

# **EIGHT THINGS IN A LEASE THAT MATTER**

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## **EIGHT THINGS IN A LEASE THAT MATTER**

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### **1. Introduction**

This article will provide a summary and brief analysis of eight of the most important issues in commercial leases, from the perspective of the tenant. The goal is to describe what you need to know in analyzing and negotiating commercial leases, including key issues to address, what issues matter, and what issues don't. Understanding and prioritizing these issues will allow you to properly manage your team to ensure the best possible outcome.

One key advantage a potential commercial tenant has over other potential tenants is an abundance of alternatives. In leasing, like in life, options translate to bargaining power. Unlike retail leasing where location is often the driving factor in a lease, an office tenant who wants to lease 20,000 square feet of office space in the central business district of a major city usually has many more options. On the other hand, a retail tenant who wants to be on a corner tract at a very busy (or soon to be very busy) intersection or an industrial tenant who needs to be next to a customer or vendor can have as few as one. The multitude of options can and should be used by a prospective office tenant to its benefit by increasing the prospective tenant's bargaining power, and resulting in a better deal.

So, let's take a look at some of the key issues in office leases.

### **2. Executive Summary: What Matters Most.**

What should tenants care the most about with respect to their office leases? Here is a summary of some of the issues to consider:

- a.** Rent (a number, yes, but multiplied by what?) and operating expenses (base year, expense stop, gross up, inclusions, exclusions, etc.).
- b.** Tenant finish allowance and base building improvements (what's already there, what do you have to add, will there be enough money?).
- c.** Renewal and preferential rights (can you stay, can you grow?).
- d.** Assignment and subletting rights.
- e.** Alterations (right to make, obligation to remove, etc.).
- f.** Landlord's services (are you comfortable, what should you pay extra for, and how much?).

- g. Subordination and non-disturbance issues (don't get kicked out.).
- h. Indemnities (even if you are an insurance company, you're not your landlord's insurance company).

### **3. Rent and Operating Expenses.**

“Like most things it comes down to money.” South Filthy, *Sandra Lynn's Blues*.

Monthly rent, often called “base rent,” is only one component included in the total cost of leasing space, but it's the one everybody always talks about. You will often hear people tossing around and discussing rates, expressed in a dollar amount, and based on “square footage.” This is problematic, since often people are quoting and comparing numbers based on different definitions of square footage, thereby inadvertently comparing apples and oranges. When you hear someone compare a \$26 rate to a \$30 rate, it's tempting to assume the \$26 rate is cheaper. That's not always the case, however, since the rate is only a part of the equation. That rate is multiplied by something else to arrive at the actual payment amount. Generally, that “something else” is square footage, such that  $[\text{Rate}] \times [\text{Square Footage}] = \text{Base Rent}$ .

Practice Pointer: The equation set forth above results in, and rates are generally discussed as, the annual cost. For example, when someone says the rate is \$26 per square foot, that is the annual cost. Accordingly, the formula to determine the monthly rental payment would be  $([\text{Rate}] \times [\text{Square Footage}]) \div 12$ .

The biggest problem prospective tenants face when attempting to compare potential lease deals arises as a result of the multitude of ways one can calculate square footage. Always ask the appropriate team member to explore, understand and summarize this very important but sometimes overlooked other half of the equation. For example, is the square footage of a proposed lease based on the usable amount of square footage (e.g., the space you actually occupy and can use)? Or is it based on the “rentable area,” which includes not only the space you occupy and use, but an additional allocation of certain areas and other space that are not for the exclusive and effective use of the tenant (such as such as lobbies, hallways, stairwells, elevators and restrooms)?

Practice Pointer: In office leases, the leasing cost is often calculated based on rentable area, which includes areas that are not usable. This means that for the same amount of usable space, a building with a lower add-on factor will cost the tenant less than a building with a higher add-on factor. The add-on factor is important because the tenant pays rent on this unusable space (typically a fraction of shared common areas and all of the space within the leased premises occupied by structural components, etc.). The tenant should always consider the add-on factor when comparing leases.

Or-and this is very common-is the definition of square footage used in a proposed lease some combination of the two? Do not assume that all quoted rental rates are comparable. Do the calculations and comparisons necessary to ensure that you are comparing apples to apples.

Practice Pointer: While there are some, more or less, uniform standards of measurement, most notably the BOMA standard, always read the lease to ensure that the calculation set forth in

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"Eight Things That Matter in a Lease"