

# **Significant Drafting Issues Specific to Commercial Leases**

**Jeffrey C. O'Brien**  
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## **Significant Drafting Issues Specific to Commercial Leases**

### **A. Drafting Commercial Lease Provisions**

The necessary and most common commercial lease provisions revolve around how rent is to be structured as well as the taxes, utilities and general maintenance of the property. Other clauses, such as those that place restrictions on assigning and subletting, as well as those that require accordance with environmental and governmental laws and guidelines must also be included in great detail. This section will address each of these provisions of a commercial lease and provisions that are similarly related.

#### **a. Rent, Security Deposits, Adjusting the Rent, Term and Options to Renew**

##### **i. Rent**

There are essentially two – Percentage Rent and Base Rent. Percentage Rent is based on the percentage of gross sales for a rentable area. Base Rent is based on the rentable square footage with an increase over time for operating expenses. Both have their advantages and disadvantages to the parties involved and require specific detail in order to be executed properly.

Base Rent is calculated by multiplying the rentable square footage of the location by the cost per rentable square foot. The cost per rentable square foot is based on the operating expenses, utilities and taxes the landlord faces annually.

Base Rent should be supplemented after the first year, or base year, to cover increases in operating expenses and taxes. In addition to base rent, the rent clause should include one of three alternatives to supplement base rent. The alternative is base year, which requires the tenant to pay monthly payments of reasonably estimated increases in building operating expenses and real estate taxes of the current year over the base year. With this alternative, the landlord needs

to be sure to designate which year, usually the year executed, as the base year from which to determine future additional rent.

A second additional rent alternative is expense stop, which requires the tenant to pay its proportion of a predetermined increase in operating expenses and taxes. Tenants may not favor this alternative as the amount paid is more speculative.

Finally, a third option is net lease. Net lease requires the tenant to pay monthly installments of the total operating expenses and real estate taxes for the current year. This differs from base year in that it is not the change from base year to the current year, but *just* the current year's expenses and taxes.

Under each of these options, provisions should be included to allow refunds to tenants who overpay if the expense increase was overestimated, or that require tenants to make good if the expense was underestimated. These provisions also need to be very specific as to how the tenant will be apportioned their share of the expenses, and what will be included and excluded from the tax and expense increase. Furthermore, tenants are more likely to agree to such additional rent if they are allowed to audit the expense increase reports at the end of the year.

A sample base rent provision is as follows:

**BASE RENT:**

**Tenant shall pay as monthly "Base Rent" for the Premises one-twelfth of the product of: (i) the Rental Rate set forth in the Data Sheet, times (ii) the number of square feet of Rentable Area of the Premises. The Base Rent shall be paid to Landlord without notice or demand in lawful money of the United States in monthly installments, in advance, on the first day of each and every calendar month during the Term. If the initial or final month of the Term of this Lease is less than a calendar month, Base Rent for such partial month shall be prorated at the rate of one-thirtieth of the monthly Base Rent for each day, payable in advance. Tenant will pay said Base Rent, together with Additional Rent as specified within Section \_\_\_\_ herein and all other amounts due under this Lease, to Landlord at Landlord's Address set forth in the Data Sheet, or to such other party or to such other address as Landlord may designate from time to time by written notice to Tenant. Tenant's obligation to pay the Base Rent, Additional Rent and other amounts due under this Lease is an independent covenant, and, except as provided otherwise herein, shall not be subject to any abatement, deduction, counterclaim, reduction, setoff or defense of any kind whatsoever.**

Percentage Sales requires a percentage of sales rent begin after the business' gross sales exceed minimum gross sales for the year. It is obviously best used for retail spaces, as opposed to office or mixed use premises. The intention is that landlords want to increase retail sales for the entire premises. A tenant will want to avoid a percentage sales rent that accrues monthly in favor of one calculated at the end of the year. This allows the tenant's gross sales to account for seasonality that might occur.

Minimum gross sales are calculated by taking the annual base rent and dividing it by the percentage decimal. For example, if 12,000 square feet are rented at \$7 per square foot at 1% sales, the minimum gross sales would be  $(12,000 \times 7) \div .01 = 8,400,000$ .

If the tenant exceeds sales of \$8,400,000 then it begins paying the landlord 1% of gross sales above that amount on top of the base rent amount. This requires the landlord and tenant to agree on specific items included and excluded in gross sales. It is not uncommon for a tenant to want internet, phone or mail orders excluded from sales since they are not produced from the leased space itself.

A key underlying theme to rent provisions is to be very specific on what type of rent provision is being used and what all is included in it. Obviously, retail locations are more likely to benefit from percentage sales provisions whereas office and mixed use spaces will likely look to base rent plus additional for expenses and taxes.

## **ii. Security Deposits**

Security deposits are frequently used as credit enhancement or as a means of protecting the landlord from tenant defaults. If the landlord is at all unsure of the tenant's future abilities to pay rent or meet its obligations, then the landlord should request a security deposit that is only

refundable if all the tenant's obligations under the lease are met at the end of the term. The amount of the security deposit will depend on the tenant's credit as well as the space rented.

There are a number of common issues with security deposits that have a tendency to arise over the course of negotiations – will interest accrue on the security deposit, will it be refunded or credited to the rent over time. Each of these issues need to be addressed in full before the lease is agreed upon. If interest is to accrue, then the security deposit, especially if it is a sizable amount, needs to be kept in a separate account from other funds.

Many lenders will look for security deposits, at least, as a form of securing not only the landlord but also the lender. If a tenant defaults without a security deposit or some other form of guaranty, the lender will not look as favorably on the landlord's project.

### **iii. Adjustments to Rent**

Rent can be adjusted to meet changes in the economy or shifts in the consumer price index (CPI). The purpose of adjusting rent is so that the landlord can collect rent in accordance with the value of the property, which can change due to inflation and changes in consumer behavior. There are three basic approaches to adjusting rent – Step-up Rent, Indexed Rent and Market Rent.

Step-up rent gradually increases the fixed rent over the course of the lease term in “steps.” These are usually predetermined amounts. If the rent is more long term, a step will be accompanied with an increase due to CPI to ensure that the landlord and tenant are recognizing the value of the premises.

Indexed rent adjusts the fixed rent with changes in particular economic indexes such as the CPI. Two general formulas are used to determine the rent adjustment with CPI.

- $(\text{Current CPI} - \text{Base CPI}) / \text{Base Year CPI} = \text{Percentage Rent Increase}$

- $(\text{Current CPI} - \text{Prior Year CPI}) / \text{Prior Year CPI} = \text{Percentage Rent Increase}$

Finally, the Market Rent adjustment is determined when the property is periodically appraised to meet its market values. This tends to be more expensive for the landlord and may be disputed by tenants. However, Market Rent takes into account supply and demand factors that are not considered with economic indices.

#### **iv. Lease Term**

The lease must have a provision setting forth when the term begins, usually the execution date and specifically when it will end. If the tenant begins business in the space before the specified term begins, then the term begins on that first day of business.

Usually, the term end date is the day the tenant must be completely moved out of the premises. The landlord should have a provision in place protecting it in the event the tenant does not move out on the specified date. For example, the landlord may face costs for holdover and/or moving the new tenant to a temporary location that the outgoing tenant should cover. In addition, there should be some financial disincentive for a landlord that does not have the premises prepared and ready for an incoming tenant. This disincentive may include a right for the tenant to terminate the agreement or for the landlord to pay costs incurred by the incoming tenant.

#### **v. Options to Renew**

A landlord is under no obligation to extend or renew a lease unless such a term has been specifically negotiated with the tenant.<sup>1</sup> Renewal and extension are very different from each other. Renewing a lease requires the new lease to be negotiated and agreed to by both parties. Extension is simply the extension of the same terms as the original lease.<sup>2</sup> If an option clause

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<sup>1</sup> *Friedman on Leases*, §14.1 (Fifth Edition)

<sup>2</sup> *Med-Care, Inc. v. Noot*, 329 N.W.2d 549 (1893).

only requires the tenant to send a notice to exercise to the landlord, courts will interpret it as an extension rather than a renewal, even if the provision includes the term “renewal.” More so, a tenant cannot opt to renew just a portion of the leased premises; the entire premises included in the lease are renewed. If the tenant wishes to change the premises included in the lease, renegotiation of the lease is required.<sup>3</sup> The landlord should protect himself from any confusion by specifically noting this in the renewal clause.

If an option to renew is going to be included, it must be supported by adequate consideration. An option to renew included in the original lease agreement, as one transaction, is sufficiently supported by consideration.<sup>4</sup>

The parties need to be specific about what the amount of future rent to be paid. If the future rent provision is not clear, the courts are not likely to enforce it unless it is to be determined by a third party.

