

ALL ABOUT LEASES

WASHINGTON PUBLIC PORTS ASSOCIATION SMALL PORTS SEMINAR

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THE BASICS



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The Basics – The Port is a “Special Purpose Municipal Government”

The legislature decides

- Transportation facilities
- Economic development
- Promotion of trade and tourism
- Interlocal agreements

It may be a great idea, but there needs to be at least “arguable” legislative authority

- Lawyers can help with this discussion
- Ultimately, this becomes a “business decision”



The Landlord and the Tenant are Not Equal

Do not view leases as an equivalency

- Particularly in the area of indemnifications, insurance and environmental liability
- The Port owns the property, but the tenant has immediate use and possession to the exclusion of the Port

The rent may not be worth the risk the Port is asked to undertake



The Basics - Port Leasing and Contracting Authority

Leases: RCW 53.08.080:

A district may lease all real and personal property owned and controlled by it, for such purposes and upon such terms as the Port commission deems proper.

Yes, but there are limits

Activities related to Port's basic authorities

- Trade and tourism
- Commerce
- Economic development

But where is the edge of the envelope

- Workforce housing?
- Low income housing?



The Basics – Delegation of Authority and Apparent Authority

Some authority delegated to the Executive Director (RCW 53.12.270)

The rest needs a Commission approval

Apparent authority

- “Subject to Executive Director/Commission approval” in each letter or offer



The Basics – Statutory Curb Lines

- The \$1.00 Lease or Contract: Article VIII, Section 7 of the Washington State Constitution prohibits “gifting” of public funds “donative intent”
- Intergovernmental Limitations; RCW 43.09.210 “true and full value”
- The proposed lease must comply with the Port’s Comprehensive Scheme of Harbor Improvements – RCW 53.20.010 – if Port funds are involved



The Basics – Other Curb Lines

The leasehold must be created via a lot line adjustment, short plat, long plat, subdivision or binding site plan process

- This requirement is frequently ignored by ports

Contractual power to indemnify

- Whoops – the Washington Public Power Supply cases
- And, why would the Port



The Basics - Port Lease Term Limitations

Lease Term: Fifty years with the option to extend up to an additional thirty years = eighty years

Airport Lease Term: Seventy-five years



The Basics – Due Diligence

Conduct reasonable due diligence

- Financial information
- History and experience
- Visit other facilities
- Google Earth©
- Internet



If the other party is not trustworthy, there is not enough paper to avoid a fight

- “Some of the best deals I ever did were the ones I walked away from”

The due diligence process

- Financial statements and the Public Records Act



Rate of Return

Understand “ROI” or “cap rate”

- The annual percentage rate of interest (determined by the Commission) that the Port desires to received on Port property or improvements
- Typical 8% - 11%
- $\text{ROI} \times \text{value} / 12 = \text{monthly rent}$
- Allows the Port commission to compare projects

Improvements

- ROI
- Capitalized over term

Capitalized lease payment

- Net present value



The Basics - the Lawyer's Role

Legal advice vs. business decisions

- The “paid paranoid”
- Lawyer’s business advice can be disregarded
- Lawyer’s legal advice should be followed
 - Lawyers think the request “just make it simple” is akin to asking your surgeon to “just operate on me quickly and without all that fancy equipment”
 - Sometimes it’s complicated because it is complicated
 - It is never “rocket science”



The Basics - What You Should Get From Your Lawyer

Produce a set of standard lease documents that Port staff can use with prospective tenants

- Form Airport lease with the FAA language
- Form Harbor lease with the DNR-PMA language
- Form Standard Lease
- Form Consent to Assignment for security purposes



Using the Port Attorney (But Not Too Much)

Work with the Port attorney to understand every word and phrase of the standard lease documents (it's not rocket science and, if you can't understand it, neither will a judge)

Regularly (yearly) work with the attorney to update the standard lease documents

- Computer morphing
- Changes in the law
- Practical pushback in the marketplace



THE LEASE



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What is a “Lease”?

A lease is a form of a contract that allows possession and use of real or personal property for a certain term

- Must be in writing
- Statute of frauds
- Legal description
- Signed and dated with notarized signatures



What are the Common Elements of a Lease?

Identify the parties

- Form of organization

Provide context – “the Whereas” clauses

- How did we get here

Insure a common understanding

- What will each party provide?
 - In a lease - the rental property and the rent paid
- What will each party be entitled to do or is precluded from doing?



Clearly document that common understanding

- Will everyone understand what was agreed to in 3 years or 5 years or 20 years?
- The role of the lawyer is to write clearly
- However, you should understand every word



Identify potential common future events and decide what happens (the “if then” analysis)

- Breach
- Assignment and use provision
- Delayed performance

Allocate the potential risks (which party should bear the loss)

- Damage to property
- Pollution
- Trespassers



Risk allocation is very important – who should bear the risk – the Port or the tenant

A “what if” game that is addressed with:

- The tenant’s insurance and
- Indemnification

Who is in the best position to bear the risk?

- Tenant personal property

Is the risk factored into the price?



