

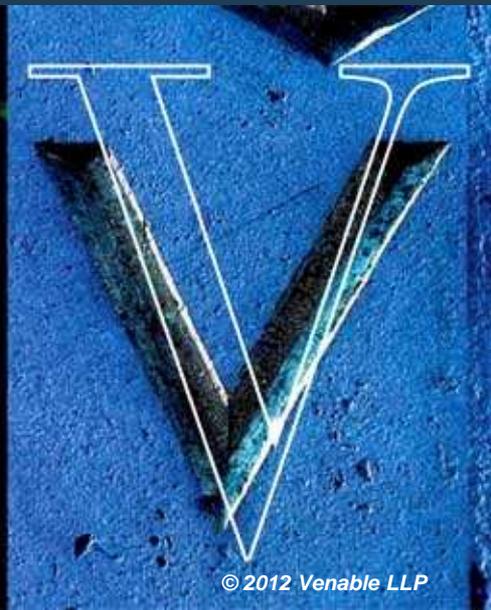
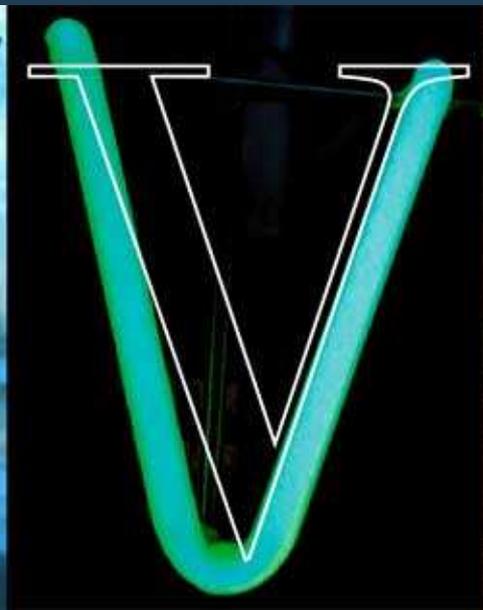
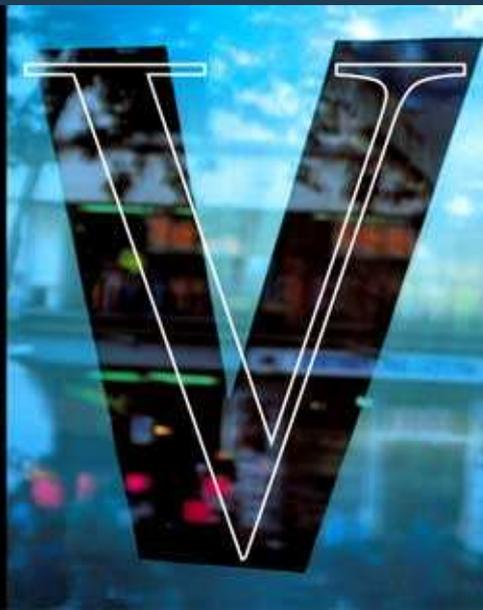
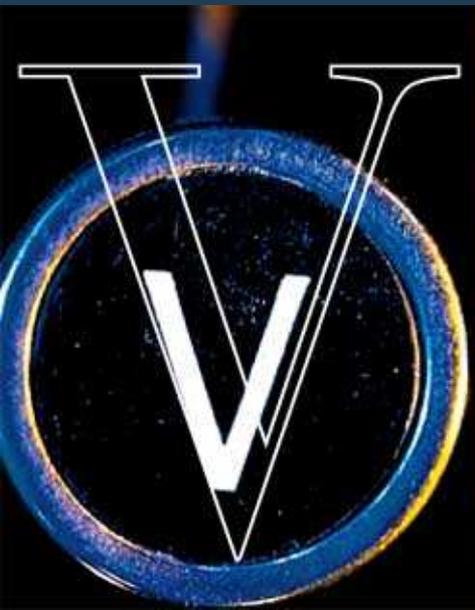
## Office Leasing for Nonprofits: Mastering the Key Issues

Tuesday, November 13, 2012  
12:30 p.m. – 2:00 p.m. EST

Venable LLP  
Nonprofit Organizations Practice  
Washington, DC

Moderator:  
Jeffrey S. Tenenbaum, Esq., Venable LLP

Panelists:  
Jennifer J. Bruton, Esq., Venable LLP  
Suzanne St. Pierre, Esq., Venable LLP



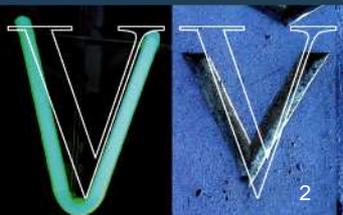
## Upcoming Venable Nonprofit Legal Events

November 16, 2012 – [The Postal Service's Financial Crisis: What It Means for Nonprofit Mailers](#)

December 11, 2012 – [Exchanges under Health Care Reform and “Private” Exchanges: What Does My Nonprofit Need to Know?](#)

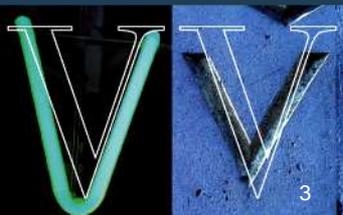
January 8, 2013 – [Exempt or Non-Exempt? The Ten Most Common Employee Classification Pitfalls Faced by Nonprofits](#)

March 12, 2013 - Preparing an Online Social Media Policy: The Top Ten Legal Considerations for Your Nonprofit (details coming soon)



# Agenda

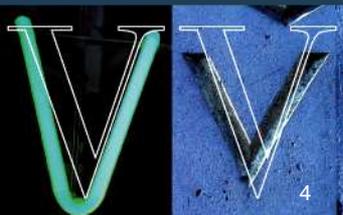
- Types of Leases
- The Leasing Process
- Principal Financial Terms of Leases
  - Options to Terminate, Renew and Expand
  - Real Estate Tax Payments
  - Operating Expense Payments
  - Electricity
  - Initial Construction (Landlord and Tenant Work)
  - Assignment and Subleasing
  - Licenses and Other Co-Location Arrangements
  - Utilities and Building Services
- Leasing and Green Buildings