Finally, a typical option to renew provision should require the tenant to provide notice of exercise of the option to the landlord. Notice should be required well in advance of the end of the lease term to prevent the landlord from beginning a search for a new tenant. The landlord can waive requirement of notice, but this puts the tenant and landlord in a holdover situation.

#### **b. Methods of Calculating Square Footage**

Because the square footage is key in determining the effective rental rate per period, square footage needs to be specifically detailed in the lease agreement. The method of calculation is different if the facility is office or mixed use space versus retail space.

Office space is measured from the inside surface of the glass in the windows (or the interior surface of the walls). The entire “plane” should be measured; however, if not everything

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<sup>3</sup> *Barge v. Schiek*, 58 N.W. 874 (Minn. 1894).

<sup>4</sup> *Wurdermann v. Hjelm*, 102 N.W.2d 811 (Minn. 1960).

is rentable, then the “plane” should end at any partition that separates rentable premises from common areas. Columns and other projections such as service, technology or mechanical rooms do not need to be deducted.

Retail space is measured from the outside surface of exterior walls and/or any walls that face the premises’ common areas. If a particular space shares walls with another, then that wall is measured from its centerline. Like office space, columns and other projections are not deducted from total square footage.

Most Minnesota measurement standards are in accordance with the Building Owners and Managers Association International standards (BOMA, 1996). BOMA extends the measurement for office spaces to the glass line even if the window is the least dominant portion of the wall. In addition, BOMA allocates common area expenses equally among tenants. Each tenant is assigned the same portion of common area expenses, instead of the previous “per floor” basis for distributing the expense.

**c. Taxes, Utilities, Maintenance, Repairs and Services**

The cost incurred by the landlord for taxes, utilities, maintenance, repairs and services can all be passed through to the tenant. The means of passing them off are not that different than allocating additional rent as discussed above; however, the landlord and tenant must agree on course of action should any category breakdown, exceed agreed quantities or cause harm to the business.

**i. Taxes**

A landlord may seek to spread the responsibility of property taxes across all tenants. There are a few options available to pass off the cost both of which require a specific notation of how it will be calculated and what is included in the cost to the tenant.



First, a tenant will be required to pay its proportionate share of the tax expense. This, similar to the additional rent alternatives above, can be calculated by dividing the total rentable square footage of the tenant by the rentable square footage of the entire complex. This figure is then multiplied by the property tax figure payable by the landlord for the entire property. The landlord is then responsible for any taxes associated with unrented space.

The second option requires the tenant pay based on the increase in taxes from the base year. Again, the tenant only pays its proportion of the increase. The tenant may retain the ability to audit the tax costs to ensure that the landlord is not being reimbursed for more than 100 percent of the taxes. In addition, the tenant should periodically have its square footage reviewed to make sure the landlord is not erroneously allocating tax costs.

## **ii. Utilities and Services**

Utilities are an element of the commercial lease that can vary based on the tenant. If a tenant requires little utilities, they may negotiate to have their utilities kept separately from other tenants who require more electricity, water or gas. Conversely, if a tenant's utility usage is high they may wish to have a maximum utilization provision.

If the tenant is the former, they will need the landlord's approval as it requires rewiring of the premises and reorganization of costs among the remaining tenants. If the tenant is the latter, the landlord will supply a maximum level of the utilities. Any usage beyond the maximum will need to be covered by the tenant.

The landlord may include a clause indemnifying them from liability in the event of interruption of utilities – also known as a breakdown or diminution clause. The landlord and tenant must agree that rent abatement does not occur during any period of repair, breakdown or

interruption of utilities. In addition, the landlord needs to stipulate that, if such an event occurs, the tenant's usage (such as wattage) is limited to ensure proper repair.

It is fairly common for a landlord to offer the second type of utility "package." However, the maximum wattage level supplied by the landlord must be specified in the lease agreement in order to be effective.

Services are treated very similar to utilities in that a maximum usage amount is set and any costs over that are covered by the tenant. Services can include HVAC, elevators and janitorial services. Again, the landlord may include a clause excusing him from liability if the service is interrupted.

### **iii. Maintenance, Repairs and Services**

Maintenance and repairs are typically treated the same in any commercial lease agreement. The landlord will want a provision allowing them to enter the premises for maintenance and repairs of the premises with notice to the tenant. Notice alone is usually all the agreement will call for, even though the tenant may wish the provision to also require their consent. If emergency repairs are needed, the agreement will not require the landlord to give the tenant any notice. A tenant may, however, seek to constrain the landlord to the extent that the landlord may only enter the premises, in non-emergency situations, during non-business hours. Or, if the tenant's premises contain sensitive, confidential information, the tenant should negotiate to require the tenant's consent before entering the premises.

In the event repairs are needed, such a provision may look to the landlord's liabilities including rent abatement, time limits for restoration and even termination of the lease if repairs are unrealistic. Sometimes repairs and restoration are not the most economic avenue for the

landlord as they may exceed insurance coverage. Because of that, a provision will be included to void the landlord's liability to repair the premises.

The tenant should protect itself in repair and maintenance situations by investing in business interruption insurance. The landlord has similar protection available through rent loss protection. Neither party wants to confine itself to a lease on property that is beyond repair or unsuitable for their business. Therefore, repair and maintenance provisions in a lease need to be carefully articulated to allow both parties ultimate protection and limited liability.

#### **d. Use and Occupancy, Personal Property and Fixtures, Assigning and Subletting**

##### **i. Use and Occupancy**

Use and occupancy provisions help develop a mix of tenants on the premises and protect the landlord from tenant use that can harm or damage the premises making insurance expensive or unattainable. These provisions can also assure tenants that any successor landlords cannot change the use of the building without consent of the tenant.

If a landlord wishes to bring about this sort of protection, the terms of the lease must specifically limit the type of use and enjoin any violation of the limitations.<sup>5</sup> The agreement may limit the use of heavy, inflammable material, machines that cause vibration or loud noise, and equipment that produces noxious odors. The description must be very clear as to what is being limited. Use of the word "only" will be upheld; however, overrestriction can result from such terminology enabling a tenant to void or terminate the lease for frustration of purpose.<sup>6</sup>

If the lease does not place a restriction on the tenant, they can use the premises for "any lawful purpose not substantially different from the usual and appropriate use of the premises."<sup>7</sup> Consequently, a tenant will want a broad use provision that allows them leeway in their

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<sup>5</sup> *Friedman on Leases*, § 27:3:1 (5th ed. 2007)

<sup>6</sup> *Baron Bros v. Nat'l Bank*, 155 N.W.2d 300 (S.D. 1968); *Friedman on Leases*: § 27:3:2.

operations and more flexibility when attempting to assign or sublet the premises. A landlord and lender will want a provision that makes the premises as profitable as possible for the other tenants, and, therefore, will restrict the use in order to make it less economically harmful to other tenants.

Any minor uses such as permitting kitchen space or media centers must be listed and agreed upon. Simply using the phrase “and uses incidental thereto” are not ideal for insurance purposes as it gives the tenant too much leeway in uses of the premises.

An example “Use of Premises” provision is as follows:

**USE OF PREMISES:** Tenant will use and occupy the Premises for purposes of conducting the business of \_\_\_\_\_. It shall be Tenant’s obligation to obtain any permits or licenses required in connection with Tenant’s use of the Premises, with the exception those building permits necessary for any build-out of the Premises.

**1) Tenant will not use or occupy the Premises for any unlawful purpose, and will comply with all present and future laws, ordinances, regulations and orders of all governmental units having jurisdiction over the Premises. Tenant shall not cause or permit any unusual noise, vibrations, odors or nuisance in or about the Premises. Landlord disclaims any warranty that the Premises are suitable for Tenant's use and Tenant acknowledges that it has had a full opportunity to make its own determination in this regard.**

**2) Tenant will not conduct or permit to be conducted any activity, or place any equipment in or about the Premises, which will in any way increase the rate of fire insurance or other insurance on the Property; and if any increase in the rate of fire insurance or other insurance is stated by any insurance company or by the applicable Insurance Rating Bureau to be due to activity or equipment of Tenant in or about the Premises, such statement shall be conclusive evidence that such increase in such rate is due to such activity or equipment and, as a result thereof, Tenant shall be liable for such increase and shall reimburse Landlord therefor and, further, shall discontinue or cause the discontinuance of such conduct or shall remove such equipment upon Landlord's demand made at any time thereafter.**

**3) Tenant shall not install, use, generate, store or dispose of in or about the Premises any hazardous substance, toxic chemical, pollutant or other material regulated by the Comprehensive Environmental Response, Compensation and Liability Act of 1985 or the Minnesota Environmental Response and Liability Act or any similar law or regulation, including without limitation any material containing asbestos,**

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<sup>7</sup> *Nave v. Berry*, 22 Ala. 382 (1863); *Walgreen Ariz. Drug Co. v. Plaza Ctr., Corp.*, 647 P.2d 643 (Ariz. 1982).

