

Why Life Sciences Leases Are Not Your Average Transaction

Law360, New York (March 14, 2016, 10:58 AM ET) -- Leases are one of the longest lived transactional documents in the real estate industry. Unlike a purchase or sale transaction, the "closing" is just the beginning of a long term relationship between a landlord and tenant. This dynamic is much more notable in the life sciences context and the process of lease negotiation and implementation requires communication and cooperation between teams of people representing both the landlord and tenant. The lease creates a roadmap for what can be a very long tenancy, and needs to be carefully negotiated. Due to the specialized nature of life science uses and increased capital infrastructure required for life sciences companies, lease terms are typically longer than other types of leases and the motivation to renew in place is much higher, so having a good underlying lease is critical. This article outlines some of the most common issues encountered when negotiating a lease with a life sciences company.



Dawn Saunders

Life sciences companies are far more regulated than the average corporate user and the types of uses are more specific and varied than a general office or retail user. The risks surrounding regulatory compliance and permitted use tend to fall more heavily on tenant, presumably as the party best able to assess whether its use complies with applicable laws and zoning regulations. Landlords will not typically make representations or provide warranties related to zoning, but even though landlords give little in the lease, this is a critical diligence item for a tenant and should be explored both for current and potential future uses (e.g., by an acquiring company or assignee/sublessees). The life sciences world is very fluid so maximizing flexibility is critical and understanding the limits of a potential leased site is important. Landlords need to understand the zoning of their projects as well, even if no representations are being made, because leasing space to a company who cannot use it will be problematic, even if no liability is assumed.

Parking regulations for life sciences projects vary far more than office uses, and often will vary depending on the specific use or mix of uses within the building, so when working on these types of leases, parking can be an important negotiating point for both sides.

Life sciences users typically use more utilities and keep longer hours than other classes of tenants. Many labs run 24 hours a day, seven days a week, which means more utility use and increased wear and tear on building systems. It also means the tenant will want access to the premises at all times. Part of the diligence process is determining the capacity of the building or project and ensuring it will meet the tenant's needs now and for any future expansion. Both landlord and tenant will want to assess capacity, although here again the tenant is best suited to determine its likely needs, while the landlord will have more insight as to capacity and the potential ability to upgrade utility service. If a shortage is

anticipated, the parties will want to negotiate how any capacity upgrades necessary will be handled.

Hazardous materials use, storage and disposal are often critical issues, especially where there are other hazardous materials users in the same building or project. As a diligence item, the parties need to evaluate code requirements and current uses at the project to make sure tenant's intended use is compatible with the existing tenant mix, and that there is sufficient storage capacity to meet its current and future needs.

Historical uses and preexisting or migratory hazardous materials also need to be addressed, both in diligence and in the lease itself. These are more concrete risks for life sciences projects than for office projects, so it is critical that the lease explicitly allocate the risk for these items. Tenants will want to ensure they are not liable for other tenants' hazardous materials and mishaps, while most life sciences landlords are very hesitant to limit their ability to recover costs associated with hazardous materials remediation, often citing such costs as typical expenses of a project used by life science tenants.

Most sophisticated owners will require an exit assessment/closure plan of some kind, and potentially a Phase I Environmental Site Assessment upon surrender. As part of the diligence process, tenants should ensure that they are provided a current Phase I and/or the prior occupant's exit assessment before signing a lease so they can establish a baseline condition and gain some comfort that there are no existing conditions. Surrender obligations should also be tailored to the tenant's particular use. For example, if solvents are used, it may be appropriate to perform inspections of the drainage system upon lease surrender. If radioactives are used, then the space must be completely decommissioned before it is deemed "surrendered" and will not be leasable to another user until all hazardous materials clearances are issued. Many lab leases will say a tenant is in holdover until the entire premises is cleared for unrestricted use.

Landlord's ability to access the premises is more critical for a life science user due to the sensitivity of experiments being performed and the proprietary nature of their work. When and under what conditions the landlord and its agents can enter the premises is often negotiated very intently, especially areas of the premises used for scientific experiments, specialized lab or manufacturing purposes. Tenant may want to accompany the landlord, require that landlord comply with safety and security requirements or restrict access altogether to certain areas of the premises.

Restoration requirements upon lease surrender are also heavily negotiated. Many improvements are specialized for a particular use and not readily adaptable to serve a subsequent user. In addition, due to the long lease terms, many improvements may be worn out or obsolete by the time the lease term ends. Specialized equipment is often very expensive and some tenants may want the ability to take it with them to a new location. Some specialized uses (e.g., vivariums) are not likely to be usable by future tenants so landlords may want to require a tenant to restore these at the end of the lease; however, restoration is expensive so tenants will likely try to minimize restoration requirements.

Allocating responsibility for repair and maintenance is also important because life sciences tenants have more specialized systems than an office user, and the tenant is often more qualified to perform repairs and maintenance than the landlord and may prefer to take on repairs and maintenance of mission critical systems and equipment. Remedies in the event of a delay or failure to repair are also heavily negotiated because the potential loss associated with a system failure in a manufacturing facility or lab where sensitive experiments are underway is much higher than in an office context.

Who performs the initial construction work to prepare a space for occupancy is often more negotiated by sophisticated life sciences users, and how specialized systems are integrated with the building management system and other building systems needs to be negotiated

and understood clearly. Life sciences buildings are far more integrated than a general office building and the systems tend to be more complicated. More sophisticated tenants often want to control the build out, which creates special concerns for a landlord, particularly in a multitenant building or project. Commissioning of systems is also critical to ensure that they are functioning as designed and properly integrated with the overall building systems.

The life sciences industry is growing and evolving and the requirements for lab space will continue to evolve with it. The ability to work closely with the landlord and tenant teams to plot the course for a long term relationship in a location where the human genome will be further deciphered, new treatments for disease will be discovered or life-saving drugs will be manufactured is a privilege that poses unique challenges to the real estate practitioner.

—By Dawn Saunders, Mintz Levin Cohn Ferris Glovsky & Popeo PC

Dawn Saunders is a member in Mint Levin's San Diego office.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

All Content © 2003-2016, Portfolio Media, Inc.