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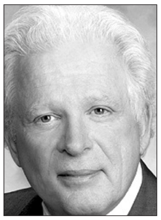
Lease terms important in negotiation process



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There are two basic parts to every commercial lease: the lease rate and the contract's terms and conditions. The latter may seem like a nonmonetary provision, but non-monetary provisions, when not favorably negotiated, can affect the tenant's pocketbook significantly.

Negotiating a successful commercial lease contract depends largely on a tenant's ability to understand what landlords want and why they want it. It also is crucial that the terms and conditions protect the tenant's assets by limiting his or her liabilities and obligations.

The following are only a few nonmonetary, but important provisions to consider:

Problem: If the tenant defaults, the landlord has the right to sell the contents of the tenant's space.

Most leases grant the landlord lien rights that can restrict the tenant's growth and business success. Vendors and lenders may be reluctant to extend credit for inventory purchases, equipment leases or trade fixtures. If the landlord has the right to sell leased space's contents when a tenant defaults, the vendor or lender cannot recover its assets. Yet, if a tenant defaults on the lease, the landlord needs to retain the right to lien and sell the tenant's building contents to collect unpaid rent.

Solution: Subordinate the landlord's lien:

This lease provision must be negotiated as a compromise that protects the landlord's ability to recover unpaid rent yet also allows the vendor or lender the right to recover their property. In most cases, landlords will agree to subordinate their lien rights to filed UCC-1s, which is a debtor filing statute that protects a legal security interest in collateral by a vendor. Normally, the lien is on personal property rather than real property, like furniture, fixtures and equipment. In the case of nonpayment, the filing allows the vendor or lender to repossess their goods. Thus, the vendor may recover their property and the landlord may sell the unencumbered contents.

Problem: The landlord requires the tenant to be responsible for the building's heating, ventilating and air-conditioning system, or HVAC.

In multimetered buildings, the landlord will attempt to shift the responsibility of the HVAC system's maintenance to the tenant. In most cases, the landlord will warranty the system for 30 to 90 days and then require the tenant to be responsible for the HVAC system for the rest of the lease term. Many times, the systems are old and may require major repairs or replacement during the term of the tenant's lease.

Solution: Lower the tenant's exposure to financial risk.

The landlord should not expect the tenant to shoulder the risk of repairing or replacing an HVAC system. The tenant would be wise to offer to share the risk of repair or replacement with the landlord. The tenant should offer the landlord a service contract with an outside vender to change filters monthly and lubricate the system. The tenant's negotiated financial liability should be limited to $500 or $1,000 per year, on a noncumulative basis, depending on the size of the space.

Problem: The tenant needs an early lease termination clause.

Space requirements and configuration needs change as a tenant's business grows. The tenant's ability to cancel the lease must be negotiated at the time of the initial agreement. Tenants may have a need to upsize, downsize or cease business activities during the lease term. Negotiating a cancellation clause reduces the tenant's financial risk and allows the business to change locations based on the owner's needs. Landlords will attempt to avoid granting this right as it can affect the financial stability of their building investment and may cause hardship in a soft market.

Solution: Guarantee the landlord's costs, but not the profit.

The landlord will provide the most business concessions during primary negotiations to encourage the tenant to enter into a lease. To gain a cancellation concession, the tenant may need to give the landlord four- to six-months' notice and pay the landlord's unamortized lease costs, such as tenant improvements, leasing commission and advertising costs. The tenant also may need to pay the landlord one- to four-months' rent to provide an income stream while the landlord attempts to re-lease the space.

Problem: Tenant must make a substantial investment in building improvements.

To make a large investment in tenant improvements, the tenant must control the property for a long period of time to amortize costs and control rent increases, yet retain the option to vacate the premises should business needs change.

Solution: Negotiate a 10-year lease plus two additional five-year renewal options at a fixed lease rate.

• Building improvements may be amortized over a period of up to 20 years. The tenant is aware of all lease costs for the 20-year period prior to signing the lease and investing in building improvements. If business needs change, the tenant may elect to vacate the space after a 10- or 15-year term without paying a penalty. • To protect the lease and the lease rate, the tenant must have a nondisturbance clause agreed to and signed by the building owner, lender and tenant. The clause states that if the lender takes back the property, the tenant's lease will survive the foreclosure and must be honored by future owners and lenders. This clause is important because Texas law, in the event of a foreclosure, grants the new owners or lenders the right to void leases, renegotiate rates or force the tenant to vacate their premises. Having this clause as part of the lease protects the tenant's lease, lease rate and ability to amortize the improvements over the lease term.

• Title insurance is needed to ensure that the owner has clear title to the property and has the right to enter into the lease.

If a dispute occurs between a landlord and a tenant, the lease contract prevails. A business owner who plans to sign a commercial lease should realize the importance of negotiating favorable terms and conditions that will meet long-term business goals and will protect against potential perils and exposure.

Market conditions set the lease rate, but thorough negotiation of the nonmonetary terms and conditions is integral for business growth and protection.

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