



Lowenstein Sandler's Real Estate Podcast: Terra Firma

Episode 12: Lease Term Sheets: Why Investing in a Thorough Review Now Will Prevent Losses Later

By [Stacey Tyler](#), [Stephen Tanico](#)

JUNE 2024

Kevin Iredell: Welcome to the Lowenstein Sandler podcast series. I'm Kevin Iredell, Chief Marketing Officer at Lowenstein Sandler. Before we begin, please take a moment to subscribe to our podcast series at lowenstein.com/podcasts. Or find us on Amazon Music, Apple Podcasts, Audible, iHeartRadio, Spotify, Soundcloud or YouTube. Now let's take a listen.

Stephen Tanico: Welcome to Terra Firma Conversations on Commercial Real Estate. I'm Steven Tanico. Today we will be continuing our slightly more technical but still entertaining series on term sheets, looking a little bit more at the technical aspects of negotiating a term sheet. Today we'll be talking about lease term sheets, and I'm joined by my cohost extraordinaire, Stacey Tyler. Stacey, thanks for joining us. And for once again wearing two hats and carrying the absolute weight of this podcast.

Stacey Tyler: Happy to be here with you as always.

Stephen Tanico: Today we'll be talking about lease term sheets before we get into the more technical aspects of what we, as attorneys would like to see in every term sheet.

I was thinking maybe we could start by talking more generally about the value of having an attorney look at a term sheet. Listeners, I promise you, this is not just a plug to get more legal expenses. We truly do think there is a value here, that will save both time and money for, any tenant or landlord, negotiating a lease.

Stacey Tyler: Yeah. I think we have all been in this situation where we are handed a signed term sheet and told, yep, this is the deal, we're ready to go to the lease. And then that ends up really handcuffing you for the entire negotiation. Because if you, as the tenant, have signed a term sheet that doesn't have some key point of course the landlord's position is going to be, well, that was an in the term sheet.

It's not part of the deal. And it becomes really hard to try to push back against that after the parties have supposedly had a meeting of the minds on the term sheet. So, I think in general, our main piece of advice and, you know, maybe we don't have to be involved in all of your conversations, but at least before you sign it, it would be great if we could take a look at your term sheet, because there are a lot of things that we could point out.

Well, it doesn't say this. It doesn't say that, or this is very vague, and we have been burned before in a lot of ways by certain things and term sheets. So, I do think that there's a lot of value in having your attorney take a look at it before signing. It's going to eventually save you a lot of time, a lot of money, and potentially a lot of risk to if

you get, a point on your term sheet that you didn't think of and you then don't have to lose on that once you get into the document negotiation, just because it really wasn't on your radar.

Stephen Tanico: Absolutely. And particularly on the business terms. Right. Because then even if you were to sign the term sheet without a legal counsel looking at it, as long as the business terms are negotiated, for the most part it allows then the lawyers to focus on the legal nuance of the deal versus, you know, these kind of knockdown fights where some business term is open and it becomes this game of telephone, right?

Where lawyer goes to client, client comes to a lawyer to lawyer to other side, and it just ends up really taking away, I think, productively for moving the deal forward. Personally, I love what I represent a landlord and the tenant signs a happy warm sheet. It's amazing. There's no better feeling than saying, I'm so sorry, but your client signed this term sheet.

Stacey Tyler: You apologize? Wow. I just say no, it's not in the term sheet.

Stephen Tanico: Wow. You know, it's much nicer to me because mine is a little bit sarcastic, but it's but it's. Well, because, you know, a any attorney's natural instinct is to try and renegotiate that. And you spend all this time effectively dancing in circles saying, no, your client already signed this. And, you know, suddenly a 20-minute phone call has moved nothing forward because you are negotiating, you know, whether the security deposit is going to be a letter of credit or cash as opposed to the kind of more nuanced aspects of, of negotiating a lease.

Stacey Tyler: Yeah, I would say also, I mean, most of the time our clients are dealing with brokers, and generally you can rely on your broker to really delve into the financial terms. So they hopefully will have helped you think about the rent amount, whether they're are going to be operating expenses, the amount of the security deposit. Hopefully they have really thought all of that through.

So that's usually not where we see term sheets lacking. It's really those points that are somewhere straddling the line between business and legal things like you said, like your guarantee. Like what? What exactly are the terms of the guarantee? It's not so simple as just saying, well, there will be one. There's a lot of different shapes that that could take or rights like do you need any big picture rights?

Sometimes your broker will include in your term sheet a renewal, right? Maybe there's renewal rent rather than just like a fair market value type language, but maybe there's a reason that you might need some other types of rights, like maybe you might need to expand someday. Maybe you might need to contract, maybe you see a need to reevaluate the lease at all in some at some point over the term.

