

## In the Spotlight

### Lease Commencement: Getting the Ball Rolling

By Jack Garson

Sometimes the hardest part of a leasing relationship is getting started — establishing if there will be contingencies, when they will expire, when the space will be delivered, and when the rent will commence. Often the transition is smooth, and everything falls into place. In other situations, however, coordinating the requirements, obligations, and schedules of both landlord and tenant feels like an in-air refueling of a jetfighter.

#### LANDING A NEW TENANT

Consider this realistic scenario: A national restaurant chain wants to lease premises in a shopping center. Another tenant currently occupies these particular premises. The existing tenant is required to vacate by a certain date, but there is no guarantee that the existing tenant will vacate promptly because there may be delays in delivery of its own new premises elsewhere.

Adding to the pressure, our national restaurant is on a tight schedule, not only because it wants to capture a particular shopping season, but also because it is publicly

traded and has promised Wall Street a certain number of store openings before its fiscal year ends. Further complicating matters, the footprint of the premises is unique and the restaurant must make major modifications to its standard store layout. To top it off, the restaurant does not want to start its own buildout until it has obtained a liquor license for the premises and, of course, the landlord will only wait “so long” before the restaurant starts paying rent.



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So how do we meet both parties' needs and reach a satisfactory deal for both landlord and tenant? First, we need to understand each party's requirements fully, the tasks each party faces, and the potential impediments to those tasks. Only then can we propose solutions to close the deal.

#### REASONABLE TENANT EXPECTATIONS

For this restaurant tenant, there is a long list of requirements and obligations. The tenant needs

construction drawings prepared and approved within its organization and then approved by the landlord and applicable governmental officials. The tenant also requires a building permit and a liquor license from the local liquor board. In some jurisdictions, the liquor board will not even consider an application without a signed lease in place. The tenant also requires that the landlord perform certain improvements to the premises and that the landlord deliver the premises by a certain deadline. Due to the tenant's preoccupation with other seasonal activities, the tenant also has “blackout” periods during which the tenant will not accept delivery of the premises from the landlord.

#### LANDLORDS EXPECT PAYMENT

The landlord's requirements and obligations are less complicated, but no less important. First, the landlord does not want to be penalized for the landlord's late delivery of the premises. To deliver the premises to the new tenant, the landlord must recover possession of the premises from the existing tenant. Second, the landlord must perform certain required improvements to the premises. These tasks are in the landlord's control to varying degrees. In the former instance, the existing tenant may holdover. In the latter instance, the landlord's efforts may be frustrated

by difficulty obtaining necessary building permits, inspections, or approvals or by difficulty obtaining materials or services from third parties. Third, the landlord wants the tenant to start paying rent within a fixed time period. The landlord has bought the shopping center in recent years at a relatively high price and to meet its debt service, the landlord cannot afford a significant gap between the rent from the departing tenant and the rent from the new restaurant tenant.

With this understanding of both parties' expectations, we can craft compromises that overcome negotiating impasses. Of course, the parties' relative bargaining power will affect these compromises.

### **LANDLORD INDEMNIFICATION**

Consider the landlord's desire to expedite the rent commencement date. The parties can eliminate a significant amount of delay by overlapping the lease negotiation process and the preparation of the tenant's construction drawings. The tenant may be reluctant to invest in preparing construction drawings until the lease has been negotiated and executed. If the tenant is in the better bargaining position and the rent is substantial, the landlord might consider entering

into a reimbursement agreement to encourage the tenant to begin the plans while the lease is still being negotiated. The landlord's reimbursement agreement is set forth in what is commonly referred to as an "indemnification letter," which provides for the landlord's payment for the plans if the parties do not execute a lease by a certain date. This agreement will usually cap the landlord's reimbursement obligation at some fixed dollar amount. In consideration of this agreement, the landlord does not merely encourage the tenant to begin preparing the plans earlier, but the tenant also agrees to begin making rent payments earlier. These compromises are also routinely shaped by the degree to which some task or goal is within the control of a party to the lease. For example, more time should be allotted to procure a governmental approval as opposed to an internal approval by a party. One might agree to allow 90 days for obtaining a building permit and even longer for a liquor license, but allow a much shorter time period for approval of construction plans by a party to the lease. In complicated situations where the task is beyond the control of either party, the solutions are likewise more complicated. Consider the landlord's task of recovering possession of the premises from the existing tenant.