# Types of Leases

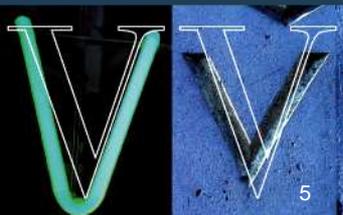
## Net Lease vs. Gross Lease

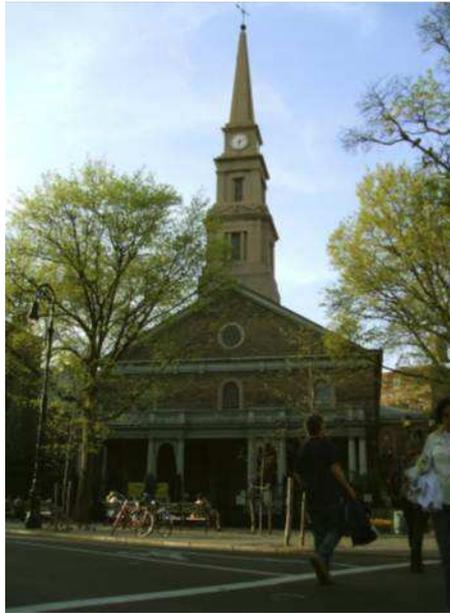
- Net Lease
  - Tenant pays directly all operating expenses, taxes, ordinary maintenance and capital improvement costs for the leased property
  - Tenant operates/controls the property and landlord provides no services
  - “The rent is absolutely net to landlord”
  - Typical form of lease for an entire building
- Gross Lease
  - Tenant pays additional rent on account of increases in operating expenses, taxes, maintenance costs and certain capital improvement costs for the leased property
  - Landlord operates/controls the property, pays the operating expenses, taxes and repair costs, and provides services



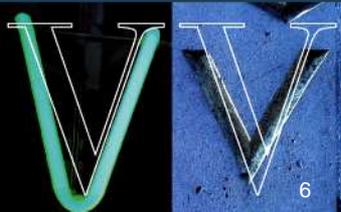
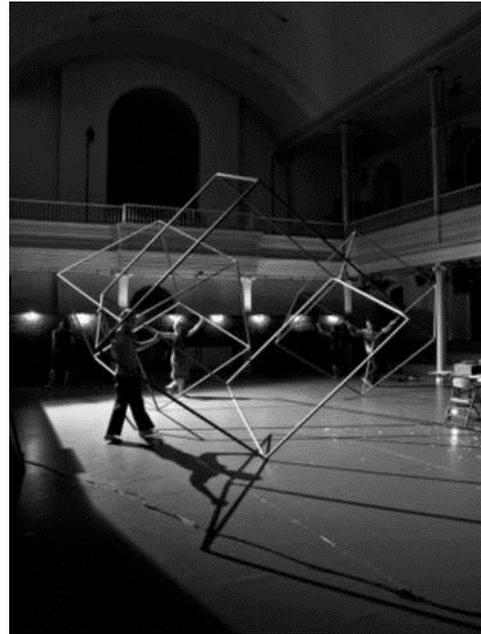
# Types of Leases

- Typical form of lease for:
  - Office lease in a multi-tenant building
  - Storefront lease in a mixed-use building
- In our presentation today, the discussion of operating expenses, taxes, and utilities and services relates to gross leases



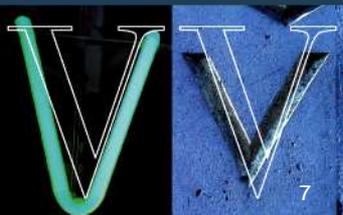


**Danspace Project  
St. Mark's Church in the  
Bowery  
New York, New York**



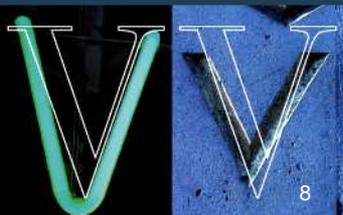
# The Leasing Process

- Working with architect to assess space needs
  - Hire an architect to develop a program
- Working with a real estate broker
  - Negotiating and signing a brokerage agreement
  - Brokerage agreement term usually a fixed time (6 months)
  - Landlord pays commissions to brokers
- Locating a property
  - Geographic considerations
  - Types of building services provided
    - Conference space
    - Security
  - Age of building (capacity of risers, age/efficiency of building systems)



