

Florida Real Estate Journal

May 1, 2009

How historical events shape lease negotiations

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If you've been involved in leasing long enough, whether as an owner, tenant, broker or lawyer, you'll surely recall a time when leases were 10 to 15 pages and certain provisions such as those relating to environmental liabilities were not even twinkles in the drafter's eye.

How then did we reach the point where the average lease is 40 to 50 pages long without the exhibits? We're here in good part because those negotiating and drafting these leases are students



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of history. Not just precedential history provided by case law, but actual historical events that have shaped the lease deal.

One such example of a history lesson that finds its way into deals today dates back to the 1970s. Prior to that time period, as a hedge against inflation, annual rent increases were commonly tied to the Consumer Price Index without restriction. Up to that point, economic trends did not suggest a significant risk to a tenant agreeing to be bound by increases in rent based on a cost of living index.

However, during President Carter's administration, from 1977-1981, the Consumer Price Index increases reached unprecedented levels, and tenants whose rent was tied to increases in the cost of

living, never having anticipated the extent of the increases, found themselves financially strapped to meet their rent obligations. Tenants' complacency was forever shattered from that experience and thus was born the ceiling (and in direct response by landlords, the floor) in cost of living increases.

Financial crises are not the only historical events that shape our deals. Natural disasters have played a significant role in how we approach negotiations. Hurricanes Charley, Frances, Ivan, Jeanne, Dennis and Wilma reminded us that even the proven, so-called "boiler

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■ See **NEGOTIATIONS,**
Page 19

plate" provisions were no match for the realities of a storm's aftermath.

Following a storm, owners and tenants alike found that many of the casualty and insurance clauses contained in mortgages and leases did not work, given the unanticipated consequences of a direct hit.

Fast-forward to the early 21st Century, and in the wake of each of the aforementioned storms, owners and tenants alike were shut out of their buildings for a variety of reasons. Many owners and tenants, suffering from a loss of rents and income, found that their business interruption insurance coverage, which they relied on in part to fund business operations, was inadequate, as they discovered too late that proceeds were not payable unless the premises suffered a direct hit from the storm. A power outage was simply not enough to collect insurance proceeds.

Those of us who negotiate and draft casualty and insurance provisions in documents must carefully consider the realities of a storm's aftermath and how and if our documents deal with such realities in an effective manner. It is no service to either the parties or the deal to "borrow" language crafted in areas of the country which aren't affected by our weather patterns.

Returning to an example of how a

historical financial crisis can influence our deals, we need only consider the current state of our economy. Given the economic uncertainties, it is no wonder that the dynamics of negotiations between owners and tenants and lenders and borrowers have altered in many respects, from as recently as a year ago.

For example, the given obligation of a tenant to produce financial records to evidence the ability to perform obligations of a lease appears to be inviolate. However, as a result of tenants' recent concerns about the financial stability of owners, some tenants are now demanding of their landlords the same proof of financial stability before entering into or renewing a lease.

In the same vein, another provision that is the object of tenants' concerns about the landlord's financial stability is the non-disturbance provision found in leases, historically the privilege of only the major tenants in a project. By negotiating for a non-disturbance agreement from the owner's lender, the tenant can be assured that so long as it is not in default, a mortgage holder foreclosing on the project will not seek to terminate the tenant's lease. Now, more than just the major tenants are negotiating for inclusion of the non-disturbance provision in their leases.

Of course, in most cases, a deal is not only shaped by the demands of the owner and tenant, but by the owner's lender as well. All loan documents include obligations relating to casualty, insurance and subordination of leases. The same pitfalls found in lease provisions relating to these matters are found in loan documents. It behooves the owner to negotiate these provisions with his lender in a manner that will allow him the flexibility to deal with his tenants and their evolving demands.

As professionals, we should approach our clients' deals armed not only with our technical expertise, but with the lessons gleaned from current events swirling around us. In many cases, our clients are at the head of the class when it comes to history lessons. But those of us who do the drafting cannot rely on our clients to be the harbingers of change for our lease documents. We must adjust the "business as usual" attitude buried in our documentation and draft provisions which work not only in today's business environment but for posterity as well. At least until the next crisis!

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