PCB, CFC or HCFC (collectively "Hazardous Materials") without Landlord's written approval of each Hazardous Material. Landlord shall not unreasonably withhold its approval of use by Tenant of immaterial quantities of Hazardous Materials customarily used in office business operations so long as Tenant uses such Hazardous Materials in accordance with all applicable laws. Tenant shall indemnify, defend and hold Landlord harmless from and against any claim, damage or expense arising out of Tenant's installation, use, generation, storage, or disposal of any Hazardous Materials, regardless of whether Landlord has approved the activity.

4) Tenant shall use the Premises carefully and conduct its business in a reputable manner. Tenant shall not commit waste or use the Premises in any way that may obligate Landlord to make any alteration to the Building or other improvements on the Land or in any way deemed hazardous. Tenant shall not bring onto the Premises or Building any hazardous or regulated substance without prior written approval of Landlord. If Landlord consents to any such request of Tenant (which consent may be withheld by Landlord at Landlord's sole discretion) than upon request of Landlord, Tenant shall demonstrate to Landlord's reasonable satisfaction that the presence of such materials in the Premises or Tenant's use thereof is in compliance with all applicable laws and regulations. Tenant shall not obstruct in any way the common areas serving applicable laws and regulations. Tenant shall not exceed the floor loading capacity designated by Landlord for the Premises. All equipment installed and used by Tenant shall be properly shielded and shall be installed and maintained, at Tenant's expense, as Landlord may reasonably direct, so as to be sufficient to eliminate the transmission of noise, vibration, electrical or other interference from the Premises to any other area of the Property.

5) By occupying the Premises, Tenant shall be conclusively deemed to have accepted the Premises as being in the condition required by this Lease. If requested by Landlord, Tenant shall sign a statement confirming the Commencement Date and ratifying acceptance of the Premises. In addition, Tenant shall have a 7-day waiting period to discover any defects and shall notify Landlord immediately of the same.

## **ii. Personal Property and Fixtures**

It is expected that tenants will move personal property and fixtures onto the premises. However, the landlord will set guidelines as to what types of fixtures are permitted and when they can be moved onto the premises. The general purpose of such a provision is to protect the landlord from being responsible for removal or installment of such property and to limit disruption to other tenants. As a result, such a provision will usually call for materials to be moved onto the premises during non-business hours and/or through certain low-traffic areas.

This clause should also note which types of property and fixtures are not permitted due to the effect they may have on other tenants' business – such as loud machines or those that cause vibration to the premises. Consent of the landlord should be required before installation of any property or fixture that could cause such harm, damage or alteration to the premises.

Any damages caused by the installment or removal of personal property or fixtures become a liability of the tenant. The tenant should thereby avoid installing any fixtures or property that would require alteration, changes, replacements or additions to the premises.

### **iii. Assigning and Subletting**

One way for a tenant to diminish its involvement in a lease is through assignment and subleasing. Assigning or subleasing does not completely release a tenant from liability or responsibility. It merely disperses some or part of the tenant's liability to the subtenant or assignee. Sometimes the lease may explicitly prohibit or limit the tenant's ability to sublease or assign the lease. However, if the lease is silent on the issue, this is generally treated as permission to sublease or assign. The tenant may then may sublease or assign whenever it wants without the landlord's approval. At-will tenants may also sublease or assign absent a specific provision to the contrary.

It is possible to have restrictions in the lease in order to limit subleasing or assignment. The lease can have a provision that absolutely denies either one. If a tenant proceeds to sublet or assign in spite of such a restriction, the landlord can void the transfer and continue to act as if the original lease is in full effect, or the landlord may seek rent from the assignee or subtenant.

The lease may also have a provision requiring the landlord's consent. In either case, the landlord can refuse to sublet or assign with or without reason. However, a landlord waives the

restriction when the landlord consents to subletting or assigning or accepts rent after the premises have been sublet or assigned.

Often times a tenant will want to add a clause that gives the landlord the power to approve subleases and assignments as long as “consent is not unreasonably withheld.” Most landlords will object to the provision, especially those in charge of a shopping area where the tenant mix is critical. However, if there is such a provision a landlord may also want to exclude itself from liability for consenting or not.

Additionally, the landlord will want to avoid additional subleases or assignments to the sublease or assignment. Any sublease or assignment longer than one year is required to be memorialized in writing under the Statute of Frauds.

A corporate tenant cannot terminate a lease agreement by dissolving itself. In that case, the obligations under the lease would pass to the shareholders. Furthermore, if there is a restriction against subletting or assigning, it remains in affect after dissolution of the corporation and it is not avoidable if the tenant reincorporates. Mergers of corporations are usually treated differently. Even with a restriction against subletting and assignment in the lease, the merger of a corporation tenant is usually not treated as a breach of the restriction. A corporate tenant will also want ensure that if there is such a restriction that it does not prohibit assignment or subletting to subsidiaries, affiliates, or parent companies. Most landlords will not have a problem with this exception, since it is vital to many corporate tenants and not a significant burden to the landlord.

Bankruptcy will also affect the tenant’s ability to sublease or assign. The trustee of the bankruptcy estate can either reject the lease or assume it. Trustees will usually assume the lease

with hope of assigning it soon after. Under bankruptcy laws, the estate can assign the premises in limited circumstances even if there is a restriction against assignment in the lease.

## **1. Subleases**

The difference between a sublease and assignment lies in the interest being transferred. An assignment is a full transfer, whereas a sublease is a partial transfer. A sublease may be for all or part of the premises and must last less than the remaining term left on the lease. If a tenant attempts to sublease all or part of the premises for all of the time remaining, the transfer will be considered an assignment of the lease rather than a sublease.

Why sublease as opposed to assign? A sublease is an agreement only between the tenant and the subtenant, and not between the subtenant and the landlord. Subleases do not affect privity between the landlord and the tenant and it does not create privity between the landlord and the subtenant.

Privity describes a mutual interest in property between two parties. There are two types of privity that concern leases; privity of estate and privity of contract. Privity of estate is created between a landlord and a tenant, while privity of contract is created between two contracting parties. Privity creates legal responsibilities and obligations between the parties.

Privity of estate creates liability for certain covenants in the lease. Specifically, it does so for those covenants that run with the land for those covenants that touch and concern the land. Privity of estate does not create liability for personal covenants or collateral covenants.

Privity of contract also remains in a sublease. Therefore, the tenant is still liable for the lease contract signed with the landlord. In sum, a sublease does not change the privity between the landlord and tenant, and it does not create privity between the landlord and subtenant. Privity, of course, will be created between the tenant and subtenant.



When a subtenant is considering a sublease, it should look at the original or prime lease between the landlord and the tenant. The tenant cannot sublease more space than was leased to it. Additionally, any other limitations set out in the prime lease cannot be avoided in the sublease. The subtenant cannot cause a default under the prime lease. The subtenant will also want to make sure the premises are suitable for its business.

The tenant will want to carefully consider any prospective subtenant. The tenant may be liable for the subtenant's actions and the tenant should ensure the subtenant complies with the prime lease. Additionally, the tenant will want an indemnification against a default caused by the subtenant, along with a security deposit. The tenant will also want a right of re-entry in order to get rid of a subtenant who neglects rent and find a replacement quickly.

The landlord will also want to ensure it is being involved in the subleasing process. The landlord should seek an agreement with the subtenant whereby the subtenant will pay rent in the event the tenant fails to do so, along with the landlord's right to enforce the tenant's rights against the subtenant should the subtenant default under the prime lease.

## **2. Assignment of Lease**

Assigning the lease is similar to subleasing. An assignment is a transfer of all or part of the leased premises for the remaining term of the lease. When a tenant decides to assign, it should be clear to the assignee and the landlord that the transfer is an assignment. It is not enough to accept rent and inhabit the premises. The assignee and the tenant should have a written agreement outlining the assignment to ensure the assignee properly assumes liability for the premises.

It is important to know who has liability because assignment affects privity differently than a sublease. Privity of estate ends between a landlord and a tenant when the tenant assigns its

leasehold interest. The assignee, in a sense, replaces the tenant. Privity of estate is created between the assignee and the landlord. The assignee is responsible to the landlord for rent, repairs and surrender of the premises when the term expires.

The assignee will want to check on the landlord's title and look at the original lease. If the landlord's title is defective, the assignee will be able to recover against the tenant.

