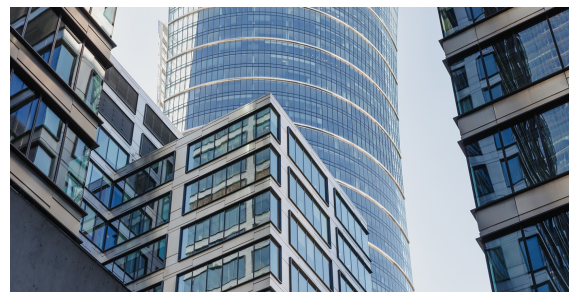


## Office Lease Fundamentals: Terms, Risks, and Best Practices

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Understanding the fundamentals of office leases is essential for any company seeking to lease and maintain commercial premises. The terms of an office lease can significantly affect occupancy costs, operational flexibility, long-term growth potential, and risk exposure. This article provides a high-level overview of the key provisions commonly found in office leases, outlines some of the risks parties should consider during negotiations, and offers practical guidance to help businesses safeguard their interests.

### Selecting a Property

When a company is evaluating a property for use as office space, there are many factors to consider. The property that the company seeks to lease must permit use as office space. To confirm the permitted uses of a space, companies should request a copy of the building's certificate of occupancy from the landlord or building management. The lease's use clause may also limit uses of the premises beyond what is permitted by the certificate of occupancy. Companies should negotiate for broad use language, as restrictions can limit operational flexibility and limit opportunities for future assignments or subletting. Companies should also assess the specific needs of their operations, for example, whether enhanced building security is required, whether the premises can accommodate necessary technology infrastructure, or whether the premises present any conditions that may need to be addressed before occupancy.

### Negotiating the Lease

Before entering lease negotiations, parties often agree on a non-binding term sheet outlining the key terms of the lease, which the parties' counsel will use to draft and negotiate the lease agreement. If the premises require alterations or renovations before occupancy, companies should consider engaging architects, contractors, and engineers to assist with planning.

During negotiations, companies should ensure that the lease agreement: (i) describes the physical condition in which the premises will be delivered to the

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tenant; and (ii) provides remedies if the landlord fails to deliver the property in the agreed-upon condition or by the agreed-upon date. Conditions precedent to the lease's effectiveness should be clearly defined, including any approvals that may be required from government agencies, corporate entities, or landlord's lenders.

## Common Economic Terms

Tenants are often required to pay a security deposit, which may be in the form of cash or a letter of credit for the landlord's benefit. The amount of the security deposit may vary based on the creditworthiness of the tenant and the duration of the lease. Companies may negotiate the inclusion of a burn-off or burn-down provision, in which the landlord must return a portion of the security deposit to the tenant after a period of timely rental payments by the tenant. In addition to security deposits, landlords may require tenants to meet financial thresholds and to comply with reporting requirements.

The base or fixed rent is the monthly rent the tenant is expected to pay and is calculated by multiplying the rentable square footage by the agreed annual rental rate per square foot and dividing by twelve. Base rent is distinct from additional rent, which includes the tenant's proportionate share of operating expenses, real estate taxes, insurance, common area maintenance, and building services. The total rent obligation under the lease generally consists of both base rent and additional rent.

If the office space requires build-out or fit-out, the parties negotiate and document the scope of work to be performed by the landlord (landlord's work) and work to be performed by the tenant (tenant's work). The lease should clearly define "substantial completion" of the landlord's work, typically meaning completion of all work except for minor punch list items that do not materially interfere with the tenant's use of the premises. Rent commencement is often tied to substantial completion of the landlord's work, with the lease specifying, for example, that base rent and additional rent obligations begin on the earlier of: (i) the date the tenant opens for business in the premises; or (ii) a specified number of days after substantial completion of the landlord's work.