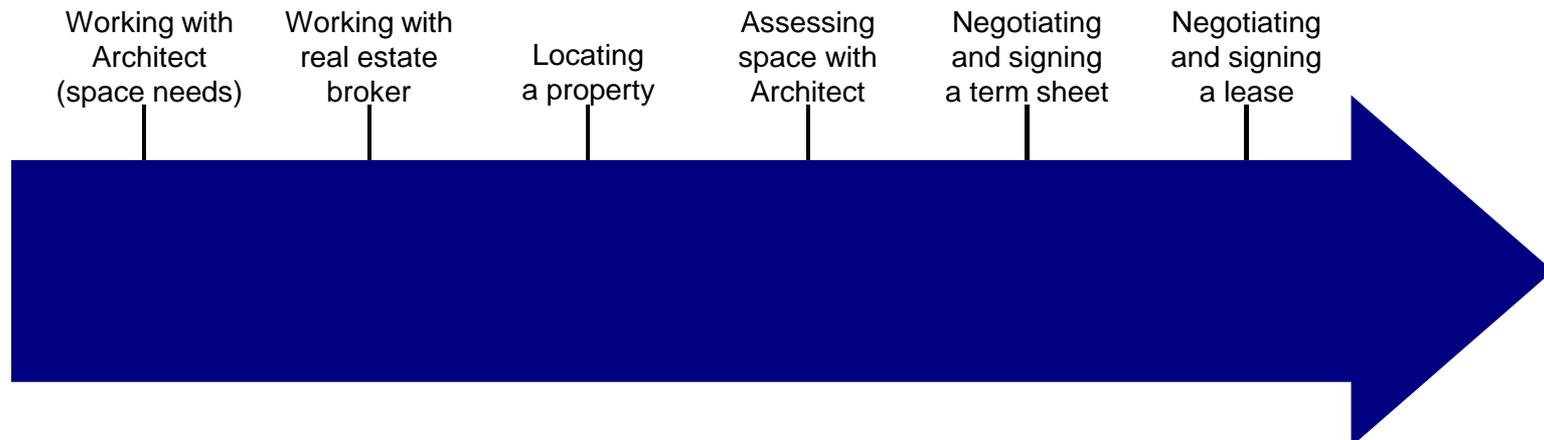
# The Leasing Process

- Assessing the space with architect
  - Make sure space is suitable for tenant's needs
    - Architect should determine:
      - Electric and HVAC needs
      - Required initial improvements to the premises
      - Permits required for tenant's construction and use (if any)
      - Effect of tenant's work on other areas of the building
- Negotiating and signing a term sheet
  - Landlord or landlord's broker will prepare initial term sheet
  - Non-binding
  - Should include essential terms of lease
  - Legal counsel should review term sheet



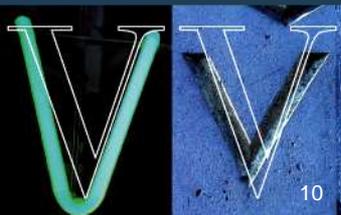
# The Leasing Process

- Negotiating the lease
  - Landlord or landlord’s counsel will prepare initial draft
  - Should reflect all business terms in the executed term sheet
- Important to involve the “team” early
- Timeline for leasing process



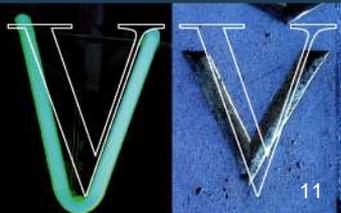
# Principal Financial and Legal Terms of Leases

- Addressed in the Term Sheet
  - Term; Termination Rights
  - Renewal Options
  - Expansion Rights
  - Base or Fixed Rent
  - Security Deposit
  - Tax Payments
  - Operating Expense Payments
  - Electricity
  - Landlord's Work
  - Broker Commission
  - Use
  - Assignment and Subleasing
  - Guaranty
- Other Important Lease Terms
  - Utilities and Services
  - Tenant's Work
  - Compliance with Laws
  - End of Term (restoration obligations and holding over)
  - Signage
  - Subordination and Non-Disturbance



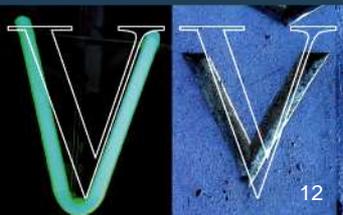


Municipal Arts Society  
West 57th Street Offices  
New York, New York  
Leased Property



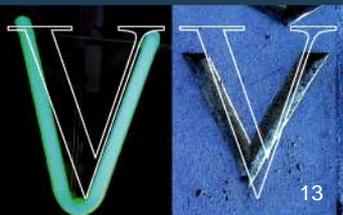
# Termination Options

- Very difficult for a tenant to negotiate an early termination right
- If landlord does agree to such a provision, there is typically a termination fee that must be paid to landlord
- Termination fee is negotiated but could be base rent that would be collected over a certain period plus the unamortized portion of improvements and landlord costs (i.e., brokerage commissions)
- If an early termination right is obtained, the timing is usually restricted – for example, may only be permitted during last 3 years of term



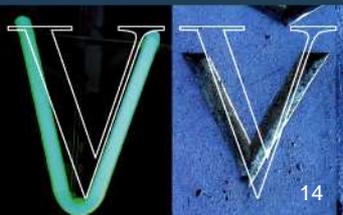
# Renewal Options

- Agreed upon extension of the initial term
- Not automatic - Typically, tenant must give advance written notice to landlord of tenant's exercise of such right; Time is of the essence
- This can be very valuable to a tenant as it provides comfort that its business will not be interrupted and can continue to operate at the same location for an extended period of time
- Renewal rent - Typically governed by a formula that provides for the determination of fair market rent at the time of the renewal
  - Fair market rent is typically determined by using “baseball arbitration”



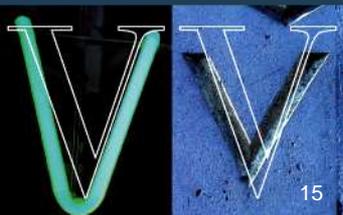
# Renewal Options

- “Baseball Arbitration” to determine fair market rent
  - Landlord sends notice to tenant stating what rent will be for renewal term
  - Tenant has a certain period of time to accept or reject such rent
  - If tenant objects, tenant gives its proposal for fair market rent to landlord
  - Arbitrator picks either landlord’s or tenant’s proposed rent; Determination of arbitrator is binding on landlord and tenant
  - Costs of arbitration is split 50/50 between landlord and tenant
- Strategy – tenant should try to bargain for 95% of fair market rent; savings to landlord on renewal



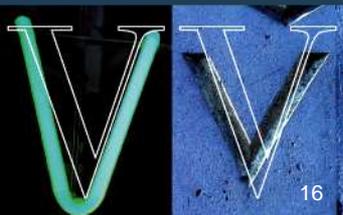
# Expansion Options

- Tenant may be able to negotiate expansion rights
  - Typically done as a “right of first offer”
  - If a certain space (as designated in the lease) becomes available, landlord will first have to offer it to tenant
  - Tenant has to send formal notice to landlord within a certain time period notifying landlord that tenant wishes to lease the space
- Strategy – Need to make a business case for expansion right as it limits landlord’s flexibility



