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CHICAGO'S COMMERCIAL LEASING MARKET: ADAPTING TO THE CURRENT MARKET LANDSCAPE

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REVISIONS TO MODEL NATIONAL VENTURE CAPITAL ASSOCIATION DOCUMENTS AND AMENDMENTS TO DELAWARE CORPORATE LAW

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Chicago's Commercial Leasing Market: Adapting to the Current Market Landscape

The commercial real estate landscape in Chicago is undergoing significant changes, with various factors contributing to the shifting dynamics of leasing. As the city continues to recover from the economic impact of the pandemic, the commercial leasing market faces new challenges and opportunities. High construction costs, evolving market fundamentals, and rising interest rates have all contributed to a decline in the development pipeline for office, industrial, and multifamily properties. These factors have prompted landlords and tenants to rethink their strategies, especially in the face of changing tenant needs and the increasing prevalence of hybrid work models.

Adapting Leases to Tenant Needs and the Impact of Hybrid Work Models. One of the most notable shifts in the commercial leasing market is the evolving needs of tenants, driven largely by the rise of hybrid work models, causing the demand for traditional office spaces to decrease. This trend is particularly evident in Class A office buildings, where occupancy rates have been slower to recover compared to other property types. Companies are now seeking more flexible leasing arrangements, with a focus on reducing long-term commitments and opting for smaller, more adaptable spaces. Landlords have responded by offering short-term leases, flexible spaces, and enhanced amenities to cater to a hybrid workforce.

Recent data from Cushman and Wakefield underscores the mixed performance in Chicago's Central Business District, where leasing activity in Q2 2024 increased by 11.3% compared to the previous quarter, bringing the year-to-date total to 2.4 million square feet (msf), 6.9% above this time in 2023. However, the market has also seen vacancy rates climb, with overall vacancies rising to 25.2%, driven by negative net absorption and an increase in sublease availability. The West Loop and River North submarkets were particularly active, contributing significantly to the new leasing volume. Despite the uptick in leasing activity, the ongoing challenge of rising vacancies and the pressure of expiring sublease terms have kept the market from fully stabilizing.

Declining Development in Commercial Real Estate Pipelines. Beyond just leasing, the development of commercial real estate in Chicago has been declining across all property types due to a combination of high construction costs, labor shortages, and the high cost of capital in the current interest rate environment. Industrial and multifamily properties, while still in demand, are also experiencing changes. For example, Chicago's industrial vacancy rate slightly increased to 4.7% in Q2 2024 but remains below the 5.1% average since 2019. The construction pipeline is thinning, with 2.8 msf delivered in Q2 and 13.5 msf still under construction, highlighting the ongoing challenges faced by developers.

The Role of Interest Rates and Economic Conditions. Interest rates play a crucial role in the commercial real estate market, influencing the cost of capital and, consequently, the feasibility of new developments and leasing decisions. The Federal Reserve's efforts to curb inflation had previously led to a series of interest rate hikes, significantly increasing the cost of borrowing. This put

pressure on the commercial leasing market, as businesses found it more expensive to finance new leases or expand their existing spaces. However, during its meeting on September 18, 2024, the Federal Open Market Committee (FOMC) gave the first rate cut in over four years and lowered its benchmark interest rate by 50 basis points, bringing the target federal funds range to 4.75%–5%. This decision marks a shift in monetary policy that could stimulate leasing and investment activity, as lower borrowing costs make it easier for businesses to finance new leases, expansions, and property purchases. The FOMC also indicated that additional rate reductions may be on the horizon, which could further improve the outlook for both property investors and developers. However, the timing and pace of future cuts will depend on inflation and broader economic data, leaving some uncertainty for the market.

Will the Market Ever Return to "Normal"? The question on everyone's mind is whether the commercial leasing market will ever return to its pre-pandemic "normal." While the market is unlikely to revert to its previous state, it is expected to stabilize over time as businesses adapt to the new normal of hybrid work and economic uncertainty. As the market evolves, with a greater emphasis on flexibility, adaptability, and the integration of technology, landlords who can offer spaces that meet the changing needs of tenants will be better positioned to succeed.

