Legal Corner

Be cautious when signing that offer to lease

Many retailers do not take the time to carefully review the terms contained in their offer to lease. Standard form documents can be simplistic, yet the legal ramifications contained therein can be drastic.

For example, several years ago, a group of dentists asked me to negotiate their lease for an optical dispensary. They gave me a copy of their signed offer and the Landlord’s standard form of lease, a document of at least 60 pages! Having previously dealt with this type of document I knew that numerous changes were required to protect their interests, since most leases are drafted to protect only the interests of the Landlord.

The dentist’s had signed the offer before having it reviewed by me or another lawyer. Upon reviewing the offer, I was shocked to find that they had already agreed to clauses which said that they must sign the lease as attached, and if they did not sign the lease, the dentists would not be permitted to open for business or receive an allowance from the landlord of over $50,000.00. Consequently, I had no room to negotiate. It was only through a colleague who acted on behalf of the landlord was I able to make any amendment to the lease.

Therefore remember: never sign any offer to lease, letter of intent to lease, or lease without first having your lawyer review the document.

Additionally, the following points should be addressed in your Offer to Lease.

Problem: Area of Your Premises

The offer will say that you are leasing an approximate area of, for example, 1,000 square feet. However, I have known occasions where the actual area rented was significantly lower or higher than stated in the offer, each with its own negative implication. If the area is smaller than you anticipated, your whole store concept and sales could be reduced. If it is larger, you are responsible for a lot more rent than budgeted.

Solution:

Add a clause to the effect that if the area is less than 90% of the stipulated area (i.e. 900 square feet) the Tenant has the right to terminate the Offer and Lease. If the area is greater than 110% of the stipulated area (1,100 square feet), then the tenant is not obligated to pay any rent on any space in excess of this 1,100 square feet, yet can use the area during the term.

Problem: Additional Rent

Most offers are drafted with a clause which say that it is a net offer to lease, or that expenses are net to the landlord. What this means is that in addition to basic or minimum rent, the tenant must also pay a portion of all other costs associated with the shopping centre, such as the cost of cleaning the parking lot, landscaping, snow removal, maintenance, insurance and taxes (commonly called “TMI”, “Operating Costs” or “Additional Rent”). The problem is that landlords pass many costs onto the tenant which the tenant is not aware. For example, recently in the news there was a problem at a plaza in Richmond Hill where the landlord increased operating costs to cover his cost of buying the centre. In my opinion, no tenant should pay for this purchase, but if the offer says that it is net, or if there is no restriction on what the tenant must pay, the landlord may be able to pass on this cost to the tenant.

Solution:

You can restrict what the landlord can charge you. For example, specify exclusions from Operating Costs in the offer: i.e. no amount for; ground lease or mortgage payments, capital taxes; or any cost resulting from the landlord’s negligence. Also if the landlord has insurance proceeds or a warranty then this must be utilized instead of passing on the cost to the tenant. Alternatively state in the Offer that Operating Costs are subject to negotiation in the lease. Additionally, always ask for a detailed breakdown of the Operating Costs for the immediately preceding year for the plaza so that you know what, and how much is being charged to you. Add a clause stating that the Landlord must provide reasonable documentation for any charge and that any contract entered into by the Landlord (snow removal for example) must be at competitive market rates. Finally, request the exact percentage of the Operating Costs that you must pay. (Note that in major shopping centres, the Landlord will exclude certain tenants from the denominator, therefore your share of costs will be higher).

Problem: Renewals

A renewal is not binding unless it has certainty. Therefore a clause which states that you may renew the lease for a further period of time at a rent to be agreed upon, is not a renewal. If you cannot agree on the rent, and it does not say that the landlord must be reasonable, therefore the landlord can stipulate any amount, just to get you out of your store.

Solution:

The renewal should be quite specific and if possible stipulate the Rent for the renewal term. If this is not acceptable, then a clause which states that the basic rent will be at the then fair market rent for similar stores with a similar use in a similar centre within a three mile radius from the perimeter of the plaza, is essential. In the event that the parties cannot agree on this fair market rent, then it should be settled by arbitration.

I have successfully included all these solutions, and many more, in my documentation. Remember, if you don’t ask, you will not get. Additionally, most landlords are reasonable and will try to include your concerns. You will be having a long term relationship with this landlord, so you should certainly set the basis for it on terms that are acceptable to you.

David Westwood is a lawyer who practices in Toronto with fourteen years experience with commercial real estate documentation. He has worked for major landlords and for a major Canadian retail chain. Please visit our website at: www.ileaselawyer.com for more information.