MANAGING YOUR LEASE COSTS: LIMITING THE TENANT'S ECONOMIC RISK

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I. INTRODUCTION.

For the past couple of decades, the level of sophistication of representation of tenants in commercial leases, both from the business side and the legal side, has risen dramatically. With the advent of such "tenant representation", more tenants now tend to scrutinize their leases carefully. While the level of bargaining power among tenants remains varied, it seems that the issues that draw tenants' ire do not result from technical legal issues in the lease document, but rather practical issues that give rise to costs which were not anticipated by the tenant at the commencement of the lease. The client may have no clue that his lawyer has masterfully negotiated the insurance and indemnity provisions, but he will certainly know, for example, if he has to start paying rent before he is able to use the space. With that in mind, this article will address those areas in the commercial lease which, with careful planning, can save the tenant money by avoiding such hidden costs.

Hidden costs in a lease can arise in various circumstances, but generally can be categorized as: (i) issues involving the lease term, (ii) issues involving the calculation and payment of rent and other charges under the lease, and (iii) operational issues. This article will address each of these three broad categories from the tenant's perspective.

II. LEASE PROVISIONS.

A. Lease Term Issues.

1. Commencement Date Issues.

When and how the lease commences and rental payments begin to accrue is an important aspect of any lease. Many landlords want a fixed commencement date so that they know precisely when the rental stream will commence. However, a tenant should avoid a fixed date for rental commencement, unless any required build out of the space is entirely within the tenant's control and the tenant is certain there will be no delays in the delivery of the space to the tenant. If the lease requires the landlord to perform certain tenant improvement work to make the space ready for the tenant, then the tenant should attempt to tie the commencement date to the landlord's completion of such work and the issuance of a certificate of occupancy for the premises. (See Appendix 1-A, Option 1.) If, on the other hand, the landlord has delivered the space to the tenant and the tenant is responsible for its own tenant finish work, then the commencement date should be tied to a certain number of days after the landlord's delivery of the space to the tenant. As a precaution, the landlord will usually require, with justification, that the commencement date actually be tied to the earlier of (i) *x* days after delivery of the premises to the tenant or (ii) the date tenant actually commences operation of its business from the premises. (See Appendix 1-A, Option 2.)

Obviously, when picking the number of days required for the tenant to perform the tenant improvement work, the tenant should carefully consider all factors that could delay its completion (including, without limitation, potential delays because of weather, shortages of materials, the landlord's failure to timely approve the plans and specifications for the space and the like). (See Appendix 1-B.) In that regard, regardless of whether the landlord or the tenant performs the tenant improvement work, the tenant should make sure that the actual commencement date is subject to delays caused by either the landlord or force majeure events. Often, landlords will delay the tenant's obligation to pay rent under such circumstances without delaying the commencement date of the lease. However, the tenant should ensure that any delay in the obligation of tenant to pay rent as a result of the landlord or force majeure events also delays the commencement date of the lease so that the tenant does not end up with a shorter lease term than was originally contemplated. Finally, the tenant should make sure that tenant has adequate time to move into the space and set up its furniture and systems prior to the commencement date so that the tenant is fully operational from the premises as of the commencement date.

2. End of Term Issues.

Just as the tenant must ensure that it is prepared to begin its business operations from the premises prior to the commencement date, the tenant should also make sure that it gets the full benefit of the entire lease term on the back end of the lease term. In that regard, some tenants will attempt to negotiate a certain period of time after the expiration of the lease term (e.g. two weeks) to remove its property so that the tenant can operate its business right through the end of the term. Obviously, many landlords are resistant to this concept and whether the tenant would be successful in this negotiation is purely a function of its bargaining power. However, this is especially important to a tenant in a retail context, since a retail tenant wants to generate sales revenue right up to the expiration of its term.

3. Holding Over.

Landlords understandably do not want tenants to hold over beyond the expiration of their lease term. As a result, landlords will generally increase the tenant's rent during any holdover tenancy to somewhere between 125% and 200% of the last rent paid by tenant during the term. While no tenant enters into a lease with an intention to hold over after the expiration of its term, circumstances may dictate that such a holdover is necessary. For example, the tenant's new space in a different building may not yet be ready for occupancy at the time of the expiration of the tenant's existing lease. Accordingly, the tenant should attempt to negotiate a holdover rent which is as low as possible. Generally, landlords will agree to a holdover rate of between 125% and 150% of the initial term rent.

Many landlords are sensitive to the tenant's plight with respect to holdovers and therefore are willing to allow a short holdover period at a reasonable rate, but will increase the rate as the holdover extends beyond a reasonable period. For example, the holdover rental rate for the first month of holdover might equal 125% of the previous month's rent, but the rate might increase for each additional month of holdover, making it more expensive for the tenant to stay in the space. Of course, the landlord would always have its common law remedies to evict a holdover tenant should it desire to do so.

Many landlord form leases also require the tenant to pay any and all damages incurred by landlord as a result of a holdover tenancy. Tenants should attempt to avoid this liability or at least limit the exposure. For example, if the landlord claims that it lost a new tenant as a result of the tenant's holdover, the landlord's claim for damages could be significant. If the tenant is unsuccessful in convincing the landlord to remove this provision from the lease, the tenant should at least limit its exposure to actual (but not consequential, special or punitive) damages.

Finally, most leases provide that a tenant who holds over is occupying the space as a tenancy-at sufferance (which means that the landlord can immediately exercise its remedies to remove the tenant from the premises). Many tenants will attempt to characterize a holdover tenancy as a "month-to-month" tenancy, which will provide the tenant authorized occupancy on a month-to-month basis during a holdover. Most landlords will reject this idea because it limits their ability to quickly replace the outgoing tenant with a new tenant.