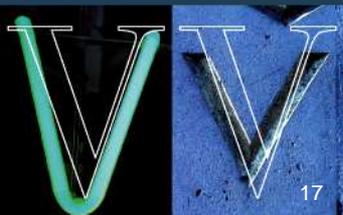
# Real Estate Tax Payments

- Taxes – real estate taxes and special assessments are reimbursable under leases
- Base Year - Typically real estate taxes are calculated by using a "Base Year" which is the first tax year of the municipality during the term
  - NYC – July 1 to June 30
  - Washington, D.C. – October 1 to September 30
  - Maryland – July 1 to June 30
  - Virginia – January 1 to December 31
  - Tenant pays for its percentage share (based on size of tenant's space in comparison to entire building) of the increase in real estate taxes over the Base Year
- Typically landlord estimates tenant's portion of real estate taxes at the beginning of the year and bills tenant monthly based on such estimate
- When actual tax bill is received by landlord for building, any shortfall or overpayment is adjusted between landlord and tenant



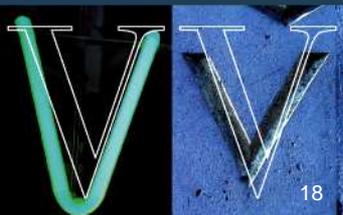
# Real Estate Tax Payments

- Special Assessments and Abatements - Tenant should perform due diligence and/or request that landlord make representations in lease regarding special assessments and abatements that are applicable during tenant's term
  - Is tenant getting benefit of special assessment?
  - Is there an abatement that will end during tenant's term that will cause tenant's real estate taxes to significantly increase?



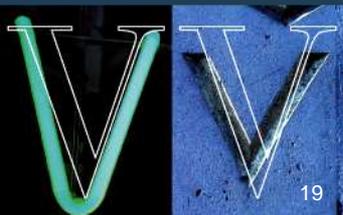
# Real Estate Tax Payments

- Real Estate Tax Exemptions - If owner of building is a nonprofit, a nonprofit tenant may be exempt from paying real estate taxes if tenant is using premises for a nonprofit purpose
  - New York City –
    - Landlord and Tenant must be nonprofits described in NY Real Property Tax Law (most IRC § 501(c)(3) entities are eligible)
    - Tenant must use space for exempt purposes
    - Amount of rent collected by landlord may not exceed landlord's carrying, maintenance and depreciation costs associated with the leased premises
    - A nonprofit owner of units in a leasehold condominium is eligible for exemption (underlying lease must be for period of 35 years or more, other requirements) (NYC Department of Finance Ruling #FLR-08-4886 dated February 13, 2009)



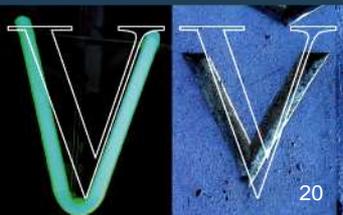
# Real Estate Tax Payments

- Washington, D.C. –
  - Nonprofit must be owner and user of real property and must use property for exempt purposes (most IRC § 501(c)(3) entities are eligible)
  - Exemption effective first day of month following approval of exemption
  - D.C. Code Section 47-1002; DC Form FP-300



# Real Estate Tax Payments

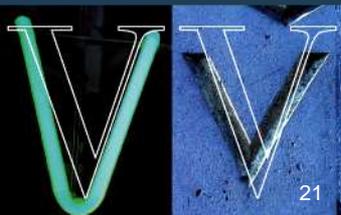
- Maryland –
  - Nonprofit must be owner and user of real property (must be educational or charitable use)
  - Requirements: (i) organization and use must be educational or charitable, (ii) no part of net income to benefit of private shareholder or individual, and (iii) use of property must be reasonably necessary for the charitable or educational work of the organization
  - Exemption must be applied for by July 1, and will be effective as of September 1 of the same year (except that for property with an assessed value of \$300,000 or less, the exemption will be effective upon transfer to the organization, if other requirements are met)
  - Maryland Code, Tax Property Article, Section 7-202



# Real Estate Tax Payments

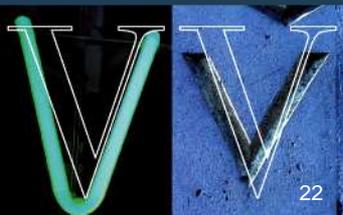
## – Virginia –

- Nonprofit must be owner and user of real property and must use property for exempt purposes (religious, charitable, patriotic, historical, benevolent, cultural or public park or playground purposes)
- Exceptions vary by locality
- Filing requirements vary locally
- Virginia Constitution Article X, Subsection 6(a)(6) and Virginia Code Section 58.1-3600, et seq.

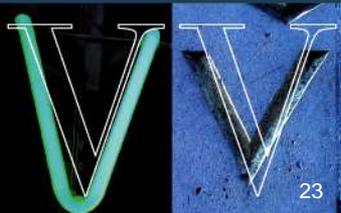


# Real Estate Tax Payments

- Survival - Tenant's obligation with respect to tax payments during the term survives expiration of the lease
- Tenant should negotiate a limited survival period (1-2 years)
- Audit - Tenant has the right to review the books and records of landlord concerning real estate taxes and other operating expenses
  - Very useful tool as it is not uncommon for errors to occur, resulting in tenant being overcharged

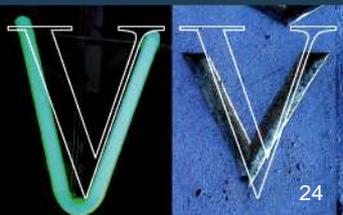


**Tides Foundation  
Thoreau Center for Sustainability  
55 Exchange Place  
New York, New York  
Owned Property (leased to  
non profit tenants)**



