

Negotiating The Lease for Your Business

By Jacob A. Chodash

Once your business outgrows your house or your garage, it's time to find a separate place for it. You contact a real estate leasing broker, who shows you several spaces, and you fall in love with one. It has a great location (it's close to your home), then rent is right, and the term is flexible. The landlord prepares the lease for you to sign.

The lease is a 30-page dense document that starts out with "Witnesseth...." What's that mean? Does it make any difference? The broker tells you that "it's all the standard stuff."

The first thing you need to realize is that a commercial lease is like an invading army – it's there to help the other side, not to help you. And the bigger it is, the worse it is for you as the tenant. Short leases are usually better for the tenant than long leases. Many states have laws protecting residential tenants under leases, but those laws will not protect you as a commercial tenant.

Let's look at some of the important business points present in every lease.

The first is a description of your space. It's best to include a copy of a survey for a single-occupant industrial building, or a copy of a floor plan marked to show the leased space for an office building. Don't depend on a street address for an industrial building, or a suite number for an office building, since those do not necessarily demarcate the boundaries of your space. Your rents may have been quoted on a per square foot basis, and you should measure your space yourself, or get a certified measurement from an architect, to ensure that you're getting what you paid for.

Who is the tenant under the lease? If you operate your business through a separate legal entity (a corporation or limited liability company, for example), then have the landlord name it as the tenant. Since you lack an operating history, the landlord may want you to personally guarantee the lease, or post a big security deposit. Either is a reasonable request for a new business.

The term, or time period, of the lease is important. It's easiest to name a specific beginning and ending date, but sometimes that is impossible if the space must be constructed first. For example, if your lease begins "on the 30th day after the Landlord finishes construction", and runs for three years after that, make certain that you and the landlord sign a document acknowledging the actual beginning and ending dates, so there is no confusion as to when the lease ends.

As a new business, think about an exit strategy if things don't go well. You could ask for a short term, with an option to renew exercisable after a prove-out period. Or get

an option to terminate early. The landlord may want a monetary payment if you terminate early, but having it is good protection.

You've probably focused most on the rent clauses. There are several kinds of rent due under modern leases.

Base or minimum rent is a fixed amount due each month during the term of the lease. Base rent may be stepped up each year according to a schedule stated in the lease, or may increase by changes in the Consumer Price Index.

If you lease a single-occupant industrial building, you will probably be asked to pay all of the maintenance and repair on the building, insurance, and taxes. This obligation may be phrased as additional rent, or just an obligation to do those things.

If you have to do maintenance and repair, have your obligation limited to smaller items, and exclude maintenance and repair to the structure, roof, and mechanical systems. I have had *many* arguments with landlords over who pays for repairs. In one instance, a water main broke with two months left on the lease, and the landlord wanted my client to pay for it! Another good way to limit your exposure is to put a dollar limit on repairs you have to make each year.

In a single-occupant industrial building, the landlord is justified in making you carry the insurance and naming the landlord as an insured party. If you have to pay the taxes, get the right to protest your tax assessment.

The additional rent is stated differently in a multi-tenant office building. Here, you will be asked to pay a proportionate share of the maintenance and upkeep on the building as a whole, and of the insurance and taxes on the building. Sometimes you get the benefit of a base year. With a base year setup, you pay a proportionate share of the *increase* in such amounts over what they were in the base year (which should be the first year of your lease). You can try to get caps on the additional rent due from you, but most landlords will refuse to give caps to smaller tenants. You should get the right to audit the landlord's figures, or insist that you get a certified statement from a CPA on the additional rent due.

If you run a store, the landlord may want percentage rent from you. Percentage rent permits the landlord to share in the success of your store as your sales rise. For example, a typical percentage rent clause would require you to pay 5% of your gross sales over a certain breakpoint as percentage rent. Get your breakpoint as high as possible.

Will your space be configured or built-out specially for you? Any alterations to your space promised by your landlord should be specified in a work letter attached to your lease. Office tenants usually get their alterations at the cost of the landlord, while retail tenants pay for their own alterations. Don't automatically assume that your landlord will put the premises in good condition; the fine print in most leases says that

you take the premises “as is”, except to the extent that the landlord agrees to do repairs or alterations.

Look at the clause on your permitted uses of the space. The permitted uses should be broad enough to cover any operations you envision. A broad permitted use clause also helps if you have to sublease or assign your lease to a new tenant, who may want to use the space for a slightly different purpose.

Most leases will prohibit you from assigning or subleasing your premises without your landlord’s consent or condition. Some leases and some state laws require that the landlord not unreasonably withhold consent, which at least forces the landlord to give you a reason before refusing to accept your replacement tenant. This can be important if you decide to sell your business, and your buyer will not close unless the lease can be assigned or sublet.

Check whether you get utilities included in your rent, or whether you have to pay extra for them. If there are other building services important to you (such as elevator, janitorial, telecommunications, etc.), then they should be specified in the lease.

Finally, think about what you will do as your business expands. Many landlords will give you an option to renew or option to expand. Ideally, you should get those options at fixed rates to protect you from changes in rentals rates, but even if you get them at the market rates current at the time you exercise the option, they provide additional flexibility for the future.

If your landlord will not give you an outright option, ask for a right of first refusal to renew or expand. A right of first refusal means that your landlord must approach you first before leasing your renewal or expansion space to a third party, and offer you the same deal as offered to the third party. Since the landlord will get the same rent and overall terms from the third party or from you, the landlord may give you the right of first refusal without quibbling.

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