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Variations In The Shopping Center Lease

When leases for shopping centers are being drafted, they can be more difficult than most other commercial leases. In a shopping center, the owner wants the leases to be as uniform as possible, but knows that each lease must have variations to meet the individual tenant's particular problems in business and in certain size or shaped spaces.

Here are some suggestions of items that should be covered in your shopping center leases. There could be many more depending on each property.

- **Type of Operation;** What is the business? The lease must clearly state the type of business conducted in this unit.
- **Effective Date of Rent;** The minimum guaranteed rent should commence a specified number of days after the center has completed the premises or when goods or services are offered for sale to the public, whichever of these two events occurs first.
- **Amount of Minimum Rent;** The lease states the monthly and annual rent. It should also provide that if the gross leasable area is larger than that recited in the lease, the minimum monthly rent will increase by a specified amount each month.
- **Computation of Percentage Rent;** The lease should show how percentage rent is computed, when payments will be due, and what will be included in gross sales for determining the percentage rental (e.g., vending machines and mail order sales). This clause should also specify how frequently the tenant will be required to submit sales reports to the landlord and that the tenant's annual sales report must be prepared by a certified public accountant.
- **Noncompetition Clause;** In order to ensure noncompetition with your center, you should include a provision that prohibits the tenant from directly or indirectly engaging in a similar or competing business within a specified radius (expressed in miles) of your center.
- **Costs of Common Areas;** The tenant should be required to pay its proportionate share of the costs of operating the center's common areas, including the following:
    - Repairs
    - Light Bulb replacement

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This publication is not a solicitation but is an information service from this office.

In This Issue

When ideas in tax and other legal areas in this publication seem to fit your situation, it is recommended that you discuss them with your professional advisor before taking action.

(continued)

- Landscaping
- Liability and property damage insurance
- Security
- Cleanup
- Snow removal
- Parking lot sweeping
- Restriping parking spaces
- Garbage removal
- Real estate taxes
- Depreciation on equipment and machinery
- Any other costs of operating, maintaining common areas.

- **Employee Parking;** As the landlord, you should reserve the right to control employee parking. You should also provide that you have the right to remove any unauthorized people from the parking areas, as well as from any common areas.
- **Center's Merchant's Association;** The lease should provide that the tenant must be a member of the center's Merchant's Association.
- **Signs;** As the landlord, you have the right to approve the size, placement, and contents of any and all signs within the center. Such a provision may prohibit paper signs, exposed neon signs, sandwich boards, etc.
- **Property Tax Increases;** The owner may specify that he will pay the real estate taxes on the leased premises and the underlying land for the first year after the center is open, but that any increases after that will be prorated and passed along to the tenants.
- **Recapture Clause;** Landlords should include recapture clauses in their leases so that they can cancel tenant's leases if rental deficiencies are not paid.
- **Permission for Assignment and Sublet;** In order to somewhat control the situation, you should have the lease provide that a tenant may not sublet or assign its lease unless it first gets your written consent to do so, and the clause should state that a consent to a particular assignment or subletting will not apply to later assignments or sublettings.
- **Insurance;** The tenant should be obligated to have property loss and personal injury insurance, naming the landlord as an insured. The tenant should be required to insure any boiler on its premises. The tenant should also be required to have fire and extended coverage insurance on its merchandise and fixtures. ❏

Information For The New Property Manager

There may be lengthy negotiations between the owner of a property and the management company before a management contract is signed. When the management plan has been worked out between them, the management company is hired and the manager takes charge of the property. At this time the manager must collect great amounts of information necessary to manage and control the property. Some should have been available from the owner, but all files must be updated and appropriate information collected, such as:

- **Property Description;** including a detailed physical description, physical layout and plan, inventory records, equipment lists, and mix and size of units.
- **Ownership Data;** including a legal description of the property, legal entity of ownership, and other legal data, tax I.D. numbers, names, addresses, and phone numbers of owners.
- **Tenant Data;** including rent rolls, tenant lists, copies of leases, documentation of current rents, delinquent rents, prepaid rents, security and other deposits, renewal schedules and utilities information.
- **Operating Data;** including all bookkeeping records, tax and licensing information, sources of additional income, lists of warranties, service contractors and suppliers, utility account numbers, budgets, and pro-formas.
- **Personnel Data;** including all current employee's files, benefits, pay period, and withholding information.
- **Legal and regulatory information;** including lawsuits, outstanding violations, etc.
- **Miscellaneous Data;** including information on master and regular keys, landscaping, pool and recreational equipment and supplies, elevator emergency keys, etc.

A new property checklist should be used to ensure that all activities and transactions relating to the takeover of the property are handled in a timely fashion. Among these items should be the management plan and a record of a complete property inspection and inventory.

Letters should be sent to all tenants, vendors, utility companies, local government offices, and other parties to notify them of the change in management. Tenants should also receive copies of any new rules, or confirmation of existing policies and procedures. ❏

Lease Negotiations With Large Corporations

A few years ago, senior corporate managers were able to make major real estate decisions by themselves. Now, a negotiating team will negotiate leases. This team may consist of legal counsel, finance department representatives, outside specialists such as real estate brokers or tenant representatives, design and engineering consultants, and others.

In today's market, corporate tenants with high credit ratings, who are willing to make long-term lease commitments negotiate from a strong position. Therefore, corporations that formerly treated real estate transactions in a casual way have now developed detailed real estate negotiating strategies. The corporate tenant sees these negotiations as a way to cut costs within the company (whether upsizing or downsizing).