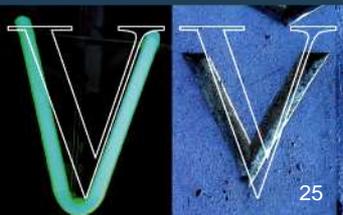
# Operating Expense Payments

- Operating Expenses – The expenses incurred by landlord to operate the building, including insurance, maintenance, and cleaning but excluding real estate taxes
- Tenant’s Operating Expense Payment – Typically tenant’s percentage of the increase in operating expense over “base year” operating expenses
- Tenant’s Percentage – The percentage of total rentable square feet of building occupied by tenant
- Base Year – Typically the calendar year in which lease commences
- Estimated Monthly Payments – Based on percentage of last year’s operating expenses with annual reconciliation



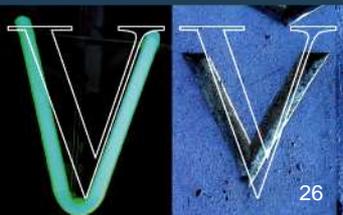
# Operating Expense Payments

- Issues
  - Capital Expenses – try to limit to capital expenses: (1) that actually reduce operating expenses or (2) are required by laws; also try to amortize cost over useful life of improvements and pay pro rata share during term
  - Other excluded costs - operating expenses should not include any costs of above standard services provided to any tenant, or costs reimbursed by insurance
  - Survival period for payment of operating expenses – propose two years after lease termination
  - Right to audit – negotiate for 6 months after landlord notifies tenant of final annual expenses; landlord pays audit costs if expenses overstated by more than 3%



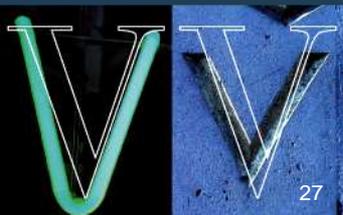
# Operating Expense Payments

- Issues
  - “Gross-Up” – if building is less than 95% occupied, calculate base operating expenses as if the building is 95% occupied
  - Caps on annual increases in operating expense escalations – only for larger tenants, only for controllable operating expenses
  - Limit the management fee that can be passed through as operating expenses
  - Require affiliate contracts to be at market rates
- Strategy – carefully define included operating expenses and exercise audit rights



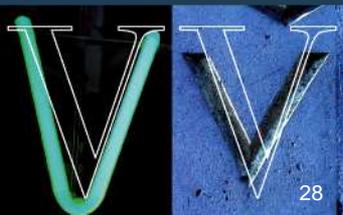
# Electricity

- Cost of electricity can be: (1) payable as a separate charge (additional rent), (2) included in base rent, or (3) payable directly by tenant to the utility
  - Submetering
    - Meter measures tenant's consumption; tenant pays landlord for tenant's consumption as additional rent; landlord pays utility for total building usage
    - Landlord imposes charges in addition to actual costs payable by landlord
      - Landlord may get a volume discount that it does not pass on to tenant - "rates in effect as if the tenant were purchasing the electricity directly from the utility"
      - Administrative charge – cost of measuring and calculating Tenant's electricity charges
      - Taxes on tenant's electrical consumption (if not included in amount paid to utility)



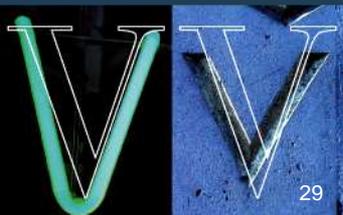
# Electricity

- Rent inclusion
  - Landlord estimates the cost of providing electricity and adds cost to base rent on a square foot basis (ex. \$3 per square foot)
  - Landlord reserves the right to survey usage and adjust the base rent accordingly; also landlord typically reserves right to increase the cost if the utility raises its rates
- Direct metering
  - Direct billing from utility; this requires a separate feed from the utility to tenant's premises
- Issues
  - Maximum power capacity to be provided by landlord – determine your needs
  - Tenant covenants not to exceed capacity of building feeders and risers – your architect should verify that the building has the capacity to meet your needs



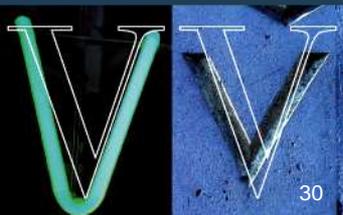
# Electricity

- Strategy
  - Obtain information from landlord regarding the calculation of additional rent for electricity; include in lease if possible



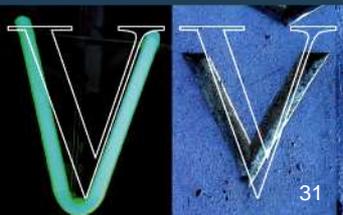
# Landlord's Work

- Issues
  - Scope of work (including any demolition, removal of furniture, etc.)
  - Tenant participation in design
  - Procedure to determine completion
  - Deadline for completion
  - Remedies for failure to complete
  - Coordination with tenant work
  - What is “building standard”?
  - Tenant – initiated changes



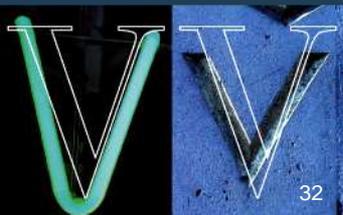
# Landlord's Work

- Lease commencement date is usually date that landlord's work is completed and possession is delivered
- Failure of landlord to deliver possession
  - Commencement date is postponed
  - Does this extend term?
  - Right to terminate – “kick out right”
  - Representation from landlord that there are no current leases/occupancies
- Strategy – fight hard for right to terminate if work not completed by certain date; need to consider course of action if termination right is exercised