B. Rent Issues.

1. Base Rent Issues.

Generally speaking, base rental rates are typically quoted to tenants on a "per square foot" basis. However, rarely does this concept make it into the lease. Unfortunately, many tenants rely on the landlord's calculation of the square footage of the premises to set the base rent rate. Prudent tenants will insist on a right to re-measure the premises upon completion of the buildout and adjust the rent based on the price per square foot originally quoted to the tenant. In most circumstances, this will benefit the tenant. However, in order to protect itself, the tenant should also insist on a cap that the rent may increase based on any such re-measurement. In other words, since the landlord is quoting a specific square footage at a specific rental rate, the tenant should not find itself in a position where it is paying significantly more than what was originally quoted by the landlord. However, it should have the right to verify that the landlord's original estimate of square footage was correct. (See Appendix 1-C.)

Another base rent issue which is often overlooked by tenants relates to the setting of the base rent for renewal terms. Usually, the renewal rental rate will be a function of the market rate at the time of such renewal. Many tenants have successfully negotiated for a base renewal rental rate of 95% of the market rate at the time of renewal, convincing the landlord to give such tenants a discount off the market rate. Landlords are often willing to give such a discount because they are able to save time, hassle and money by renewing an existing tenant rather than finding a new tenant for the space. In any event, the analysis of the market rent as it applies to a renewing tenant should account for the fact that there will be no relocation cost to the landlord, no reconfiguration cost, no or lower brokerage fees, etc. These factors should serve to reduce the market rate for the tenant from that which would be quoted to new tenants coming in.

2. Operating Expense Issues.

(a) Base Year Concept.

In a full-service or gross lease, the base rent figure is intended to include operating expenses for the first year of the lease (the "Base Year"), with the tenant being required to pay only increases in such operating expenses in subsequent years. While seemingly a simple concept, the Base Year concept can be very tricky for tenants. Accordingly, a tenant must carefully analyze the language of the lease to ensure it is getting the benefit of its bargain. First, the tenant must pay attention to the year used as the Base Year for the lease. This should be the calendar year in which the

lease is executed, not the previous calendar year. Similarly, if the lease is executed late in the year, the tenant might consider negotiating for a Base Year of the following calendar year, to ensure that it receives at least a full year of base rent without paying increases in operating expenses.

Second, the tenant must make sure that the landlord has a full year of operating expenses in the Base Year. For example, if the tenant is leasing space in a building recently put into service, then the landlord may not have a full compliment of expenses in its Base Year of operating expenses. As a result, the tenant will pay a much larger increase in its share of operating expenses in the second year, because the Base Year was not a truly representative sample of operating expenses.

Many landlords will "gross up" operating expenses for any year in which the building is not fully occupied, with the result being that the tenant will pay a larger share of the actual operating expenses in order to ensure that the landlord is fully compensated for the cost of operating the building. While this is an accepted and standard procedure, the tenant must ensure that the operating expenses calculated into the Base Year are similarly "grossed up" in order to provide a fair comparison from the Base Year to the current year.

Finally, a concept which is often missed by tenants resulting in significant increased lease costs relates to the treatment of the Base Year concept on the renewal of the lease. As previously mentioned, in most cases, upon renewal of a lease the base rent rental rate will adjust to the market rate. If that is the case, then the Base Year should also adjust to the year in which the renewal occurs. Otherwise, the tenant will be paying a market rental rate (which includes operating expenses for the year in which the renewal occurs), but will be paying increases in operating expenses over the original Base Year. In other words, the tenant would be paying for the increase in operating expenses over the Base Year twice, both in its new base rental amount, and in its additional rent.

(b) Tenant's Share Calculation.

Another concept which affects the amount the tenant pays in operating expenses is the calculation of the tenant's share. As previously mentioned, the tenant should always get the right to re-measure the premises and, perhaps, the building in order to confirm the landlord's calculation of the tenant's share of operating expenses. The tenant's share should be described as a formula (e.g., the number of rentable square feet in the premises divided by the number of rentable square feet in the building) rather than a fixed percentage (e.g., 25%) so that if the building expands, the tenant will receive the benefit of the smaller percentage. However, the tenant should be careful to avoid any additional cost if the building contracts by placing a cap on its percentage share. Finally, the tenant should ensure that the denominator used in the formula to calculate the tenant's share is the building square footage, rather than the "occupied" square footage of the building. The impact of this minor change can be dramatic.

(c) Definition of Operating Expenses.

Most landlord form leases contain an extremely broad definition of operating expenses and tenants are left to negotiate exclusions from such definition in an attempt to limit what expenses the landlords pass through to the tenants. While this is normally a function of the size of the lease and the bargaining power of the tenant, attached to this article as Appendix 2 is a comprehensive list of exclusions to operating expenses a tenant might attempt to include in the lease.

(d) Cap on Operating Expenses.

Regardless of the definition of operating expenses, the tenant should attempt to obtain a cap on increases in operating expenses from year to year. While most landlords are generally amenable to some form of a cap, it will typically be limited to non-variable operating expenses and would therefore exclude costs such as taxes, insurance, utilities and snow removal. The landlord will prefer a cumulative cap, which allows the landlord to cumulate percentage increases from year to year. For example, if the lease provides for a cumulative cap of 5% increases per year, and the increase in the first year is 3%, then the operating expenses in the second year could increase up to 7% before they would reach the 5% cumulative cap. On the other hand, the tenant would prefer a non-cumulative, year-over-year cap so that operating expenses in any given year could not increase by more than 5% over the operating expenses in the previous year. Once again, the result will be a function of the bargaining power of the parties.

(e) Gross Up Provision.

