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Planning for the Unexpected: *Casualty issues in Commercial Properties*



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PROPER BUSINESS PLANNING includes planning for unlikely but significant events such as a casualty that impacts commercial property. In part 1 of a 2 part article, we will focus on some key issues that tenants need to consider.

- **Tenant's Termination Right** – A tenant does not want to be locked into its lease when the premises have been partially or totally damaged and the repairs cannot be completed within the foreseeable future. At a minimum, a tenant needs the right to terminate if the estimated time for restoration would exceed a reasonable time period. Depending upon the size of the space, time periods between 6 months to a year, are common thresholds for tenant's termination right. Additionally, if neither party has terminated because they believe the restoration can be completed quickly, the tenant may need a second termination right if the landlord's repairs are not timely completed (such as 90 days beyond landlord's original restoration estimate). Consider whether it is reasonable for the landlord's restoration period to be extended for force majeure and/or delays in obtaining insurance proceeds.
- **Landlord's Termination Right** – From the tenant's perspective, the tenant wants to avoid the landlord using casualty damage as an excuse for terminating its lease (perhaps because it is for below market rent) by requiring the tenant's lease not be terminated unless the leases of similarly situated tenants are also terminated.
- **Repair Obligations** – A tenant should have a clear understanding of who is responsible for insuring, repairing and replacing the leasehold improvements made during the initial build-out of the premises.



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- **Damage to Key Project Areas** – Damage to areas other than the premises may affect the tenant’s operations. For example, damage to the parking areas may effectively halt the tenant’s business. Tenant should identify key areas and negotiate for appropriate relief. Likewise a retail food tenant may want the right to terminate if the casualty damages key anchor tenants, even if the food court is physically unaffected.
- **Abatement.** Most landlords agree that a tenant’s “base rent” is abated during a casualty. The tenant should also ensure that any regularly scheduled additional rent (e.g., CAM and tax payments) under the lease are also abated while the landlord performs its restoration obligations.
- **Tenant Fault and Waiver of Subrogation.** In the insurance provisions of the lease, it is critical that the tenant negotiate for a mutual waiver and release of damage to the property of both parties. Building tenants, through their common area maintenance payments, pay for the landlord’s property insurance. It is therefore inequitable for the landlord to pursue the tenant for damage to property, even if the landlord believes the damage arose because of tenant negligence.

Likewise, the tenant should make sure the casualty section of the lease does not conflict with this concept. The tenant should not be liable in the casualty section for building damage, even if arising from tenant’s negligence. Related to this, the issue of “tenant’s fault” should not be a consideration in tenant’s termination right or the tenant’s rent abatement right. In addition to conflicting with the waiver of subrogation provision, casualty language that focuses on fault ignores the time and cost involved when parties litigate the issues of “fault.”

In our next article we will focus on the casualty issues that landlords and their lenders should consider.



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