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The Commercial Leasing Process

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Introduction

Commercial leasing markets are variously described as a “landlord market” or a “tenant market” as the strength of the relevant economy ebbs and flows. Leasing decisions are certainly affected as the amount of available space and the choices available to the parties will vary in a particular economic environment. But the process itself remains largely constant. Whoever — landlord or tenant — happens to have the upper hand at the time, both parties must still consider and resolve a panoply of issues. The landlord/tenant relationship is multifaceted and long-term; the leasing process itself complex and arduous.

The Process

To understand the landlord/tenant relationship, one must begin by recognizing a few basic principles:

1. The landlord knows its building; the tenant does not.
2. The landlord is in the leasing business; it negotiates leases every day. Only tenants with the largest businesses and far-flung empires will have ongoing leasing experience and separate facilities personnel and, even for these tenants, a headquarters move is extraordinary. For most tenants, a major leasing transaction is something handled at most once in a decade (or perhaps even less frequently). The tenant’s “point person” may well be someone whose only contact with the leasing world is his or her residential lease (signed, never read).
3. The landlord’s team members have likely been working together on this building (and possibly others) for some time; the tenant may well be working with a newly assembled team of advisors with whom it is not familiar and who may not know each other.
4. The landlord controls the leasing process; its team prepares the marketing material, the lease form and lease drafts.
5. The tenant’s cash outlay at the beginning of a relocation can be extraordinary. Take, for example, a lease of 100,000 square feet (five floors in a typical Manhattan office building). This may seem a great deal of space but, at a fairly modest allocation of 600 square feet per person, and without allowing for auditoria, dining rooms, a library or research area and the like, this would only accommodate 167 professional staff. (As explained later, the square-foot per person measurement includes areas of common usage, such as elevators and bathrooms, to which no staff is assigned.) At a gross rental of fifty dollars per square foot and a build-out cost of seventy-five dollars per square foot, the cash outlay in the first year would be at least twelve and a half million dollars (ignoring “free rent” periods but also not taking into account professional fees, moving costs and other miscellaneous expenses).

This is not to characterize the landlord as Goliath to the tenant’s David, whatever the market. It is simply that the landlord begins with certain advantages. These advantages, coupled with the heavy costs to the

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tenant, mandate that the tenant approach the transaction with appropriate preparation and solid advice. This may sound obvious, but it is often absent. It is not that unusual to find a tenant well into its space search without a clear sense of its needs. Is there a required move date? If so, can the prospective landlord meet it? What operations are to be moved? More importantly, do the people in charge of those operations agree? Will a consolidation reduce ancillary space needs? What is the projected growth? When new space is examined, can the existing build-out of the new space be salvaged? Can equipment and furniture in the existing space be reused?

In some instances, the answers are elusive. In more instances, the right questions have simply not been asked. It is imperative that the tenant select its advisors early enough to be certain that the right questions are posed in time. It is also imperative that the tenant allocate the time and personnel to address these questions and to understand and analyze the answers. The core of the tenant's team will be an architect/interior designer, a real estate broker or consultant, and legal counsel. Others — engineers, contractors and/or construction representatives — will be added as the project takes shape. These advisors should assist the tenant in identifying present and future needs and ensuring that the space selected best accommodates these needs.

A note of caution, however. The team should not become unwieldy or uncompromising. As with any organization, the team can fall prey to the tendency to justify its own existence and to lose sight of the overall objective -- making a favorable but rational transaction in the context of a long-term relationship, recognizing that not every tenant can strike the "best" deal in the marketplace. As landlords were reminded in the early '90s, no market lasts longer than the memory of a party to an overly aggressive lease deal.

Comparing Proposals

Once the team has been assembled, the tenant may be asked to compare a number of proposals full of unfamiliar jargon. (A glossary of some of the most commonly used terms is attached as Schedule A.) Here the tenant is not unlike the supermarket shopper — forced to compare products in glossy but confusing packages (the "giant size" with three ounces free against the "economy size" for one-third less...two full floors, each 10,000 "rentable" square feet, with an eighteen percent "loss factor" versus 18,000 usable square feet, representing a portion of one floor...). Each building is physically different, and, of equal importance, each landlord will have its own response to the tenant's requirements. Although the leasing process from the tenant's perspective will, in part, focus on obtaining comparable responses from various landlords, the landlords are not selling a standardized product. Rather they are each seeking to distinguish their buildings, emphasizing those aspects of the tenant's needs that they can best accommodate.

Throughout, the tenant must keep its eye squarely on the ball. What does the tenant need and where can its needs be met most efficiently and economically? This is not simply a matter of finding a common basis for comparison of fixed rent per square foot. A significant relocation can affect the tenant's bottom line in myriad ways. Will the company employees be comfortable with the new commute? Is the tenant staking its future on a landlord's vague promise that the neighborhood is "coming around"? Will the promised twenty-four-hour security materialize? What if Company X relocates to the new waterfront project and its competitors stay behind in the center city, renegotiating their existing leases? Where is the tenant's own customer base located and, if relevant, will its customers stay where they are? How "smart" are these new buildings? How important are expansions or renewal rights, building identity, ceiling heights, views, or emergency generator capacity?

The foregoing only briefly illustrates the need for thorough and ongoing communication within the tenant team. Tenant's counsel, for instance, must find a way to translate the landlord's "puff" into something tangible, but must also make its client cognizant of the realities of the legal system. Not every "right" has an effective legal remedy.

The architects, space planners and other team members also must reconcile dreams with reality. Can the building really accommodate the tenant's high-tech needs? Is there sufficient core depth to accommodate support services efficiently? Will the acoustics in the performance space be as promised, or will they be affected by the proximity of the building's freight elevator and the odd space configuration? Will an experimental lab — even if it is a "small one" — be permitted in a midtown office tower? Can the landlord or the financial advisors really assure medium-term costs, or will the budget be destroyed by the cost of removing asbestos from the five-year expansion space, or by complying with the Americans with Disabilities Act, or by an increase in real estate taxes when the landlord sells the building or even restructures its ownership interests?

Negotiating the Lease

In the ideal world, the business deal would first be struck and the economic protections agreed to and then the lease terms would be set down by the scribe. To state the obvious, the reality is much different. Almost without exception, the commercial office lease in the United States is a complex document bringing together numerous disciplines in an attempt to govern what can be a twenty- or thirty-year, or even longer-term, relationship. The landlord plays a variety of roles to the tenant's role as consumer: landlord, seller, de facto partner, contractor, creditor, debtor, public utility, insurer, broker and maybe others. The lease document attempts to interweave these various relationships and serves, therefore, as part lease, part sales contract, part credit agreement, part construction contract, part

service supply contract and so forth. Moreover, the lease form that is used will rarely be varied. As the issues are the same (though perhaps of less consequence), the tenant for a relatively small space and short term will find itself reading the same voluminous lease document.