As previously mentioned, the lease will generally provide that if the building is not fully occupied in any given year during the lease term, then the operating expenses for the building will be "grossed up" by increasing the operating expenses to the amount which the landlord projects would have been incurred had the building been fully occupied. While this is an accepted

practice, the tenant should protect itself by negotiating a couple of safeguards. First, only the variable components of operating expenses should be grossed up (such as electricity, janitorial and the like). Fixed operating expenses should not be grossed up since they would be the same regardless of the occupancy rate of the building. In addition, the tenant should negotiate the lowest percentage possible, and should resist a gross up to 100% occupancy on the theory that very rarely are buildings fully occupied. Typically, the landlord and tenant will settle on the gross up to 90-95% occupancy. Finally, as previously mentioned, if the operating expenses are grossed up in any given year where the occupancy is lower than the agreed threshold, then the Base Year should be similarly grossed up.

(f) Audit Right.

The tenant should always negotiate the right to audit the landlord's books and records relating to operating expenses. (See Appendix 3.) While landlords are generally agreeable to this concept, they may put limitations on such ability. One issue that generally arises when negotiating these limitations relates to the compensation of the person or entity performing the audit. A landlord will want to limit the tenant's ability to engage an auditor on a contingency fee basis, on the theory that such an arrangement provides an incentive for the auditor to be aggressive in its review of the landlord's books and records. On the other hand, the tenant would like the ability to engage an auditor on a contingency fee basis, because it allows a look at the books and records at no expense to the tenant.

If the tenant's audit finds that the landlord has overstated operating expenses by a certain amount (e.g., 3%), the tenant should request that the landlord pay the cost of the tenant's audit.

3. Additional Charges.

There are several charges under a lease in addition to rent of which the tenant must be aware. These are charges which, if not understood by the tenant at execution of the lease, could cause significant consternation upon receipt of an invoice from the landlord for such charges. As a result, tenant's counsel should carefully scrutinize such additional charges and limit to the extent possible tenant's liability with respect thereto.

(a) Default Interest.

Many landlord-oriented lease forms require the tenant to pay default interest at a rate equal to the "maximum rate allowed by applicable law." Although it is difficult to argue against an interest factor on payments which are in default, the tenant should at least attempt to minimize the rate used to calculate the interest. In that regard, rather than the maximum rate allowed by applicable law, the tenant should suggest a fixed percentage rate of interest (e.g., prime plus 4%) which is higher than tenant's cost of funds. That way the interest rate is penal, but not overreaching. The tenant should also attempt to have the default rate apply only after an appropriate notice and cure period, not from the date the payment was originally due. This at least protects the tenant from the scenario where its payment was somehow lost in the mail and the tenant was never notified of such fact.

(b) Late Fee.

If at all possible, the tenant should avoid having to pay both default interest and a late fee. If the default interest rate is high enough, the landlord will be more than compensated for any late payments through such higher interest rate. If the tenant must agree to a late fee, it should attempt to avoid a fee based on a percentage of the late payment, especially in large leases. Rather, the tenant should suggest a fixed amount (e.g., $25-$250) to compensate the landlord for the administrative burden created by the late payment.

(c) Administrative Fee.

Many leases also include an administrative fee for services performed by the landlord which go above and beyond the typical landlord services (for example, landlord's supervision of construction, landlord's exercise of self-help rights after a tenant default, etc.). While this fee is unavoidable in certain circumstances, the tenant should ensure that the amount of the fee is appropriate considering the extent of the landlord's effort. For example, a tenant should not pay a 15% administrative fee for landlord's supervision of tenant improvement work which consists only of paint and carpet.

In addition, there are certain areas where a tenant should avoid an administrative fee altogether. These areas include (i) situations where the landlord is providing typical services generally provided by landlords free of charge (e.g., landlord maintenance items), (ii) items where the landlord is not really exerting effort (e.g., after hours HVAC) and (iii) alterations performed by the tenant and supervised by the landlord.

Many tenants have queried the author about the appropriate amount of an administrative fee. While landlords will typically attempt to receive 15% of the

amount of the work being performed, in many cases that figure can be reduced to 10% or, in some circumstances, less than 10%.

(d) Construction Management Fee.

A construction management fee is an item the tenant should negotiate with the landlord during the letter of intent process. Many landlords will attempt to assess a construction management fee for tenant improvement work in the space. The tenant should ensure that the landlord is actually earning any such fee. For example, if the tenant is performing the tenant improvement work, the construction management fee on behalf of landlord may not be appropriate. In any event, it should be significantly less than if the landlord were responsible for the performance of the work.

C. Operational Issues.

Several issues arise in connection with the operation of the tenant's business from the premises which may give rise to unanticipated costs with respect to a lease. This section will address such operational issues from the tenant's perspective with a view towards reducing the tenant's exposure in connection with such operational matters.

1. Parking.

The tenant should always determine prior to executing a lease whether it will be required to pay any sums in addition to its base rent with respect to parking. Typically, landlords only charge tenants for parking in densely populated downtown locations. However, parking charges are becoming more common in suburban locations and tenants must carefully scrutinize the parking costs when contemplating executing a lease. At a minimum, a tenant should never pay for more parking than it actually needs. Therefore, the tenant should determine whether the parking spaces allocated to the tenant pursuant to the terms of the lease are mandatory or optional. If mandatory, the tenant will be required to pay for such spaces whether it uses them or not. The tenant should always attempt to have the option of giving spaces it no longer needs back to the landlord. In addition, much like the base rent, the tenant should attempt to limit increases in the parking rate during the term of the lease. If the tenant has no control over the increases in the parking charges, it cannot have certainty with respect to the overall cost burden of the lease.