Three sample assignment and sublease provisions:

**(1) Tenant shall not assign this Lease or sublet all or any part of the Premises without the prior written consent of Landlord, which shall not be unreasonable withheld. Landlord has legitimate concerns regarding the compatibility of new or different occupants of the Premises, including concerns based upon the use to which such occupants may make of the Premises, and may therefore withhold its consent to any such transfer based upon any concern Landlord may have regarding the use to which the proposed transferee may put the Premises or based upon concerns related to possible lack of harmony between such proposed use of transferee and other uses or occupants in the Building or concerns related to the financial strength, character or reputation of the transferee. No transfer of any nature shall relieve Tenant of primary liability to Landlord hereunder unless Landlord agrees in writing. If Tenant is a corporation (other than a publicly traded corporation) or partnership, any change in the control of Tenant shall be deemed to be a transfer under this Lease. In the event of any transfer approved by Landlord which results in the generation of rent in excess of the amounts charged by Landlord hereunder, Landlord shall be entitled to any such surplus.**

**(2) Tenant may sublet the Premises without the prior written consent of Landlord. Tenant shall immediately notify Landlord upon any sublease and shall provide a copy of any sublease agreement.**

**(3) Tenant may not sublet the Premises or assign the Lease without the prior written consent of Landlord.**

#### **e. Environmental Matters**

Both parties of the lease are required to adhere to environmental guidelines and requirements when conducting business on the premises. The landlord is required to show compliance with any and all present and future state, county, city and federal property laws, as well as any environmental laws especially those relating to hazardous materials. The landlord is required to disclose whether or not any violations have been cited for the premises in the past,

and how it was corrected. The tenant, depending on the type of business and premises, is typically restricted from storing, using or producing any hazardous materials on the premises in order to avoid environmental harm.

The tenant can protect themselves from any liability stemming from violations of Comprehensive Response, Compensation and Liability Act (CERCLA) or any other environmental damage on the premises by requesting a copy of the Environmental Site Assessment that is usually prepared by an environmental engineering firm on the landlord's behalf. Having such an assessment conducted on a regular basis can also help safeguard the landlord from any future liabilities.

A provision detailing any past environmental problems and absolving the tenant's liability for those, while at the same time requiring the tenant and landlord to be liable for future environmental violations is necessary to any lease agreement.

#### **f. Governmental Compliance**

Both landlord and tenant need to make sure the premises adhere to governmental requirements and guidelines. The lease agreement should stipulate who is responsible for the costs associated with bringing the premises up to standard. The tenant will want a lease provision requiring the landlord to promptly make changes and cover all costs and expenses, if a new law comes into existence during the course of the lease. A landlord will usually try to shift the risk and cost of compliance with federal, state and agency regulations to the tenant by including it as "additional rent" or an increase in operating expense.

A common requirement is that the premises comply with the American Disabilities Act ("ADA"). Typically, each party will provide an indemnity to the other for noncompliance. If the tenant changes the space and brings it out of compliance, the tenant is liable for any fines and

costs needed to bring it back into compliance. Conversely, if the landlord leases space that is not in compliance, the landlord will be liable for costs and fees needed to bring it into compliance.

Under Minnesota and Federal law, both parties are liable for ADA compliance and the lease agreement should reflect this while also supplying the indemnity as noted above. The agreement should, however, specify who is liable for what space. It should be made clear who is liable for common areas and how the cost is to be shared, if at all, across the tenants.

**g. Leasing Premises Under Construction**

For the most part, the landlord is not responsible for the condition of the premises at the start of the lease term. This is in stark contrast to residential property which has implied warranties for habitability and housing codes. The commercial tenant must usually take the property “as is”. The tenant should therefore make a careful inspection of the premises and discuss how improvements will be made and paid for if any are undertaken. This general rule does not apply if the premises have not yet been built. However, there are statutes that require the landlord to provide certain safety requirements. When there is construction involved on an existing building it would be prudent to obtain Builder’s Insurance (as discussed more fully herein).

Tenants do not generally have a right to alter or repair the premises absent any specific provision. This prohibition covers material changes in the nature or character of the building. It is sometimes relaxed for long-term tenants. Most commercial leases will have some sort of provision to address alterations, repair and improvements. Minor changes are usually permitted. If the minor changes are done without consent, the landlord will still probably not have any enforceable actions.

Construction and improvements often involve delays, so both parties should be clear (in writing) about when occupancy begins so there are no disputes about rent. These dates are often set out in “commencement letters.” Landlords should also take into consideration delays and how to administer services during the construction.

A sample alterations and improvements provision:

**Tenant shall not alter or make any improvement to the Premises without the prior written consent of Landlord. Landlord’s consent may be conditioned upon Landlord being provided with plans and specifications for the proposed alteration or improvement, information regarding the identity of the persons who will perform the work or provide the materials, and security against mechanic’s liens, all of which must be acceptable to Landlord. All such work must be done in a workmanlike fashion using new, first-grade materials. Tenant shall be responsible for the reasonable costs incurred by Landlord in reviewing any plans and specifications to be submitted pursuant to this section and for the reasonable costs incurred in observing the construction of the subject improvements to determine whether the Building and its structure are being adversely affected. All such alterations and improvements shall, at Landlord’s option, become the exclusive property of Landlord at the expiration of the Term.**

**Tenant shall not permit any mechanics or other lien to be levied against the Land or Building unless Tenant shall in good faith contest the same, in which event Tenant shall provide Landlord with security to protect Landlord’s interest in the Land and Building. Any such security shall be in an amount at least one hundred twenty five percent (125%) of the amount of such lien and reasonably satisfactory to Landlord. Nothing herein shall be construed as a consent by Landlord that would subject Landlord’s estate in the Land or Building to any lien or liability under the mechanic’s lien laws of the State of Minnesota.**

#### **h. Miscellaneous (Boilerplate) Clauses**

There are a number of miscellaneous clauses or boilerplate clauses that are included to aid in the interpretation and application of the lease agreement. Such clauses help define terms throughout the lease and will often speak to which laws are binding on the agreement.

Examples of miscellaneous or boilerplate clauses are as follows:

**(A) This is a Minnesota contract and shall be construed according to the laws of Minnesota.**

**(B) The submission of this Lease to Tenant or its broker or other agent does not constitute an offer to Tenant to lease the Premises. This Lease shall have no force and effect until, (i) it is executed and delivered by Tenant to Landlord and (ii) it is fully**

reviewed and executed by Landlord; provided, however, that upon execution of this Lease by Tenant and delivery to Landlord, such execution and delivery by Tenant shall, in consideration of the time and expense incurred by Landlord in reviewing the Lease and Tenant credit, constitute an offer by Tenant to Lease the Premises upon the terms and conditions set forth herein (which offer to Lease shall be irrevocable for ten (10) business days following the date of delivery).

(C) The captions in this Lease are for convenience only and are not a part of this Lease.

(D) If more than one person or entity shall sign this Lease as Tenant, the obligations set forth herein shall be deemed joint and several obligations of each such party.

(E) Time is of the essence.

(F) The provisions of this Lease which relate to periods subsequent to the expiration of the Term shall survive expiration.

(G) If any provision of this Lease is invalid or unenforceable to any extent, then such provision and the remainder of this Lease shall continue in effect and be enforceable to the fullest extent permitted by law.

(H) This Lease contains the entire agreement of the parties hereto with respect to the Premises and Property. This Lease may be modified only in writing, executed and delivered by both parties.

(I) Nothing contained in this Lease shall be deemed or construed to create a partnership or joint venture of or between Landlord and Tenant, or to create any other relationship between the parties other than that of landlord and tenant.

(J) This Lease shall be binding upon and inure to the benefit of the parties hereto and, subject to the restrictions and limitations herein contained their respective heirs, successors and assigns.

## **B. PROTECTING THE LANDLORD**

There are a number of avenues available to the landlord to protect itself from the uncertainty of a tenant. Such actions include guaranteeing the lease by a third party, stipulating when default and termination remedies are available to the landlord, arbitrating any disputes, and clarifying when waiver occurs and what it covers. These approaches should be taken during the negotiation and execution of the lease agreement in order to be most effective.

**a. Lease Execution – Do It Right!**

In executing a lease, the landlord wants to be sure to protect itself from any improprieties, defaults, breaches, damage, etc. that the tenant may cause during the course of the lease term. The landlord, while limiting liability, will also need to ensure that any liability involving the premises that could damage its future value is allocated properly. The following four protective measures ensure the landlord is protected from such harsh possibilities.

**b. Guarantees and Guarantors**

A guaranty usually arises if the tenant has questionable, inadequate credit. The landlord will require a third party – an individual or entity – to sign a guaranty ensuring payment of the rent and other obligations unique to the tenant. Ideally, the guarantor is someone who will benefit from the tenant's operations or business such as key employees, partners, shareholders, suppliers or franchisors. A sample guaranty is available in **Appendix A**. While it is easier to acquire and draw from a security deposit when a tenant defaults, a guaranty is more beneficial in keeping the space filled and in business.

The landlord will want to include a waiver of suretyship defense clause in any guaranty to prevent the guarantor from backing out on any liability associated with a tenant's default. In addition, the landlord wants to ensure the guarantor does not escape liability if the lease is modified or extended. The landlord should have the guarantor affirm the guaranty whenever the lease is modified or extended to ensure the guarantor is aware of its continuing liability.

