

Client Bulletin

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Real Estate Update: Office Relocation

For all those airline and transportation executives that are tasked with the challenge of leasing office space, we hope this Client Bulletin will bring holiday cheer to a project that normally has Grinch-like implications. Leasing office space involves financial, operational, and legal challenges that require advice from real estate brokers, architects, engineers, lawyers, and contractors. There are three significant areas that executives need to focus on to complete a successful relocation.

Planning a Relocation

Relocating to a new office space starts with input from operations, human resources, and financial departments. The decision to move to a new office space is usually determined by the number of employees anticipated to work in the new office space, the company's economic limitations for payment of rent, escalations for operating expenses, electricity and insurance, relocation costs and build-out costs. Real Estate brokers can provide estimates for these costs based on the quality of and location of the building along with trends in the real estate market. This analysis should be accomplished twelve to eighteen months in advance of the termination of the current lease.

Avoid Holdover Rent

Any relocation plan must include a strategy for leaving the current office space to prevent costly and unnecessary expenses associated with remaining beyond the expiration period of the lease. Leases usually contain a holdover provision which states that if the tenant remains in possession of the premises beyond the lease termination date, the rent payment increases significantly (double or triple the rent payment stated in the lease). Under New York law, this type of provision is not considered a penalty and has been consistently enforced by the courts.

Tenants should plan their relocation strategy so that departure from the current office space is completed prior to the expiration of the current lease or simultaneously with the expiration of the current lease.

Lease Negotiations – Financial and Legal Considerations

Negotiating lease terms cover financial and legal provisions. If a Letter of Intent is involved, the "LOI" should state the financial and legal terms to be incorporated into the lease. Financial considerations include rent, operating cost escalations (a direct pass through escalation is preferable over the consumer price index or a percentage increase escalation), electricity, tenant allowance for build-out, and free rent. Legal considerations include the use clause, work letter, exit strategies, and insurance and indemnity provisions.

Use Clause

There are several legal considerations that an airline tenant must consider. First is the "use" clause. The use clause is the provision that allows the tenant to occupy the space for a specific purpose. Usually, executive and/or administrative office use is permitted. However, an airline tenant needs to consider the possibility that there will be a flow of public traffic for ticketing. The use clause may need to reference tenant's ticketing operations.

Work Letter

One of the most critical lease provisions is the Work Letter. A Work Letter is the agreement between the landlord and the tenant to build out the new office space. Negotiating the Work Letter allows the tenant to control how the tenant allowance is spent, how an architect's drawings and modifications to drawings are approved, participation in the construction process, and how the quality of work is controlled. The most important decision for the tenant is who will perform the work: the landlord's contractor or the tenant's contractor.

This decision depends on the cost of the project, the reliability of the landlord to complete the work, and the tenant's experience with construction projects.

Exit Strategy

Tenants need an exit strategy from a lease for many reasons. The key exit strategy in a lease is the sublease provision. Sublease provisions usually include the landlord's right to take back the space upon a sublease offer. If the landlord does not take the space back, the landlord may consent to a sublease under "reasonable" conditions. However, these conditions are usually extensive and often require significant financial information from the subtenant. Tenant should attempt to limit these conditions including limiting the time it takes the landlord to approve the sublease, the scope of financial information required from the subtenant and fix the amount of the landlord's legal costs associated with the sublease. While these points are not easy to negotiate, a tenant should push for these rights. Other exit strategies include the right to terminate the lease. The right to terminate a lease is often associated with the payment of a penalty. As an alternative to relying on subleasing or termination provisions, a tenant could agree to a short term lease with an option to renew.

Insurance and Indemnity

Other important legal considerations in the lease are the indemnity granted in favor of the landlord and the insurance requirements. While landlords usually do not negotiate indemnity provisions, it is important for the tenant to review these with their risk managers and insurance brokers to confirm that the potential liability exposure under the indemnity provision will be insured. The ideal indemnity provision is that both parties insure for their own negligence. Most leases, however, state that the landlord is only responsible for willful misconduct or gross negligence.

When considering relocating office space, tenants must plan a strategy to vacate their current office space and negotiate key financial and legal provisions in advance of actually receiving a written lease. These suggestions should assist tenants in minimizing relocation costs and disruption to management and employee transition into a new office space.

HAPPY HOLIDAYS!!



If you have any questions or would like further information, please contact:

John D. Horenstein, Esq.
Michael J. Holland, Esq.
Condon & Forsyth LLP
Times Square Tower
7 Times Square
New York, NY 10036
Tel: (212) 894-6784
Fax: (212) 370-4453
E-mail:

jhorenstein@condonlaw.com

mholland@condonlaw.com