

Ten Tips for Leasing Commercial Space

by Robert C. Pearman, Jr. Esq.

Smaller tenants entering into commercial lease negotiations have traditionally been at a disadvantage, forced into accepting boilerplate leases, with fine print and legal language drafted by the property owners and their attorneys. The result is often to leave tenants unaware of the costs and liabilities they actually incur. During periods of recession in the commercial and retail rental market, more flexibility arises in the negotiating positions of tenants. Nevertheless, if the small business tenant is unaware of the nuances of lease negotiation and key legal and business aspects, he or she will not be able to take full economic advantage of the benefits of a weak rental market, and may be taken advantage of in a strong one.

Following are just 10 points that may help guide you to ask the right questions and seek the right concessions from your prospective landlord.

1. *Pass Through Expenses.* Landlords desire to "pass through" to tenants much of the building's operating expenses. These expenses may take the form of increases to real estate taxes or insurance premiums, and collectively, Common Area Maintenance charges (CAM) which can include everything from security to landscaping and remodeling a lobby or resurfacing parking lots. When combined with typical yearly increases in monthly rent (escalation clauses), *the effect on bottom line leasing expenses are dramatic.* Tenants should *narrow the wording of the operating expenses provision* by excluding many foreseeable expenses which do not benefit that tenant and items unforeseen initially but which could become a surprising, substantial obligation in the future, e.g., costs related to government requirements such as sprinkler retrofitting. These seek to ensure that costs of large, long-term capital improvements are spread over the useful life of those improvements and not all charged when incurred during your lease term and seek an upside cap on the amount of increase due to pass throughs. The tenant should negotiate the right to audit the landlord's books and records on this point.

2. *Property taxes.* The sale of real property that has not changed hands for many years can trigger a *big property tax reassessment.* If occupying a building in that circumstance, or where you have reason to believe a sale may soon occur, seek language that will lessen the effects

of reassessment on your lease payments.

3. *Tenant Liability.* When a lease is ambiguous as to which party shall pay for required structural repairs, the tenant is at risk that it could be construed as the tenant's obligation to pay. This risk is heightened in long-term leases. Thus, *avoid signing leases where you make broad, sweeping promises about compliance with laws* and maintaining the premises in compliance with all regulations; try to expressly *make it the landlord's responsibility* to take care of earthquake retrofitting, asbestos abatement, and other large-scale, structurally related capital improvements.

4. *Tenant Improvements and the Tenant Work Letter.* An addendum in the form of a "work letter" to most form leases should be included to allocate responsibility for the construction and payment of tenant improvements. The work letter should address related issues such as approval of plans, the construction schedule, the effect of delays on the commencement date, and allocation of costs associated with bringing the premises into compliance with existing laws.

The tenant wants to minimize unforeseen construction costs: steps to take include requiring the landlord to cover expenses necessitated by inherent defects or inadequacies in the base building shell or infrastructure, and in bringing the building and leased space up to code. The tenant wants the owner to provide a fully finished space, with the tenant paying only for improvements uniquely suited to its intended use, e.g. fixtures and *special* electrical or environmental needs. The tenant should also *maximize the tenant improvement allowance* by broadly defining the tenant's allowable use for it.

5. *Commencement Date.* The tenant should want to delay the commencement date until they are able to occupy the premises for its intended use, in order to delay the obligation to pay rent. This can result in a significant savings to the tenant at the outset of the lease. Related to the tenant improvements issue discussed above, *insist that*

the lease commencement await the completion and approval of those improvements, especially where the landlord's contractor is doing the work.

6. *Insurance.* Do not assume that insurance provisions contained in form leases are standard or that the required insurance is available at commercially reasonable rates. *Have an insurance expert review the insurance provisions* to confirm that the required coverage exists or that it can be reasonably obtained and that the provisions will adequately protect the tenant's economic interests.

7. *Damage and Destruction.* Most form leases provide that tenants may terminate the lease only if the landlord fails to begin repairs of the premises within, say, ninety (90) days after an event causing major damage, and that this failure has continued for thirty (30) days after written notice from the tenant. If the damage can be repaired quickly at the landlord's expense, the tenant wants the right to maintain the lease. Otherwise, the tenant wants the right to terminate the lease. The tenant also wants *rent abatement* if the premises must be temporarily vacated, in whole or part, because of the damage or destruction.

8. *Assignment and Subleasing.* Tenants want to be in a position to mitigate losses if forced by economics to vacate all or part of the premises, so the lease conditions for the landlord's consent to a transfer of the lease are vitally important. The law in many jurisdictions allows a landlord to absolutely withhold

its consent to transfer, so you must negotiate freely transferable rights up front. And *anticipate possible change in your business structure* that may require flexibility in the future, e.g., if one partner may soon leave but those remaining will continue the business, you want to make sure that type of change does not require landlord's consent.

9. *Personal Lease Guarantees.* Landlords often require personal lease guarantees from shareholders of small corporations or partners in partnerships, in order to enhance their protection from risk of default. *A number of structures exist to lessen the impact* of that requirement on the individuals involved. An individual's liability under a guarantee can be limited to their partner's percentage share of that business. Negotiate a clause requiring the landlord to exhaust the assets of the partnership before it sues any partner individually.

Also, firms should negotiate declining liability whereby the amounts personally guaranteed will decrease over time.

10. *Dispute Resolution.* Commercial tenants have limited defenses and rights in law suits involving non-payment of rent. For instance, in many jurisdictions the tenant cannot withhold rent to protest a failure of the landlord to make required repairs or perform agreed upon maintenance. The tenant would have to affirmatively sue while still making rent payments. While landlords are unlikely to surrender legal protections, you may wish to negotiate for some third party review of any dispute, e.g., via mediation, as a way to vindicate lease rights without having to go to court or run the risks of withholding rent.

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