2. Landlord Services/Utilities.

For any services that the landlord provides to the tenant pursuant to the terms of the lease (including utilities), the tenant should make sure that it is not paying more than the market rate for such services. Some examples of these costs that are typically passed through to the tenant include after-hours HVAC and non-building standard electricity costs. While it is reasonable for the landlord to charge the tenant for services that it uses which are in excess of the building standard services, the landlord should provide such services at market costs and should not be entitled to a profit with respect thereto.

In addition, many landlords are attempting to capitalize in this age of utilities deregulation by negotiating bulk utilities deals with providers in exchange for benefits (such as significant cash payments back to the landlord). A prudent tenant will carefully scrutinize the cost of utilities provided by the landlord and should insist on limiting its exposure for utilities costs to current market rates.

3. Alterations.

The tenant must be cautious of lease provisions which require the tenant to restore the premises to its original condition at the end of the term. While this provision often remains in a lease unnoticed, it could result in substantial costs to the tenant at the end of the lease term. If the tenant is making alterations which the landlord will require to be removed at the end of the term, the lease should provide that the landlord must notify tenant of such fact prior to tenant's installation of such alterations.

In most cases, landlords will require the right to review tenant's plans and specifications. This is a reasonable request; however, the tenant should limit any fees charges by the landlord in connection with such review to major alterations (i.e., those which affect the building systems or structures). Otherwise, the review should be a cursory review which does not merit the payment of a fee.

Finally, to the extent possible, tenants (especially creditworthy ones) should resist the landlord's requirement that the tenant secure payment and performance bonds in connection with the performance of any work on the premises. This can be a costly endeavor and, except in rare circumstances, is not really necessary.

4. Assignment and Subletting.

The tenant should also carefully scrutinize review fees charged by the landlord in connection with the landlord reviewing an assignment or sublease request

from the tenant. In that regard, the tenant should attempt to limit any review fees to the actual out-of-pocket costs incurred by landlord in connection with landlord's attorney's review of the proposed assignment/sublease, with a cap on such expense to ensure that the cost does not exceed what would otherwise be reasonable. Depending upon the size and complexity of the lease, this fee should typically be limited to the range of $500 to $2,500. In addition, in many cases in connection with an assignment or sublease, the landlord will require the tenant to pay to the landlord a portion of the "profit" or "bonus value" realized by tenant in connection with such assignment or sublease. While this is a fairly normal occurrence, the tenant should limit the amount of the profit payable to landlord as much as possible (e.g., 50%). This should also be acceptable to the landlord because by sharing the profit with the tenant, the landlord is creating an incentive for the tenant to sublease the space for the highest possible value, which in turn helps the landlord keep rental rates (and consequently the value of the building) as high as possible. Finally, the tenant should make sure that all of the tenant's costs incurred in connection with any such subletting or assignment are deducted prior to calculating such profit or bonus value. These expenses would include tenant's legal fees, commissions paid to brokers, improvements made for the subtenant or assignee and the like. (See Appendix 4.)

5. Insurance.

Many tenants fail to carefully review the insurance requirements contained in their lease and later find themselves in a position where they have to purchase additional insurance coverage because their existing insurance program does not match the requirements of the lease. The tenant should carefully review (and have its risk manager or insurance agent review) these provisions to ensure first that the requirements are reasonable and second that the requirements match the tenant's existing insurance program or are easily obtainable at little to no cost to tenant. In addition, while many tenants may desire to self-insure certain risks, the right to self-insure is not typically included in landlord form leases. Therefore, if the tenant maintains a self-insurance program or contemplates that at some point in the future it may consider one, it should specifically negotiate such right in the lease document. If the landlord is agreeable to a self-insurance right, the tenant should expect certain conditions to and limitations on such right. See Appendix 5 for a typical self-insurance clause.

6. Waiver of Claims/Waiver of Subrogation.

Most lease forms contain a provision whereby each party waives any claims it may have against the other with respect to risks which are insured or required to be insured pursuant to the terms of the lease. This is typically followed by a provision regarding such party to also obtain from its insurance carrier a waiver of such carrier's rights of subrogation with respect to such claims. However, if not carefully drafted, these provisions could leave a loophole which might give rise to unanticipated costs. If the tenant has waived a claim it may otherwise have against landlord because the tenant's insurance would otherwise cover such claim, the tenant may still nevertheless be required to pay a significant deductible on its insurance prior to the coverage becoming applicable. Therefore, the tenant should be careful to ensure that any such waiver of claims provision excludes the deductible, since that portion of the claim would not be covered by the tenant's insurance.

The tenant should also ensure that any waiver of claims provision is limited to the extent of the insurance carried by Tenant, so that if the insurance limit applicable to any such claim is less than the amount of the claim, then tenant has not waived its right to recover from the landlord the amount in excess of the insurance proceeds.

Finally, the tenant must carefully scrutinize the waiver of claims provision to make sure that it does not conflict with the insurance and indemnity provisions set forth in the lease. Many, if not most, lease negotiators the author has encountered do not understand the relationship between these three lease provisions. While an in-depth analysis of this inter-relationship is beyond the scope of this paper, the author encourages the readers to carefully study each lease to understand the allocation of risk. The goal of both the landlord and the tenant should be to shift as much risk as possible to the insurance companies in the most efficient manner. However, if the insurance and indemnity provisions allocate risk to one party and the waiver of claims provision allocates that risk to the other, the lease has created an ambiguity which will result in significant delays in settling the claim. To avoid this problem, many leases provide that the waiver of claims provision applies only to the property insurance, thereby allocating the risk with respect to liability coverage via the insurance and indemnity provisions.

7. Landlord's Self-Help Rights.

In many cases, landlords will require the right to perform tenant's obligations under the lease to the extent the tenant has failed to do so. As a precaution in any such provision, the tenant should ensure that the

landlord's ability to exercise this self-help remedy is limited to the extent necessary to cure the default, and that tenant will not be responsible for any work performed by the landlord in excess of what is necessary to cure the default.

