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Commonly Negotiated Provisions in a Sale-Leaseback Lease Agreement

While the purchase and sale agreement creates the foundation of a sale-leaseback transaction, the lease agreement is equally, if not more, important to the success of both parties going forward. As the second key document, the lease agreement represents the long-term agreement between the two parties, and it is likely to be scrutinized even more than the purchase and sale agreement. A lease agreement governs the ongoing relationship between the new landlord and tenant, often becoming the focal point for risk allocation. Below, we explore the most commonly negotiated lease provisions of a sale-leaseback transaction.

Commonly Negotiated Provision #1: Financial Terms

With the lease in a sale-leaseback transaction generally having a longer term, it is imperative to negotiate favorable financial terms. The primary cost is base rent, which is generally calculated using a capitalization rate (or cap rate) and applying it to the sale price of the real estate to calculate the annual rent. Also, for certain retail establishments, percentage rent may be an important driver with respect to the financial impact of the lease for both the landlord and tenant. Percentage rent is rent in addition to base rent that a tenant pays based on a percentage of its gross sales exceeding a predetermined threshold, sometimes referred to as a breakpoint.

Commonly Negotiated Provision #2: Assignments and Change of Control

On the lease side of the transaction, several provisions are commonly negotiated to address long-term control and use of the property. These include restrictions or requirements for landlord consent in the event of a change of control of the tenant, as well as terms permitting assignment of the lease during certain "permitted transactions," such as a corporate sale or asset disposition.

Subleasing is often addressed to allow flexibility for the tenant while maintaining the landlord's oversight. In transactions involving multiple properties (for example, chain retail stores), tenants may negotiate for the right to substitute properties, offering operational flexibility while maintaining the overall value and security of the lease for the landlord.

Commonly Negotiated Provision #3: Lease Term and Renewal Options

One of the most critical provisions is the length of the lease, which typically ranges from 10 to 25 years and often depends on the stability of the tenant and the nature of the business occupying the property. These leases commonly include renewal options in five- or 10-year increments, providing tenants with long-term operational security and landlords with predictable cash flow. It's also standard to negotiate annual rent escalations, which are often tied to a fixed percentage.

Commonly Negotiated Provision #4: Use Restrictions

Landlords often implement use restrictions or exclusions to prevent conflicting business operations on site, particularly in situations where the property is a part of a larger commercial retail development. These restrictions help maintain or enhance the property's value by controlling the types of businesses allowed. Tenants may negotiate these terms to protect their current operations, avoid unnecessary limitations, and support their future business goals.

Commonly Negotiated Provision #5: Maintenance and Alterations

Because sale-leaseback transactions are long-term leases, maintenance and alterations will become a factor at some point to ensure the property remains in good condition. Maintenance and alterations provisions detail the responsibility each party bears and

to what extent. Although roles can vary based on negotiations, the landlord is often responsible for routine maintenance to the property, whereas the tenant may be required under the lease to pay common area maintenance (CAM) fees. While alterations are also often carefully negotiated, tenants may wish to modify the property to suit their specific needs. In some cases, the landlord might offer a build-out allowance to support these changes.

Commonly Negotiated Provision #6: Financial Reporting

Financial reporting is a key provision in commercial leases, offering transparency and assurance to both parties. For landlords, it provides a way to assess the tenant's financial health, ensuring that rent obligations are consistently met. Regular updates allow landlords to identify potential financial issues early, reducing the risk of tenant default. Tenants, on the other hand, may negotiate less frequent reporting due to fluctuations in business income. However, strong financial reports can empower tenants to negotiate more favorable lease terms.

Commonly Negotiated Provision #7: Insurance and Financial Ability Requirements

In commercial leases, insurance requirements and financial ability terms are often negotiated between tenants and landlords to protect their interests and mitigate risks. Tenants may negotiate the amounts required for specific insurance policies, which typically cover potential liabilities and property damage, or, if they own a substantial number of assets covered under a blanket policy, tenants might request approval for the property to be covered by the blanket policy. Additionally, landlords may require potential tenants to meet general financial ability requirements, which can sometimes be surprising. This process dives deep into tenants' records by analyzing financial statements, credit scores, collateral, business plan, readily available capital, etc. to ensure that a tenant has the stability needed to fulfill lease obligations.

Commonly Negotiated Provision #8: Casualty and Condemnation Provisions

Casualty and condemnation provisions outline what happens if the property is damaged or condemned. Tenants often lose some control over the situation because the landlord's lender typically manages the insurance or condemnation funds. This shift can reduce tenants' financial authority. Therefore, it's crucial to negotiate these terms clearly to define tenants' rights, protect their interests, and retain some control over proceeds. Setting clear expectations for possible outcomes in such events is essential.

Commonly Negotiated Provision #9: Repairs and other Post-Closing Matters

Similar to a "post-closing agreement," which a borrower and a lender may enter into, landlords and tenants can also agree to certain actions which must occur following the closing of the sale-leaseback transaction. Required repairs, minor title defects or code violations, and other similar items that do not materially or adversely affect the use or value of the property are typically included in these provisions and addressed after closing occurs to streamline the diligence and closing processes for both the landlord and tenant.

The negotiated terms described above play a vital role in ensuring the investment's value and the tenant's continued success. In a prior [Triple Net](#) blog post, we discuss important provisions of the purchase and sale agreement and how its provisions can contribute to a successful sale-leaseback transaction. Whether you are a seller becoming a tenant, or a purchaser becoming a landlord, it is important to review all key terms prior to finalizing any lease or purchase and sale agreement in order to understand their potential impact, both now and 20 years from now.

Please contact the authors or any attorney with Frost Brown Todd's [Retail and Shopping Center Finance](#) team if you have specific questions about lease agreements or help determining whether a sale-leaseback transaction is right for you.

Sale-Leaseback Summer Series

So far in our sale-leaseback summer series, we've covered [sale-leaseback fundamentals](#) and [due diligence considerations](#), [1031 exchanges](#), [reverse build-to-suit transactions](#), key provisions in purchase and sale agreements, and integrating sale-leasebacks in M&A deals. Be sure to visit our [Triple Net Blog](#) as we explore other issues affecting sale-leaseback transactions, including compliance challenges specific to transactions involving institutional capital, such as private equity and real estate investment trusts (REITs).

Check out other articles in this series:

- [Breaking Down Sale-Leaseback Transactions | Part 1](#)
- [Reverse Build-to-Suit: Sale Leaseback Transaction with a Twist | Part 2](#)
- [How Investors Use 1031 Exchanges and Sale-Leasebacks to Maximize Returns and Preserve Capital | Part 3](#)
- [Sale-Leaseback Due Diligence Considerations | Part 4](#)
- [Integrating Sale-Leaseback Transactions with Mergers and Acquisitions: A Value-Maximization Strategy | Part 5](#)
- [Commonly Negotiated Provisions in a Sale-Leaseback Purchase and Sale Agreement | Part 6](#)

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