

Negotiating Leases for Your Business and Related Relationships

by Alan Gassman & Scotty Schenck

What do you need to protect yourself when you're negotiating a lease? It can seem like a minefield at times, but luckily we have plenty of tips that should help you through the possible (and probable) confusion. These tips came from a webinar that Alan Gassman and Christopher J. Denicolo gave on Tuesday, June 27 as part of the Maui Mastermind lecture series. For a replay click here <https://youtu.be/FYxamaXQ52E>. The following article was drafted by Scotty Schenck.

When you're considering buying real estate, or leasing property for your business, go over these steps, think them through and don't get caught paying more than you have to. Your employees, customers, and wallet will thank you later.

(1) Ponder the financial decision of property as a whole

Often times, investing in real estate or a space for your business is one of the largest financial decisions of your life. It's important to consider whether you want to select an opulent office space or reap more financial security from spending less on rent/a mortgage and on maintenance. Unless you're a retailer that will benefit from ultra-prime locales on Main Street, the latter is typically superior.

And don't be afraid to have a strategical mindset. Shop for less expensive leases from competing landlords and always keep a plan B in mind. Even if you can't convince your dream location's landlord to drop his rent, you can go with plan B and save money.

Make sure to check your bases, and involve plenty of professionals to make sure you are getting the agreement you want. Involve CPAs, financial advisors, insurance agents to review required coverages, contractors to assure the quality/condition of the building and fill you in on expected maintenance, and zoning specialists to make sure it's approved for the type of business you will be doing. If you want to build-out on the property, know what you're getting into. Be careful with advice from your leasing agent or any entity being paid via commission. Don't forget to give your psychiatrist or psychotherapist a call while you're at it.

And lastly, check your formalities. Did you know that a lease in Florida extending beyond a one-year period is not effective unless signed with two witnesses?

(2) Whenever you have a legal document before you, remember the two golden words

Read it! In lease agreements, we often see things that you wouldn't expect or plan for. But this advice extends to any legal document you're given to sign. If you can't read the Lease and even if you do, have your lawyer (or at least *a* lawyer) read it for you. Make sure they have experience in lease reading/drafting. Read things that you hand others to sign, because you'll often forget what was in it too. Nothing is worse then finding out there was an exception or clause that will cost you money in certain circumstances, or lose your business.

Never be afraid to ask for clarity; your financial future may depend on it.

(3) Who are you leasing with?

Don't sign with bullies. Only contract with good people, whether you're a landlord or a tenant. It's a big demerit to have a landlord who is a shady person or a liar. Do a background check on the landlord or organization you're leasing with.

(4) Do you know your options for limiting liability?

Limiting guarantees limit your liability to the landlord in case of unforeseen circumstances. Imagine your employee accidentally burns down your office building. Who's going to pay for that? Unless you have limiting guarantees, it might be you as a business owner. It will be significantly simpler and less dreadful to limit your guarantees in some way. And here are three ways to do just that: (i) limit your liability to a percentage of excess liability, (ii) limit it to a specific dollar amount, or (iii) limit it to a specific amount of time—for example, “only for defaults occurring in the first X amount of years under the Lease, and thereafter not exceeding \$50,000.”

You can also give yourself a safety valve in the Lease by creating a buy-out clause, where before a certain period, say 180 days, you can buy your way out of a lease by paying some percentage of the rent. Landlords might too want a buy-out clause to get rid of a tenant as well.

Yet another way to limit liability is to separate your business locations into their own companies to minimize the risk of liability spreading from one to another. If one store front goes under or is facing litigation, you won't lose everything.

(5) Is location everything?

Remember the late-2000s and the recession. Business owners who had modest fixed expenses did not face as much damage as others. Business owners who went over their head with opulent business locations were often hit the hardest.

Location preference often butts its head with lower overhead and being able to move the money not spent on pricey rent towards advertising. Think about what you're paying in rent. Is it better for you to buy the whole building? If you decide to close down early, you can sell the building and avoid paying 3-5 years of rent. It's not the right decision for every business owner, but it is something to consider. Is it better for tax purposes for you to pay higher rent but let the landlord do build-outs? You could also put the build-out under a separate company.