8. Relocation Right.

In some cases, especially in smaller office leases, the landlord may require the right to relocate the tenant within the building. This right is important to the landlord in order to free up large blocks of space for larger tenants. While most tenants do not like this provision, many smaller tenants will be required to accept it, and in those cases they should ensure that any such move is at no cost to the tenant. Accordingly, the tenant should require the lease to provide that the landlord will reimburse to the tenant all costs associated with such move, including moving costs, changes to the tenant's stationery and business cards, printing and postage for notices to tenant's customers and the like. In addition, the tenant should require that the move take place over a weekend or at night in order to minimize any disruption to tenant's business.

9. Building Name Change.

In certain circumstances, a landlord may change the name of a building in an attempt to reposition the building for a particular reason. In such a case, the tenant will incur expenses (such as changing its stationery and business cards) which should be reimbursed by the landlord. While the tenant may not have a say in whether the building's name is changed, it should ensure that such change is at no cost or expense to the tenant.

III. CONCLUSION.

This paper has touched on several provisions in a typical lease which could give rise to hidden or unforeseen costs to the tenant. While the author does not purport to represent that the tenant will win all of the battles discussed herein, the purpose of the article is to sensitize the tenant's counsel to these economic issues which are often overlooked during the lease negotiation process. However, long after the lease is negotiated and placed in the filing cabinet, these issues may come back to harm the tenant. Careful negotiation of a lease at the outset can limit those circumstances where the tenant finds itself exposed to costs which were not anticipated at the commencement of the lease.

APPENDIX 1 - SELECTED LEASE PROVISIONS

A. Option 1 – "Commencement Date" means the earlier of (i) the date the Tenant actually occupies the Premises for the conduct of its business, or (ii) the first business day of the week following Tenant's receipt of a five (5) business day factually correct notice stating that the tenant improvements are substantially complete and a certificate of occupancy (or its equivalent) has been issued for the Premises.

Option 2 – "Commencement Date" means the earlier of (i) the date that Tenant actually occupies the Premises for the conduct of its business, or (ii) the date which is ninety (90) days after Landlord's delivery of the Premises to Tenant.

B. Notwithstanding anything to the contrary as set forth herein, if any actual delay shall occur in the completion of the Work to the extent and as a result of:

(a) any delay in any of the dates set forth in this Tenant Improvements Agreement (including, without limitation, the Space Plan Date, the Plan Delivery Date, the Contractor Submission Date and the Contractor Selection Date), to the extent caused in full or in part by any delay on behalf of Tenant or any Tenant Related Party,

(b) any occurrence described in the definition of Change Costs,

(c) Work that is non-Building Standard that requires a lead time (not due to a Landlord default or error) to obtain materials or construction time to perform in excess of that required for Work which is Building Standard or which would be normal and customary for general business office purposes, as reasonably determined by Landlord, or

(d) any other act, omission, delay or default of Tenant or Tenant's agents, representatives or employees or the Construction Manager, including any violation of the provisions of the Lease or any delay in giving authorizations or approvals pursuant to this Tenant Improvements Agreement, then any such delay shall be considered a Tenant Delay and will be subject to the terms of Section __ of the Lease.

No Tenant Delay shall be deemed to have occurred unless and until the Landlord has provided written notice to the Tenant specifying the action or inaction that Landlord contends constitutes a Tenant Delay. If such action or inaction is not cured within one (1) day after receipt of such notice, then a Tenant Delay, as set forth in such notice, shall be deemed to have occurred commencing as of the date such notice is received and continuing for the number of days the construction of the Tenant Improvements was in fact delayed as a direct result of such action or inaction.

C. Upon completion of the tenant improvements, Landlord and Tenant shall re-measure the Premises to determine the rentable area of the Premises in accordance with BOMA Z65.1-1996 Standards and if such re-measurement yields a rentable area that is lower than _____ square feet, then Base Rental shall be adjusted downward to reflect an annual rental rate of $_____ per square foot of rentable area in the Premises.

APPENDIX 2 - OPERATING EXPENSE EXCLUSIONS

Notwithstanding anything to the contrary in this Lease, Operating Expenses shall not include any expenses or costs for the following items:

(1) Costs of capital replacements, capital improvements, and capital additions, and related amortization thereof except to the extent such items either (i) reduce Operating Expenses or (ii) are required in order to comply with any federal, state or municipal law, code or ordinance which was not promulgated as of the Commencement Date of this Lease (which such items shall be amortized, together with an amount equal to interest at _____ percent (__%) per annum over the useful life of such capital investment items);

(2) Except as provided above, depreciation or amortization of the Building or its contents or components;

(3) Expenses for the preparation of space (including tenant finish-out costs) or other similar type work which Landlord performs for any tenant or prospective tenant of the Building;

(4) Expenses incurred in leasing or obtaining new tenants or retaining existing tenants, including, but not limited to, marketing costs and leasing commissions;

(5) Legal expenses, except for legal expenses incurred with respect to the Building which relate directly to the operation of the Building and which benefit all of the tenants of the Building generally, such as legal proceedings to reduce property taxes;

(6) Interest, amortization or other costs associated with any mortgage, loan or refinancing of the Complex;

(7) Any ground rent incurred for the Complex;

(8) Costs of repairs, restoration, replacements or other work occasioned by the gross negligence or intentional misconduct of Landlord, any Landlord Related Party or any other tenants;

(9) Costs incurred to correct violations by Landlord of any law, rule, order or regulation which was in effect as of the date hereof;

(10) Costs of Landlord's general corporate overhead and general administrative expenses, organizational fees and partnership expenses;

