

Insights

Triple Net - A Series on Commercial Leasing by Krieg DeVault: Tenant Considerations for Letters of Intent

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*Author's Note: This article kicks off "**Triple Net: A Series on Commercial Leasing by Krieg DeVault**" in which members of the Firm's Real Estate & Environmental Practice Group will analyze important issues and provide practical guidance for landlords and tenants when entering into commercial leases.*

Letters of Intent ("LOIs") lay the foundation for a successful lease negotiation. Despite their importance in outlining foundational business and legal issues to be addressed in the lease, landlords and, in particular, tenants execute LOI's without addressing critical business and legal issues which can lead to protracted and expensive lease negotiations.

This article discusses four overlooked issues tenants may wish to address in LOIs:

- 1. Understanding the Type of Lease.** Broadly speaking, there are three main lease types: (i) gross (a/k/a full service); (ii) net; and (iii) modified gross. With a gross lease, tenant pays an all-inclusive rent amount which consists of both base rent and operating expenses. The operating expense portion of rent generally increases each year based on the negotiated terms in the lease. With a net lease, tenants pay a portion of the building's operating expenses which are passed through from landlord. The most common net lease structure is the "triple-net" lease wherein tenant pays for all of the building's operating expenses, typically pro rata based on tenant's square footage. A modified gross lease is a cross between a gross lease and a net lease wherein tenant pays a portion of operating costs in addition to its base rent. Tenants often fail to appreciate the different types of leases and tenant's ability to negotiate certain protections such as capping annual operating expense increases and excluding certain operating expenses from passing through to tenant.
- 2. Sublease/Assignment Rights.** LOIs rarely address sublease or assignment rights. The initial lease draft typically restricts tenant from assigning or subleasing the leased premises. If tenant needs flexibility to leave the leased premises (e.g., tenant is in a growth stage where it could quickly outgrow the leased premises), it is important for tenant to negotiate sublease and assignment rights which give tenant broad discretion to assign or sublease the space, cap fees which may be charged in connection with such assignment or sublease, and allow for assignment or subleasing to any affiliate, subsidiary or successor entity to tenant.

3. **Guaranty.** LOIs frequently contain guaranty provisions, but such provisions tend to be broad in nature. The LOI stage is an ideal time for tenants to narrow the scope of the guaranty from the broad and onerous guaranty provisions which will be inserted into the initial lease draft. Tenants should consider: (i) capping the guaranty (e.g., 75% of tenant's monetary obligations); (ii) limiting the scope of the guaranty (e.g., the guarantor is responsible only for monetary obligations, not all of tenant's obligations under the lease); and (iii) limiting the term of the guaranty (e.g., the guaranty terminates at the end of the initial term of the lease).

4. **Enforceability of LOI.** LOIs are usually intended to be non-binding "agreements to agree" which confirm the parties' understanding of certain terms before entering into a lease or other definitive agreement. However, courts have held LOIs to be legally binding in instances where the specific language in the LOI led the court to believe the parties intended the LOI to be binding or when the parties viewed the definitive agreement to be a mere formality to be drafted from the agreed-upon terms in the LOI. To avoid an LOI from becoming a binding agreement, the parties should expressly state in the LOI which provisions are binding (common examples include an exclusivity period to negotiate the lease or confidentiality) and which provisions are non-binding (most every other provision).

Conferring with legal counsel during the LOI stage will help tenants identify other issues to be addressed depending on the need of each tenant. Tenant has stronger leverage during the LOI stage which may allow for more favorable terms than if tenant waits for the lease negotiations to address critical issues.

The members of the Krieg DeVault **Real Estate & Environmental Practice** have extensive experience representing landlords and tenants in drafting and negotiating commercial leases. If you have any questions about commercial leases or any other real estate issues, please contact **Christopher Engel** or a member of Krieg DeVault's **Real Estate & Environmental Practice**.

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