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Key Terms Every Letter of Intent Should Include

A letter of intent (LOI), also known as a "term sheet," sets the stage for a lease. Signed by both the owner and tenant, the LOI indicates that both parties intend to go through with a lease, and includes terms that are fundamentally important to the tenant's operation, such as rent and tenant improvements. And the LOI can affect other parties, such as brokers, who can cause trouble if their services aren't addressed accurately in the LOI.

That's why it's crucial to draft an airtight, error-free document and to make sure that some of the terms in the LOI will survive it, even if the deal falls through in the end. With the help of New York attorney Sujata Yalamanchili, we'll tell you how to draft an LOI that clarifies key terms so that the tenant doesn't approach you later, claiming that it misunderstood what would be included in the final draft of the lease.

Focus on Five Negotiable Terms

Although the LOI is a preliminary step, and both sides should have the understanding that other terms will be decided later during formal negotiations, that doesn't mean that this important document shouldn't be taken seriously. There can be unpleasant ramifications if terms are left out of an LOI or are ambiguous.

"The LOI isn't meant to be the lease, so you don't have to address every single issue in exhausting detail," says Yalamanchili. "But even though it's only an outline of the deal, you still need to make the terms that you do include very clear." Owners can save themselves anguish later by including several crucial pieces of information in the LOI in great detail, instead of trying to cover too many terms in not enough detail, she stresses. Ambiguous terms in the LOI can lead to blow-ups later in an otherwise good deal. Include these sometimes overlooked terms in your LOI in as much detail as possible:

Identification of the premises. "This is sometimes harder than it sounds," says Yalamanchili. That's because not all space is equal. The first question to address is whether certain space is "rentable" or "usable." There's a huge difference, she says, but it's often left out of the LOI and leads to arguments later when the tenant is displeased about paying for space it can't actually use for business.

In addition to specifying rentable versus usable space, you should depict exactly where the space is in the building or center. In an office building, identify the suite number and attach a floor plan. "Sometimes, owners and tenants have a different understanding as to what space the tenant is ultimately getting," says Yalamanchili.

Rental rate. Even when the rental figure is clear in a term sheet, you might need to go a step further and specify whether that's a "net" number or a "gross" number, says Yalamanchili. It's common to see rent stated as a dollar-per-square-foot figure, but sometimes it's stated as a monthly or annual flat number, she notes. If the space itself isn't clear—for example, when a tenant leases an entire floor of a building but the exact measurement of the entire floor will be determined after the buildout—then you may want to charge a dollar-per-square-foot, rather than a flat amount. "If there's a reason the exact square footage might change down the road, you would want to do it by the square foot," Yalamanchili suggests.

Scope of, responsibility for work. If the tenant will be doing its own buildout, the LOI should specify whether an allowance will be provided. For a complex buildout, you should also include

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what costs are included. Yalamanchili has seen a number of battles at the lease stage over whether soft costs or hard costs were intended to be paid for by the owner. Even fees for the same category of cost may be split between the owner and tenant.

For example, some owners pay for certain engineering costs but not others. When an owner has an interior designer on staff, the question should be raised as to whether the tenant is expected to pay for those services out of its allowance or whether the service will be provided for free.

However, if the exact details of a certain item haven't been decided yet, don't feel pressured to come up with figures. For example, if you've agreed to give the tenant a $100,000 buildout allowance, but the exact scope of work will be determined later, that's okay, Yalamanchili notes.

Security deposit. It's also okay if there's not specificity over something that hasn't been decided yet—such as the exact amount of the security deposit if you're still reviewing the tenant's financials. But make sure that you note that in the LOI, urges Yalamanchili. "If you leave the security deposit out, you run the risk that the tenant will infer that a deposit isn't required," she warns. Instead, say the security deposit will be determined "subject to Landlord's review of tenant's financial statements."