The new tenant may desire a fixed date for delivery of the premises, after which the landlord would be in breach of the lease and exposed to the risk of paying damages to the tenant. Understandably, the landlord is leery of taking on the risk of ensuring that the existing tenant will timely vacate the premises.

### **CONSIDER COMPROMISES**

The parties can compromise by requiring the landlord to provide the existing tenant with the appropriate notices to vacate and by agreeing to sue to evict the existing tenant in the event it holds over in the premises. Further, the parties can agree to give the new tenant a right to terminate the lease if the landlord has not recovered possession of the premises by a certain date. The parties might even require the landlord to reimburse the new tenant for certain costs in the event of such a lease termination. With such an agreement, the landlord can provide the tenant with considerable comfort — comfort that the landlord will act aggressively and that the tenant's losses due to delay will be minimized — without exposing the landlord to the risk of extreme losses, such as the tenant's lost profits, for a failure to deliver the premises that the landlord cannot fully control.



These types of compromises, in fact, have become the hallmark of contemporary commercial leasing. Increasingly sophisticated landlords and tenants sit down at the negotiating table with a bevy of advisers and complicated agendas and attempt to enter into a deal. The deal only survives with creativity and compromise.

It goes without saying that in lease negotiations, the landlord desires the tenant and the tenant wants the space. But what happens when the tenant must have the space by a certain date? Even if the space is vacant, the landlord usually must perform certain improvements to the premises. As noted above, permits, long-lead items, and a variety of other situations could delay the landlord. While the tenant seeks a guaranteed delivery date, the landlord refuses to expose itself to unlimited damages for failure to meet this deadline. Without a compromise, the deal is dead.

### RENT ABATEMENT

Yet, a reasonable compromise is readily attainable. First, the landlord must establish a realistic delivery date that fits within the tenant's expectations. If the landlord fails to deliver the premises by this date, the landlord will be required to abate the tenant's rent. This abatement is not merely a waiver of the rent that would accrue during the period of delay. Rather, this abatement extends beyond the actual delayed delivery date. The landlord may, for example, agree to provide one additional day of rent abatement, commencing on the date of actual delivery, for the first 30 days the landlord is late in delivering the premises, and two days of rent abatement for every day of delay

thereafter. If the landlord is more than 90 days late, the tenant will have the right to terminate the lease and, in such event, the landlord must reimburse the tenant for all of the costs that the tenant has incurred in connection with the lease, capped at some fixed amount. This compromise provides considerable protection for the tenant without exposing the landlord to enormous risk.

In our example, the landlord must also understand and address the hurdles the tenant faces in opening for business. In addition to the preparation and approval of construction plans addressed above, the tenant must procure a liquor license and construct its own improvements to the premises. The liquor license is often the more problematic of these two tasks. The parties must decide when the tenant is required to apply for the license and the consequences of delay in obtaining or failure to obtain the license. Where the landlord has superior bargaining power,

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the landlord will shift the risk of obtaining the liquor license to the tenant, require the tenant to research

the matter, and confirm that the tenant will be able to obtain the license. In this situation, the lease is not contingent upon obtaining the license, and the tenant is bound to the lease regardless of whether the tenant obtains the license.

### BARGAINING POWER

Where the tenant has more bargaining power, however, the parties must enter into a complicated provision that allocates the risk of failure to obtain the liquor license. In such a provision, the parties will require the tenant to apply for the license as soon as permitted. The landlord will, of course, be required to cooperate. The tenant must use "best efforts" or "commercially reasonable efforts" to obtain the license. The tenant has a fixed time period in which to obtain the license and if the license is not obtained within such time period, then the tenant is permitted to terminate the lease. If the license is integral to the tenant's operations, then either party can terminate the lease. Again, depending on the bargaining power of the parties, one party may be required to reimburse the other party for costs incurred in this process, and the tenant might be required to pay the landlord for some or all of the rent the landlord lost during this time period.

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