And you want the right to terminate early. Or maybe this is some kind of asset that you might be interested in owning. So, you might want to have a purchase option or a right of first refusal for the space. So those are the types of things that it's really almost impossible to get the landlord to agree to them.

If you've already signed the term sheet that doesn't have it at all, you really just want to be sure that if there is an aspect of the deal that's very important to you, that that is coming up during the term sheet stage, because it's just more likely that you're going to win.

Stephen Tanico: Absolutely. And I think really, you know, there is great value, particularly on a lease, negotiation for having a really good broker who's knowledgeable in the area. Right? I

it's amazing when it when a client sends me kind of a tenant side term sheet, and it's so clear that their broker has been in the area knows the compare the comps, knows really the nuance of that.

And you see the term sheets far more fleshed out on the business terms because of that advisor already having contributed to the term sheet, versus, you know, landlord gives term sheet to tenant, tenant signs it and then the entire process begins.

Stacey Tyler:

Yeah, I mean, and I've seen it go both ways too. I've also seen like very experienced brokers where they just don't include something in the term sheet. I'm on a deal right now that is such a headache. And and there's, you know, there was a term sheet signed and there's no free rent period written in it at all.

And obviously that is a key business point, especially when you have a big build out. And I'm just shocked that the brokers didn't include it. And I think what happens a lot of times is especially if the parties are used to working with each other, maybe they think that there's an understanding, they know how they would typically do things, and they just assume that everybody's on the same page, but you don't know how long it's actually going to take that deal to get signed.

You don't know if everybody that was at the table at the beginning is still going to be involved once the lease is actually being negotiated. So, I just think it's always safest for everybody to make sure that you get anything that's key to the deal from your perspective in writing, because that's the only way that you're going to be able to memorialize the understanding that you had before you actually got into the lease negotiation.

Stephen Tanico:

For sure. And it's interesting, right, because I think a lot of the time, also, particularly with a longer-term lease, there's this hyper focus on the immediate moment we want to sign this lease, we want to move in, we want to do this build out. and sometimes you lose sight of the idea that you're committing 20 years to this space.

And so thinking about, you know, what a replacement of an Hvac system might seem like. No big deal if it's a brand-new building. But 15, 20 years from now, it's going to be a humongous deal that, you know, someone will have to deal with. And it could very well be you as the tenant because, you know, you weren't thinking about that 15, 20 years ago when you were entering into a lease for a new shiny building that had just been built.

Stacey Tyler:

Yeah. And you and you bring up a great point about like, the practical side of things. I think a lot of people really think about just the numbers or just thinking about the rent. You're thinking about what you're going to have to pay every month to keep the lights on and whatnot. And then, like we said, there's all the legal aspects that we as your attorneys can help with, but there's still the whole practical aspect.

What does this building look like? What does your operation look like? What do you need in the space to to do your business? What kind of parking do you need? You know, all of those nitty gritty details, and that's the kind of thing that your broker can really help with, especially if they have an inspector on their team.

The walkthrough of the space that happens when you're negotiating the term sheet, that's when you find stuff like that out. What is the age and the status of the Hvac unit? How close is it to failure? What are the other physical components of the space that might be a cost center for you? that's going to help you at the term sheet stage.

You don't want to sign a term sheet saying OSHA, I'm responsible for all repair, maintenance, and replacement of the premises and then find out after that. Actually, the premises is about to fall down and now you're responsible to rebuild it. That's where it would be helpful if you had known some of those more practical facts about the space and the deal before you signed the term sheet, so that you could negotiate around it.

Stephen Tanico:

Now, if I am a tenant and you know, I hear what you're saying, and I come back to you and I say that just seems like a very high upfront cost of both time and money just to sign a term sheet, you know, explain to me the value in spending that money and time there, versus kind of knowing that I'm committed to this place before, kind of really investing that time and money for due diligence or for legal fees or kind of any of the ancillary costs related to entering into a lease.

Stacey Tyler:

Sure. Yeah. So, I think that's really a concern that a lot of our clients have, especially if they're working with a broker and seeing a lot of different spaces, and maybe they're entertaining term sheet negotiations with a lot of different providers. They're not going to want to spend a ton of money on any one particular deal until they feel like they've been able to zero in on which one is the best.

So, I would definitely agree that the tenants should really rely on, especially their broker team, because the brokers getting paid once they earn that commission. So, you don't have to worry about they're, you know, they're they're not billing by the hour at the outset when they're doing these term sheet negotiations. So, it's really to the tenants benefit to get a strong tenant representation, representation with the broker team.