Landlords commonly offer a tenant improvement allowance as an inducement to enter the lease, depending on the market, building class, lease term, and condition of the space. The lease should specify the total allowance amount, what costs are eligible (typically including hard costs, architectural and engineering fees, permits, and sometimes project management fees), the process for tenant submission and landlord approval of construction plans and budgets, and the disbursement method. Tenant improvement allowances are typically disbursed on a reimbursement basis, with the tenant required to submit evidence of costs incurred, such as paid invoices, lien waivers, and architect certifications, before the landlord releases funds, though some leases provide for a percentage to be paid upfront or upon completion of certain construction milestones. If the actual cost of tenant improvements exceeds the allowance, the tenant may be responsible for all excess costs, and the lease should

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typically specify whether the landlord has any approval rights over above-allowance work. The lease should also address responsibility for obtaining permits and approvals, construction insurance requirements, mechanic's lien protections, and coordination procedures if both landlord and tenant are performing work simultaneously.

## Services

Landlords usually provide base building services (i.e., heating, ventilation, air conditioning (HVAC) during business hours, elevator access, cleaning, water, trash removal, and security), which should be listed in the lease along with service levels and hours. Tenants may need to pay additional fees for after-hours services. Electricity and other utilities may be included in operating expenses or separately metered, and leases should clearly state which costs are billed directly and how expenses are allocated. Tenants typically reimburse landlords for the tenant's proportionate share of building operating costs. Leases should specify included and excluded expenses, calculation methods, expense caps, and audit rights. Leases often define service standards, landlord obligations, and tenant remedies if services are interrupted, including, in some cases, rent abatement or termination rights for prolonged disruptions. Parking arrangements, spaces, fees, and relocation rights must be clearly outlined. Landlords can change service providers and systems, but tenants should ensure lease protections against reduced service or increased costs.

## Repairs and Alterations

Generally, the lease specifies what types of alterations are allowed and whether the landlord's consent is required. Leases often distinguish between minor cosmetic alterations, which may not require approval, and structural or material alterations, which typically require the landlord's prior written consent. The landlord may require approval of alteration plans and/or of the contractors hired to perform the work. The parties should ensure the lease addresses ownership of the improvements, as well as any tax or insurance implications such improvements may have. Additionally, leases generally specify whether the tenant will be required to remove the alterations and restore the premises to their original condition upon the termination of the lease.

## Default and Exit Strategies

Under the lease, certain events will generally trigger default, in some cases subject to notice and cure periods. Triggering events often include failure to pay rent, breach of covenants, bankruptcy or creditors' rights events, transfers that are not permitted, and other similar events.

While it is preferable to have tenant exit strategies in the lease (i.e., early termination rights, broad assignment rights, and contraction rights), these are generally highly negotiated points.

Landlords commonly oppose granting tenants early exit rights for several key reasons. First, they seek to secure reliable, long-term rental income, which helps to underpin the financial predictability of their property holdings. Additionally,

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landlords often incur significant upfront costs, such as tenant improvements and leasing commissions, which they intend to recover over the full duration of the lease. Many landlords are also subject to mortgage covenants that require specific occupancy levels. Allowing tenants to exit early could result in breach of these lender requirements, potentially triggering adverse financial consequences. Finally, landlords typically prefer to retain control over the mix and caliber of tenants in the property, ensuring that the building maintains its value and reputation in the market. Early exit rights can disrupt these strategic objectives and introduce additional risk for the landlord.

Tenants seek flexible lease terms to preserve control over their leased premises, particularly by limiting landlord recapture rights during assignment or subletting. They aim to minimize profit-sharing arrangements so that most or all proceeds from subleases or assignments remain with the tenant. Additionally, tenants often request a broad definition of “affiliate”, “transfer” and “assignment,” ensuring assignment and transfer rights extend to various corporate restructurings, changes of control and business divestitures, without requiring further landlord consent. Establishing clear and reasonable consent standards, including specific response timeframes and objective approval criteria, is also important for efficiency and fairness. Finally, tenants seek to reduce or eliminate termination penalties, making early exit more financially feasible if business needs change.

## Summary

Strategic negotiation of lease provisions, including rent structure, security deposits, maintenance obligations, and termination and assignment rights, allows companies to structure office leases that align with their business objectives. A well-drafted lease protects a company’s financial position, preserves the flexibility needed to respond to growth or contraction, and minimizes exposure to unexpected costs and liabilities.

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