

Don't Let Tenant's Rent Abatement Apply to Additional TIA

Many tenants these days demand a tenant improvement allowance (TIA) that is substantially bigger than what you want to give. For example, you may want to give the tenant a \$30-per-square-foot TIA, but the tenant demands \$45 per square foot. If the tenant has good credit, you may give in and loan it the extra amount (\$15 per square foot in our example) as an additional TIA. To ensure repayment, you would amortize the additional TIA amount (with interest) in the tenant's rent over the initial lease term.

However, your lease may contain a roadblock to your getting repaid the additional TIA on time. Suppose the lease lets the tenant abate its rent under certain circumstances—such as during the repair period if the building is damaged or a portion is taken in a condemnation action. If the lease does not say that the rent abatement does not apply to the additional TIA, the tenant may refuse to pay the additional TIA during the abatement period. That could seriously hurt your cash flow.

How to Plug Loophole

To plug this loophole, Santa Monica, Calif., attorney Susan Fowler McNally suggests that you make clear in the lease that if the tenant's rent abates for any reason, the abatement will not apply to the additional TIA. Treat the additional TIA as a loan that must be repaid, no matter what happens, she says. That will help you maximize your rent and ease the pain of the rent abatement. Note that the initial amount of the TIA (\$30 per square foot in our example) is not treated as a separate loan, so the rent abatement would apply to that portion of the TIA.

McNally suggests that you follow this two-step strategy to ensure that the additional TIA escapes the rent abatement:

Step #1: Add abatement language. State in the lease that whenever the tenant's rent will abate, the tenant will be entitled to abate only the amount exceeding the portion of the monthly

rent allocated to repaying the additional TIA, says McNally. For example, suppose \$450 of the tenant's monthly rent has been allocated to repaying the additional TIA. You would want a rent abatement to apply only to the amount exceeding \$450 of the monthly rent.

Model Lease Language

Wherever this Lease provides for the abatement of rent payable by Tenant to Landlord, including, without limitation, Clauses [insert #s of relevant clauses, e.g., casualty and condemnation clauses], the following limitation shall apply with respect to abatement of rent for the Premises initially demised hereunder: Only the rent payable by Tenant in excess of the monthly amount \$[insert amount of monthly rent allocated to repaying additional TIA] shall be abated.

Step #2: Add lease termination clause. If the lease is terminated before the expiration date for any reason—for example, because the tenant defaulted under the lease—you should require the tenant to immediately repay you the remainder of the additional TIA that the tenant has not already repaid through its rent, says McNally. To do that, state that if the lease is terminated, the tenant must pay you, within a short period of time—for example, 30 days after the termination date—an amount equal to the “present value” of the additional TIA multiplied by the number of months remaining in the initial lease term. Use the same interest rate that you used amortizing the additional TIA into the rent to compute the present value of money, she advises. That way, you will get the remaining portion of the additional TIA computed in current dollars.

Model Lease Language

In the event this Lease is terminated for any reason, Tenant shall, within [insert #, e.g., thirty (30)] days after such termination date pay Landlord the then present value of the product

of \$[insert original additional TIA amount] multiplied by the number of months remaining until the Expiration Date. The “present value” shall be computed by using the interest rate set out in Clause [insert #] hereof.

Remember to show our Model Lease Language to an attorney before using it in your leases.

PRACTICAL POINTER

Expect a savvy tenant to demand that you reduce its termination payment to the extent that you have received insurance or condemnation award proceeds covering the tenant's improvements built with the additional TIA, notes McNally. Otherwise, you would get a windfall of payments by both the tenant and the insurer for the same improvements.

CLLI Source

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