And hopefully they have somebody on their team who can walk the space with you and have a more technical eye to look at things like the HVAC components and whatnot. that's that's free really, because they're ultimately just getting their commission once your deal gets signed, if and when it ever does. So, they're going to help you with that upfront work. At no additional cost to you. Most of the time when I do a term sheet review for a lease, unless it's a quite complicated deal, they're not usually longer than a couple of pages. if it's a deal with, like, maybe it's a very long, term and maybe there's a really complicated build out or a lot of different rights.

Maybe it's new construction. That's when we're seeing multiple page term sheets. You're going to need a lot more representation there. But for the most part, if it's a straightforward lease, I'm not spending hours and hours helping you review it. I'm reading your page or two. I'll write you a quick email with some bullet points. Why don't you include XYZ?

And that's that. I really don't think it's a huge investment upfront in legal expense, but I see all the time the value in getting that input from your attorney before you sign the term sheet. Because like I said, it's just so hard after you sign the term sheet once the landlord has already drafted the lease. It's so hard to say, oh, actually, I want this.

And you never brought it up before because the landlord just has such a strong position at that point to say, well, it's not in the term sheet and it's not part of the deal.

Stephen Tanico:

And I think it's also important, right, to have the right broker, a legal team around you to, are knowledgeable about the different asset class. You know, I'm I'm far less concerned about certain things in a Class-A office building than I am in a build to suit industrial building, right? That that kind of changes the the calculus quite a bit in terms of what to not necessarily what to focus on, but things to consider that are a little bit different between those two asset classes.

Stacey Tyler:

Absolutely. And we see that in a lot of the national brokerages, they have completely different teams depending on not only the asset class but the structure of your deal. Like, for instance, if you're thinking of doing a sale leaseback, they have a whole department that does nothing but that. If they're if you're thinking of doing a lab or some kind of other really specialized build out, they might have a whole team that really only focuses on that.

So that's when you're going to get very specialized, market specific advice. They're going to have seen what's in term sheets for the building that's down the street. you know, so I agree with you. I think it's it should be part of your thinking when you're shopping for a broker. What is their experience not only in this particular geographical area, but in deals exactly like mine.

If you're just doing an office lease, a lot of people are great at that. There's just less, you know, magic to it.

Stephen Tanico:

Now, I've got this term sheet, I've negotiated the business terms. Are there kind of any, I don't want to say hidden, but maybe any kind of financial terms that I might not be thinking about beyond, security deposit and rent figures.

Stacey Tyler:

So, I would say this is kind of hand in hand with the security deposit point. I would say, think about what your guarantee means. Most of the time, a landlord is going to want as part of their underwriting of the risk of the deal, they're going to want some kind of a security deposit, which is going to be tied to their physical risk in the space. It's usually based on a certain proportion of your annual rent. And maybe it also takes into account what kind of work you're doing in the space; how much it would cost the landlord to undo it if you just left in the middle of the night. But usually, they're thinking about that amount of money in tandem with the guarantee that you may be required to give.

Those two things are part of what is going to protect the landlord from the risk that the tenant completely fails, goes out of business, burns the building down whatever.

It's important for our clients to understand that a guarantee is not just a, you know, a single concept. It is a document that can be negotiated in lots of different ways.

You could be giving a guarantee from an entity, or it could be from a person. We try to really push our clients to not agree to personal guarantees that, Kimberly, you know, mess up your life if things with your business go wrong. but even if you do, there's lots of different ways that you can mitigate it. So, it's not always the case that once you sign a guarantee, that's it.

You're on the hook for every single thing that could go wrong with the space. You can limit guarantees in time. Like say for instance, you are only doing a guarantee that lasts for the first few years of the lease term and after that it expires.

Generally, landlords might be willing to do that because the riskiest time for a tenant is the time it takes them to move in, do the fed up and get open and operating and making money in the space so they might be willing to have your guarantee burn off after that time.

They might be willing to do that, especially if you're making a big investment in the space, if you're refurbishing it, if you're adding value to the building, then maybe they're comfortable having that guarantee burn off. Once you've completed that work, you've delivered them value kind of in a different sense. The guarantee can also be limited in dollar value.

So maybe you have a guarantee for the entire term, but the total recourse against the guarantor is capped at a certain dollar threshold. And if the costs are higher than that, too bad the landlord is out of luck at that. You also have uncertain markets, especially in New York, something called a good guy guarantee that is essentially just guaranteeing to the landlord that the guarantor is going to cause the tenant to vacate, and they'll make sure that the rent is paid through that period, that it takes them to give notice and get the tenant out. That is something, like I said, is quite common in New York City. And some other markets are open to it as well. But it's going to depend on whether the landlord is familiar with that and comfortable with it. So that's one area that I think our clients really could think about and push on more at the term sheet stage now.

