



REAL ESTATE LEASING NEWSLETTER

THE NEED FOR SPEED – LEASING CHALLENGES IN TODAY'S ECONOMIC MARKETPLACE

by Peter McLean

"Time is money." Although I do not know who first coined that phrase, it certainly holds true in the realm of commercial leasing. Developers know well that what they finance and sell is not bricks and mortar, but rather creditworthy leases and cash flow. In fact, in many (if not most) instances, the acquisition of the land itself may even depend on the developer having an executed, financeable lease.

Why, then, do some leases seem to take an inordinately long time to negotiate and execute? While there are many purely business reasons that may affect the leasing process (and it is a process), timely attention to certain factors can increase the pace and efficiency of negotiations and often lead to a more rapid resolution. The purpose of this article is to suggest what appear to be, at least from this attorney's perspective, certain choices and actions which can accelerate the lease negotiation process.

Letter of Intent or "Fast Track"? Often I am asked whether it is better to spend time negotiating a letter of intent ("LOI") or "just go straight to a lease." In virtually every circumstance where I see parties choose to go directly to a lease, the process is inevitably prolonged. Why? Generally because the reason the parties have not already agreed upon a letter of intent (even though they are almost always "non-binding") is that the parties are **not** in agreement (or at least one of the parties **knows** they would not be in agreement if the issue were to be discussed) on some material issue – rent, recapture, extension options, exclusives, assignment rights and the like. I sometimes hear as a reason for this tactic that one party wants to get the other party more deeply involved in the project before raising an issue that might be a "deal killer." While there may be instances when such a tactic is appropriate, it rarely leads to smooth negotiations or timely execution of a lease. An executed LOI provides guidance to the business persons involved (at least reminding them of their non-binding agreements) and often is the only framework given to the attorney(s) tasked with preparing the initial draft of and negotiating the lease. The closer that the initial draft can come to reflecting the agreed upon business terms of the parties, the greater the likelihood that negotiations will wrap up quickly.

Schedule the Work. Having a schedule for draft preparation and review can be most helpful in keeping negotiations moving. Understanding when a party will be (and just as importantly will not be) available can assist greatly in avoiding having documents languishing in an "In" basket while people are on vacation or similarly out of pocket for prolonged periods when they would have been able to review and provide comments if only the draft had been received a day or two earlier. There will always be times when the people who need to review and comment are not available, but timely scheduling can help in attempting to minimize those periods.

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Site Plan Issues. The pressures on developers to sign leases as early as possible in the life of a project in order to facilitate timely acquisition and construction financing often adds an element of site plan uncertainty to the project. For example, even if a property is properly zoned, final site plan approval is rarely obtained until after one or more of the major leases regarding the project has been executed. The greater the uncertainty regarding the site, the more that difficulties related to flexibility in site design arise during lease negotiations. Understandably, tenants want to know what they are leasing. What will their space look like? Where will it be located? What will the common areas look like? Where will its access and parking be located? What visibility will its premises have? Landlord/developers, however, need to retain the flexibility to meet the requirements of governmental officials, unknown site characteristics, fluid economic demands and other site related contingencies. The tensions arising from those two polar positions can frequently protract negotiations.

Signage. While not often an issue in office or industrial leasing, signage is a significant factor in retail lease negotiations. What signage will be available, where the tenant will be located on monument and pylon signage and what building, pylon and monument signs will look like are all material issues. Having a developed signage plan and knowing the scope and extent of applicable governmental restrictions on signage are keys to any prompt resolution of these lease issues. Since signage is often a part of the overall site plan approval process, many of the same tensions discussed above related to the site planning process are also present regarding signage.

Common Area Maintenance. While not a profit center for a landlord, common area maintenance ("CAM") charges are effectively additional rent to a tenant, and are therefore closely monitored. Having some estimate of how much CAM charges will be at a project, together with communicating any items that are specific to a particular site (such as charges to a master owner's association of which the project is a part) can often prevent subsequent disagreement between the parties, and are important issues to set forth in the LOI.