Landlords, developers, and brokers must be aware of this new style of negotiation. While the real estate executive plays a key role in developing the strategy, the other parties must be ready to respond quickly to requests for information and be prepared to discuss issues that rarely if ever arose in the past.

Request For Proposal

The document that best illustrates the new negotiating process is the Request For Proposal (RFP), sent to property owners. The RFP incorporates the specification for rental rates, free rent, up fitting, operating expenses, options, cash incentives and other "money clauses" that the corporation intends to negotiate. A short list of prospective sites or buildings is then prepared based on the initial responses to the RFP. The corporate real estate executive (often with the aid of a real estate broker) will negotiate to obtain the best deal with the prospective landlords.

The RFP usually contains a number of items that are nonnegotiable–for example, amount of usable square feet, geographic area, lease term, expansion option, parking facilities, and security. On the other hand, many items remain negotiable, such as rent rate, concessions, rent escalations, cash inducements, and amenities. The parties should understand from the outset that failure to obtain a non-negotiable term could kill the deal for the tenant. Other items may be "throwaways" that could be modified or omitted from the lease.

Example: A corporate tenant may lack the capital funds to improve the leased premises, and so may be willing to pay a higher rental rate or extend the lease term in exchange for a larger allowance for improvements. Alternatively, the tenant may be willing to fund all or part of the improvement costs in exchange for a lower rental.

Give-and-Take in Negotiations

Although it is obvious that any negotiating process involves give and take by both sides, corporate real estate executives have learned the importance of understanding the strengths and weaknesses of their bargaining position as well as that of the landlord. Within reason, these tenants are assured of getting whatever is needed if the bargaining team is aware of the options and takes carefully calculated risks based on solid information. ❑

A Comfort Zone in Loans and Investments

Each investor has a "comfort zone" about loans. The leverage seeker wants the largest loan that is practical. Others may have experience or training that calls for no loans at all. They must have the property free and clear.

Most of us have a loan comfort zone somewhere between these extremes. Nearly everyone accepts the idea of some sort of mortgage. The use of OPM (other people's money) makes sense.

The comfort in loans may affect the type of investment. Many of these "free and clear" owners prefer land as the investment. They want no improvements on it, just the bare land.

Here's some of the benefits of investing in unimproved land. These can make a lot of sense:

1. There are no tenant problems. There may be a simple lease for farming or grazing, but only limited contacts between lessor and lessee. Often, the investment land lies unused.

2. A well-chosen land investment can result in huge profits. We have all heard stories of owners who have purchased land for just a few dollars an acre, then later sold for millions! (The key is "well-chosen.")

3. Land is a secure investment. Even in the worst economic situations, the land is still there. Value can fluctuate, but the investment will not disappear.

4. Land represents wealth. It can be a quick source of cash for an owner to use for another investment. Land looks good on a financial statement. It adds permanence and stability to an applicant for loans or for a line of credit. ❑

Anticipate Problems In Choosing Investment Property

No single property can fit all of the investment goals and rules an investor has set. Even if the investor tried to build a property to specifications, he would find some things "not quite right". The investor is, therefore, wise to anticipate problems and have some basic strategies for dealing with them. Here are some suggestions to help the investor devise other approaches to meet special needs:

- Energy saving potential is more important than style or appearance. Given increasing shortages of natural gas and rising prices of fuel, energy saving has become paramount for successful real estate investing.
- Location is usually more important than the buildings on the lot. You can always make repairs and improvements to a building, but you can't do anything to change the qualities of a location.
- An older property is preferable to a new property if you want to be reasonably certain about income and cost potentials and are seeking the most rentable space for each investment dollar.
- Good workmanship is preferable to good materials if you have to make a choice. Workmanship can overcome the defects of poor materials, but you would pay constantly for poor workmanship. Hopefully, you can avoid this kind of choice because poor workmanship and poor materials mean extra costs and continuing problems.
- Low down payments are preferable because they increase the earning rates on your equity. However, be sure you have a financial reserve in case the property does not produce enough net income at times to pay for the financing.
- Plain properties without distinctive architecture or other characteristics are the most durable investments. Luxuries or extras may make the property look better, but they do not improve the income potential.
- In a given market, smaller units will usually be more saleable, easier to manage, and easier to keep rented in changing markets. Any apartment property with more than 20 units will require professional management.
- Size of the property and units within the property should fit the average for the market. Smaller or larger units often present problems that result in lower prices and higher costs.
- Use experts when in doubt. The costs of using appraisers, builders, lenders, and lawyers are considerably less than those associated with making mistakes. If your investment cannot produce enough income to let you pay for expert help, then it may be the wrong investment.
- Convertibility. The property should lend itself to changes as the market changes so that you can always maximize the rent potential.
- Flexibility. The space in the property should be easily changed to meet different user needs at minimal costs of time and money.
- Specifying repairs to be made before buying is a safer, less costly financial strategy. Estimate them ahead of time, thereby being able to negotiate for a lower price.
- Financing trade-offs. To keep loan payments low, negotiate for long-term payout bases at equivalent rates. Include in your estimates the initial costs of the loan and the repayment costs and privileges.
- Sharing equity increase potentials with lenders can often produce a lower rate loan on terms favorable to your investment objectives. ❑

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