The Forecast for Leasing Over the Next Year. Looking ahead, the commercial leasing market in Chicago is expected to remain challenging, particularly for the office sector. Vacancy rates may continue to rise as more businesses adopt hybrid work models and reduce their office footprints. However, the industrial and multifamily sectors may see more stability, driven by ongoing demand for logistics space and housing. According to Savills, the Suburban Chicago office market has seen a slight increase in availability, with landlords struggling to execute deals due to inadequate capital and additional properties being surrendered to lenders. For landlords, adaptability will be key to success in this environment. Offering flexible leasing terms, investing in technology and amenities, and understanding the evolving needs of tenants will be critical in attracting and retaining businesses in the coming year.

The Importance of Expert Legal Guidance in an Evolving Market. Chicago's commercial leasing market is at a pivotal moment, facing challenges like hybrid work models, rising interest rates, and declining real estate pipelines. While the market may not return to pre-pandemic norms, it will continue to evolve, requiring landlords and tenants to be flexible and forward-thinking. With these seismic shifts, it becomes critical to have the right legal support to help navigate the complexities of lease agreements, zoning regulations, and the challenges presented by fluctuating conditions. By partnering with knowledgeable legal counsel, businesses and property owners can better position themselves to negotiate flexible lease terms, restructure deals due to economic shifts, or understand the tax implications of their real estate transactions.

For more information or any questions, please contact Monica Shamass at (312) 648-2300 or by e-mail at monica.shamass@sfbbg.com.



Revisions to Model National Venture Capital Association Documents and Amendments to Delaware Corporate Law

Litigation Practice Honored

SFBBG's litigation practice has been recognized by Chambers Spotlight Illinois for 2025. Through their independent research, Chambers ranked the practice among the top small to mid-size firms' litigation groups in Illinois.

Welcome to SFBBG!

The Firm is thrilled to announce the addition of three talented new attorneys. Adam Hirsch and Dean Kalant joined the firm as partners in the litigation practice area. Marc Engel was added to the Firm's real estate tax team as special counsel.

Firm Success Stories

In September, SFBBG attorneys Bruce Bell and Jonathan Northington advised on the successful closing of the sale of their clients' market-leading security and fire and life safety systems company. The company was purchased by a global and industry-leading systems integrator for an undisclosed sum.

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Frequent readers of Sensitive Solutions will recall that in August 2022, a federal jury in Benton, Illinois returned a verdict in favor of SFBBG's independent sales representative clients that included awarding exemplary damages under the Illinois Sales Representative Act. Following that verdict, the defendant, an Italian manufacturer of corrugated box machines, appealed to the U.S. Court of Appeals for the Seventh Circuit. After briefing and oral argument, the federal appellate court affirmed the verdict. SFBBG's Adam Glazer and Bill Klein tried the case and fended off the appeal efforts of the defendant, resulting in a 7-figure award of commission payments, attorneys' fees, interest, and exemplary damages, which has now been paid in full.

Speaking Engagements

Mike Kim was a featured speaker in July in a video blog hosted by HOALeader.com, a discussion forum for condo and homeowners association board members.

Joan Berg was a moderator of "New Vistas in Canonical Research" panel at the North American Conference of the Orthodox Canon Law Society on October 19.

Published Articles

- Dan Beederman's article ("Litigation or Arbitration: Which is Better? You Be the Judge!") was featured in the October issue of *Wholesaler*, a publication of the Professional Plumbing, Heating, Cooling & Piping ("PHCP") community.
- Adam Glazer's "Sales Rep Prevails 'Up Front' and Recovers Commissions and Overrides" and Christian Manalli's "Buy-Sell Are a Key Component for Succession Planning" were articles published by *The Representative's* summer edition (an Electronics Representatives Association publication).
- Joan Berg was interviewed for an article "Fiduciary Duty Explained" published in *CooperatorNews Chicagoland*, a condo, HOA and co-op resource.
- On October 16, *Forbes* featured an article by Bruce Bell entitled, "What If Your Tax Preparer Screws Up the Filing? Are You to Blame?"

Fast Work

Special congrats to real estate tax partner Jason Newton on his tremendous time in the 2024 Chicago Marathon. Jason completed the 26.2 miles in just under 3 hours 17 minutes.