The relationship between landlord and tenant is further impacted by the nature of the United States legal system. Non-U.S.-based clients are often astonished by the differences between the civil code systems with which they are familiar and the workings of the American common law system. The common law system establishes general principles by which legal relationships are governed. Yet, much (significantly more than in civil code jurisdictions) is left to agreement of the parties. (Even where statutes have been enacted to address various contingencies, they can most often, absent some strong public policy consideration, be overridden by contractual agreement.) And American lawyers, especially those in large metropolitan areas, attempt to establish these agreements by written contract — often in great detail and covering even the most remote of circumstances. Each judicial decision or previously unforeseen occurrence gives rise to a new lease clause.

As if all of this were not daunting enough, the lease negotiation process can itself contribute to the complexity of the task. Issues are rarely tabled and settled in an apparently logical, or even chronological, fashion. Seemingly diverse issues can have significant economic consequences, and ostensibly non-economic issues can rise to an equivalent level. Basic economic terms are often left open until late in the negotiation process and settled as a package. A tenant may be willing to pay a bit more for "non-recourse" protection or broader termination rights. Significant additional issues can arise late in the game, as the tenant refines its space or design requirements or simply learns more about the building. And market forces may intervene. A tenant rumored to be "in play" will present the landlord with a very different risk profile. Or landlords or

tenants may find themselves competing against one another for the same transactions.

Significant Lease Issues

With this background, it should be apparent that a primer on leasing would extend into several volumes and might be outdated by the time it was produced. However, it is possible to review briefly some of the most significant and current issues. Of these issues, those that require explanation are addressed in the following text. With most of these issues, there is no right answer or single approach. Thus, this article often raises these issues in the form of questions that the tenant and its advisors should be addressing. Other issues that do not require explanation are noted in Schedule B, which is a checklist of basic lease considerations. The text follows the order of Schedule B.

I. Premises

As noted earlier, little progress can be made in a space search until the tenant's basic requirements have been identified and refined. This process (called "programming") is intended to ascertain the tenant's current and prospective operational needs in a manner which is translatable into both space and service requirements. For example, food service for the tenant's staff is not only a space issue but, if cafeteria or dining services are required, will involve technical issues such as venting of kitchen equipment, "wet storage" of refuse, fire safety and public assembly code compliance, and access (elevating and stacking) issues. Once the tenant's programming is sufficiently complete, the tenant's representative can begin to compare various proposals, perhaps including the tenant's existing premises if a lease renegotiation is possible.

This comparison should proceed on a "usable square footage" basis. Landlords will typically market space on a "rentable basis," allocating various common areas (elevators, stairways, lobbies and the like) among the available premises. By adjusting these allocations, the

landlord can moderate apparent increases in face rents while maximizing overall return. Landlords generally look for a certain economic return from their vacant space on the basis of the floor or floors involved as opposed to the particular square footage. In addition to the economic differential between "usable" and "rentable" measurements, premises will vary in their design efficiency; an irregular shape or the presence of building equipment on the floor (such as on-floor cooling units) can reduce the "usable" square footage; window to core depths can affect layout and thus space requirements. A common and rational basis for comparison is, therefore, critical. For example, in our own leasing program we have compared premises based upon the rentable square footage per lawyer's desk.

But square footage is by no means the only relevant consideration in identifying the best available premises. As noted earlier, the tenant's advisors must confirm that the space is suitable for the tenant's intended use on a variety of other fronts, including legality of intended use, physical limitations, delivery date, layout efficiency, and availability of required services and amenities.

The examination should also take into consideration the tenant's future needs. The tenant's growth projections are, of course, quite fallible. Indeed, it is sometimes said that the only certainty is that growth will be other than as projected. However, the tenant's team must consider whether future plans for growth, consolidation or even attrition are consistent with available options to expand or contract the premises.

Here, as in so many instances, the negotiation process will have to reconcile the tension between the landlord's and the tenant's desire for the utmost flexibility. The landlord will want the tenant's firm commitment for additional space with as little obligation on its own part as possible. The tenant, in turn, will seek to characterize every decision as an "option." An agreement with a tenant to "take" additional space (the so-called "must-take" obligation) on, let us say, the fifth anniversary of the lease commencement assures the landlord of a tenant for

the space on a date certain or within some fairly narrow range. The landlord now knows that it need market the space for the interim period only. An “option” on the part of the tenant means that the landlord cannot currently lease the space for more than the interim period, but may find itself seeking another tenant five years hence (and the rental for two shorter periods may well not equal that for a single longer period). Substantial tenants may negotiate various “takes” and “options”, and may also seek some limited control over additional space. If, as indicated earlier, the tenant’s growth projections turn out to have been too conservative, it may be in the market for additional space sooner than expected. While the landlord may resist giving the tenant additional options, it may agree to notify the tenant of the availability of additional space on a “first offer” or “first refusal” basis that would necessitate prompt decision by the tenant whether to lease the available space. Here, from the landlord’s perspective, the “first offer” is less restrictive than the “first refusal”. The landlord can approach its existing tenant before marketing the space rather than after substantial negotiations with outside parties.

The rental on expansion space can be agreed currently, with the attendant market risks to both parties, or left to future agreement on a “fair market rental value” basis. An existing and substantial tenant may argue for a discount off the fair market rental value, claiming that the landlord’s savings in “down-time” and perhaps marketing costs yield a greater net rental to the landlord. For the tenant, the time of agreement on the rental value is critical. In the case of “option” space, can it convince the landlord to permit it to delay its decision whether or not to lease the space until the rent is determined? This approach may or may not be successful in a given negotiation. At the minimum, however, it necessitates an earlier determination of rental value than may be prudent. In order for the landlord to have sufficient time to remarket the space if the tenant opts not to lease it, the rental value may have to be determined as much as eighteen months in advance. Significant changes in the interim could render the “fair market rental value”

significantly unfair to one party or the other. An adjustment to the agreed fair market rental value to reflect interim market swings is possible but, at best, imprecise.

II. Parties; Credit Considerations

Lease negotiations proceed, as noted earlier, in an apparently haphazard fashion. Questions yield answers but also more questions. It is not sufficient simply to identify the parties to a transaction; the particulars must be addressed. The ownership structure of a landlord is often quite complex, with tiers of partnership investors none of whom can be reached directly in the event of a tenant claim. In addition, most leases limit the liability of the landlord to its interest in the building (which usually has a mortgage lien with first priority against it). Absent more, the tenant may be left only with a claim against the landlord’s interest in the leased premises. With this claim coming behind significant secured financing, there may be little real value for the tenant to attach. Thus the need for the tenant and its advisors to consider the landlord’s creditworthiness if the landlord has promised to advance a significant buildout allowance now or five years into the future upon expansion. Can the tenant be assured the funds will be available? To achieve sufficient comfort on the credit issues, letters of credit, guarantees and rent offsets are among the alternatives that may have to be explored. Moreover, the landlord’s first mortgagee may be willing to assume some obligations, especially as to initial lease costs, to assist in securing a major tenancy.