The boilerplate

- Attorney fees (“Yes or No”)
- Notice
- Waiver
- Alternative dispute resolution
- Amendment
- Entire Agreement



The signatures

Personal guaranty or other security

- The lease bond
- The “Bank of America” rule



GETTING TO THE DEAL



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First, the MOU

The Memorandum of Understanding

- Used for bigger or non-standard transactions

The “deal points” in a short form

Agreed by the parties, but subject to documentation

Negotiated without attorneys

Specify the use of Port’s standard lease document



Second, the Transactional Document

Use standard forms that the Port has developed

- It avoids missing issues
- It allows for continuous improvement
- They have been market tested
- You understand them
- They are cheaper

Control the contract drafting

- Cost benefit analysis



PORT STANDARD LEASE DOCUMENTS



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The Standard Port Lease Documents

It is helpful and cost-effective to have a standard lease document for each type of Port operation

- Marine and harbor land tenants (including PMA language)
- Airport and airport industrial park tenants (including FAA language)
- Existing building and retail (common maintenance issues)



It is not helpful (except to your lawyer) or cost-effective to have your lawyer draft every lease

- The transactional cost is too high
- The tenant relation cost is too high
- It takes too long
- I am the “paid paranoid”



The Theory of Lease Drafting

The lease will be strictly construed against the Port in any lease enforcement action because a Port is both the landlord and a government

A well drafted lease (not necessarily a long document) will avoid 90% of the disputes

The “economic loss rule” is prominent in Washington



Allocate liability and risk (the “Economic Loss Rule”)

- Insurance
- Suitability of the leasehold or buildings
- Environmental
- Port property damage or loss
- Tenant property damage or loss
- Consequential damages



Determine how issues will be resolved

- Rent adjustments
- Tenant building approvals
- Assignments
- Personal guaranties
- Default
- Property and building removal
- Termination



Lease Specific Issues

The relationship between the “use” and “assignment” clauses

The “assignment challenge” clause

The “assignment fee” clause

The “building approval” clause

The “environmental” clause



The Leasehold Excise Tax Clause

12.84% of the “contract rent” which may be more than the stated rent

No rent periods

Other discounts

“Tenant shall pay all applicable Washington State Leasehold Excise tax”



The “Use” Clause and “Assignment” Clause Interrelationship

The “use of premises” clause restricts use of the leasehold to a specific purpose as opposed to allowing uses consistent with zoning

- Tightly drafted to limit use to the tenant’s stated purpose
- Particularly important in a multi-tenant development
- Particularly important if the rent is based upon other “economic factors”



The “assignment” clause sets forth the degree of control the Port may exercise in the assignment process

- No assignment
- “Not unreasonably withheld”
 - As a practical matter it is very difficult for the Port to refuse assignment
 - Particularly true when the new tenant can meet the rent security requirements



Include language relating to change of ownership of the tenant entity

- “For the purposes of this Lease, any change of ownership including sale, liquidation or other disposition of some or all of the corporate stock [LLC units] will be considered an assignment.”



A tight use restriction makes an unwelcome assignment less likely

- Where “assignment clauses” have been the subject of many court fights – the use restriction is a matter of contract
- Avoid “subjective” use clause which sets a performance standard such as a “first class hotel” or a “clean and well-run restaurant”



The “Assignment Challenge” Clause

Avoid the pressure of consequential damages for failure to approve an assignment

- “If Lessor refuses to consent to an assignment, Lessee’s sole remedy shall be the right to bring a declaratory action to determine whether Lessor was entitled to refuse such assignment under the terms of this Lease.”



The “Building Approval” Clause

Sets forth a clear timeline for improvements that is based upon specific dates as opposed to specific events

- Avoid clause that relates to “X days after building permit issued” or other triggers outside the Port’s control. If such a clause is used, add a drop-dead date.
- “However, in any event construction shall commence no later than ___ days after execution of this Lease.”



The “Environmental” Clause

Every lease should contain an environmental clause which includes:

- Indemnification by the tenant of the Port
- A reporting requirement
- A fine payment requirement

Rarely, if ever, should a Port provide an indemnification

- May be past environmental conditions coupled with a non-disturbance clause



The “L&I Waiver Clause”

An injured tenant employee can sue the landlord but cannot sue the employer, so the Port cannot sue the employer unless there is a waiver.

LIMITED WAIVER OF IMMUNITY UNDER WASHINGTON STATE INDUSTRIAL INSURANCE ACT, TITLE 51 RCW : For purposes of the foregoing indemnification provision, and only to the extent of claims against Lessee by Lessor under such indemnification provision, Lessee specifically waives any immunity it may be granted under the Washington State Industrial Insurance Act, Title 51 RCW



The “Holding Over Clause”

Tenant must pay 150% of rent during any hold over period

- Encourages tenants to make a deal to renew lease



THE CARE AND FEEDING OF TENANTS



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Managing the Lease and the Tenant

The lease provides the basic tools

- Payment date – a tenant must always pay the rent as a condition to any other discussion
- Late fee clauses
- Surety clauses
- Approval clauses

The tenant is a “customer” once the lease is executed



-
- Address the tenant's issues early, fairly and proactively
 - Assign a Port staff person the task of maintaining the relationship
 - Regularly visit the tenant, and ask about concerns
 - Be flexible
 - Show some tenant appreciation
 - Always know the Port's real rate of return



Above All Communicate Early and Often

Ongoing communication with tenants is critical

- Keep the tenant informed about changes in plans
- Keep the tenant informed about special events that may impact the tenant's business
- Let the tenant know that the Port values the relationship
- Encourage the tenant to approach the Port early with any lease or payment problems



QUESTIONS



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