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Savvy tenants avoid surprises by paying heed to trouble spots

Failing to spend the time to carefully read a commercial lease before signing it can cause costly surprises and potentially devastating results to the business, as well as to the owner's financial condition.

A landlord's willingness to negotiate the terms of a lease will depend on many factors; however, every tenant should understand several issues before signing a commercial lease.

• **Plan ahead.** In a market of rising rental rates, the sooner a lease is negotiated the better. Allow sufficient time to locate acceptable space, negotiate the lease and build out the space. The build-out could take anywhere from 30 days to six months or longer, not including delays. Failure to allow sufficient time may result in having to settle for unfavorable lease terms and possibly being forced to hold over in an existing lease space, subjecting a business to increased rental and consequential damages.

• **Commencement of rent.** Pay careful attention to when rent payments are scheduled to begin. Many leases require tenants to begin payments on a specified date, regardless of whether the space is ready for occupancy or whether the tenant has occupied the space. Tie the commencement of rent payments to the date the space is ready for occupancy and the date the business has the opportunity to move in.

• **Cap the lease guaranty.** When required to guarantee the obligations of the tenant under the lease, provide for a cap on the amount of the guaranteed obligations, which are usually the landlord's out-of-pocket lease costs (commissions, improvement allowances, etc.) or the amount of base rent and operating expenses that are estimated to be due under the lease. Additionally, many landlords will allow the liability cap to automatically be reduced as the tenant

pays rental obligations. Failing to place a cap on a lease guaranty could have a devastating impact on the guarantor, especially if the tenant fails to maintain adequate insurance coverage.

• **Limit operating expenses.** Other than base rent, operating expenses, also known as common-area maintenance charges, make up a significant part of the total rental payment. Ask the landlord to provide records of the past few years of the actual operating expenses to estimate the total amount of rent. Only allow a capital expenditure in operating expenses if such expenditure is required by changes in the law (as opposed to compliance with existing laws) and to the extent the expenditure actually reduces the expenses. Tie the determination and amortization period of capital expenditure to "generally accepted accounting principles" as pronounced by the Financial Accounting Standards Board. If the right to audit operating expenses hasn't been obtained, the tenant cannot challenge the amount unless it sues the landlord and subpoenas the operating expenses records.

• **Assignability.** Always have an exit strategy. Assigning the lease or subleasing the premises is a common way to lessen the burden of a lease. Therefore, pay close attention to any conditions or restrictions to any assignment or sublease. A good lease requires the landlord to be reasonable in the approval process. Remember the often-misunderstood rule: Unless the lease (or landlord's assignment approval) expressly states the assignor will no longer be liable after the assignment, the assignor will continue to be liable for the obligations of the tenant under the lease.

• **Relocation right.** This is a big surprise to most tenants. Unless limited in the lease contract, the landlord can relocate a tenant to any other location in the project. If this is a deal breaker, be sure to negotiate that point up front. If the relocation right must remain, provide for the limited occasions upon which the landlord may do so and make sure the landlord agrees in writing to cover all costs of building out the new premises, moving the business, new address announcements, etc.

• Insurance and indemnity provisions.

Prior to signing any commercial lease, ask an experienced real estate attorney and insurance professional to review the insurance requirements and indemnity provisions. Additionally, be sure the lease contains a mutual waiver of subrogation that waives both parties' rights (and its insurance companies' rights by way of subrogation) to bring any claim against the other party for any property damage that is covered by that party's insurance. These waivers should apply "not withstanding anything to the contrary."

• **Have options.** No one knows for sure what the future will hold, so having options is an important part of good planning. A well-planned lease will include the option to extend the lease term, the option to expand the premises and, as another exit strategy, the option to terminate the lease. Failure to obtain this flexibility could cause a tenant to incur substantial costs and disrupt business by requiring a move to another location within a few years.

• **Understand compliance with laws.** Most tenants fully intend to comply with the law, but when it requires the business to pick up the tab for asbestos abatement, constructing Americans with Disabilities Act improvements or installing fire sprinklers, complying with the law brings on a whole new and expensive meaning. Ask questions and fully comprehend the laws that may be applicable to the premises before agreeing to "comply with all laws" in the lease.

• **Defined terms.** Pay careful attention to the defined terms used in the lease, as these terms can mean more than expected. Each time a defined term is used, it is time well spent to go back and look carefully at the definition and how it applies in each instance described in the lease.

Being aware of what to include in a well-written lease will help tenants smooth the way for a satisfactory lease contract. It's always a good idea to carefully read the leasing contract and obtain experienced counsel to avoid future problems.

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