**c. Default and Termination Clauses**

It is important to have language in the lease as clear as possible to avoid problems such as unnecessary defaults or to allow for termination.

### **i. Default Clauses**

A tenant defaults when it fails or is unable to perform one of its conditions or provisions in the lease. Not all lease covenants are created equal. Some provisions of a lease are more important than others, and so some breaches are more serious than others. Non-material breaches do not allow a landlord to evict a tenant. In order to clarify each party's understanding of what constitutes a breach of the lease, the parties may specify remedies for particular provisions when drafting the lease.

A tenant's rights are not automatically terminated upon default. Many leases require the landlord to give notice of the default and give the tenant opportunity to cure it before the tenant is actually in default. The method of notice for default should be clear to both parties at the beginning of the lease. This includes identifying the delivery method and who the notice will be given to. This will avoid misunderstandings and accidental claims. (A sample notice clause is given below, under *Termination Clause*.)

After notice is given, the party in default is usually given a grace period to cure the default before any actions against the breaching party are taken. Grace periods following defaults can vary. A tenant will want the grace period to begin after written notice of the default as opposed to right after the occurrence of the default. Most landlords will not necessarily have a problem with this, although they may worry about repeated defaults.

If a tenant defaults but the landlord continues to accept rent, the landlord waives its right to terminate the lease or seek remedies. The landlord must usually accept the late payments repeatedly before the landlord is considered to have waived the default. A landlord can avoid a waiver with a non-waiver provision in the lease. The provision should stipulate that acceptance of rent with knowledge of default does not constitute a waiver. If a landlord is unsatisfied with



the default and decides to file an action for eviction, then the landlord should not accept anything less than full payment unless the parties sign a settlement agreement.

Commercial leases often make the tenant's good standing a condition for purchasing or renewing. When a tenant defaults but still desires to renew, the landlord should take the opportunity to bargain on different lease provisions (such as reasonably withholding consent for subleasing or assigning).

Landlords will often want to have a provision in the lease that allows them to cure tenant defaults with or without notice. This provision usually requires the tenant to pay for any expenses the landlord incurs in curing the default including interest. Tenants, on the other hand, will want to be given notice and an opportunity to cure the default whether or not the landlord is able to cure the default.

A sample default provision:

**If: Tenant shall fail to pay any Base Rent, Additional Rent, or other amounts required to be paid by Tenant under this Lease upon the date the same is due, Landlord shall be entitled to immediately and without notice to Tenant terminate Tenant's occupancy and evict Tenant from the Premises.**

**If: (i) Tenant's interest in the Premises is sold under execution or similar legal process, or (ii) Tenant is adjudicated a bankrupt or insolvent and such adjudication is not vacated within thirty (30) days, or (iii) a receiver or trustee is appointed for Tenant's business or property and such appointment is not vacated within thirty (30) days, or (iv) a reorganization of Tenant or any arrangement with its creditors is approved by a court under the Federal Bankruptcy Act, or (v) Tenant makes an assignment for the benefit of creditors, or (vi) Tenant's interest under this Lease shall pass to another by operation of law, or (vii) Tenant shall admit in writing its inability to make any past or future payment called for under this Lease, then Tenant shall be deemed to have breached a material covenant of this Lease and Landlord may re-enter the Premises and declare this Lease to be terminated.**

**If: (i) Tenant fails to keep or perform any of the other terms, conditions or covenants of the Lease for more than ten (10) days after notice of such failure shall have been given to Tenant, or (ii) Tenant causes or permits any material damage to or within the Premises and fails to repair such damage within ten (10) days thereafter; then Landlord, besides any other rights or remedies it may have at law or in equity, may either (a) terminate this Lease upon the expiration of ten (10) days after written notice is given to Tenant, in which event the Term shall end on the date set forth in that notice, or (b) re-enter the Premises in accordance with applicable**

law, dispossess Tenant and/or other occupants of the Premises, remove all property from the Premises and store the same in a public warehouse or elsewhere at Tenant's expense, and hold the Premises without becoming liable for any loss or damage which may occasioned thereby. Tenant agrees that such re-entry by Landlord shall not be construed as an election on Landlord's part to terminate this Lease, that right, however, being continuously reserved by Landlord. Landlord shall not be deemed to have elected to terminate this Lease unless Landlord provides Tenant with written notice of that election.

If Landlord elects to re-enter the Premises, Landlord may make such alterations and repairs as may be appropriate in order to relet the Premises, and relet all or part of the Premises for such period (which may extend beyond the Term of this Lease), at such rental and upon such other terms and conditions as Landlord in its reasonable discretion believes appropriate. All sums received by Landlord from such reletting shall be applied; first, to the payment of any costs and expenses of such reletting, including brokerage and attorneys' fees and of costs of such alterations, which said alteration costs shall not exceed \$\_\_\_\_\_ repairs, second, to the payment of any indebtedness other than Base Rent, Additional Rent due from Tenant to Landlord; third, to the payment of Base Rent, Additional Rent and other charges due and unpaid hereunder; and the residue, if any, shall be applied in payment of future payments for which Tenant is responsible as they become due hereunder. If the sums so received during any month are less than the amounts due during that month, Tenant shall pay the deficiency; if such sums are greater, Tenant shall have no right to the excess. The deficiency shall be calculated and paid monthly. Notwithstanding any such re-entry by Landlord, Landlord may at any time hereafter elect to terminate this Lease for such previous breach.

Should Landlord at any time terminate Tenant's right of possession upon a breach without terminating this Lease, Landlord shall also have the right to accelerate the entire indebtedness (including the amount of Base Rent and reasonably estimated Additional Rent reserved in this Lease for the remainder of the Term), reduce the same to present value using a discount rate of ten percent (10%) per annum and recover a judgment from Tenant in that amount. In addition, Tenant shall be responsible, and Landlord may recover a judgment from Tenant, for Landlord's actual costs of constructing any leasehold improvements to the Premises which are not being directly paid for by Tenant together with such brokerage commissions as Landlord may have incurred in connection with this Lease and any other inducements given to Tenant during the Term, including any abated rent (collectively, the "Transaction Costs"). Notwithstanding anything else contained in this Lease to the contrary, upon a default of Tenant, whether or not Landlord shall elect to terminate this Lease, Landlord shall be entitled to recover the unamortized balance of any such Transaction Costs, on an accelerated basis, so as to make the same immediately due and said amount shall be deemed payable as Additional Rent. For purposes of the Lease, the "unamortized balance" shall mean the actual total amount of the Transaction Costs reduced, however, over the Term, as if said sum were being amortized, at an interest rate of twelve percent (12%) per annum, in equal monthly installments over the number of months Tenant is to pay Base Rent under this Lease. Landlord's right to do so accelerate the unamortized balance of the Transaction Costs shall be an additional remedy of Landlord and shall be exercisable either alone or in combination with Landlord's other remedies set forth in this Lease.

**Mention in this Lease of any particular remedy shall not preclude Landlord from any other remedy, in law or in equity.**

**No waiver by Landlord or Tenant of performance by the other party shall be considered a continuing waiver or shall preclude Landlord or Tenant from exercising its rights in the event of a subsequent default. No acceptance by Landlord of a partial payment tendered by Tenant shall be deemed to be a waiver of the balance of the amount due even if the tender states that acceptance will constitute payment in full.**

## **ii. Termination Clauses**

Termination of the lease is another way of exiting the lease. The tenant will want to ensure certain termination rights in the lease that are triggered by certain circumstances. Most often a tenant will want the right to terminate the lease if the premises are made untenable for a length of time, usually 90 days to one year. The tenant will also want the right to terminate the lease if a substantial part of the premises is made unavailable or if necessary facilities are made unavailable. Tenant default does not normally automatically provide for termination of the lease.

Upon termination of a lease, a landlord is typically allowed to recover unpaid rent up to the termination point, but not rent due beyond that point, unless there is a specific provision in the lease allowing collection of future rent. The future rent collected is usually diminished by rent received from reletting.

A landlord's termination rights do not limit the availability to other remedies in the event of a breach. The termination process does not begin immediately. First, the breaching party is given notice, followed by a grace period. Notice is necessary for other remedies as well sought from a breach.

A sample notice clause:

**Any notice required or permitted to be given to either party shall be deemed given one day following the date the same is mailed, correctly addressed, by United States certified mail, postage prepaid, return receipt**

**requested, or on the date of personal delivery. Until changed, notices and communications to Landlord and Tenant shall be addressed as follows: (contact information here)**

**Each party shall have the right to specify as its proper address any other addresses in the United States of America by giving to the other party at least fifteen (15) days written notice of a new address.**

**d. Mandatory Arbitration**

Mandatory arbitration clauses require parties to go before the American Arbitration Association to solve disputes on lease terms or other issues arising from the lease.

