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HOW OFFICE LEASE STRUCTURES SHOULD CHANGE POST PANDEMIC

LANDLORDS SHOULD REVISIT STANDARD LEASE PROVISIONS, LIKE OPERATING EXPENSES AND BASE YEAR CALCULATIONS.

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The pandemic will no doubt bring unprecedented changes—many of which are still yet to be realized. Office landlords, however, can get a jumpstart by revisiting some common lease provisions that the pandemic has made outdated. While many people have focused on the force majeure clause in leases, other provisions like operating expenses and base year calculations should also be revisited.

“In addition to force majeure, a concept that many people have become familiar with over the last few months, there are several other typical office lease provisions that may need to be revisited to account for COVID-19 issues,” Andrew Ouvrier, partner at Cox, Castle & Nicholson, tells GlobeSt.com. “Operating expenses, base year calculations, casualty/destruction, and rules and regulations are all lease provisions that require additional scrutiny, and possibly modifications in an effort to minimize negative and unforeseen impacts of COVID-19.”

Operating expense provisions are among the top elements of a standard lease that should be revisited. “Operating expenses are the costs incurred by office building landlords for the operation of their buildings, which tenants typically reimburse through the payment of additional rent,” says Ouvrier. “It is common for there to be limits on what costs a landlord can include in operating expenses. Due to COVID-19, many office landlords have incurred substantial costs in implementing operational and physical upgrades to their buildings in order to comply with governmental requirements, and public health and safety recommendations. If possible, those landlords will want to be able to include those costs in operating expenses.”

It is important to note that operating expense are not catchalls—they typically come with restrictions. For that reason, landlords should be intentional with inclusions and exclusions. “Office leases typically place restrictions on what can be included in operating expenses, especially when it comes to capital improvements,” adds Ouvrier. “Landlords may want to consider adding the right to include as part of operating expenses all of the costs, including capital expenditures, that the landlord incurs in connection with the safety and/or security of the building. These expenses may include any operational and physical modifications made to implement public health and safety recommendations or other best practice protocols."

Base year calculations are another lease provision that landlords should reconsider. "If significant one-time costs are incurred in the base year for operational and physical modifications in response to the COVID-19 pandemic, then office landlords may want to consider excluding all one-time costs from the base year to reduce the impact of a potentially inflated base year for operating expenses," says Ouvrier. "Examples of such one-time costs include capital improvements and operational protocols such as capital expenditures incurred in connection with the safety or security of the building, operational and physical modifications made to implement public health, and safety recommendations and best practice protocols."