



BEST BEST & KRIEGER ^{LLP}
ATTORNEYS AT LAW



MASTERING THE ART OF LEASING FOR PUBLIC ENTITIES

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BIG PICTURE



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UNDERSTAND DEAL & CONTEXT

- Review letter of intent or key deal terms with client
- Context:
 - Does client have great leverage or no leverage?
 - Are there special risks or specific concerns?
 - Short and simple or long and complex?
 - Are there statutory requirements?
 - e.g. public property so **Rev 106.7 disclosure**
 - Does the counterparty have a policy of refusing to negotiate contract terms?
 - e.g. federal agencies, state agencies, railroads



HOPE FOR THE BEST, ASSUME THE WORST

- Answer every “what if?” question
 - What if the landlord or tenant fails to perform?
 - What if the tenant runs out of funding or starts to run a prohibited use from Premises?
 - What if the scope changes along the way?
 - What if building defects are discovered later?



CONTROL THE DRAFTING PROCESS

- Avoid using the other side's standard form
- Many standard forms are lopsided (esp. wireless forms) or favor broker (CAR/AIREA)
- Standard forms save time and spotlight issues



- Develop master form for repetitive situations or multi-user properties



USE AN APPROPRIATE FORM

- Can't assume form agreements provided or used previously are perfect; review everything closely
- Omissions can be as deadly as included language
- Use a checklist to issue spot or fill in gaps



SPECIAL PUBLIC ENTITY CONCERNS



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SPECIAL PUBLIC ENTITY CONCERNS

- Beware \$1 leases and duty/cost of capital repairs
- Extend short approval/response times if council approval required
- Include possessory tax disclosure – Rev & Tax Code 107.6
- Limit liability for utility provider role
- Prevailing wage triggers (lease concessions, FMV issues)



SPECIAL PUBLIC ENTITY CONCERNS

- Indemnified parties of public entity should include public officials and volunteers in addition to employees, contractors and agents
- Limit public entity indemnity of private parties – avoid LL indemnity of T
- Distinguish between City as LL vs City as zoning authority or other police role
- Eliminate confidentiality requirement when included in form leases
- Final lease subject to approval of City Council



DRAFTING STRATEGIES



DRAFTING GROUND RULES

- Save each new iteration as a new version, identifying which party produced it
- Trust but verify
 - Run an electronic comparison to catch changes not reflected in other side's redline
- Keep the staff negotiator in the loop
 - Ask/know client priorities
 - Ask/know major/minor issues, when to compromise, when to seek direction
- Verify lease vs license (exclusive vs non-excl. use)



GENERAL LEASING ISSUES

- Expenses –ask what is split and how
- Capital improvements–ask who pays what & when
- Compliance with laws– ask who pays for upgrades
- Condition of premises on delivery (ask who pays for what imprvmnts.; what warranties are given/needed)
- Control scope of tenant improvements and alterations–need review and approval of plans
- Beware “friendly” leases with other public entities at \$1 or under-market rent
- Lengthen response time frames if City Council approval is required (to allow for agendas, etc.)



NOW FOR THE FINE PRINT



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PREMISES

- Include exhibits with space plan drawings and/or photos, list of equipment or improvements, maps, diagrams
- Be specific!
- Describe use of common areas, if any
- Describe areas to be used other than premises
- Exclusivity vs. shared use areas



TERM

- Define term and start date for rent and occupancy (they might be different)
- Address delivery/construction periods by LL & T
- Work through best and worst case to understand effect on commencement date and rent
- Add any free rent period into term
- Renewal options benefit T only and limit LL flexibility and control of property
- Avoid evergreen terms (i.e. automatic renewals)



RENT

- Basic rent plus any increases
 - CPI vs fixed increases
 - Beware \$1 rent with other public entities
 - FMV requirement
- Percentage rent (retail/other)
 - Audit/reporting requirements
 - Continuous covenant to operate & “go dark” as breach
- Additional rent/Expenses
- Free rent



TAXES/SPECIAL ASSESSMENTS

- Make sure it is clear that taxes due are in addition to rent if not included.
- Address possessory interest tax liability for T (Revenue and Taxation Code 107.6)

**TAXES NOT
INCLUDED**



EXPENSES

- What is included? (Common Area/Premises/Building repair and maintenance)
- When paid? (Monthly estimates vs. reimbursement/invoices)
- Who has duty for repairs? (T for premises, LL for building, or some other arrangement?)