Additional complexities may arise in a new development. Municipalities often use development rights as a bargaining chip to improve infrastructure and housing. Developers may agree to complete subway improvements or low-income housing in return for additional development rights. The unwary tenant may find itself held hostage to a dispute between the developer and the municipality over broken promises even if the leased premises are apparently complete and ready for occupancy.

Lastly, the tenant should be interested in the probable stability of ownership. Is the current landlord a long-term owner or not? For example, a building owned by a so-called “vulture” or “opportunity” fund is more likely to be resold in the foreseeable future than a building owned by an institutional investor. Also, a building acquired by a foreclosing bank lender will not necessarily be resold within the time periods prescribed by applicable law.

III. Term

Beyond the obvious need to settle on the duration of the tenancy, the landlord and tenant will need to address a number of related issues. Will there be circumstances, for instance, in which the tenant will be able to cancel its lease in whole or in part prior to the end of the term? Such a right would, of course, be attractive to a tenant but may be very difficult for a landlord to grant.

Perhaps less obvious is the subsidiary issue of when the lease term commences. Clearly, the tenant will not want its rental obligations to commence at least until it has possession of the premises and, ideally, not until the premises are in sufficient shape to commence operations. But what of its other obligations? If the lease term commences currently, a tenant in a building under construction may find itself responsible for insurance and other obligations, and perhaps liable for accidents at the premises, long before it gains any meaningful access to the premises. On the other hand, if the parties agree that the term will only commence upon the happening of certain conditions in the future (such as completion of base building construction), what is the nature of the tenant’s interest? For example, if the landlord goes bankrupt before the lease term commences or before the tenant takes possession, the lease may be rejected (terminated) in the bankruptcy proceeding and the tenant lose its right to possession of the premises.

In addition, the tenant will normally desire lease renewal or extension rights. The same issues discussed above in respect of expansion options apply, especially as to timing and determination of rent.

IV. Base Rent

We discussed earlier the need for a tenant to be able to compare lease proposals on some rational basis. What is the base or fixed rent on a usable square footage basis? What is the free rent period (and the scope for free rent; i.e., does it include operating and tax expense escalations—see Section V below) at lease commencement and upon the exercise of expansion and renewal options?

Beyond this, the tenant should understand the components of its rental obligation. We will discuss escalations in Section V below. As discussed more fully in that Section, the base rental may be on a “net rental” or “gross rental” basis. The former means that a tenant will be paying its pro rata portion of all operating expenses and real estate taxes in addition to the net rental. With a gross rental, a portion of the stated fixed rent includes a base charge for operating expenses and real estate taxes (typically the expenses and taxes at or about lease commencement, though in many instances simply an arbitrary figure), and the tenant will be paying its pro rata share of increases in such costs over the base charge.

Various other charges may be characterized as part of base rental. Electricity and cleaning are common examples. In some areas, such as New York City, this characterization may lead to the tenant paying a rent or occupancy tax on this amount even though it is more in the nature of a separate payment for services or a product. More generally, a tenant should be wary whenever separate components are included in a base rental calculation. Simply put, inclusion of more components will make it more difficult for the tenant to verify costs and to ensure that no intermediary (i.e., the landlord or its affiliate) will be making a profit on services or products purchased from a third party. The object is, in effect, to eliminate the middleman.

Take, for example, electricity costs. A direct meter approach, where the tenant purchases electricity directly from the public utility and consumption is measured by a separate meter, will provide the best means of cost

protection. Yet, direct metering may not be available for all tenants, especially in older buildings, without expensive alterations to the building electrical system, and the rate available to the tenant will likely be higher than that charged to a landlord as bulk user. One alternative is submetering, where the landlord purchases electricity from the utility at a given rate and monitors usage by each tenant on a submeter. This approach provides a means of confirming the tenant's consumption — but not the rate charged. Unless the tenant negotiates for a direct pass-through of the rate charged to the landlord (with perhaps an administrative charge added), the landlord may be making a significant profit.

The third common alternative, "electric rent inclusion," provides even less protection to a tenant. In this circumstance, the landlord and tenant agree to a fixed increment to the base rental to reflect the tenant's electricity consumption based upon the tenant's proposed electrical installations and equipment. The landlord (or, if negotiated, both parties) will then have the right to monitor or survey usage from time to time based upon the actual electrical installations and equipment at the time of survey. But often these provisions assume only an upward adjustment in the rental charge. The tenant may have no way of confirming the propriety of the initial charge and the survey of usage is unlikely to be as accurate as direct metering.

In the case of cleaning services, the tenant's options may be even more limited. Typically, in a gross rental lease, the landlord will engage a cleaning contractor for the entire building, factoring the cost of cleaning into its base rental, and passing increases through to the tenant under the escalation provisions. The tenant should be concerned about both cost and quality. Is the landlord charging more than the market and making a profit by using an affiliated company? Does the tenant have any control over quality?

Tenants are often able to negotiate some means of assessing cost, but the quality issue is much more difficult. A substantial tenant may seek the right to hire

its own cleaning contractor. Landlords can reasonably object to this approach, however, because the presence of two cleaning contractors may impair building security, tax the freight elevators and create labor problems. And even if the tenant is successful in negotiating for a separate cleaning contract, it may find itself with no material change in quality ("the people remain the same, only the uniforms change") while subsidizing a portion of the landlord's cleaning contract. When the tenant seeks a decrease in base rent to reflect the fact that the landlord is not providing cleaning services to the tenant, the landlord would be justified in reducing the base rental only by the actual savings on its cleaning contract; those savings are likely to be less than what the tenant is paying under the separate contract.

V. Tax and Operating Escalations

In a so-called "triple net lease" (commonly where the tenant is leasing an entire building), the landlord is largely a passive owner and the tenant assumes the responsibility for property maintenance and direct payment of the various costs associated with the building's operation, including real property taxes. More typically, the landlord retains various of these responsibilities and seeks to be reimbursed by the tenants for its costs. This is often referred to as a "gross" or "full service" lease. As noted above, gross lease rentals may be on a "net rental" or "gross rental" basis. In either event, the tenant will be reimbursing the landlord for some or all operating expense and tax charges.

