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## **SPECIAL CONSIDERATIONS IN INDUSTRIAL LEASING**

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## **SPECIAL CONSIDERATIONS IN INDUSTRIAL LEASING<sup>1</sup>**

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How many times has a client told you: “Send me a lease form”? The client thinks that all leases are the same – an off-the-shelf lease form should be good for all commercial lease transactions, right? Wrong.

Many areas of concern are common to all lease situations, but identifying the type of property, use, and rent will tell the lawyer which of the basic types the lease falls into – most commonly retail, office, industrial, or ground. The lawyer will then be able to consider the concerns and provisions unique and common to that type of lease and to prepare a starting point that the lawyer and the client can then flesh out with the details of the transaction to produce the final document. While all types of leases have a lot in common, there are particular considerations that differentiate among lease forms used for these various types of lease.

The difference between an industrial lease and a generic lease can vary greatly depending on the particular industrial tenant. Even a single company, especially a large company with various product lines, may have various types of industrial leases. For example, in the oil and gas services industry we deal with leases of well bores for testing and training, explosives and radiation storage bunkers, laboratories, chemical storage and blending facilities, rail siding sites, warehouses, dock leases, offshore base leases, drilling fluid plant leases, manufacturing sites, and larger sites containing any number of these individual components. In addition to the use of the facility, industrial leases also vary greatly in what is being leased. Most commonly we think of an industrial lease as a lease of a free-standing, single-tenant building and associated exterior storage areas; however, industrial leases may also cover one or more bays in a multi-tenant building, an unenclosed storage yard, or some particular industrial object such as the test wells, chemical blending equipment, and explosive or radiation storage bunkers as noted above. In short, an industrial lease is whatever the particular industrial tenant needs it to be. While this paper may refer to specialized types of industrial leases from time to time, the focus will be on matters common to the majority of industrial leases and how these matters should be customized for the particular industrial tenant. Similarly the emphasis will be on leases of free-standing buildings, but additional comments will be given regarding other types of industrial leases where needed.

The following is a list of typical lease terms and how their treatment in industrial leases varies from a more general purpose form of lease:

A. **TERM** – As with many industrial lease terms, this can vary depending on the particular circumstances. The tenant will want to consider the cost of tenant

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<sup>1</sup> This paper is based upon a paper the author previously presented to the American Bar Association Real Property Trust and Estate Law Section at the 2015 Spring Symposia on April 30, 2015, in Washington, D.C.

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improvements and amortization, the cost to relocate operations to a new facility and the impact of a relocation on the tenant's business in determining the initial lease term. Typically, however, industrial leases tend to have longer terms coupled with the ability to renew, often in a range of 5 to 10 years, but sometimes even longer – especially when there are significant improvements that must be amortized over a long period of time or where relocation would cause a major disruption in the tenant's supply chain.

On the other hand, if the industry is cyclical, the tenant may wish to include termination options or use only 1-to-3-year terms. Of course, this will often result in a balancing act as to whether the benefit of the short term or termination right offsets any increase in rent and termination penalties imposed by the landlord. Some large companies with numerous leased sites find that the increase in cost for all leases outweighs the benefit for the relatively few leases that might be terminated. Another factor to be considered is the likelihood of subletting. If the property is in an area served by numerous diverse industries, it will be much easier for the user to find a subtenant than if the area is dominated by a particular cyclical industry. As we all know here in Texas, when there is an oil bust there is no shortage of sublease space on the market and few if any interested subtenants.

B. LOCATION – In addition to generic location factors such as accessibility and distance to customers and workers, an industrial user may need to ensure access to a rail spur or dock. An industrial user must consider not only what utilities are available at the site, but also the quantity and quality of those utilities. For example, modern high-tech machining requires a very consistent electrical supply or delicate machinery may go off-line due to a power surge or drop – often creating a large amount of very expensive scrap metal. Similarly, a large manufacturing plant needs to be near enough to electrical or gas power to provide the volume of power necessary to operate the plant. If the property is part of an industrial park, the lease should grant the tenant access to all shared amenities such as driveways, roads, and parking areas.

C. OPERATING EXPENSES, REPAIRS & MAINTENANCE – Nearly all industrial leases are some form of triple net arrangement. The tenant pays the cost of property taxes, property insurance, and its own liability insurance. Often the tenant will reimburse the landlord for the cost of the landlord's liability insurance, though this is more commonly built into the rent. Virtually all single tenant leases require the tenant to put all utilities in its own name. Leases in an industrial park or in a multi-tenant industrial building may cover some or all of these costs in common area charges or sub-metering and may include reimbursement of off-site operating expenses for the industrial park. A standard industrial lease requires the tenant to perform all repairs other than repairs to the roof, foundation and structure of the building. More aggressive tenants may attempt to have the landlord repair and/or replace major building systems such as HVAC systems, parking areas and driveways and underground plumbing, but such clauses are the exception, rather than the rule. Finally, day-to-day maintenance and cleaning are virtually always the tenant's responsibility.

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