Twenty Tips for the Small Business Owner Negotiating a Commercial Lease

Eric C. Perkins, Esq.

Negotiating a commercial lease with a landlord or property manager can be an intimidating job. A lengthy and complex legal document, seemingly little to no bargaining leverage, and the ever-present time pressure to get a deal done are all often working against you. Notwithstanding these challenges, a commercial lease is, at its essence, nothing more than a business agreement reflecting mutually agreed-upon terms between two willing parties.

The following tips can help you better understand commercial leases and position you to make informed decisions that will hopefully bode well for the future success of your business.

1. Base Rent. This is the base amount required to be paid in the first year of the lease. How does it compare to the market and other similar properties? Also, look carefully at rent increases over the term of the lease (and for any renewal terms).

2. Incentives. The local real estate market is improving, but tenants still have some bargaining leverage at many shopping centers across the region. Incentives ranging from free rent to tenant improvement allowances can be included in the lease. Does the lease include any such concessions? Working with an experienced commercial real estate agent in your area can be valuable in terms of identifying and negotiating concessions from the landlord.

3. Term. What is the length of the lease? How flexible is the landlord in giving the tenant a shorter (or longer) occupancy if required? One or more renewal options are not unusual. Early termination options are not unheard of, but less common. An early termination option can save a tenant an enormous amount of money (and stress) if business does go as well as originally hoped and the tenant needs to regroup or wind down its affairs.

4. Lease Deposit. This is often referred to as a security deposit and is almost always required by a landlord. The amount is usually one month's rent paid in advance. Carefully review any conditions, contingencies, or potential deductions that might reduce the amount of your deposit that gets refunded upon termination of the lease.

5. Personal Guaranty. This is a common form of security to protect landlords, but creates significant risk for the owner(s) of a small business and is often used by landlords as powerful leverage in situations where a tenant is in financial trouble and falls behind on its lease obligations. A business owner's goal here should be to try to limit the scope of the personal guaranty in any way possible to limit his or her exposure, either in terms of dollar amount, amount of time, or the list of obligations that are specifically subject to the personal guaranty.

6. Services and Utilities. Each new property will have unique services such as electricity, telephone, internet service, water, cleaning, heat, air conditioning, and security. Know what's important to you and evaluate each property's services independently, the charges for such utilities and services, and who is responsible for repairs and replacements.

7. Amenities. Each property has certain design features that are classified as amenities for use by the tenants. These might include reserved parking spaces, signage, storage, common areas, landscaping, conference rooms, etc. Are the amenities offered important to you? Will you be paying for amenities that are not of value to your business? In some cases, applicable law may require you to have certain of these "amenities" in place (e.g., a minimum number of reserved parking spaces). The key here is to plan carefully, be creative, and don't hesitate to think outside the box and ask for any amenities you believe will be important to the success of your business.

8. Landlord-Funded Improvements. Commercial landlords will often provide certain types of improvements as part of the leasing process for a new tenant (referred to as "tenant improvements"). These concessions might include new carpet, painted walls, suspended ceilings, air conditioning configuration, lighting configuration, or similar improvements. How generous is the improvement allowance and how does it compare to other properties in the area?

9. Proximity to and Types of Business Neighbors. Some tenants need to be in close proximity to other businesses of a similar type. If this is something that is critical to your business, your location within a shopping center or mixed-use facility will be an important issue to negotiate.

10. Permitted Use and Exclusivity. Tenants typically want to negotiate as broad of a "permitted use" as possible to maximize its flexibility as to what types of activities it can engage in (or what types of products and services it can sell) from the leased premises. Coupled with an exclusivity provision that will prevent the landlord from leasing space in the same building or center to a tenant that would directly compete with you, it is easy to see the value of such provisions to a tenant .

11. Co-Tenancy Clause. If you are leasing space in a shopping center or other facility anchored by one or more key tenants (e.g., a grocery store, Wal-Mart, Target, etc.), you want to negotiate for the right (referred to as a co-tenancy clause) to terminate you lease without penalty if a key tenant terminates its lease or goes dark (i.e., ceases regular business operations).

12. Casualty and Related Termination Rights. Do you require air conditioning beyond regular business hours? Some buildings may not be able to accommodate this need. The landlord and architects for each building should give you an assessment of this capability.

13. Casualty Events and Insurance. What sort of extraordinary events are defined in the lease that will permit one or both parties to terminate the lease? Similarly, commercial leases typically contain provisions defining insurance coverage requirements and which party bears the expense of obtaining and maintaining insurance. Working with an experienced commercial insurance agent can be very helpful in understanding these provisions and making sure you comply with your obligations.

14. Subletting and Assignment Rights. Small tenants are able to negotiate much flexibility in terms of being able to sublet the leased premises or assign the lease to a third party, but at a minimum, you want (and need) your landlord to be reasonable in considering any request to assign the lease. Ideally, landlord and tenant will be able to negotiate a pre-approved set of criteria for an acceptable sublessee or assignee and a detailed description of the approval process and timeline.

15. Floor Coverings, Wall Treatments, and Window Treatments. All of these issues have both cosmetic and practical considerations for a new tenant. If replacements or improvements are deemed necessary, try to push that responsibility and cost to the landlord.

16. "As Is" Delivery. Landlords typically propose that new tenants take the leased premises "as is" and waive any claims for the existing problems with the space (leaks, malfunctioning HVAC unit, etc.). If you are not successful in negotiating any warranty protection from such problems or defects, then you should have a thorough site inspection performed by a professional before signing a lease.

17. Signage. Some properties require specific sizes and styles of signage. This may be signs on the exterior of the building, directory board signage within the building, or marquee signage at shopping center entrances. Knowing what costs may be incurred, or whether the landlord is assuming this expense, is essential.

18. Parking. The availability of on-site parking adjacent to your business will likely be important to the success of your business. Reserved spaces and valet parking are becoming more common. Carefully consider what your wants and needs are, and negotiate accordingly.

19. Expansion Space. If future expansion is anticipated, will the property (and landlord) accommodate your plans for growth?

20. CAM. Common area maintenance and operating expenses are a notorious source of confusion and controversy in commercial leases. Landlords strive to pass through as much of the operating and property maintenance expenses to tenants as possible. Tenants should carefully review these lease provisions and understand what they are being charged for, and carefully monitor each billing statement to confirm the terms of the lease are being properly applied. As a tenant, you want to minimize your responsibility for the landlord's administrative overhead or capital improvements being made to the property (among other costs).

This is by no means an exhaustive list of issues to consider when reviewing or negotiating a commercial lease, so be sure to consult with your real estate and legal advisors along the way. Perkins Law is pleased to review and offer feedback on commercial leases on both flat fee and combination flat fee/hourly fee engagements.

PERKINS LAW, PLLC

Eric C. Perkins, Esq.
4870 Sadler Road, Suite 300 Glen Allen, VA 23060 P.O. Box 5545 Glen Allen, VA 23058-5545
eric@ericperkinslaw.com www.ericperkinslaw.com
Office (804) 205-5162 Mobile: (804) 332-3648 Fax (804) 482-2835