In some gross rental situations, landlords seek to account for increases in these costs through use of a formula, rather than a direct accounting. One such formula increases rent by the same (or a stated proportion of the) percentage increase in the consumer price index. This approach is, at best, a rough approximation of increases in the landlord's costs. Increases in the cost of consumer goods may have little relevance to the cost to the landlord of maintaining its building. In New York, some landlords use a so-called "porter's wage" formula, which is based upon the labor cost for a particular category of building

employees. Here again, the porter's wage would have no relation to the cost of fuel and many other operating expenses. Formula approaches have an appeal because of their relative simplicity and thus may be suitable for a modest size tenancy. In such a circumstance, the tenant should carefully review the formula with its advisors to evaluate its fairness.

More commonly, especially for medium to larger tenancies, the landlord will use, and the tenant will expect, a direct cost approach. In gross rental markets, such as New York, larger tenants should consider whether to seek a net rent or to accept a gross rental and, if the latter, how the base amount incorporated in the rental will be calculated. In theory, there should be little or no difference between the actual rental amounts paid under the net rental and gross rental approaches, except, perhaps, in the initial year or two of the base term. If a gross rental is used, the bases for operating cost and real estate tax escalations must be established. These can be based upon estimates (especially for buildings under construction or which have not leased up) or upon the actual costs and taxes for a specified year (such as the first year of the lease term).

A tenant needs to understand not only how the base amounts will be derived for a gross rental lease but, whether it takes a net rental or a gross rental, the relative efficiencies of prospective buildings and landlords. Projected efficiency is not a matter of precise calculation. Rather, it is mostly judgmental and is subject to change (as, for example, if the landlord or managing agent changes).

If the direct cost escalation method is used, the review and negotiation of the actual provisions is one of the most critical aspects of the leasing process. In the commercial arena, lease provisions are construed, for the most part, in accordance with their terms. Thus, even if actual results vary significantly from projections, perhaps because an unintended charge was allowed or an obvious charge not properly considered in formulating base amounts, the fact of the increase alone, however

"excessive", generally will not be sufficient reason for a court to "cap" or otherwise modify the express terms of the lease agreement. The protections must appear in the lease itself.

The potential scenarios are, of course, without limit. For example, the tenant may have agreed to pay tax escalation based upon the real property taxes for a specified year. Later, the landlord may contest the taxes for that year and obtain a reduction, resulting in a lower base amount than the tenant expected. With a lower base amount, the tenant may find itself paying additional taxes for subsequent years under the escalation provisions. Similarly, the tenant may have agreed to pay its fair share of operating costs but did not expect to be subsidizing the landlord's capital improvements late in the term of its lease.

Schedule C includes a substantial list of typically negotiated exclusions from operating cost escalations. A note of caution, however. The list has been developed from experience and anecdotal information about what landlords have strained to include in operating costs. If the landlord's definition of operating expenses is properly drafted and could not be read to include specious items, such as art work in the lobby, then counsel need not engage in a lengthy discussion about exclusions. On the other hand, if the definition of operating expenses is broad (as it usually is), the scope of the included costs as well as the counterpart exclusions must be carefully defined. To give but one illustration, in the face of an exclusion for leasing costs which did not make reference to the particular tenant's lease (compare Schedule C, Item 12), one landlord attempted to charge the tenant for the costs, amortized over the term, of procuring that tenant's lease.

VI. Landlord's and Tenant's Work; Alterations

In rare instances, a tenant may select space that is ready for occupancy, either because the tenant can adapt its requirements to a standard office configuration provided

by the landlord or because the prior tenant's build-out fortuitously accommodates the new tenant's needs. In almost all cases, however, the tenant will find itself with a significant design and construction job at hand. Perhaps the premises are raw space consisting of concrete slabs and columns and exposed wiring or, even more costly, an existing build-out that must be gutted and rebuilt. In these instances, the lease document will become in part a construction contract, a credit instrument, or both, as the landlord and tenant negotiate the costs of, and the responsibilities for, demolition and build-out.

In the past, landlords often forced tenants to engage the landlord or one of its affiliates to build out the premises. The risks to tenants of such an approach may seem evident but often were not fully fathomed. Today, many landlords see the role of contractor as presenting more risks (delays in rent commencement, liability and the like) than rewards. Institutional owners (especially foreclosing lenders) may simply not have the capacity to offer any significant construction services. For all of these reasons, most landlords prefer to shift build-out responsibility as much as possible to the tenant. The outcome is most likely something of a hybrid—some landlord work and the balance tenant work, with the financing provided in whole or in part by the landlord.

The tenant's design team will want ample opportunity to inspect any premises under consideration. Can any of the existing build-out, perhaps interior stairways, be salvaged and incorporated into the proposed design? Are there existing conditions that will make a build-out more expensive or time-consuming? As set out more fully in VII. below, the presence of asbestos can be one such factor. The goal of the tenant's design team will be to identify (and, if necessary, negotiate lease terms that will result in) space that will be delivered by the landlord in the condition that will best accommodate the tenant's build-out. The tenant may require that the landlord assume the responsibility for (and the risks associated with) demolition of existing improvements, asbestos removal and the like. The tenant will also want the landlord to perform any agreed upon work to the base

building or base building systems, as this work essentially involves matters outside of the tenant's prospective premises and presents more of a risk to the tenant because of the potential impact on other tenants or the building and its systems. The landlord is likely to accept these responsibilities, and it may extend its involvement in the tenant's build-out to be responsible for, or at least to have significant control over, any portions of the tenant installation that will affect its basic building systems. For instance, the landlord may require that its contractor complete any installations affecting the life safety, electrical or air-conditioning systems. And, from the tenant's perspective, this may be best for all concerned so long as it can control the cost and timing of the work to be undertaken by the landlord.

Delays, by landlord or tenant, will figure prominently in these lease negotiations. The landlord will be seeking the assurance of a fixed rent commencement date. Any delays could pose significant financial difficulties for the landlord as its operating costs and debt service accrue. From the tenant's standpoint, little could be more embarrassing for the tenant representative and his or her team than to be forced to present the tenant's financial officer with a rent bill for space not yet available for occupancy.

The tenant should also bear in mind that many of the same risks that it faces in completing its space may reappear from time to time throughout the lease term as alterations to the tenant's space become necessary. Expansion of the premises, periodic refurbishment, changes required by law, and even the installation of new computers can place the tenant and its landlord at odds. Will the landlord attempt to control the work by requiring its involvement or the use of particular contractors? Will the landlord be charging a significant fee for "supervisory" services? Will the tenant be permitted to perform the work at times of its choosing, or only during overtime periods? Will the tenant have necessary access to portions of the building outside of the premises? Will the tenant be able to bring additional electrical service to its premises or connect computer networks on non-

contiguous floors? In the best scenario, tenant's operations personnel should be able to coordinate any such work with building management, leaving the lease document in the bottom drawer. But disputes do arise, and the tenant should not simply rely on a present air of good will.

