's obligations under the lease, many landlords will allow you to limit the amount of the guaranty to the amount of the landlord's total costs in providing a tenant improvement allowance and paying the real estate commissions. This amount should be reduced each month as it is amortized over the term of the lease. Negotiating a limited amount of liability under a personal guaranty limits your personal financial exposure under the lease.

The above ideas provide you some major strategies that will reduce your occupancy costs and manage important risks.