(11) Costs of repair or restoration paid by insurance, condemnation or third parties (including deductible amounts so paid);

(12) Costs which would be included in Operating Expenses which are paid to any affiliate of Landlord to the extent such costs exceed competitive market rates for such services;

(13) Rentals for items (except when needed in connection with normal repairs and maintenance of permanent systems) which if purchased, rather than rented, would constitute a capital expenditure which is specifically excluded in (1) above (excluding, however, equipment not affixed to the Building which is used in providing janitorial or similar services);

(14) Costs of all capital repairs resulting from an earthquake, tornado, hurricane or flood, regardless of whether such repairs are covered by insurance and costs due to repairs resulting from an earthquake, tornado, hurricane or flood to the extent such costs exceed $25,000;

(15) Expenses in connection with services or other benefits which are not offered to Tenant or for which Tenant is charged for directly but which are provided to another tenant or occupant of the Building;

(16) Costs incurred by Landlord due to the violation by Landlord or any tenant of the terms and conditions of any lease of space in the Building;

(17) Overhead and profit increment paid to Landlord or to subsidiaries or affiliates of Landlord for goods and/or services in or to the Building to the extent the same exceeds the costs of such goods and/or services rendered by unaffiliated third parties on a competitive basis;

(18) Any compensation paid to clerks, attendants or other persons in commercial concessions operated by Landlord or in the parking garage of the Building or wherever Tenant is granted its parking privileges and/or all fees paid to any parking facility operator (on or off site);

(19) Rentals and other related expenses incurred in leasing HVAC systems, elevators or other equipment ordinarily considered to be capital expenditures, except for (1) expenses in connection with making minor repairs on or keeping Building Systems in operation while minor repairs are being made and (2) costs of equipment not affixed to the Building which is used in providing janitorial or similar services;

(20) Advertising and promotional expenditures, and costs of signs in or on the Building identifying the owner of the Building or other tenants' signs;

(21) The cost of any electric power used by any tenant in the Building in excess of the Building-standard amount, or electric power costs for which any tenant directly contracts with the local public service company or of which any tenant is separately metered or submetered and pays Landlord directly; provided, however, that if any tenant in the Building contracts directly for electric power service or is separately metered or submetered during any portion of the relevant period, the total electric power costs for the Building shall be "grossed up" to reflect what those costs would have been had each tenant in the Building used the Building-standard amount of electric power;

(22) Services and utilities provided, taxes attributable to, and costs incurred in connection with the operation of the retail and restaurant operations in the Building, except to the extent the square footage of such operations are included in the rentable square feet of the Building and do not exceed the services, utility and tax costs that would have been incurred had the retail and/or restaurant space been used for general office purposes;

(23) Tax penalties incurred as a result of Landlord's failure to make payments and/or to file any tax or informational returns when due;

(24) Costs for which Landlord has been compensated by a management fee, and any management fees in excess of those management fees which are normally and customarily charged by landlords of comparable buildings in the Market Area;

(25) Notwithstanding any contrary provision of the Lease, including, without limitation, any provision relating to capital expenditures, any and all costs arising from the presence of hazardous materials or substances (as defined by Applicable Laws in effect on the date this Lease is executed) in or about the Premises, the Building, the Property or the Complex including, without limitation, hazardous substances in the ground water or soil, not placed in the Premises, the Building, the Property or the Complex by Tenant;

(26) Costs arising from Landlord's charitable or political contributions;

(27) Costs arising from defects in the base, shell or core of the Building or improvements installed by Landlord or repair thereof;

(28) Costs arising from any mandatory or voluntary special assessment on the Building, the Property or the Complex by any transit district authority or any other governmental entity having the authority to impose such assessment;

(29) Costs for the acquisition of (as contrasted with the maintenance of) sculpture, paintings or other objects of art;

(30) Costs (including in connection therewith all attorneys' fees and costs of settlement judgments and payments in lieu thereof) arising from claims, disputes or potential disputes in connection with potential or actual claims litigation or arbitrations pertaining to Landlord and/or the Building and/or the Property and/or the Complex;

(31) Costs of any "tap fees" or any sewer or water connection fees for the benefit of any particular tenant in the Building;

(32) Costs incurred in connection with any environmental clean-up, response action, or remediation on, in, under or about the Premises or the Building, including but not limited to, costs and expenses associated with the defense, administration, settlement, monitoring or management thereof;

(33) Any expenses incurred by Landlord for use of any portions of the Building to accommodate events including, but not limited to shows, promotions, kiosks, displays, filming, photography, private events or parties, ceremonies, and advertising beyond the normal expenses otherwise attributable to providing Building services, such as lighting and HVAC to such public portions of the Building in normal Building operations during standard Building hours of operation;

(34) Any entertainment, dining or travel expenses for any purpose;

(35) Any flowers, gifts, balloons, etc. provided to any entity whatsoever, to include, but not limited to, Tenant, other tenants, employees, vendors, contractors, prospective tenants and agents;

(36) Any "validated" parking for any entity;

(37) Any "finders fees", brokerage commissions, job placement costs or job advertising cost;

(38) Any "above-standard" cleaning, including, but not limited to construction cleanup or special cleanings associated with parties/events and specific tenant requirements in excess of service provided to Tenant, including related trash collection, removal, hauling and dumping;

(39) The cost of any magazine, newspaper, trade or other subscriptions;

(40) The cost of any training or incentive programs, other than for tenant life safety information services;

(41) The cost of any "tenant relations" parties, events or promotion not consented to by an authorized representative of Tenant in writing;

(42) "In-house" legal and/or accounting fees;

(43) Reserves for bad debts or for future improvements, repairs, additions, etc.; and

(44) Any other expenses which, in accordance with generally accepted accounting principles, consistently applied, would not normally be treated as Operating Expenses by landlords of comparable buildings in the Market Area.

