

What to ask before signing a new lease

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Most professionals in Austin are all too aware of the challenges in the local commercial real estate market. In fact, some estimate that up to 26 percent of all commercial space is available to lease or sub-lease. This does, however, present unique opportunities for a business owner who wants to renegotiate a lease, add to or upgrade space or even consider buying a property.

Landlords and owners tend to be more flexible on the terms of contracts in markets like this, including price, length of lease, property maintenance and improvement allowances.

But before taking the plunge to move, change a lease or even buy, there are questions that need answers.

● *What are some common mistakes when signing lease contracts?*

A common mistake is the tendency to focus mainly on negotiating lease rates, rather than business contract issues that can affect the long-term profitability and day-to-day running of a business. For example, some business owners make a personal or business guarantee of the entire lease amount, which may affect their ability to borrow from vendors or lenders, as it is a long-term liability.

Knowing when to ask for professional representation helps the business owner navigate the technical business issues connected to lease contracts.

● *How do I determine the right size and location for my business?*

There is no set formula for choosing the right size facility for your business — it will depend on the way you use your space. If it's solely to house employees, understand how much space they need to effectively do their jobs, and how it needs to be organized. If you will be interacting with clients or customers, know their profiles and anticipate their expectations. Real estate and design professionals can help with additional decisions regarding location and size, using tools such as demographic data.

● *How can I structure a flexible lease for*

a growing business?

Leasing commercial real estate will most likely be one of your most expensive overhead items, and it is important that you build it into your short-term and long-term business plans. In other words, if you plan to double your employees or inventory every year, you must choose space and negotiate a deal that will allow you to do so.

Two specific items should be carefully negotiated in a lease contract for maximum flexibility. First, a cancellation clause allows a tenant to cancel a lease after a specific time period if the landlord cannot provide additional space. Second, it's advantageous to gain a first right of option to lease other space in the building, especially adjacent space.

● *How do I determine the appropriate length of lease for my business?*

Most owners will require a five-year lease. Shorter leases will reduce the leverage the tenant has to negotiate other terms. Although five years may seem like a long commitment to a small business, certain businesses will actually need 10 years or longer to amortize their investment in improvements.

Again, business owners need to think of how this ongoing expense fits into their business plans. It's also a good idea for a tenant to gain *options to renew* in an initial lease, at a *fixed option price*, giving protection from large price increases at the time of renewal. Without fixed renewal rates, the tenant is essentially captive because of the need to amortize the improvements.

● *How do I make sure my landlord is responsible — and responsive — for repair, maintenance and upgrade issues?*

This is an important part of the initial negotiation, as tenants should seek to limit both their liability and obligations in the lease contract. The tenant needs a mechanism that not only clearly spells out their responsibilities, but also penalizes the landlord if the landlord does not meet obligations within the allotted time.

It's also crucial that the contract state the landlord is responsible for meeting all federal, state and local codes, ordinances and regulations — current and future. Many tenants have been left covering the cost of adding sprinkler systems to meet changing fire codes, for example, because a lease contract did not properly protect them.

● *What terms of commercial leases are most landlords likely to negotiate?*

The economic terms of a lease are always up for negotiation, and a tenant should not shy away from looking for "deals" — especially in the current market environment.

Negotiable items include free rent, tenant improvement allowance, moving expenses, relief from building operation expense escalation and free operating equipment — things such as furniture, phone systems or computer cabling. There are also literally dozens of noneconomic clauses that can be negotiated, based on a company's needs and priorities.

● *What happens if my landlord sells my building or goes bankrupt?*

According to Texas law, leases convey if a building is sold to a new owner. If an owner goes bankrupt and the lender forecloses, however, all leases are void and tenants must renegotiate with the new owner — leaving you open to a rate increase.

It's a good idea to have a protection clause in a lease contract, agreed to by both the owner and lender, which states that the lender will honor the tenant's lease if the owner defaults.

● *How do I know if leasing or buying is the right decision for my business?*

Many business owners simply assume they cannot afford to buy. In fact, buying can be financially advantageous and add to the value of your business.

It is important to first understand that buying vs. leasing a facility is a working capital decision — one that must be made with your business and financial advisors.

Some factors to consider include whether your location is so important to your business goals that it must be secured permanently; are you making a significant capital investment in special equipment or build-out that cannot be moved and whether your business has unique infrastructure needs — unusual size wastewater facilities, gas or power lines.

Ask yourself the questions, find the answers and the decisions will be easier and likely the best ones for you and your business.

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