VII. Prior Condition of Premises

The tenant's consideration of alternative locations should extend beyond those conditions obvious from a walk-through of the premises. Latent or hidden conditions may well exist that can increase the cost of the tenant's build-out or, more importantly, create safety and health concerns during occupancy. Environmental hazards represent one such condition. The presence of asbestos or PCBs can constitute a significant and costly hazard if not properly handled. Many landlords have taken the initiative and have agreed to remove or encapsulate these materials in conjunction with a tenant relocation. At the minimum, the tenant's team should have access to environmental studies of the premises and be assured that any hazardous conditions have been properly addressed. Tenants should understand, however, that today's list of hazards may rapidly become out of date and that tomorrow's hazards should also be addressed. Has the landlord undertaken an obligation to keep the premises in an environmentally safe condition? And, even if so, will the tenant bear the costs of monitoring or addressing future hazards either directly or through operating escalation provisions?

Many of the most publicized hazards are associated with buildings constructed before the increased environmental sensitivity of the '70s. However, newer construction has been found to present its own hazards in the form of the so-called "sick building syndrome." The desire for energy-efficient systems and efforts to exclude outdoor pollutants may exacerbate the risks of indoor pollutants. These energy-efficient and protective systems, it is now realized, may simply recirculate throughout a building toxins and other hazardous substances emanating from indoor carpeting, synthetic fibers and the like. Claims

from tenant employees of illnesses attributable to these working conditions have increased dramatically. No ready solutions to this problem have yet emerged, but at the minimum the tenant's team should inquire as to recent complaints and incidents.

VIII. Compliance with Laws; Repairs

Aside from rental disputes, perhaps the most frequent disagreements between landlords and tenants are those over responsibility for legal compliance costs and necessary repairs. Anticipated costs are rarely an issue; rather, the parties to the lease (or at least one of them) may forget the long-term nature of the lease contract and how quickly the social and legal environment changes. It is endemic to the American legal system that nearly every catastrophe begets a new set of laws. In New York, a substantial fire begot Local Law 1973-5, requiring wide-ranging upgrades of building systems in most Manhattan office buildings. The First Interstate fire in Los Angeles, followed more recently in 1990 by the fire at the Health Services Building, spawned a host of sprinkler and other fire safety ordinances. Falling bricks from a crumbling facade begot New York City's Local Law 1980-10. And with each enactment, landlords and tenants were forced to review responsibility for the unforeseen requirement.

One topic of more recent import is the Americans With Disabilities Act. The tenant's architect will presumably factor into its design compliance issues arising strictly from the tenant's installation (such as conference rooms). But what of the base building? Will the tenant's installation trigger compliance requirements in public areas, and, if so, who will bear the cost? The Act does not clearly delineate responsibility for leased premises and current regulations leave the matter to negotiation between the parties to a commercial lease — an unusual approach in the U.S. regulatory scheme.

Landlords typically retain responsibility for compliance and repair costs relating to common areas of the building and to structural portions of the leased premises. Yet this allocation still leaves significant room for disagreement. If a new ordinance requires additional emergency lighting

in the premises, will that be part of the tenant's responsibility or be allocated to the landlord because of the tie-in to the base building systems?

The parties may find it best to address specifically pending issues. The unforeseen must also be addressed, however, and it is not sufficient for the tenant that the landlord simply assume responsibility for compliance costs. Many operating expense provisions will distinguish compliance costs from other capital expenditures and include these costs in tenant escalation payments. This may well be appropriate in some instances, but what if compliance is not mandatory or can at least be deferred until the next significant alteration? Is the wrong tenant paying?

IX. Services

In lease provisions regarding available services, the issues mirror some of the general points noted earlier. What does the tenant require? What does it expect? Does the lease assure the tenant of the continued availability of these services throughout the term? Does the tenant have the flexibility to augment the services provided by the landlord in an efficient and economic manner?

Such an analysis was presumably at some point fairly straightforward. Unfortunate experiences in prior tenancies have, however, caused many tenants to focus more closely on these provisions. And the more sophisticated requirements of many tenants today mandate that specialized attention be brought to bear. For example, the electricity requirements for computer installations and the costs associated with any interruption of service should not be underplayed. Electromagnetic interference from elsewhere in the building or even from an underlying subway system could wreak havoc on a tenant's business. This is not to say that the lease document can or should address all of these matters with the utmost particularity. The goal should not be to have a tenant measuring elevator performance against a stop watch, but rather to assure the tenant of quality service and an adequate means of addressing disputes.

X. Insurance

The insurance provisions in a commercial lease represent another fairly specialized area and may warrant review by an insurance specialist. At its most basic, however, the lease should confirm that the landlord has available and in effect insurance coverage sufficient to pay for restoration of the building — including restoration of the tenant's leasehold improvements, if the parties so agree — after significant casualty. But regardless of the terms of the lease, will the insurance proceeds be available for restoration or do the landlord's financing arrangements require or permit otherwise?

The tenant must confirm that the coverages required of it by the lease are also available and in place. Beyond that, the tenant's advisors should confirm that the insurance coverage required of both parties is being properly utilized. Does that lease provide for waivers of subrogation or other protections to avoid a claim against the tenant by the landlord's property insurer after that insurer has paid on a policy that has in effect been subsidized by the tenant?

XI. Casualty and Condemnation

Clients typically have little patience for any detailed discussion of lease provisions relating to casualty and condemnation. The remoteness of the risk causes them to want to turn to more immediate issues. The remoteness of the risk can, however, be offset by the gravity of the consequences.

As noted earlier, the review of the landlord's and tenant's insurance should address the sufficiency and scope of casualty insurance coverage and the availability of proceeds. There are, in addition, other practical considerations to be addressed. The tenant's business cannot be suspended pending lengthy negotiations about the timing or responsibility for repair. If the tenant must find alternative space, it needs to move quickly. It also needs to know if and when the original premises will be available. Otherwise, the planning of interim measures is impossible.

XII. Assignment and Subletting

Control and profit are key issues for both landlord and tenant in any discussion of assignment and subletting. From the landlord's standpoint, the identity of the tenant is foremost in any credit analysis. It does not follow, however, that, so long as a creditworthy tenant remains primarily liable for lease obligations, the identity of the occupant (by assignment or subletting) is of no concern to the landlord. The identity of the occupant can affect the landlord's investment in other ways. A financially troubled or defunct occupant could conceivably make the building less attractive to other tenants. Equally troublesome is a strong but controversial occupant. The landlord may properly be concerned about building security if a proposed occupant is the subject of public demonstrations or even bomb threats. And what of a number of small tenancies? Many landlords impose a minimum square footage requirement on tenancies since numerous small tenancies may put some additional strain on building services or, more importantly, create a "balkanized" character more in keeping with lower grade "B" or "C" buildings.