(6) The Terms of the Arrangement

Would you rather have a two year lease with four, two-year options to extend or a five year lease with one, five-year option? To me, the answer is simple. I would rather have more options and be able to consider where I am every two years. But you do need to be careful about the changes

that can occur. Will the Lease terms be identical? Will there be an allowance for refurbishing? And, will the rent be fixed, change with CPI, or be based on the market at the time?

Your financial destiny may very well depend on exercising your option to extend the Lease on time. ***Do not forget to exercise it!*** The option extends until the Landlord writes you a letter reminding you that you haven't exercised your extension.

Further, ask for free rent. It will give you time to figure things out, to inspect, and to open your business. You can also ask for more free rent when you extend your options in the future.

(7) Negotiation with rent and common area maintenance, are you getting a good deal?

When trying to negotiate, common area maintenance is one of the easiest places to see landlords make concessions. It can also be a place for them to sting tenants. There have been some instances where we've seen landlords get a percentage of the common area maintenance just for maintaining it. They can also charge exorbitant prices, or even get you paying for costly repairs you never expected.

One way to combat this is by setting a dollar-amount ceiling for how much you are willing to pay for common area maintenance, or you could put into writing that you are not required to pay any more than the other tenants.

Also, ask for the right to reduce rent if other tenants pay less later in their leases.

Further, when calculating total square footage, and checking the square footage discussed in the Lease, make sure that it is the total usable space. You can also add a clause your rent will go down if the square footage is inaccurate.

(8) What can you do to lower liability on your lease?

You can lower the liability of your agreement to a specific dollar amount, such as no more than \$50,000, or by month, such as \$4,000 per month for each month left in the lease if there is an early termination. And don't forget about catastrophic liability issues, such as fires.

Imagine a rancher is trying to limit his liability when he leases land to a tenant by leasing through a ranch operating company. You can put an 80 percent mortgage on that ranch company, owed to the rancher's family limited partnership. If the rancher gets sued for any reason by the tenant, he can only lose 20 percent equity and not the whole value of the property. In conjunction, the lease could be triple net leased from the company to the operating company and then the operating company can sublease where the tenant will agree only to look to the ranch operating company if there is an injury. Such an arrangement will hold up in many states.

(9) What type of agreements is your landlord trying to get you to sign?

There are three types of agreements that we suggest you get. First is the memorandum of lease. In Florida, a memorandum of lease requires two witnesses and a notary public to be recorded.

And that is, of course, in addition to the witnesses you need to draw up a lease of greater than one year. Second is the subordination/attornment agreements, where the bank mortgage is superior to the Lease and allows the bank to step in if the Landlord defaults. Non-Disturbance agreements will allow you to continue operating your business/occupying the property even if the bank has foreclosed it.

Lastly, you should always ask for rights of first refusal. This will give you the ability to negotiate/refuse an extension on the Lease if there is no set option. With a right of first refusal to an adjacent space, the Landlord cannot sell or lease that adjacent space without offering it to you first. And you can also get a right of first refusal to purchase the entire building.

(10) What other amenities should I be concerned about?

When purchasing a place for business, parking and signage plays a huge role. The best option is to have reserved parking with the right to put up signs. We have seen people end up with zero parking spaces. You should also ask for as much signage as other tenants. However, be careful to know the limitations placed on signage by your municipality (such as banning lights on signs at night to prevent light pollution).

Other amenities can be just as important, such as handicap parking, medical waste pickup access, and antennas on your roof. Again, don't be afraid to ask or get it in writing.

(11) Conditions and repairs

The opposite of the golden words, "read it," are the two worst words, "as is." This means there are no warranties as to the condition of the space or office. When you see these words it should send a red flag in your mind to get an inspector if you are seriously considering a property.

Like with common area maintenance, repair liability can also be minimized by adding provisions into a lease agreement. But remember when language is vague, ties usually go to the Landlord. Further, require your landlord to keep the common areas in first-class condition, as well as maintaining quiet enjoyment rights to prevent noxious uses of the building and its immediate surrounding. If a landlord owns the properties around your potential businesses space, get it in writing that other businesses like yours and that will detract from your business (think bars or a children's play center) are not allowed.

Don't forget that you should always ask to get what you agree on in writing, ask for more rights and liability reduction, and always read what you sign (or better, have a lawyer do it!)

Moral of the story: You can't get what you don't ask for!