EXPENSES

- Any controls or limits? (caps? exclusions?)
- Audit rights
- NNN (“triple net”)=T pays for everything
- Full Service (“gross” or “modified gross”) = expenses are included in first year rent and T pays all increases over first year’s expenses



CAPITAL EXPENSES (“CAP EX”)

- T wants to avoid big swings in expenses; LL wants to pay expenses as needed
 - Usual compromise= capital expenses are amortized (i.e. spread out) over cap ex useful life
- Repair vs. replacement (expense vs. capital items)
- Amortization of expenses vs. collection of reserves (if LL, choose 1 method)



CAPITAL EXPENSES (“CAP EX”)

- Deferred maintenance can be a major expense later passed through as cap ex- not a nice surprise!
- Resolve up front who pays known deferred maint. expenses



UTILITIES

- Who pays for utilities?
- LL generally not responsible for any interruptions
- What happens if LL controls or is the utility?



IMPROVEMENTS

- TIs= Tenant Improvements
- Any material TIs require detailed plans and prior LL approval
- All work by T to be performed in compliance with laws by qualified/licensed contractors
- Who does initial TIs varies by deal
- TI Allowance can trigger prevailing wages



REMOVAL OF IMPROVEMENTS

- Option for Landlord to keep improvements or require removal by T
- If improvements are attached, generally becomes part of property & stays, unless not desired by LL
- Ground lease – improvements revert to LL at end of term unless otherwise specified
- Cell towers often have special arrangements



ASSIGNMENT OR SUBLETTING

- No assignments or subletting without consent by Landlord (should use reasonable consent standard)- **watch for short approval times**
- Rent sharing for any market rent above rent (50/50 is usual compromise **but may be higher for public entities**)
- Many criteria for sublease/assignment
 - Pay attention to these – more flexibility is better for T
 - If no assignment or subletting allowed, LL loses a default remedy (CC 1951.4)



INDEMNITY: DON'T PLAY FAIR

- T should always indemnify LL, but public entities should limit to breach of lease and occupancy, not kitchen sink indemnity
- Sometimes LL indemnifies T
- Many public clients refuse to indemnify counterparties (or should); check with city attorney on policy

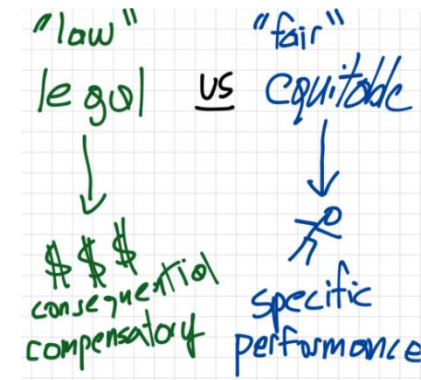


CASUALTY/INSURANCE

- Make sure insurance requirements apply to contractors and subs
- Landlord generally pays for insurance on Building; Tenant for Premises and its own FF&E
- Tenant reimburses Landlord for insurance in additional rent
- Make sure to run by risk manager
- Typical insurance is general liability, auto liability, employer's liability, all-risk property, and workers' comp
- Self-insurance



REMEDIES



- Spell out all default remedies-lease should mirror CA statutes (CC1951.2 and 1951.4)
- Leases use both equitable and contractual remedies (right to occupy v. contract duty to pay rent, etc.)
- No on mandatory arbitration (except appraisal arbitration for lease rates, sf issues or construction)
- Note debt limitation issues (consider a termination clause for loss of funding when public entity is T)



HAZARDOUS SUBSTANCES



- T should indemnify LL – full bells & whistles
- Strict language to prohibit any haz mat uses
- Ok to allow certain exceptions (batteries, office cleaning supplies and generators) document



FINALLY, IT'S ALL ABOUT PERSPECTIVE



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A FEW CONSIDERATIONS FROM TENANT'S PERSPECTIVE

Top 5 issues to focus on:

- Check the facts: Double check math, start of rent, lease term, \$\$ penalties for failure to respond (AIREA form)
- Expenses – what is included in rent or not
- Compliance with laws – are premises compliant and, if not, who pays?
- Building Systems – Good working order at commencement
- Repairs and Maintenance – check remedies against LL if failure to repair

Read the fine print & boilerplate!



Thank you for attending.

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