This year, the Delaware Court of Chancery issued an opinion with significant consequences to corporate governance law and investment agreements between founders, corporations, and investors. Model versions of these agreements are published by the National Venture Capital Association (NVCA), a well-known nonprofit venture financing association, and are a popular starting place for negotiations in venture deals. The NVCA updates its model documents to reflect current market terms and changes in statutes and case law. The court's decision has not only prompted changes to the NVCA's model documents, but it has spurred important amendments to the Delaware General Corporation Law (DGCL) that will impact past and future venture deals.

The Case and the Court's Ruling

In *West Palm Beach Firefighters' Pension Fund vs. Moelis & Co.*, the issue was whether certain provisions in the stockholder agreement between the founder (and controlling stockholder) and the corporation improperly hindered the board of director's rights and discretion in managing the business and affairs of the corporation as prescribed by DGCL § 141(a). The provisions required the consent of the founder before the board took certain actions, limited the board's ability to regulate its size and composition by allowing the founder to select the majority of the directors, and required that the founder appoint the majority of each board committee. These provisions gave the founder a certain level of control over the board and its management decisions.

The court ruled these provisions were invalid and unenforceable because they substantially prevented the board from exercising the rights and responsibilities granted to it under DGCL § 141(a), citing the section as "the source of Delaware's board-centric model of corporate governance." The court further held, based on DGCL § 141(a), that such restrictions on the board must be provided for in DGCL, Chapter 1, or the certificate of incorporation.

Updates to NVCA Model Documents

The provisions at issue in *Moelis* were ones that had become commonplace in venture deals, reliant on Delaware's general deference to the right of private parties to contract as they deem appropriate. Therefore, the provisions were included in the NVCA's model documents, specifically the stock purchase agreement (SPA) and investors' rights agreement (IRA). The *Moelis* ruling therefore upended years of standard practice and called into question the validity of stockholders' corporate governance rights agreed to in their prior deals. As a result, the NVCA updated its model SPA, IRA, and certificate of incorporation (COI).

The SPA was revised to include a proposed provision that makes the formation of board audit and compensation committees a condition of closing the stock purchase. These committees are more appropriate for later-stage corporations or those with larger boards, as they typically include independent directors. As a result, investors in early-stage corporations and corporations with fewer directors should

take an alternative approach to affecting decisions by the board or its committees. Such an alternative would be utilizing the new proposed language in the COI.

The COI was revised to grant a preferred stockholder's designated director a guaranteed position on board committees – a provision typically reserved for the SPA or IRA. However, to avoid conflicts of interest and potential invalidity of a committee decision, this right does not apply to committees where their sole purpose is to consider a matter where the designated director would have, as determined by the board, a conflict of interest. The designated director may also refuse to serve on a committee despite the preferred stockholder's appointment.

Consistent with updates to the SPA and COI, the IRA was revised to include a proposed provision providing for the creation and maintenance of audit and compensation committees at the request of any director, with such committees consisting solely of non-management directors if agreed by the parties. The new language also provides that all non-employee directors will have the right to sit on such committees. To address *Moelis* and the court's reiteration of the fiduciary duties owed by the board of directors, the board must determine in good faith that neither its creation of committees nor its appointment of non-employee directors to the committees would be inconsistent with exercising its fiduciary duties.

Amendments to Delaware Corporate Law

As mentioned above, *Moelis* also prompted a speedy reaction by the Delaware General Assembly. The state's legislature passed Senate Bill 313 (S.B. 313) within a few months after the case. S.B. 313 was signed into law by Governor John Carney and became effective on August 1, 2024, with retroactive application. The law amended the DGCL by adding § 122(18), which essentially overturned *Moelis* by allowing a corporation, even if not provided for in its certificate of incorporation, to enter into agreements with provisions the court had recently deemed facially invalid and unenforceable. The new law had some supporters, but it was also criticized as being hasty and premature, particularly because it was passed before the Delaware Supreme Court could weigh in. *Moelis* and the new DGCL § 122(18), which will face tests in court, have combined to create uncertainty about corporate governance parameters and the limits they impose on stockholders' rights to exercise influence and control over a corporation.

Consequences to the Startup and Venture Community

As a result, founders, investors (angels and VC firms alike), and directors are highly encouraged to have their governing documents reviewed and, as necessary, revised to ensure the terms and rights bargained for and agreed to will be enforceable in the event of a dispute. For guidance on your current or future venture deals, please contact Jonathan Northington at jonathan.northington@sfbbg.com or at (312) 648-2300.