This requirement has a tendency to hurt the landlord who usually relies on the lease terms. In arbitration the lease terms are usually interpreted in favor of the weakest party, the tenant. Since arbitration is less gruesome and inexpensive, it is favored by the tenant, whereas the landlord may want to bring matters to court where the lease terms in a commercial contract fair better.

**e. Waiver**

Waiver of breaches or any other agreements previously made can occur at any time during the lease term. If a waiver does occur, it is important that both parties understand the waiver is only for that specific event and in no way terminates or waives the lease agreement itself. This maintains liability of the tenant for any obligations beyond the single breach that may have occurred.

**C. LEASE DEFAULTS**

Anytime a tenant defaults the landlord may be entitled to take certain actions if a waiver has not been granted. There are various types as defaults of which are covered in this section.

### **a. Default for failure to pay rent**

The most common default is the failure to pay rent. If a tenant defaults, there are certain courses of action a landlord may pursue to remedy the default. The landlord may terminate the lease, re-enter and retake possession. The lease must have specific provisions authorizing these remedies for a landlord to pursue them. Nearly every lease contains provisions that allow for the landlord's right of re-entry upon the tenant's breach of a covenant. The provisions should also outline the landlord's right to damages if the landlord hopes to receive any.

Many leases require the landlord to give notice of the default and give the tenant opportunity to cure it before the tenant is actually in default. Notice specifically for rent due is not normally included in leases. Most landlords are not required in leases to send a notice before rent is due. However, many landlords do send notices, especially in leases with large rent amounts.

As mentioned earlier, to collect unpaid rent or damages the landlord will need to bring a collection claim separate from the eviction claim. The landlord should consider the likelihood of success along with the costs and solvency of the tenant before bringing a collection claim. If the amount of damages or unpaid rent is substantial, the claim may be filed in district court. If the amount is minimal (under \$7,500), it should be filed in conciliation court, a.k.a. small claims court. If a landlord is successful with a collection action the court will put a lien on the tenant's non-exempt real estate and levy the tenant's bank account, excluding wages and retirement savings.

### **b. Default for matters other than rent**

Though failure to pay rent is the most common type of tenant default, a default can occur for failure to perform any other conditions, covenants or agreements in the lease agreement. If a

tenant files or has filed against it or any guarantor, a bankruptcy or creditor's action, a default may occur that requires the landlord to take action to protect itself.

As noted above, default can occur if the tenant abandons the premises. The landlord may opt to leave the premises vacant and sue to collect rent, however, the landlord retains a duty to mitigate any losses if it re-enters or terminates the lease. The tenant may attempt to argue that the landlord accepted the surrender in re-letting, terminating or re-entering the premises. Therefore, an agreement should stipulate that acceptance of a surrender must be formal, in writing and with affirmative action subsequently taken by the landlord. If formal acceptance is not required, a landlord may be found to have accepted the surrender by advertising for a new tenant or re-letting the space.

### **c. Default for guarantors**

In order to avoid a default by a guarantor, a landlord should require a guaranty of payment **and** performance by the guarantor. This ensures that the premises continue being viable and profitable for that space and other tenants. As noted above, the landlord should also require a waiver of suretyship defense, which prevents the guarantor from later trying to avoid liability for the tenant's defaults.

Additional protection is available by adding stipulations that enable the landlord to terminate the lease or require a substitute security (i.e. large security deposit or letter of credit) should anything happen to the guarantor. For example, if the guarantor dies or becomes insolvent, and attempts to rescind or terminate the guaranty, a default will result. Upon a guarantor's death, the landlord has a claim against the guarantor's estate. The tenant would benefit from the lease containing a provision that enables it to provide a substitute guarantor to prevent action against the deceased guarantor's estate.

In any event, the lease agreement should be very specific about what happens if the guarantor is unable to fulfill its duty.

**d. Anticipatory Breach**

Anticipatory breach results when a breach occurs before the actual time of required performance. For example, this can take place if the tenant signs the lease and prepares the premises for business but does not conduct business on the date it was required to do so in the lease. It can also occur with rental situations where a tenant gives notice that it will not be paying upcoming rent or additional rents when they are due. Essentially, this is equal to a default and the lease should note how the parties will consent to such breaches and the remedies that are available.

**e. Holdover Tenants**

Holdover tenants are a direct result of the lease term ending and the tenant remaining in its leased premises without extending or renewing the original lease. By continuing to occupy the premises, the tenant is held to a month-to-month lease under the same terms and conditions of the original lease (or last agreement) and the monthly rent is equal to the last monthly rental payment of the term.

The landlord is entitled to terminate the month-to-month lease at any time after giving the tenant the required notice. The tenant is placed in a risky situation because rent may increase if the landlord already rented the premises since it did not receive notice of the tenant's intent to exercise its option to renew. Or, the landlord may charge the tenant for any damages and/or costs associated with a new tenant not having access to the space.

## **D. THIRD PARTY ISSUES**

### **a. Landlord Consents**

A landlord may consent at any time to agreements, waivers or other obligations with third parties that involve the tenant's premises and the tenant's lease obligations. However, the landlord must be sure that any third party involvement does not absolve the tenant of its obligations.

Also, the landlord may require consent before alterations, changes or renovations done by the tenant in addition to the tenant's use, production or sale of harmful materials, or the ability to conduct business that is in conflict with the originally agreed up on terms. If the landlord consents to any of these actions or others like them, the landlord will want assurance that the tenant is liable for any damages, fines, fees or costs associated with the action.

### **b. SNDA's – Subordination, Non-Disturbance and Attornment**

A subordination, non-disturbance and attornment agreement (SNDA) is like three separate agreements that are commonly executed together into a single agreement. An SNDA involves the landlord, tenant, and the landlord's mortgagee, and is usually signed at the beginning of the lease or when the landlord refinances. The SNDA serves several purposes for the three parties.

The first clause, the subordination clause, places the tenant's leasehold interest subordinate to any mortgage, whether it is signed before or after the lease. Originally, this clause was used by mortgagees to kick out tenants who were paying below market rates. Now, mortgagees are more interested in retaining tenants and avoiding high turnover. As a result, many subordination agreements give the mortgagee the option of subordinating the lease or not.

Along with the subordination is the non-disturbance clause. It protects the lease for the tenant in the event of a foreclosure. A tenant will have a prior mortgagee sign the agreement to



retain the tenant's right to possession after a foreclosure. The non-disturbance clause also ensures the mortgagee is the first to receive insurance proceeds. If a tenant does exchange a subordination clause for a non-disturbance clause, the lease will still follow a mortgage in insurance proceeds and condemnation awards. A subtenant may also want to secure a non-disturbance agreement with the landlord.

The attornment clause is the counterpart to the non-disturbance clause. It ensures the tenant will honor the lease agreement even if the mortgagee becomes the landlord subsequent to a foreclosure.

The SNDA can raise problems when a landlord seeks financing for an inhabited building. The tenants will demand concessions if they are to sign a SNDA. To avoid this situation, the landlord should include a generic provision in the original lease that subordinates the tenant's rights to a mortgagee.

A sample SNDA clause:

**Tenant agrees that this Lease shall subordinate to any present or future first or junior mortgages and to any and all advances to be made thereunder and to the interest thereon and all renewals, replacements and extensions thereof provided the mortgagees named in said mortgages shall agree to recognize this Lease in the event of foreclosure if Tenant is not in default. In the event of any mortgagee electing to have this Lease be deemed a prior lien to its mortgage, then upon such mortgagee notifying Tenant to that effect, this Lease shall be deemed prior to the lien of said mortgage, whether this Lease is dated prior to or subsequent to the date of said mortgage. This provision shall be self-operative but in the event that any such mortgagee shall require that Tenant execute a document evidencing such subordination, Tenant shall sign an instrument to that effect and in the event Tenant does not do so within ten (10) days following a written request, Landlord shall be deemed to be Tenant's attorney-in-fact for this purpose.**

A sample subordination, non-disturbance and attornment agreement is included in **Appendix B.**

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## APPENDIX A: GUARANTY

### GUARANTY

The undersigned Guarantors in consideration of, and in order to induce \*\*\*, a \*\*\* (“Landlord”), to enter into the attached Lease dated \*\*\* (the “Lease”) with \*\*\*, a \*\*\* (“Tenant”) \*\*\* (“Guarantor”) does unconditionally irrevocably and absolutely guarantee to Landlord and Landlord’s heirs, successors and assigns the prompt and timely payment of rent and the prompt and timely performance of all obligations expressed as to be performed by Tenant under the terms and provisions of the Lease, including payment of damages for any breach of the Lease, and any liability of Tenant accruing under the Lease for any period preceding as well as any period following the term of the Lease (collectively, the “Lease Obligations”). Guarantor’s obligations under this Guaranty shall extend through \*\*\* provided Tenant has paid all amounts due and payable under the Lease to Landlord and shall be binding upon Guarantor’s heirs, successors and assigns.