Tenants may in the abstract agree with the legitimacy of the landlord's concerns, but the tenant may also have valid concerns that are inconsistent with the landlord's desire for control. A tenant is likely to view its leasehold interest as an investment, perhaps quite a substantial investment. Should the landlord's desire for control restrain the tenant's ability to operate its own business or to protect its investment? Should the landlord have the right to consent to or, even more troublesome, the right to stop, a change in the tenancy resulting from a corporate reorganization, such as a merger, stock acquisition or leveraged buy-out? And what if the tenant's space needs change? Should not the tenant be able to transfer its leasehold at will or subject only to the barest restraints? Can the tenant effectively protect its investment if the lease (as so many do) prohibits it from assigning the lease or subletting space to the most likely users — other tenants in the building?

The details of the assignment and subletting provisions can be critical. If the tenant has reserved some significant sublet rights, can the landlord foil these rights by using other lease provisions to its advantage? A sublet right cannot be terribly meaningful if the use provision is unduly restrictive or if the subtenant is constrained in its own efforts to reorganize or otherwise conduct its business.

Even in a strong economy, the issue of profit-sharing may take a distant second to the needs of both parties to protect their respective downsides. But again the leasehold relationship typically is a long-term one. In a few years the tenant's seemingly exorbitant rent may look like a bargain. Who should profit in this instance? Landlords typically reserve the right to "recapture" space proposed to be sublet or assigned in an effort to garner any profit potential from this space. And beyond this, the recapture mechanism may provide another means by which the landlord can control its building, perhaps accommodating another tenant's space needs before affording anyone outside the building an opportunity.

If profits on an assignment or subletting are to be shared, the formula for determining "profit" is critical. The party bearing the risk of the assignment or subletting should certainly be entitled to recoup its out-of-pocket costs on the assignment or subletting and perhaps even some additional amounts (such as the costs of carrying the "vacant space" or the unamortized costs of leasehold improvements to the space) before any net amounts are calculated and split. But should each transaction be treated separately or should cumulative losses be aggregated before the tenant shares its "profits"?

XIII. Subordination and Non-Disturbance Provisions

Prospective tenants may not fully appreciate the extent to which a lease negotiation can be a tripartite affair. In troubled economic times the lender's interest is apparent and the owner's mortgagee may have substantial and direct input into a lease negotiation. But even in a vibrant

economy, the developer-owner's interests in the property may be more apparent than real. Often other investors, including many that appear only as lenders, have substantial economic stakes in the property, including rights to share in any cash flow from or appreciation of the property.

Tenants and their advisors would do well to understand the lender's concerns and how they relate to those of the tenant. A small tenant may find itself asked to accept a lease with a "subordination provision," which would acknowledge that the interests of an existing lender or even future lenders are "superior" to those of the tenant. In a foreclosure, such a provision would entitle a lender to foreclose and acquire ownership of the property free and clear of the tenant's interest, in effect cancelling that interest. One might properly submit that the lender's interest is in creating and preserving tenancies. Why would a lender take action that would reduce a property's cash flow? The answer is that most lenders would not, but under the right set of circumstances some lenders would. What if an existing tenancy effectively blocked a more attractive and larger transaction? The lender in such an instance may well be inclined to exercise its rights under a subordination provision.

Insubstantial tenants have often accepted the risk of the foregoing analysis. But larger tenants are typically able to avoid at least most of the risks associated with the subordination provision by requiring the lender's agreement to "non-disturb" its tenancy. Even in these instances, lenders will often seek some differentiation from owner/borrowers. A lender may agree not to terminate an existing tenancy but only on the condition that it not be responsible for its borrower's past defaults. This is, in fact, quite a typical compromise between a tenant and a lender but one that the tenant's advisors should have otherwise addressed in assuring the tenant that a troubled owner/borrower's default will not deprive it of the benefit of its bargain. Perhaps a letter of credit will be required to assure a tenant that build-out funds are available, while not imposing on a foreclosing lender the direct obligation to advance additional funds.

Even if there is general agreement on the availability of a non-disturbance agreement, ancillary questions remain. Will the benefit of the non-disturbance agreement run to subtenants? Are there ground lease arrangements that must be addressed? Are there any limitations on the enforceability of these agreements, perhaps in a bankruptcy context?

XIV. Defaults

An analysis of lease default provisions should be properly focused. If a tenant has in fact failed to pay rent or meet other significant lease obligations, the landlord should be entitled to appropriate remedies to recover possession of the premises and the benefits of its bargain. The job of the tenant's representatives should be to ensure that a tenant is not inadvertently put into default under its lease or otherwise deprived of appropriate opportunities to tender performance. Notice of alleged defaults and an opportunity to cure those defaults are critical, more so because of a line of cases in New York creating what has become known as a "Yellowstone" injunction. Under this line of cases, the courts have intervened to review disputes between landlords and tenants over alleged lease defaults and to enjoin the exercise by the landlord of any remedies pending resolution of the dispute, but only if the dispute is brought to the court before action has been taken by the landlord to terminate the lease.

Lease assignments may also present unanticipated risks to the assignee if action by the assignor, the predecessor tenant, can still trigger a lease default. If a party properly assumes the tenant's lease obligations, should its leasehold still be impaired if the assigning party runs into financial difficulty?

XV. Disputes

Disagreements between landlords and tenants during the lease term are virtually inevitable. Counsel for both parties should recognize the need for efficient and cost-effective dispute resolution mechanisms. A lengthy litigation is unattractive. Some would argue of course that this can encourage parties to settle. It may be

preferable, however, to have a fairly rapid and simple arbitration process available when the issue is not whether the lease should remain in effect, but the proper amount of escalation charges or the responsibility for certain repairs. And the arbitration mechanism need not be identical throughout. Some parties have found it particularly effective to settle disputes regarding renewal rents and the like through a form of “baseball” arbitration (the technique used to resolve disputes over major league player salaries), where the arbitrator is required to select either the landlord’s or the tenant’s submission. It avoids what many regard as one of the serious shortcomings of the traditional three-party arbitration. In “baseball” arbitration, the arbitrators are constrained from simply “splitting the difference” and the parties are penalized for unrealistic submissions.

Final Observations

The breadth and depth of our topic makes difficult the drawing of any concise or pithy conclusions. The process — one that is full of diverse issues and is time-consuming and often tedious — simply cannot be shortcut. Only the careful management of the process by a team of decision-makers and advisors can yield the desired result, a sensible and foresightful agreement.

©2000 John L. Opar. Mr. Opar is a partner in the Property Group of Shearman & Sterling LLP. This article is a companion piece with: “Corporate Headquarters Leasing: Getting Started” by Lee Kuntz, also a partner in the Property Group of Shearman & Sterling LLP.