In summary, the key to effective and efficient lease negotiations, as with any type of negotiations, is effective communication. This starts with a thorough LOI or similar term sheet which accurately frames the material issues and sets forth the intentions of the parties with respect to those issues. Discussing the project in detail early in the process with the attorney(s) who will be involved in the drafting and negotiations can also be extremely helpful and may possibly be the client's most effective use of his or her time, as the better the attorneys understand the entire transaction and the development plans for the project, the better the attorneys can assist in keeping negotiations relevant and "on track."

Here would be my short checklist/wishlist for items to accomplish when commencing a new lease negotiation:

- Have a reasonably detailed LOI or other term sheet setting forth clearly the intentions of the parties on the basic lease terms as well as any project specific issues. A good LOI will cover all issues that have the potential to be "deal killers."

- Ensure all parties understand the site and any particular challenge(s) related to the site. Have as final a site plan as possible, but clarify that the site plan is subject to change and specifically identify the parts of the site plan that are not subject to change.
- Ensure all parties understand the signage issues for the project.
- Ensure all parties understand any particular CAM issues.
- Get a commitment from all parties to a proposed schedule for negotiations and **stay on schedule**. Review drafts and respond promptly.

If these guidelines are observed, the chances of more rapidly achieving an executed lease are greatly increased.

Situations, Strategies & Solutions

(This question and answer feature is intended to provide a brief discussion of various individual issues encountered by landlords and tenants in the context of a larger lease transaction.)

Situation

I am a landlord negotiating the lease with the final anchor tenant in my 500,000 square foot shopping center development. The lease proposed by the tenant includes a permitted use paragraph wherein the tenant describes the goods and services that it will initially sell and provide in connection with its standard business operations. The tenant has asked that I review such paragraph and represent and warrant that such proposed permitted uses are not prohibited by the applicable zoning for the shopping center, any recorded agreements encumbering the shopping center, or any leases or other agreements in effect with respect to the shopping center. I have reviewed the tenant's permitted use paragraph, and I do not believe there are any problems with such proposed permitted uses. Should I have any concerns about making the requested representations to the tenant?

Strategy/Solution

It is true that you know more about the zoning, documents of record and leases and other agreements affecting the shopping center than the tenant. Rather than making the requested representations, however, the better approach would be to provide a list of all use restrictions applicable to the shopping center under the zoning affecting the property, recorded documents affecting the property and/or leases and other agreements affecting the property and require that the tenant review such list and acknowledge that its stated permitted uses are subject to such restrictions. After all, the tenant knows more about its business operations and the goods and services it intends to sell and provide than you. Accordingly, if you are able to represent that the listed use restrictions are the only ones applicable to the tenant's premises, it is reasonable for you to ask the tenant to draw its own conclusions as to whether or not any of such restrictions are problematic.

Situation

I am a restaurant tenant about to enter into a lease with respect to a 6,000 square foot building on an outparcel adjacent to a 200,000 square foot power center development. My lease is one of the first lease agreements being executed by the landlord, and the landlord says that I must agree to be bound by future exclusives that the landlord will need to grant to anchor tenants (and does not yet know what goods and services those exclusives will cover). The landlord has conceded that in no event will any exclusive granted prevent the operation of a sit down restaurant serving primarily American cuisine (which is my intended use of my premises). Is such a provision fair in light of the fact that the landlord does not know what exclusives it may need to grant in the future?

Strategy/Solution

The answer to your question depends heavily on whether or not the landlord is giving you an exclusive for operation of a sit down restaurant featuring primarily American cuisine. If the landlord is not granting you such an exclusive, such request of the landlord seems unfairly restrictive. I would suggest that you provide a list of all possible "next generation" uses of the premises and ask the landlord to agree that in no event will the landlord grant any exclusives that would prohibit any of such stated uses. After all, exit strategy is an important aspect of your overall negotiation, and if you give the landlord the ability to grant exclusive after exclusive that further restricts your ability to assign and sublet, you have severely limited your exit strategy options.

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