Whether or not any existing relationship between the Guarantor and Tenant has been changed or ended and whether or not this Guaranty has been revoked, Landlord may, but shall be not obligated to, enter into transactions resulting in the modification, creation or continuance of Lease Obligations, without any consent or approval by Guarantor and without any notice to Guarantor. The liability of Guarantor is unconditional and shall not be affected or impaired by any of the following acts or things (which Landlord is expressly authorized to do, omit or suffer from time to time, both before and after revocation of this Guaranty): (i) any modification of the contractual terms applicable to the Lease Obligations; (ii) any waiver or indulgence granted to Tenant, any delay or lack of diligence in the enforcement of the Lease Obligations, or any failure to institute proceedings, file a claim, give any required notices or otherwise protect any other person liable in respect of any of the Lease Obligations; (iii) the assertion by Landlord of any right or remedy available under the Lease, including without limitation the termination thereof and/or (at Landlord’s discretion) the acceleration of Rent and other monies due and owing under the Lease; (iv) any full or partial release of, settlement with, or agreement not to sue, Tenant or any other guarantor or other person liable in respect of any of the Lease Obligations; or (v) any release or discharge of Tenant in any creditors’, receivership, bankruptcy or other proceeding; the impairment, limitation or modification of any liability of Tenant or remedy against Tenant in any such proceeding; or the rejection, disaffirmance, disallowance or the like of the Lease or this Guaranty in any such proceeding.

Guarantor hereby waives notice of acceptance hereof, or any action taken or omitted in reliance hereof, or of any default of Tenant under the Lease. Guarantor hereby further waives any requirement that Landlord first exhaust or pursue Landlord’s remedies available under the Lease or any other guaranty or security for Tenant’s obligations under the Lease before Landlord proceeds directly, and recovers, against the Guarantor.

Guarantor will not exercise or enforce any right of contribution, reimbursement, recourse or subrogation available to Guarantor against any person liable for payment of the Lease

Obligations, or as to any collateral security therefor, unless and until all of the Lease Obligations shall have been fully paid and discharged.

Guarantor acknowledges that he has derived or expect to derive a financial or other advantage from each and every obligation of Tenant to Landlord under the Lease.

This Guaranty is a guaranty of payment and not of collection, and Landlord shall be under no obligation to take any action against Tenant or any other person liable or resort to any collateral security as a condition precedent to Guarantor being obligated to perform as agreed herein. Guarantor waives any rights to interpose any defense, counterclaim or offset of any nature and description which it may have or which may exist between or among Landlord, Tenant and/or Guarantor, excepting only that of full and indefeasible payment of all obligations hereunder and under the Lease. This Guaranty shall be construed as a continuing, absolute and unconditional guaranty without regard to the validity, regularity or enforceability of the Lease and any other indebtedness at any time held or owing by Landlord to or for the credit or the account of Guarantor against and on account of the obligations and liabilities of Guarantor hereunder. Each and every right, remedy and power hereby granted to Landlord or allowed it by law or other agreement shall be cumulative and not exclusive of any other, and may be exercised by Landlord at any time and from time to time.

Guarantor agrees to pay all costs and expenses, including reasonable attorney's fees, incurred by Landlord in connection with the protection, defense or enforcement of this Guaranty.

Guarantor irrevocably submits to the jurisdiction of the Hennepin County, Minnesota District Court, Fourth Judicial District for any suit, action or proceeding arising out of or relating to this Guaranty or the Lease and Guarantor agrees that a final judgment in any such suit, action or proceeding to which Guarantor are party brought in such a court shall be conclusive and binding upon Guarantor. **GUARANTOR EXPLRESSLY WIAVES THE RIGHT TO A JURY TRIAL IN ANY ACTION ARISING OUT OF OR RELATED TO THIS GUARANTY AND THE LEASE.**

Guarantor shall not be discharged, released or exonerated, in any way, from its absolute, unconditional and independent liabilities hereunder, even though any rights or defenses which Guarantor may have against Tenant, Landlord or others may be destroyed, diminished or otherwise affected by:

- (a) any declaration by Landlord of a default by Tenant or Guarantor;
- (b) the exercise by Landlord of any rights or remedies against Tenant or any other person or entity; or
- (c) the failure of Landlord to exercise any rights or remedies against Tenant or any other person; or
- (d) the sale or enforcement of, or realization upon (through judicial foreclosure, power of sale or any other means) any security, even though

(i) recourse may not thereafter be had against Tenant for any deficiency, or (ii) Landlord fails to pursue any such recourse which might otherwise be available, whether by way of deficiency judgment following judicial foreclosure, or otherwise; or

(e) any bankruptcy, insolvency or reorganization of Tenant.

This is a continuing Guaranty and shall remain in full force and effect and be binding upon Guarantor and their respective heirs, devisees, executors, administrators, successors and assigns and shall inure to the benefit of Landlord, its endorsees, successors and assigns. Guarantor may not, without the written consent of Landlord (which may be withheld at Landlord's sole and exclusive discretion), revoke this Guaranty.

Guarantor hereby waives and agree that he shall have no right to subrogation to the rights of Landlord with respect to the obligations of the Tenant, and Guarantor waives (a) any right to enforce any remedy which Landlord now has or may hereafter have against Tenant and (b) any benefit of, and any right to participate in, any security now or hereafter held by Landlord. Guarantor waives any right to plead or assert any election of remedies in any action to enforce this Guaranty.

IN WITNESS WHEREOF, Guarantor has duly executed and entered into this Guaranty the day and year set forth below.

\_\_\_\_\_

\*\*\*

\*\*\*

\*\*\*

Social Security # \_\_\_\_\_

State of Minnesota            )  
County of Hennepin         )

Subscribed and sworn to before me this \_\_\_\_  
day of \*\*\*, 2007.

\_\_\_\_\_  
Notary Public  
SEAL

## APPENDIX B: SNDA

### SUBORDINATION, NONDISTURBANCE AND ATTORNMENT AGREEMENT

This Subordination, Nondisturbance and Attornment Agreement (the "**Agreement**") is dated as of the \_\_\_ day of \_\_\_\_\_, 2007, between \*\*\* (the "**Lender**") having an address at \*\*\*, and \*\*\* (the "**Tenant**") having an address of \*\*\*.

#### RECITALS

1. Tenant is the tenant under a certain Lease (the "**Lease**"), dated \*\*\*, of premises described in the Lease (the "**Premises**") located at \*\*\*, and constituting a portion of the real property more particularly described in Exhibit A attached hereto and made a part hereof (being hereinafter referred to as the "**Property**"). \*\*\* ("**Landlord**") is the current landlord under the Lease.

2. This Agreement is being entered into in connection with a mortgage loan (the "**Loan**") being made by Lender to Landlord, to be secured inter alia, by: (a) a first mortgage on the Property (the "**Security Instrument**") to be recorded in the real estate records of \*\*\* County, Minnesota (the "**Official Records**"); and (b) a first assignment of leases and rents on the Property (the "**Assignment of Leases and Rents**") to be recorded in the Official Records. The Security Instrument and the Assignment of Leases and Rents are hereinafter collectively referred to as the "**Security Documents**".

#### AGREEMENT

For mutual consideration, including the mutual covenants and agreements set forth below, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

1. Tenant agrees that the Lease is and shall be subject and subordinate to the Security Documents and to all present and future advances under the obligations secured thereby and all renewals, amendments, modifications, consolidations, replacements and extensions of the secured obligations and the Security Documents, to the full extent of all amounts secured by the Security Documents from time to time. Said subordination is to have the same force and effect as if the Security Documents and such renewals, modifications, consolidations, replacements and extensions thereof had been executed, acknowledged, delivered and recorded prior to the Lease, any amendments or modifications thereof and any notice thereof.

2. Tenant agrees that, in the event of a foreclosure of the Security Instrument by Lender or the acceptance of a deed in lieu of foreclosure by Lender or any other succession of Lender to fee ownership, Tenant shall attorn to and recognize Lender as its landlord under the Lease for the remainder of the term of the Lease (including all extension periods which have been or are hereafter exercised) upon the same terms and conditions as are set forth in the Lease,

and Tenant hereby agrees to pay and perform in favor of Lender all of the obligations of Tenant under the Lease as if Lender were the original lessor under the Lease.

3. In the event that Lender succeeds to the interest of Landlord under the Lease, Lender and Tenant hereby agree to be bound to one another under all of the terms, covenants and conditions of the Lease for the balance of the term of the Lease, and so long as Tenant complies with and performs its obligations under the Lease, Lender shall not disturb Tenant's possession of the leased premises.