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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SCHEDULE A

Glossary of Commonly Used Terms

“Base rent” or “fixed rent”	Typically expressed in dollars per square foot and calculated to cover current costs, including landlord’s debt service and some profit component. Represents only a portion of tenant’s overall rent obligation. The number is sometimes presented as a monthly amount (usually outside of New York) or an annual amount.
“Base year amounts”	Operating expenses and/or tax expenses during a specified base year. If these expenses rise above the base year amounts in later years, the tenant will be responsible for escalation payments. Typically expressed as the dollar amount payable in the specified base year and determined at the conclusion of such year on the basis of actual expenses. Used as an alternative to the expense stop approach.
“Expense stops”	Fixed number that establishes a minimum amount above which tenant will be responsible for escalation payments. Typically expressed in dollars per square foot and used as an alternative to a base-year approach.
“Gross lease” and “Net lease”	Differentiation of leases based on the allocation of responsibility for repairs, maintenance, taxes, insurance and the like, with a “triple net” lease allocating most responsibility directly to the tenant. The tenant can still be responsible for these costs in the gross lease but via landlord reimbursement rather than direct obligation.
“Gross rent” and “Net rent”	Different presentations of tenant’s overall rent obligation. Both are calculated as the sum of the base rent plus operating and tax expenses, but in the case of “gross rent” the rent includes only that portion of such expenses as exceeds the “base year amounts” or the “expense stops”, as the case may be.
“Rentable area”	A presentation of available space on a per-square-footage basis which includes allocated portions of common areas and sometimes “phantom space”. It can be tied to a published standard (for example, so-called “BOMA”, or Building Owners and Managers Association, standards) or can just as easily be whatever the landlord requires to ensure an economic return.
“Usable area”	A more rational presentation of available space discounting landlords’ efforts to allocate common areas and the like, and sometimes thought of as “carpetable” area.

SCHEDULE B

Basic Considerations

I. Premises.

- A.
 - 1. Establishing basic requirements
 - 2. Comparison of premises on basis of “usable” square footage
 - 3. Confirmation of square footage by tenant’s architect
 - 4. Restrictions on “remeasurement” by landlord
- B. Suitability for proposed uses.
- C. Availability:
 - 1. Compare projected delivery date with tenant’s requirements
 - 2. How realistic is delivery date in light of existing tenancies or construction work?
- D. Expansion Space:
 - 1. Options vs. mandatory “takes” vs. first offers or refusals
 - 2. Decision dates
 - 3. Recapture, subletting restrictions

II. Parties; Credit Considerations.

- A. Who is landlord? What is nature of ownership interest (e.g., fee simple, leasehold, condominium)? Is landlord’s credit sufficient for material obligations, such as completion of construction or funding of build-out allowance?
- B.
 - 1. Who is tenant? Are there related entities who need occupancy rights? If a partnership entity, such as a law firm, should there be limitations on “recourse” to partners? How will the retirement of partners be handled?
 - 2. Security deposit
 - a. Form (e.g., cash or letter of credit)
 - b. How invested if cash
 - c. Access to interest if cash

III. Term.

- A. Current term vs. conditions to commencement of term — completion of work; vacant possession; landlord or tenant consents (e.g., approval by landlord’s lender or tenant’s regulators).

1. Need for outside date
 2. Effect of landlord bankruptcy
 3. Consider Rule against Perpetuities implications
- B. Termination rights.
- C. Renewal rights — compare timing of decision to renew as against determination of rent.

IV. Base Rent.

- A. Comparison of base rent on “usable” square footage basis.
- B. Free rent periods — base rent only or escalations as well?
- C. Treatment of electricity charges:
1. “Rent inclusion”
 2. Direct metering or submetering
 3. Treatment as rent for rent occupancy tax purposes
 4. When payable (e.g., during build-out)

V. Tax and Operating Escalations.

- A. Computed against base year or base amount? Alternative formulations based on “porter’s wage” or CPI. Consider “net lease” alternative.
- B. How certain that tax base reflects assessment of completed value? Consider local standards for reassessment — will property be reassessed upon a sale or refinancing or renovation?
- C. “Gross-up” provisions.
- D. Any opportunity to recover if base amounts are higher than actual costs?
- E. Verify tenant’s “share”.
- F. Review definitions and exclusions (See Schedule C).
- G. Audit and contest rights; right to refuse payments on estimated basis; refunds.

VI. Landlord’s and Tenant’s Work; Alterations.

- A. Comparison of landlord’s “contribution” to build-out costs:
1. Nature and extent of “base building” work
 2. Work letter or cash contribution; availability of credit against work letter items
 3. Availability of landlord “financing” of build-out costs
 4. Selection of contractor for tenant build-out

- B. Procedures:
 - 1. Standard and timing of plan and contractor approval
 - 2. Responsibility for landlord and tenant “delays” (seek prior notification and limit to actual delays)
 - 3. Access by tenant to other portions of building
- C. Other provisions:
 - 1. Obligation and/or right to remove specialty alterations
 - 2. Ownership of improvements for tax credit and other purposes

VII. Prior Condition of Premises.

- A. Asbestos, PCB’s or other environmental hazards
- B. “Sick building syndrome”

VIII. Compliance with Laws; Repairs.

- A. Allocation of responsibility to landlord and tenant:
 - 1. Structural vs. non-structural
 - 2. Non-premises areas
 - 3. Conditions as in VII above
 - 4. Conditions arising in future
- B. Compliance with Americans with Disabilities Act
- C. Cap on cost

IX. Services.

- A. Review of available HVAC, cleaning, elevator, electricity, water and other services and cost of same (and against tenant requirements).
- B. Specification of standards in lease.
- C. Ability to verify charges.
- D. Capacity to supplement available services (e.g., supplemental air conditioning, extra cleaning).

X. Insurance.

- A. Have expert review adequacy of landlord coverage and compliance with tenant requirements.
- B. Mutual waiver of subrogation, endorsement and/or right to waive recovery prior to loss (with waiver in lease).

XI. Casualty and Condemnation.

- A. Does landlord restoration obligation extend to tenant build-out?
- B. Are landlord's restoration obligations consistent with its lender's requirements?
- C. Timing of restoration decisions and outside dates for completion.
- D. Rights of cancellation by landlord and tenant.
- E. Build-out and move-in period for tenant after completion of landlord's restoration work (prior to recommencement of rent).

XII. Assignment and Subletting.

- A. Certain transfers to be permitted without consent (assignments and subleases to affiliates, mergers, transfers of stock or assets).
- B. Consider effect of other lease provisions on assignment and subletting right (e.g., use provision, alterations, directory listings, further assignment and subletting).
- C. Landlord recapture:
 - 1. Should tenant share in profit
 - 2. Should landlord's recapture right apply to initial subletting
 - 3. When should landlord decision be required? Same timing issue with landlord consent
- D. Profit-sharing:
 - 1. Right to recover costs
 - 2. Only obligation to pay to Landlord "as and to the extent received"
- E. Remedies:
 - 1. Can landlord enjoin tenant breaches
 - 2. Does tenant have effective remedy if landlord improperly withholds consent

XIII. Subordination and Non-Disturbance Provisions.

- A. Subordination to be conditioned on non-disturbance from landlord's mortgagees, ground lessors — what if existing mortgage?
- B. Application to subleases.
- C. Enforceability.

