
AVOIDING HIDDEN COSTS IN OFFICE LEASE

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With today's sky-high commercial office rents in major U.S. metropolitan markets like New York City, Los Angeles, Boston, Washington and others, leasing office space can be very expensive, having a material impact on a company's bottom line. Even so, many companies attempt to save money in the short run by not retaining an experienced attorney to negotiate its lease, resulting in hidden and unforeseen costs which, over the course of the lease term, may far outweigh the up-front legal fees associated with negotiating a fair lease. The following are just a few examples of hidden costs that a tenant may encounter in its office lease.

1. **INITIAL CONSTRUCTION COSTS (LANDLORD PERFORMING BUILD OUT).** It is very important for the lease to specify the condition in which the premises shall be delivered by the landlord. If the landlord is performing the demolition and the construction of the tenant's premises, then the "work letter" attached to the lease will specify the nature and scope of the construction, with a procedure for preparing and approving plans and specifications, the construction schedule, the approval of contractors, and various other matters related to the construction of the tenant's premises. Unless the construction is a "turn-key" (i.e. the landlord pays for 100% of the work), the lease will typically provide for a construction allowance, which is a specified amount of money to be contributed by the landlord towards the cost of the work, with the tenant responsible for any amounts expended by the landlord in excess of the construction allowance.
 - **Potential Hidden Cost** – The landlord's lease form will typically provide that the tenant is responsible for any amounts incurred by the landlord in excess of the construction allowance. Unless the tenant has protections built into the lease to limit how much the landlord can spend on the construction without the tenant's approval, the landlord has a "blank check" to incur construction costs in excess of the construction allowance. This is even more of a concern when the construction is being performed by the landlord's affiliated construction company, which is very often the case. Without adequate protections in the lease, the tenant can be on the hook for thousands of dollars of unnecessary and unwanted construction costs.

2. **DELIVERY CONDITION OF PREMISES (TENANT PERFORMING BUILD-OUT).** Many companies with large office portfolios and sophisticated project management divisions prefer to perform their own build-outs to their own, highly developed office specifications. When tenant is performing its own build-out, the lease will typically provide that the premises are to be delivered by the landlord “AS-IS” condition, with no obligation on the landlord’s part to perform any work or improvements, or make any repairs to the premises, prior to delivery to the tenant. An “AS-IS” delivery without any defined parameters protecting the tenant can result in hidden and unforeseen costs to the tenant.
 - **Potential Hidden Cost** – If the lease simply provides that the delivery of the premises shall be on an “AS-IS” basis, the landlord has no legal obligation to demolish the prior tenant’s installation, remove its furniture, equipment or cabling, or correct any issues or problems with the premises, such as the discharge of existing legal violations or removal of hazardous materials. If the tenant’s construction plans and budget do not include funds for demolition, removal of furniture or equipment (such as a prior tenant’s supplemental AC unit or other heavy equipment), the tenant may be faced with thousands of dollars of unexpected demolition and removal costs, delaying its own construction and adding unforeseen amounts to its own construction budget. In order to avoid these unforeseen lease costs, the lease should provide certain exceptions to the landlord’s “AS-IS” delivery standard, and shift the burden of the delivery condition of the premises from the tenant to the landlord.
3. **CAPITAL IMPROVEMENTS AS PART OF OPERATING EXPENSES.** Most leases require the tenant to pay its proportionate share of the operating expenses for the building. Depending on the size of the tenant’s lease and its negotiating leverage, the tenant will try to exclude certain items from what the definition of what can be included in operating expenses.
 - **Potential Hidden Cost** - One item that the tenant should always try to exclude from operating expenses for which the tenant is obligated to pay are capital improvements to the building, which are improvements or upgrades to the building performed by the landlord and which enhance the value of the building. While the tenant should pay its share of the day-to-day operating expenses of the building, it should not pay for major upgrades to the building unless the landlord is required by law to perform the upgrade, or the upgrade results in greater efficiencies or reduces overall operating expenses for the building. Without adequate protections in the lease from these capital costs, the tenant may be stuck paying thousands of dollars in unforeseen costs of elective cosmetic or mechanical upgrades by the landlord which result in enhanced value for the landlord, but are not really operating expenses of the building.
4. **RESTORATION OF PREMISES AT END OF LEASE TERM.** Another major unforeseen and unwanted lease cost can incur at the end of the lease term, when giving back possession of the premises to the landlord. The lease will typically require the tenant to remove its furniture, trade fixtures and equipment at the end of the lease term. While most leases provide that alterations or improvements installed by the tenant become the property of the landlord upon installation in the premises, many landlord lease forms give landlords wide latitude to require the tenant to remove those same alterations and improvements at the end of the lease term and restore the premises to the condition existing prior to the installation of the alteration or improvement. These are provisions which the tenant should try to limit or eliminate altogether.
 - **Potential Hidden Cost** - If the lease does not place limitations on the landlord’s right to require the tenant to remove its alterations and improvements, the tenant can be forced to incur substantial

unwanted costs and expenses on the way out of a building. Accordingly, the end-of-term provisions should be modified to require that the tenant shall only be obligated to remove alterations or improvements which are not customary office alterations. Built-in workstations, interior glass walls and doors and office pantries are examples of customary alterations which the tenant should never be required to remove at the end of the lease term. However, alterations or improvements which are not customary for a typical office build-out, such as reinforced floors, internal stairwells or executive restrooms, are the types of alterations which the tenant can agree to remove at the end of the lease term.

These are just a few of hidden unforeseen costs which the tenant may encounter in a poorly negotiated lease. If you have any questions regarding the topics discussed above or other leasing issues or need assistance in negotiating your office or retail lease, please contact Jonathan Weiss at jweiss@wilkauslander.com or by phone at 212-981-2312. The foregoing does not constitute legal advice. A lease is a legally binding contract with serious legal consequences. Before signing a lease, you should consult with an experienced leasing attorney.