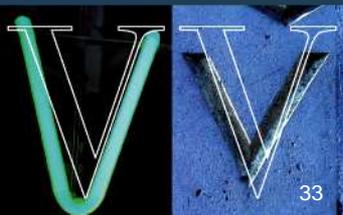
# Tenant's Work

- General Rule
  - All improvements, alterations and installations by tenant are subject to landlord approval
  - Exceptions – cosmetic alterations – painting, carpeting, partitions
- Standard
  - Reasonableness, except with respect to work affecting building structure and systems
- Strategy
  - If tenant work is required for occupancy, have landlord pre-approve plans or scope of work



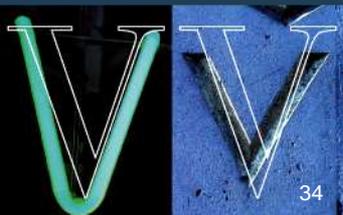
# Tenant's Work

- Process
  - Provide time periods for landlord approval of plans and specifications (issue of deemed approval)
  - Specify landlord requirements in lease – insurance, approved contractors, etc.
- Landlord contribution to tenant's work
  - Issues
    - Is landlord paying for a scope of work or agreeing to reimburse up to a limit?
      - Usually the latter, otherwise landlord performs work to control costs
      - If reimbursement up to a limit, limit may be insufficient to cover total costs



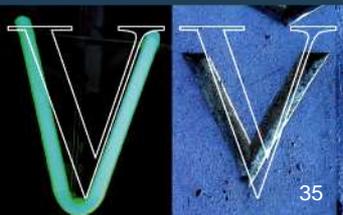
# Tenant's Work

- What is reimbursable? Hard costs, and sometimes soft costs, telephone equipment
- What are conditions to reimbursement?
  - Specify documentation in lease
  - Tenant's funds are typically paid in first
  - Payable monthly or upon completion of work?
- Tenant's responsibility for changes to base building systems – who does this work? who pays?
- Landlord typically charges a fee for review of plans and construction supervision; try to negotiate a waiver of these fees for tenant's initial work and/or limit construction supervision fee to apply only to major alteration projects



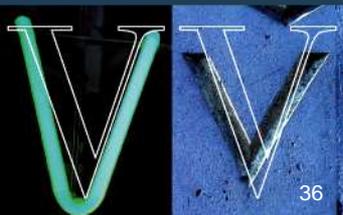
# Assignment and Subleasing

- Assignment
  - All rights and obligations are transferred for remaining term
  - Original tenant may or may not be released from liability upon assignment
- Sublease
  - Right to occupy all or portion of premises for time period less than remaining term
  - Agreement between tenant and subtenant – subject and subordinate to lease
  - Tenant remains liable for full lease obligations



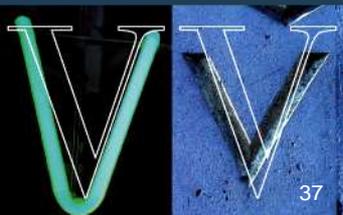
# Assignment and Subleasing

- General Rule
  - Assignment and subleasing are not permitted without landlord consent
  - Landlord should agree to be reasonable in granting/denying consent
  - Criteria for consent can be helpful
    - Net worth
    - Not a building tenant
    - Reputation
    - No advertising
- Exceptions
  - Assignment/subleasing to “affiliates” and “successors by merger” not applicable – in the case of nonprofits, consider specifying supporting organizations, successor organizations and “partner” organizations
  - Assignment as part of merger/sale of all assets (transfer of all assets to successor nonprofit)



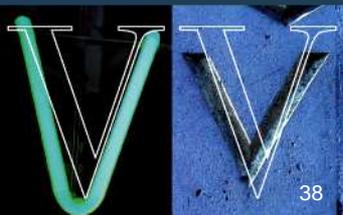
# Assignment and Subleasing

- Process
  - Time periods for approval should not exceed 30 days; negotiate for two-step approval process
  - List required documentation for approval in lease
- Right of Recapture
  - Option of landlord to take back space to be subleased/assigned
  - Decreases tenant flexibility
  - Need short deadline to exercise option (this should be before going to market)
  - Coordination with assignment/sublease approval timeframe
  - Recapture sublease
- Assignment/Sublease Profit
  - Typically split 50/50



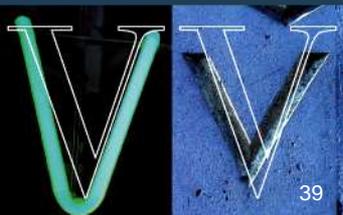
# Get Me Out of this Lease!

- Landlord Default
- Negotiated Early Termination (unlikely)
- Assignment/Subleasing
  - Assignment
    - may be subject to recapture
    - assignee/assignment document must be approved by landlord
    - assignee must assume all lease obligations for remainder of term



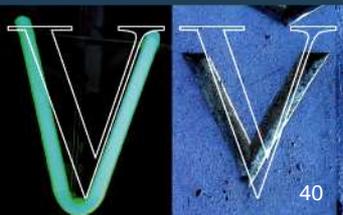
# Get Me Out of this Lease!

- Sublease
  - may be subject to recapture
  - subtenant/sublease must be approved by landlord
  - subtenant cannot have rights that are inconsistent with lease terms
  - as sublessor, you want to pass through maximum obligations to subtenant
  - issue of enforcing lease for benefit of subtenant
  - issue of recognition of subtenant by landlord if tenant defaults



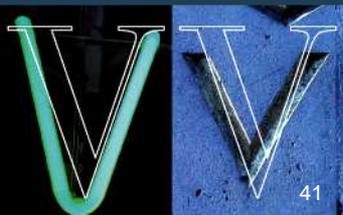
# Get Me Out of this Lease!

