

Creative Solutions is a bi-monthly column offering creative solutions to unusual problems in drafting leases for retail space. Please email your questions or problems you are encountering and your Creative Solutions to Glen Cornblath, gcornblath@ksc-law.com.

Sometimes the phrases we look at over and over again in our leases lose their meaning unless we stop and really pay attention to the consequences of the provision in context. For example, in a typical triple net lease, the tenant “shall maintain, repair and replace” the equipment, interior of the premises or, in some cases, the entire premises. What happens when that clause is in a short term lease? The tenant must potentially incur the high cost of structural repairs and replacements in the final months of its lease.

Another example is the clause requiring the tenant to comply with applicable codes, laws and ordinances. If a building code change in the last year of a three year lease requires a sprinkler system, does the tenant have to incur that expense? Without anything limiting the tenant’s obligations, the answer is yes.

In both cases, the tenant is potentially responsible for major capital expenditures from which it will not benefit. No tenant wants to spend significant sums on repair or replacement that will primarily benefit the landlord. What are the tenant’s alternatives.

The tenant could refuse to incur the expense and claim the lease did not contemplate that the tenant would be obligated to pay for these type of large expenditures in a short term lease. Perhaps the tenant can even show that the landlord did not expect to benefit from such a windfall. But relying on a court to hold that the standard lease language does not include the obligation to invest significant sums in the final years/months is dangerous and costly.

Tenant representatives should limit the responsibility of the tenant in the lease documents in some fashion. One alternative is a dollar amount: the tenant is not obligated to spend more than \$X on capital expenditures in the final Y months/years of the lease.

Another alternative is to require the landlord to contribute to the cost of the expenditure based on some formula. For example, in the final two years of a lease, the tenant is required to pay for capital expenditures equal to the cost multiplied by a fraction the numerator of which is the number of months remaining in the term and the denominator is 24; the landlord pays the balance. Of course, this assumes a two year “life” for the expenditure which may need adjusting depending on the nature of the work. The lease can peg the “life” of the expenditure to generally accepted accounting principles or to the IRS code or to the expected “life” of the improvement.

The lease may limit the tenant’s liability also by clearly defining what the tenant is obligated to repair or replace and what the tenant is not obligated to repair or replace. The tenant should be obligated to make any repairs or replacements required by code which are directly the result of its use, regardless of when the code requirement occurs.

So, if in the final months of a restaurant lease, code changes and requires – retroactively – that restaurants must be fully sprinklered, or have inside garbage rooms, the tenant must make the change. On the other hand, with the same lease, if the code requirement applied to all establishments open to the public, then the tenant is not solely responsible.

In addition, the lease may define the kind of work which the tenant is responsible for and the kind which the landlord must perform. For example, the tenant may transfer responsibility for certain aspects of structural repairs and replacements to the landlord. Or the landlord may retain the obligation to repair and replace major mechanical systems like HVAC. Responsibility for replacing these major components may also be tied to their useful life so if the roof or the parking lot or the HVAC unit is at the end of its useful life, the landlord pays for that cost but if it is a repair which occurs prior to the end of the useful life, the tenant performs that repair.

Please send me your “creative solutions” to this issue and I will put them in the next column.

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