XIV. Defaults.

- A. No termination without notice and opportunity to cure (otherwise, New York "Yellowstone" remedy ineffective).

- B. Defaults should not apply to assignor after assignment of tenant's interest.
- C. Rights of assignor in event of tenant/assignee defaults (notice, right to cure, right to re-assume lease).
- D. Rental offsets, self-help, landlord defaults.

XV. Disputes.

- A. Covenant of landlord to act reasonably.
- B. Arbitration of specified disputes, such as disagreement on rental value — consider “baseball” arbitration.

XVI. Other.

- A. Can tenant acquire equity interest in building?
- B. Interest and attorneys' fees should be available to both parties.
- C. Rent abatement if premises not usable.
- D. Right to record memorandum of lease, especially where significant period before possession on or where options to expand or renew.
- E. Right to signage in building and elevator lobbies; right to name (or restrictions on name) of building (e.g., will not be named for tenant's competitors).
- F. Lease or license of roof space for communications equipment.
- G. Parking and other amenities — availability and cost.

SCHEDULE C

Operating Expense Exclusions

1. [real property taxes¹] [real property taxes attributable to a transfer of the Building or any interest therein or in Landlord, or a refinancing thereof] or franchise, transfer, inheritance or capital stock taxes or taxes imposed upon or measured by the income or profits of Landlord,
2. principal or interest or other charges on any debt of Landlord,
3. depreciation or amortization,
4. the cost of any item or expense, which, in accordance with generally accepted accounting principles, is, or should be, capitalized on the books of Landlord,
5. the cost (including taxes) of any electricity furnished to any area of the Building leased to or occupied by Tenant or other tenants of the Building or available for leasing or occupancy by tenants,
6. the cost of any alterations, additions, changes or decorations which are made in order to prepare space (including the Premises) for tenant occupancy, whether new or continued,
7. the cost of performing work or furnishing services to or for any tenant other than Tenant, at Landlord's expense, to the extent that such work or service exceeds or is more favorable than any comparable work or service provided to Tenant at Landlord's expense,
8. the general overhead of Landlord and labor costs (including salaries, wages, bonuses, medical, surgical and general welfare benefits (including life insurance), pension and union and general welfare payments and other fringe benefits, severance and sick day payments and social security and payroll taxes) and all other compensation of all administrative personnel, officers, executives and staff members of Landlord or Landlord's agents above the grade of building manager,
9. any accrued and unfunded pension or other benefits for any personnel,
10. any rent, additional rent, imposition or other charge under any lease (including any ground or "sandwich" lease) or sublease to or assumed by Landlord,
11. any cost which would otherwise be an Operating Expense to the extent the same is reimbursable to Landlord by proceeds of insurance, condemnation award, refund, credit, warranty, service contract, any tenant (including Tenant) of the Building (except reimbursement pursuant to provisions in the nature of this Section) or otherwise,
12. brokerage and leasing commissions, legal costs (including attorneys' fees and disbursements), space planning or architectural or engineering fees, closing costs and expenses and transfer and similar taxes incurred in leasing or procuring tenants for the Building, including Tenant, or in connection with any mortgaging, financing, refinancing, transfer, sale of the Real Property or any part thereof or interest therein, or entering into or extending or modifying any lease, including this lease, or sublease to or assumed by Landlord,

¹ If payable under separate provision

13. the cost incurred by Landlord in performing work or furnishing any service to or for a tenant of space in the Building (including Tenant) at such tenant's cost and expense, regardless of the amount billed or received by Landlord for performing such work or furnishing such service,
14. any amount paid to any affiliate of Landlord to the extent any such amount is in the excess of the amount which would be paid in the absence of such relationship,
15. advertising, marketing or promotional expenditures,
16. the cost of the acquisition or leasing of any artwork [other than the costs of maintaining, insuring and securing same],
17. any cost or expense of furnishing HVAC, cleaning or other services to retail space located in the Building,
18. the cost of any construction, refurbishing, reconstruction or restoration of the Building,
19. accounting fees, other than those incurred in connection with the operation of the Property and the preparation of statements required pursuant to the provisions of this Lease and similar provisions of other leases of space in the Building,
20. costs and expense (including court costs, attorneys' fees and disbursements) related to or arising under or in connection with disputes with tenants, any lessor under a lease or any holder of a Mortgage or disputes which result in punitive damages being assessed against Landlord, or disputes relating to claims of personal injury or property damage,
21. the cost of any work or services performed or other expenses incurred in connection with installing, operating, and maintaining any specialty service or facility other than a public or common area of the Building, such as an observatory, broadcasting facility or any luncheon, athletic or recreational club; provided, however, that this exclusion shall not apply to the cost of HVAC, cleaning or other services furnished to an area of space leased to a tenant (other than Landlord or an affiliate of Landlord) and used by such tenant for such purposes,
22. any costs incurred in the removal, containment, encapsulation, or disposal of or repair or cleaning [or monitoring] of areas affected by (a) any Hazardous Material or (b) any asbestos,
23. any cost or expense incurred in connection with correcting latent defects or inadequacies in the Building [of which Landlord has notice within _____ (___) years after the Rent Commencement Date],
24. costs incurred to correct any misrepresentation by Landlord expressly made herein,
25. payments for rented equipment, the cost of which would constitute a capital expenditure if the equipment were purchased,
26. the value or lost income to Landlord of any space in the Building which is utilized for the management of the Building,
27. any compensation paid to clerks, attendants or other persons in commercial concessions operated by Landlord or any affiliate of Landlord,
28. late fees, penalties, interest charges or similar costs incurred by Landlord,
29. costs associated with the operation of the business of the legal entity that constitutes Landlord as the same is separate and apart from the cost of the operation of the Building, including legal entity formation, internal equity accounting and legal matters,

30. unrecovered expenses resulting directly from the negligence of Landlord, its agents, servants or employees,
31. new items of maintenance or higher standards for maintenance and repairs than were included in base year operating expenses,
32. the cost of (including increased operating expenses related to) any additions to the Building after the original construction,
33. costs incurred due to violation by Landlord or any tenant of the Building of the terms of any lease or any laws, rules, regulations or ordinances applicable to the Building,
34. costs of complying with Americans with Disabilities Act,
35. costs of owning, operating, repairing or maintaining any parking areas or facilities, or any other amenities or common area, serving primarily [the ground floor or] any retail space in the Building,
36. Management fees to the extent that they exceed ___% of the aggregate base rent only of tenants of the Building.