- Strategies for Assignment/Subleasing
  - Allow ample time for transaction
  - Preliminary discussion with landlord regarding recapture, preliminary approval, landlord requirements, need for mortgagee approval, time frame
- Landlord usually not liable for damages due to unreasonable failure to approve assignment/sublease – tenant remedy is usually specific performance



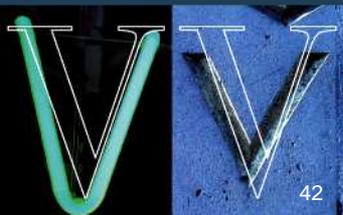
# Licenses and Other Co-Location Arrangements

- Licenses and “Desk Sharing Arrangements”
  - Some nonprofits support, incubate or collaborate with other nonprofits
  - These arrangements – which can involve separately demised space or a few desks in the tenant’s offices – are treated the same as subleases
  - If a license is contemplated, consider obtaining landlord consent in the lease to licenses of less than a stated percentage of the premises to specific persons/entities or for specific purposes
  - Even if licenses are pre-approved in lease, tenant should sign a written license agreement with the licensee to clearly define licensee’s rights in the space and its financial obligations



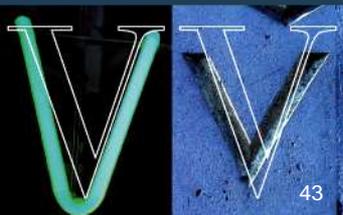
# Licenses and Other Co-Location Arrangements

- Co-Location Arrangements
  - Nonprofits often seek ways to co-locate with other nonprofits, in order to save costs and for mission-driven reasons
  - Where purchasing a building for this purpose is not practical or desired, nonprofits may be able to achieve benefits of co-location by leasing separate premises in the same building
  - Considerations:
    - It is generally recommended that each nonprofit have a separate lease, rather than one nonprofit tenant with subleases to other nonprofits (to avoid liability risk due to subtenant non-performance)



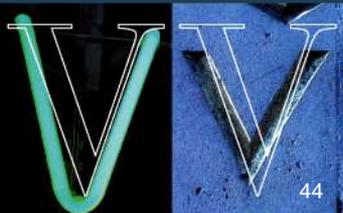
# Licenses and Other Co-Location Arrangements

- A facility within the building – such as a conference center, kitchen, or a gym – can be leased by one nonprofit, which can grant licenses to other nonprofits for use (with landlord's approval); however, the nonprofit which leases the facility should obtain written agreements from other tenants to share costs, have ability to terminate arrangement if other tenants fail to pay costs, and obtain security from other tenants if possible
- All parties using shared facility should be covered by insurance policies for the premises
- Liability for personal injury/property damage for use of shared facility must be agreed in advance



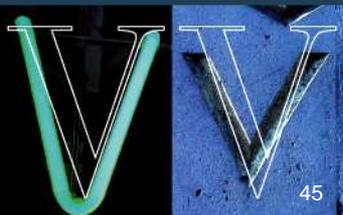


**Cooper Union  
New Academic Building  
Cooper Square  
New York, New York  
Owned Property**



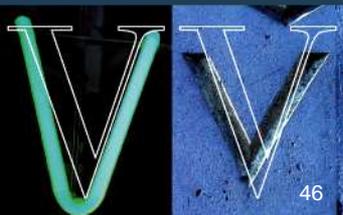
# Utilities and Building Services

- Landlord only required to provide what is expressly required in lease
- Electricity described above
- HVAC (heating, ventilation and air conditioning)
  - Tenant may be responsible for (and may be required to install) an HVAC unit for its premises, or may elect to install supplemental air conditioning units
    - Tenant controls system but is required to maintain it at tenant's expense
    - Tenant may be required to replace the HVAC system (a big cost)
    - Tenant will pay for electricity, and for condenser water (purchased from landlord), to operate the system
    - Condenser water can be an annual charge for maximum specified tonnage or an hourly fee



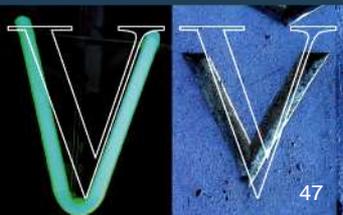
# Utilities and Building Services

- Tenant may be supplied with HVAC from building systems
  - Issue of days/hours that HVAC is provided as “standard” service (i.e., without additional charge)
  - Overtime charges for after-hours services
    - “building standard” charges – what are current charges?
    - Landlord’s “actual cost” is preferable – but actual cost can include engineering labor cost, equipment depreciation, repair and maintenance cost and administrative costs; need to know this cost
  - Advance notice to order overtime HVAC



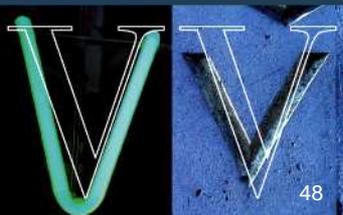
# Utilities and Building Services

- Water/Sewer
  - Usually included in base rent “for ordinary lavatory and pantry purposes”
  - Will hot water be included or will tenant need to install hot water heater?
- Telephone/Internet
  - Not included
  - Landlord provides right to use risers
- Cleaning
  - Clarify that cost is included in base rent
  - Get specification for daily, weekly, monthly cleaning; attach to lease
  - Is exterior cleaning – windows, storefronts, sidewalk – landlord’s responsibility?
  - Is garbage removal included?