APPENDIX 3 - AUDIT RIGHT

If there exists any dispute as to the calculation of Tenant's Share of Operating Expenses (a "Dispute"), the events, errors, acts or omissions giving rise to the Dispute shall not constitute a breach or default by Landlord nor shall Landlord be liable to Tenant, except as specifically provided below. If there is a Dispute, Tenant shall so notify Landlord in writing within three (3) years after receipt of the Statement. Such notice shall specify the items in Dispute. Notwithstanding the existence of a Dispute, Tenant shall timely pay the amount in dispute as and when required under this Lease, provided such payment shall be without prejudice to Tenant's position. Upon receipt of such payment, Landlord shall thereafter provide Tenant with such supplementary information regarding the items in Dispute as may be reasonably requested by Tenant in an effort to resolve such Dispute; provided, however, that Landlord shall not be required to provide any supplementary information to Tenant unless all sums shown to be due by Tenant on the Statement are paid in full. If Landlord and Tenant are unable to resolve such Dispute, such Dispute shall be resolved by arbitration pursuant to the procedure set forth in Section __, subject to the audit rights of Tenant contained in Section __. The cost of arbitration shall be paid by the party found to be least accurate (in terms of dollars in dispute). If a Dispute is resolved in favor of Tenant, Landlord shall, within thirty (30) days thereafter, refund any overpayment to Tenant. The determination of the Arbitration Panel shall be final and binding, subject to the audit rights of Tenant contained in Section __, and final settlement shall be made within thirty (30) days after receipt of such decision. If Tenant fails to dispute the calculation of Tenant's Share of Operating Expenses in accordance with the procedures and within the time periods specified in this Section __, or request an audit of the Operating Expenses in accordance with the procedures and within the time periods specified in Section __, the Statement shall be considered final and binding for the calendar year in question.

Tenant, at Tenant's expense, shall have the right, no more frequently than once per calendar year, following thirty (30) days' prior written notice (such written notice to be given within three (3) years following Tenant's receipt of Landlord's Statement delivered in accordance with Section __) to Landlord, to audit Landlord's books and records relating to Operating Expenses; provided that such audit must be concluded within sixty (60) days after Landlord receives Tenant's notice that it intends to audit Landlord's books and records; and provided further that the conduct of such audit must not unreasonably interfere with the conduct of Landlord's business. Without limitation upon the foregoing, Tenant's right to audit Landlord's books and records shall be subject to the following conditions:

(1) No audit shall be allowed unless Operating Expenses for the calendar year in question have increased by more than _____ percent (__%) over Operating Expenses for the immediately preceding calendar year;

(2) Such audit shall be conducted during Normal Business Hours and at the location where Landlord maintains its books and records;

(3) Tenant shall deliver to Landlord a copy of the results of such audit prior to instituting arbitration proceedings;

(4) No audit shall be permitted if a monetary Event of Default by Tenant has occurred and is continuing under this Lease, including any failure by Tenant to pay an amount in Dispute;

(5) Tenant shall reimburse Landlord within ten (10) days following written demand for the reasonable cost of all copies requested by Tenant's auditor;

(6) Such audit must be conducted by an independent, nationally-recognized accounting firm or a local accounting firm reasonably acceptable to Landlord that is not being compensated by Tenant on a contingency fee basis and which has agreed with Landlord in writing to keep the results of such audit confidential by executing and delivering to Landlord a confidentiality agreement in a form reasonably acceptable to Landlord, such confidentiality agreement to also be signed and delivered to Landlord by Tenant;

(7) No subtenant shall have the right to audit, but Tenant may cause an audit to occur on behalf of a subtenant;

(8) If, for any calendar year, an assignee of Tenant (as permitted by this Lease) has audited or given notice of an audit, Tenant will be prohibited from auditing such calendar year, unless in the case of an audit having been noticed but not yet performed by such assignee, the assignee withdraws its audit notice, and, similarly, if Tenant has audited such calendar year or given such notice, the foregoing restrictions of this Section __ will apply to the assignee's right to audit; and

(9) Any assignee's audit right will be limited to the period after the effective date of the assignment.

Unless Landlord in good faith disputes the results of such audit, an appropriate adjustment shall be made between Landlord and Tenant to reflect any overpayment or underpayment of Tenant's Share of Operating Expenses within thirty (30) days after delivery of such audit to Landlord. In the event of an overpayment by Tenant, within thirty (30) days following the delivery of such audit, Landlord shall, if no Event of Default exists hereunder, make a cash payment to Tenant in the amount of such overpayment, or, if an Event of Default exists hereunder, credit such overpayment against delinquent Rent and make a cash payment to Tenant for the balance. In the event Landlord in good faith disputes the results of any such audit, the parties shall in good faith attempt to resolve any disputed items. If Landlord and Tenant are able to resolve such dispute, final settlement shall be made within thirty (30) days after resolution of the dispute. If the parties are unable to resolve any such dispute, any sum on which there is no longer dispute shall be paid and any remaining disputed items shall be resolved by arbitration pursuant to the procedure set forth in Section __. The cost of such arbitration shall be paid by the party found to be least accurate (in terms of dollars in dispute). The determination by the Arbitration Panel shall be final and binding and final settlement shall be made within thirty (30) days after receipt of such decision.