Stephen Tanico:

And I think, you know, kind of the guarantees. A perfect example of just the nuance that can come into play and really make a significant difference. Because when you're dealing with a guarantee, for example, it's not so much I don't want to have a guarantee at all. And the landlord's like, no, absolutely not. It's okay, I'm willing to give this guarantee, but let's get into the weeds a little bit and the nuance of it to kind of provide me with the best protection and also satisfying what the landlord's looking for.

I kind of crudely describe leases like a prenup. you negotiated them at the beginning, and everyone is having a great time. Weddings on the horizon. This marriage is going to last forever. And then, you know, ten years down the road, you. Although this out of the, the draw and realize that, you know, maybe you were a little too friendly ten years ago. But I think there's significance to the idea that the term sheets even a better first step because it really just spells everything out. So clearly. Right. You know, for example, I think when we negotiate into term sheets alteration thresholds. Right. So the idea that yes landlord, I do need your consent if I'm doing something structural or if I'm doing \$1 million project, but, you know, trust me a little bit. As long as XYZ criteria are met that I can do this without your consent. And again, it's kind of the best part about transactional law is the idea that both parties should walk away feeling like they're kind of in the middle. There's not just a clear winner and a clear loser. and there again, you have a situation where both parties feel like they've got a win. And yet at the end of the day, they both did get a win, which is kind of a nice aspect, right?

Stacey Tyler:

Everybody should be a little unhappy. And that means you probably did a good job. Yeah, I mean you reminded me of another good point too, that I feel like clients don't spend a lot of time on. I mean, maybe if they are doing a good amount of work that they agree on the dollar amount of the tie allowance, the tenant improvement allowance. But I think a lot of times they don't really think about the mechanics of how that is going to be paid, how it's going to work. So, I would say it's worth it to think about, okay, you're just going to hand me a big pile of money upfront, or do I have to do the work and then get the money? Do I have to complete the whole thing, or are there certain, milestones that I have to reach in order to get those funds advance to me? How is that process going to work? And we've seen a lot of value in getting the parties to really think that through. The landlord probably has a standard procedure, like they want your contractor to submit requisitions on a monthly basis, and they have to provide lien waivers or whatever the might. They probably have a whole baked out checklist for what they expect for that process. But as the tenant, you don't know what that is until they tell you. So, it's just easier for you to wrap your head around it or push back on it. If you find that out at the term sheet stage.

Stephen Tanico:

It's funny, you reminded me of a landlord client now where we're actually dealing with this exact problem. there was a large amount of tenant improvement allowance, and the lease, is just a little unclear on how it gets paid out. And so, the landlord doesn't want to just give the tenant a lump sum. They want the tenant to take it as a rent abatement effectively, and the tenant wants to be paid, and neither of them want to pay the contractor. And so, it's actually led to a series of mechanics liens being filed

just because of the nature that they can't agree on. Who's going to actually have to wire money out.

Stacey Tyler: Yeah. And that's a lot of lawyer time. I, I'm hearing like that. They're talking to you about it still they already signed the lease. They're filing liens. They're threatening to sue. They're writing angry letters. That's a lot of wasted time and expense that would have been avoided if they had just kind of thought it through a little bit more before they sign the document.

Stephen Tanico: Amazing. Stacy, that about wraps it up for us today. But before we we kind of like to end these more technical episodes with kind of a general question first thought that comes to your mind when someone asks you, what's the most important thing to remember when negotiating a lease term sheet?

Stacey Tyler: I would say don't sign it until your lawyer has reviewed it. I think that's exactly what Kim said at in our, financing term sheet episode. But it's true. And I the other point I would make is everything is negotiable. You can push back on anything.

Stephen Tanico: Amazing. Thank you, Stacy, for again carrying the weight of this podcast by both being a host and a guest. And thank you listeners for tuning in today. Be sure to like, subscribe, and follow terrafirma wherever you're listening to this episode. Stacy and I would love to hear from you, so feel free to reach out to us at terrafirma@lowenstein.com Until next time.

Stacey Tyler: Ciao!

Kevin Iredell: Thank you for listening to today's episode. Please subscribe to our podcast series at [lowenstein.com/podcast](https://www.lowenstein.com/podcast) or find us on Amazon Music, Apple Podcasts, Audible, iHeartRadio, Spotify, Soundcloud or YouTube. Lowenstein Sandler Podcast series is presented by Lowenstein Sandler and cannot be copied or rebroadcast without consent. The information provided is intended for a general audience and is not legal advice or a substitute for the advice of counsel. Prior results do not guarantee a similar outcome. Content reflects the personal views and opinions of the participants. No attorney-client relationship is being created by this podcast and all rights are reserved.