Unique arrangements. Specialized assignment and subletting provisions should be set out in the term sheet, as well as any early termination option, option to purchase, option to expand space, or other items that not every tenant gets. A franchise tenant may be required by its franchisor to have the right to assign its lease to the franchisor without your consent. You'll want to include that in the LOI. Likewise, if you expect a tenant to give you all or part of its profits from an assignment or sublet, you should make that clear ahead of time.

"Anything unusual should be spelled out in the term sheet, as well as the method for making determinations about unusual items," says Yalamanchili. For example, if you've given the tenant the option to buy the property from you later, you'll want to specify how that price will be calculated, such as "the appraised value at the time of the sale."

Insist that Two Terms Survive Letter

Most LOIs aren't binding—that is, if the lease isn't ultimately signed, the parties can't be held to the terms that were in the LOI. Generally, most owners and tenants want the document to be non-binding until they've signed the lease, with some exceptions, such as when you've taken the property off the market for an extended period of time for lease negotiations with a prospective tenant or incurred many fees—such as those for architects or attorneys, says Yalamanchili. In those cases, a tenant that backs out of the deal could cost you a lot, and you'll want to try to hold it to its promise if it has committed to the space at great expense to you, she notes.

But there are two important terms that owners should want to survive a dead deal. Can you bind a tenant to some but not all of the terms in the LOI? Yes, says Yalamanchili. "It's fairly well-settled law that letters of intent are not enforceable and binding if a lease falls through, but there are two important provisions that you can—and should—specify as surviving the letter of intent and becoming binding on you and the tenant.

Confidentiality provision. Yalamanchili emphasizes that a good LOI should always have a confidentiality provision. "If you're negotiating terms with a tenant, and the deal doesn't go through, you want to make sure that the terms you discussed are kept confidential afterwards," she says. You can do this by including in the confidentiality provision in the LOI wording that says that even though the letter isn't binding on both parties, the confidentiality provision is. Ask your attorney about using the following language in your LOI:

Model Language
Tenant and Landlord and their principal shareholders or partners, employees, agents, and representatives will not disclose the subject matter or terms or this letter of the transaction contemplated hereby unless written consent is obtained by Landlord or Tenant, which written consent may be withheld at either's sole discretion.

Broker disclosure. It's important to identify up front who the real estate brokers are for the deal. You should make a clear identification of the brokers' right in the LOI and make reference in the LOI to a separate broker agreement, says Yalamanchili. Like the confidentiality provision, a broker disclosure should survive the termination of the LOI and be binding. Ask your attorney about adapting the following language for your LOI:

Model Language
Tenant represents and warrants to Landlord that no broker or finder was involved with this transaction, other than [insert names of brokers]. Landlord will be respon-

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sible for any commission or fee due or owing in connection with this matter, but Tenant will indemnify, defend, and hold Landlord harmless from any fees, costs, or other expenses associated with a breach of the foregoing representation.

In most states, the property owner is responsible for paying the commission and brokers can file a lien on the property if they're not paid. Even if the deal doesn't go through, there might be some broker fees. Yalamanchili warns that if you haven't identified the brokers and made that binding, one or more additional brokers could later try to claim a commission.

"If you haven't named the brokers you're aware of in a broker agreement, referenced that broker agreement in the LOI, and made that portion binding, you're vulnerable," she says. You could end up paying an additional unmentioned broker out of pocket if you've already used your broker budget on the brokers you assumed were the only ones on the deal, or risk having an unknown broker place a lien on the property.

"Getting into battles with brokers is a terrible thing for owners to do," says Yalamanchili. Not only do they have an effect on the market, it's a small world—you and your property could be tainted in the broker community if there's a dispute, she adds.

PRACTICAL POINTER: If you know that you'll lose a substantial amount of money if a certain tenant backs out of a lease, but you don't want to make the LOI binding or the tenant refuses to sign a binding LOI, consider requiring the tenant to post a nonrefundable deposit that you'll be able to keep if it decides not to lease your space.

Insider Source

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