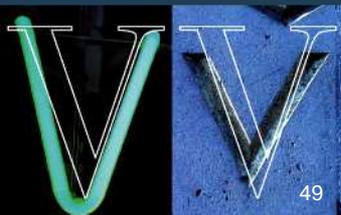
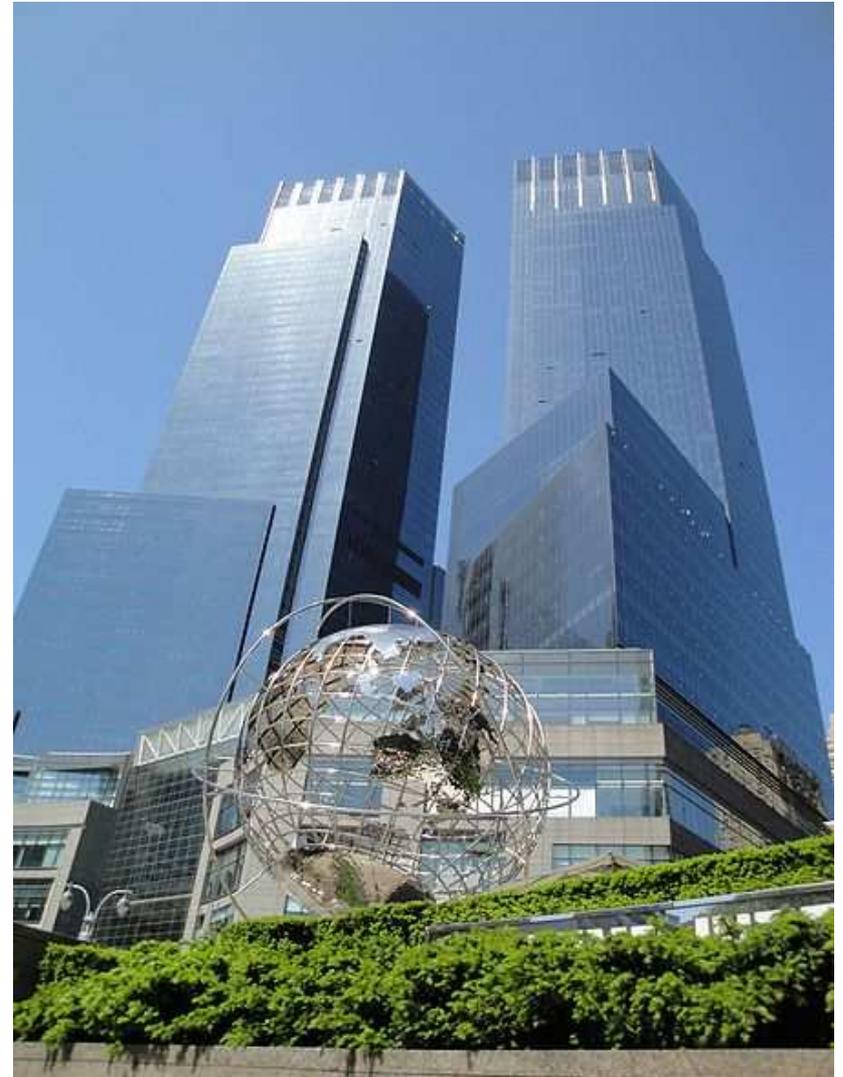


# Utilities and Building Services

- Security
  - Is it provided 24/7? If not, how does tenant access the premises after hours?
- Issue: Right to rent abatement/terminate lease for failure of services (excluding failures due to casualty/condemnation)
  - Lack of services must render premises unusable or access is prevented
  - Right to abatement after stated number of consecutive days without services
  - Right to terminate after longer consecutive period without services
  - Rights sometimes exclude failure of services for reasons beyond landlord's control
  - Strategy – bargain for rights in event of lengthy loss of services for any reason

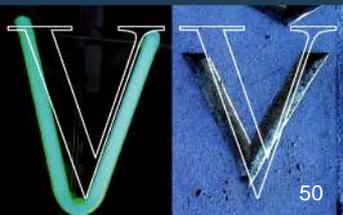


**Jazz at Lincoln Center  
Time Warner Center  
New York, New York  
Owned Property (condominium unit)**



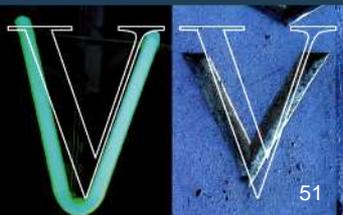
# Leasing and Green Buildings

- Nonprofits are in the vanguard of green building developers/users
- Nonprofits can lease in green buildings and/or can build interiors that meet green standards
- Most popular green building certification is LEED (Leadership in Energy and Environmental Design), developed by the US Green Building Council, but there are other rating systems and green construction laws
- LEED certifications do not require periodic renewal (and as of now landlords generally do not covenant to re-certify or maintain green standards)
- Some governments/owners are adopting performance based on green standards – this may allow tenants to measure impact of green building features on operating costs and compare costs among buildings



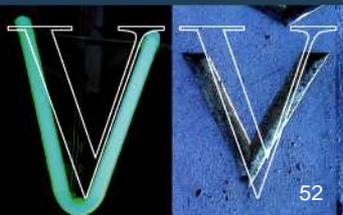
# Leasing and Green Buildings

- New York City Local Law 84 of 2009 – requires annual reporting of energy and water use by owners of privately-owned properties with individual buildings of over 50,000 sq. ft., or multiple buildings totaling over 100,000 sq. ft.
- City compiles information by property and also provides an annual report  
<http://www.nyc.gov/html/gbee/html/plan/l184.shtml>
- This information allows “benchmarking” – comparison of efficiency of various buildings, can be used by potential tenants to identify efficient buildings



# Leasing and Green Buildings

- To consider – if tenant leases in a building subject to green mandates, will tenant be subject to green requirements relating to tenant fit-out, alterations, maintenance and use? If so, what is projected incremental cost to tenant?
- Nonprofits that wish to promote the green environment can agree to share pro rata costs of capital improvements by landlord which increase energy efficiency, reduce water use, or achieve other green goals.



## Questions

Jeffrey S. Tenenbaum, Esq.  
[jstenenbaum@Venable.com](mailto:jstenenbaum@Venable.com)  
t 202.344.8138

Jennifer J. Bruton, Esq.  
[jjbruton@Venable.com](mailto:jjbruton@Venable.com)  
t 202.344.8508

Suzanne St. Pierre, Esq.  
[sst.pierre@Venable.com](mailto:sst.pierre@Venable.com)  
t 212.370.6222

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