4. Tenant agrees that, in the event Lender succeeds to the interest of Landlord under the Lease, Lender shall not be:

(a) liable for any act or omission of any prior Landlord (including, without limitation, the then defaulting Landlord), or

(b) subject to any defense or offsets which Tenant may have against any prior Landlord (including, without limitation, the then defaulting Landlord), or

(c) bound by any payment of rent or additional rent which Tenant might have paid for more than one (1) month in advance of the due date under the Lease to any prior Landlord (including, without limitation, the then defaulting Landlord), or

(d) bound by any obligation to make any payment to Tenant which was required to be made prior to the time Lender succeeded to any prior Landlord's interest, or

(e) accountable for any monies deposited with any prior Landlord (including security deposits), except to the extent such monies are actually received by Lender in segregated cash amounts identified to Lender in writing as such at the time received, or

(f) bound by any termination, amendment or modification of the Lease made without the consent of Lender; or

(g) obligated to complete any improvements or construction on the Property or to pay or reimburse Tenant for any tenant improvement allowance or construction allowance; or

(h) be required after a fire, casualty or condemnation of the Property or Premises to repair or rebuild the same to the extent that such repair or rebuilding requires funds in excess of the insurance or condemnation proceeds specifically allocable to the Premises and arising out of such fire, casualty or condemnation which have actually been received by Lender, and then only to the extent required by the terms of the Lease; or

(i) be responsible to provide any additional space at the Property or elsewhere for which Tenant has any option or right under the Lease, or otherwise, unless Lender at its option elects to provide the same, and Tenant hereby releases Lender from any obligation to provide the same, and agrees that Tenant shall have no right to cancel the Lease and shall possess no right to any claim against Lender as a result of the failure to provide any such additional space; or

(j) be liable for or incur any obligation with respect to any representations or warranties of any nature set forth in the Lease or otherwise, including, but not limited to,

representations or warranties relating to any latent or patent defects in construction with respect to the Property or the Premises, Landlord's title or compliance of the Property or Premises with applicable environmental, building, zoning or other laws, including, but not limited to, the Americans with Disabilities Act and any regulations pursuant thereto.

5. Tenant covenants and acknowledges that it has no right or option of any nature whatsoever, whether pursuant to the Lease or otherwise, to purchase the Property or the real property of which the Property is a part, or any portion thereof or any interest therein and to the extent that Tenant has had, or hereafter acquires any such right or option, the same is hereby acknowledged to be subject and subordinate to the Security Instrument and is hereby waived and released as against Lender.

6. Anything herein or in the Lease to the contrary notwithstanding, in the event that Lender shall acquire title to the Property, Lender shall have no obligation, nor incur any liability, beyond Lender's then interest in the Property, and Tenant shall look exclusively to such interest of Lender in the Property for the payment and discharge of any obligations imposed upon Lender hereunder or under the Lease, or otherwise, subject to the limitation of Lender's obligations provided for in Paragraph 4 above.

7. Tenant hereby agrees to give to Lender copies of all notices of Landlord default(s) under the Lease in the same manner as, and whenever, Tenant shall give any such notice of default to Landlord, and no such notice of default shall be deemed given to Landlord unless and until a copy of such notice shall have been so delivered to Lender. Lender shall have the right to remedy any Landlord default under the Lease, or to cause any default of Landlord under the Lease to be remedied, and for such purpose Tenant hereby grants Lender such additional period of time as may be reasonable to enable Lender to remedy, or cause to be remedied, any such default in addition to the period given to Landlord for remedying, or causing to be remedied, any such default. Tenant shall accept performance by Lender of any term, covenant, condition or agreement to be performed by Landlord under the Lease with the same force and effect as though performed by Landlord. No Landlord default under the Lease shall exist or shall be deemed to exist (i) as long as Lender, in good faith, shall have commenced to cure such default within the above referenced time period and shall be prosecuting the same to completion with reasonable diligence, subject to force majeure, or (ii) if possession of the Premises is required in order to cure such default, or if such default is not susceptible of being cured by Lender, as long as Lender, in good faith, shall have notified Tenant that Lender intends to institute proceedings under the Security Documents, and, thereafter, as long as such proceedings shall have been instituted and shall be prosecuted with reasonable diligence. The Lease shall not be assigned (except in the event of an assignment that is permitted in the Lease without Landlord's consent) by Tenant, modified, amended or terminated (except in the event of a termination that is permitted in the Lease without Landlord's consent) without Lender's prior written consent in each instance. Neither Lender nor its designee or nominee shall become liable under the Lease unless and until Lender or its designee or nominee becomes, and then only with respect to periods in which Lender or its designee or nominee becomes, the fee owner of the Premises. Lender shall have the right, without Tenant's consent, to foreclose the Security Instrument or to accept a deed in lieu of foreclosure of the Security Instrument or to exercise any other remedies under the Security Documents.



8. Tenant has no knowledge of any prior assignment or pledge of the rents accruing under the Lease by Landlord. Tenant hereby consents to that certain Assignment of Leases and Rents from Landlord to Lender executed in connection with the Loan. Tenant acknowledges that the interest of the Landlord under the Lease is to be assigned to Lender solely as security for the purposes specified in said assignments, and Lender shall have no duty, liability or obligation whatsoever under the Lease or any extension or renewal thereof, either by virtue of said assignments or by any subsequent receipt or collection of rents thereunder, unless Lender shall specifically undertake such liability in writing. Tenant agrees that upon receipt of a written notice from Lender of a default by Landlord under the Loan, Tenant will thereafter, if requested by Lender, pay rent to Lender in accordance with the terms of the Lease.

9. If Tenant is a corporation, each individual executing this Agreement on behalf of said corporation represents and warrants that s/he is duly authorized to execute and deliver this Agreement on behalf of said corporation, in accordance with a duly adopted resolution of the Board of Directors of said corporation or in accordance with the by-laws of said corporation, and that this Agreement is binding upon said corporation in accordance with its terms. If Tenant is a partnership or limited liability company, each individual executing this Agreement on behalf of said partnership or limited liability company, as the case may be, represents and warrants that he is duly authorized to execute and deliver this Agreement on behalf of said partnership or limited liability company, as the case may be, in accordance with the partnership agreement or operating agreement for said entity.

10. Any notice, election, communication, request or other document or demand required or permitted under this Agreement shall be in writing and shall be deemed delivered on the earlier to occur of (a) receipt, or (b) the date of delivery, refusal or nondelivery indicated on the return receipt, if deposited in a United States Postal Service Depository, postage prepaid, sent certified or registered mail, return receipt requested, or if sent via a recognized commercial courier service providing for a receipt, addressed to Tenant or Lender, as the case may be, at the following addresses:

If to Tenant:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

with a copy to:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

If to Lender:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

with a copy to:

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11. The term "Lender" as used herein includes any successor or assign of the named Lender herein, including without limitation, any co-lender at the time of making the Loan, any purchaser at a foreclosure sale and any transferee pursuant to a deed in lieu of foreclosure, and their successors and assigns, and the terms "Tenant" and "Landlord" as used herein include any successor and assign of the named Tenant and Landlord herein, respectively; provided, however, that such reference to Tenant's or Landlord's successors and assigns shall not be construed as Lender's consent to any assignment or other transfer by Tenant or Landlord.

12. If any provision of this Agreement is held to be invalid or unenforceable by a court of competent jurisdiction, such provision shall be deemed modified to the extent necessary to be enforceable, or if such modification is not practicable, such provision shall be deemed deleted from this Agreement, and the other provisions of this Agreement shall remain in full force and effect, and shall be liberally construed in favor of Lender.

13. Neither this Agreement nor any of the terms hereof may be terminated, amended, supplemented, waived or modified orally, but only by an instrument in writing executed by the party against which enforcement of the termination, amendment, supplement, waiver or modification is sought.

(NO FURTHER TEXT ON THIS PAGE)

This Agreement shall be construed in accordance with the laws of the state in which the Property is located.

IN WITNESS WHEREOF, the parties hereby execute this Agreement as of the date first above written.

TENANT: \*\*\*

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By: \*\*\*

Its: \*\*\*

STATE OF MINNESOTA    )  
  )ss.  
COUNTY OF \_\_\_\_\_)

The foregoing instrument was acknowledged before me this \_\_\_\_ day of \_\_\_\_\_, 2007,  
by \*\*\*, \*\*\* of \*\*\*, Tenant.

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Notary Public  
Stamp and/or Seal

LENDER: \*\*\*

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By: \*\*\*

Its: \*\*\*

STATE OF \_\_\_\_\_ )  
 )ss.  
COUNTY OF \_\_\_\_\_ )

The foregoing instrument was acknowledged before me this \_\_\_\_ day of \_\_\_\_\_, 2007,  
by \*\*\*, \*\*\* of \*\*\*, Lender.

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Notary Public  
Stamp and/or Seal

THIS INSTRUMENT DRAFTED BY:

Mansfield Tanick & Cohen, P.A.  
1700 U.S. Bank Plaza South  
220 South Sixth Street  
Minneapolis, Minnesota 55403-4511