APPENDIX 4 - ASSIGNMENT AND SUBLETTING

Except in the case of Permitted Transfer, in the event that the rent and other consideration due and payable by a sublessee or assignee under any such permitted sublease or assignment exceeds the Rent for the portion of the Premises so transferred, then Tenant shall pay to Landlord, as additional Rent, fifty percent (50%) of all Profit (hereinafter defined) received in connection with such sublease or assignment, immediately upon receipt thereof by Tenant from such transferee. For purposes of this paragraph, "Profit" shall mean the amount by which all rent and consideration due and payable by any sublessee or assignee under any such sublease or assignment exceeds the Rent payable hereunder with respect to the portion of the Premises so transferred (the "Transferred Space"), after deducting in connection with such sublease or assignment for (i) commercially reasonable broker's commissions paid by Tenant with regard to the transfer, (ii) reasonable legal fees paid by Tenant with regard to the transfer, (iii) commercially reasonable expenses of finishing out or renovation of the Transferred Space involved [but specifically excluding any charges payable to partners, shareholders or employees of Tenant in connection with such sublease or assignment]; (iv) any improvement allowance or other economic concession (planning allowance, moving expenses, etc.), paid by Tenant to sublessee or assignee; (v) lease takeover payments; (vi) costs of advertising the space for sublease or assignment; (vii) any other costs actually paid in assigning or subletting the Transferred Space or in negotiating or effectuating the assignment or sublease; and (viii) the Review Fee; provided, however, under no circumstances shall Landlord be paid any Profits until Tenant has recovered all the items set forth in (i) through (viii) for such Transferred Space, it being understood that if in any year the gross revenues, less the deductions set forth in (i) through (viii) above (the "Net Revenues"), are less than any and all costs actually paid in assigning or subletting the affected space (collectively, "Transaction Costs"), the amount of the excess Transaction Costs shall be carried over to the next year and then deducted from Net Revenues with the procedure repeated until a Profit is achieved. In the event of an assignment, then as long as Landlord shall be entitled to receive a portion of the Profits, the payment of Rents shall be paid to Tenant. Provided however, Tenant shall upon request by Landlord, provide Landlord with an assignment of all Rents in excess of the amount of Profits Tenant is entitled to retain and shall execute any documents reasonably requested by Landlord to effectuate such assignment.

APPENDIX 5 – SELF-INSURANCE PROVISION

COMMENT: Sometimes, tenants request the ability to self-insure. This request should be granted only for large, creditworthy tenants and then, only if the risk manager for the project has approved such self-insurance. If the ability to self-insure is approved by the risk manager and the asset manager, the following provision may be inserted in the Lease:

Tenant's Self-Insurance. Tenant may provide self-insurance in lieu of the insurance required in Section __, whether by the establishment of an insurance fund or reserve to be held and applied to make good losses from casualties, or otherwise, which conforms to the practice of large corporations maintaining systems of self-insurance. As a condition to establishing a self-insurance plan in lieu of the insurance provided in Section __, Tenant shall deliver to Landlord the following (collectively, the "Self-Insurance Documents"): (1) a certificate of an independent actuary or other independent, qualified person reasonably acceptable to Landlord stating that the self-insurance plan is adequate to provide the protection of the insurance policies described in Section __; (2) a balance sheet as of the end of the most recent quarter of the then-current fiscal year of Tenant (or, if the first quarter in such fiscal year has not expired, the last quarter of the previous fiscal year), prepared by a national firm of certified public accountants (reasonably acceptable to Landlord) in accordance with generally accepted accounting principles consistently applied ("GAAP"), accompanied by such accounting firm's unqualified opinion that the Tangible Net Worth of Tenant exceeds $_____; and (3) a letter (a "Compliance Letter") certifying that, to Tenant's best knowledge, such information is true and correct in all material respects as of the date stated, there has been no material adverse change in the financial condition of Tenant since such date, and there are no lawsuits pending (individually or in the aggregate) which, if adversely decided, could reasonably be expected to have a material adverse effect on Tenant's financial condition. Thereafter, Tenant shall deliver to Landlord as soon as available (and in any event within 45 days) after the end of each fiscal year, a balance sheet for such fiscal year, prepared by a national firm of certified public accountants (reasonably acceptable to Landlord) in accordance with GAAP, accompanied by such accounting firm's unqualified opinion that the Tangible Net Worth of Tenant exceeds $_____, together with a Compliance Letter. If at any time Tenant's Tangible Net Worth is less than $_____ or if the contents of the Compliance Letter is not reasonably satisfactory to Landlord, then Tenant shall be required to immediately obtain and maintain the insurance provided for in Section __. If Tenant self-insures any of the risks to which coverage is required under Section __, Tenant's self-insurance program shall be amended to include the waivers of subrogation and the additional insured status mentioned above in favor of Landlord and its agents and affiliates. Furthermore, (a) the self-insurance protection shall be equivalent to the coverage required above and Tenant shall not be relieved from the indemnification obligations of this Lease, and (b) the Self-Insurance Documents shall indicate the additional insured status mentioned above as well as the waivers of subrogation, and shall state that Landlord will be notified in writing 30 days prior to cancellation or material change of such self-insurance program. If Tenant fails to comply with the requirements relating to self-insurance and insurance, Landlord may obtain such insurance and Tenant shall pay to Landlord immediately on demand the premium cost thereof. It is expressly understood that the self-insurance permitted above does not relieve Tenant of its statutory obligations under the Texas Workers' Compensation Act. If Tenant self-insures under this Section __ and is obligated to defend Landlord under any provision of this Lease, Landlord shall have the right to engage separate counsel for its defense at Tenant's expense, and Tenant shall pay, as incurred from time to time, Landlord's attorneys' fees and expenses (including, without limitation), expert witness fees) relating to Landlord's defense. As used herein, "Tangible Net Worth" means the excess of total assets over total liabilities (in each case, determined in accordance with GAAP) excluding from the determination of total assets all assets which would be classified as intangible assets under GAAP, including, without limitation, goodwill, licenses, patents, trademarks, trade names, copyrights, and franchises.