



COMMERCIAL LEASE ISSUES

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With the surplus of office space in the Hampton Roads area it is a renters' market and many small businesses are lured in by tales of the good deals that can be had for commercial space, such as free parking, landlord funded renovations, and the like. There is, however, an area that small businesses often neglect when it comes to leasing space - the failure to fully understand the terms of the lease they are signing. If you are aware of the common pitfalls in commercial leases, you can help protect your business from unexpected liabilities by negotiating better terms. Here are some common pitfalls to be aware of:

- 1) **Length of the Lease:** Watch out for terms in excess of three to five years. Whatever you do, never sign a long-term lease of 10 or 20 years, no matter what terms are offered. That is a very long time and the business environment can change very fast. Instead, seek to negotiate a short-term lease with an option to renew. This may raise the rent amount, but it is a better alternative for the small business than agreeing to a lengthy term.
- 2) **Property Description and Rent Calculation:** The lease should clearly describe the premises leased and clarify whether it includes use of common areas such as bathrooms, kitchen areas, and parking facilities. In most instances, the landlord will calculate the rent amount based on the square footage of the space leased. Be aware of what footage the landlord uses to calculate the rent and whether it includes any common areas. Also, if possible, negotiate which party is responsible for other costs like utilities, property taxes, insurance, and repairs. In addition, the lease will usually provide for an annual percentage-based rent increase. Negotiate with the landlord for a cap on the percentage increase in order to avoid burdening your business with unmanageable rental costs later.
- 3) **Security deposit:** The lease should specify not only the amount of the security deposit, but also the terms regarding its return, including the timeframe and how any deductions will be itemized.

- 4) **Overly broad terms in the "hold-harmless" clause:** Overly broad indemnification clauses can make the tenant liable for damage the landlord causes. In the hold-harmless clauses of many commercial leases, the tenant promises it will be responsible for the damage it causes, will reimburse the landlord for resulting costs, and won't sue the landlord for accidents. This seems fair, but in some instances such provisions have been interpreted to mean that tenants agree to reimburse landlords even for damage the landlord causes. The best protection from such hold-harmless clauses is to specifically agree to indemnify the landlord only for harm your business causes within the space it leases and try to limit it to damage caused by gross negligence.
- 5) **Allowed Use of Premises and Signs:** Make sure that the lease actually allows your business to use the premises for the purpose of its business. This may sound like common sense, but it is an important detail. You should also try to build in some flexibility so that your business can make changes to its business model down the line, without having to renegotiate the lease. If necessary, be certain that the lease agreement does not prohibit your business from putting up signs that are visible from the street and check local zoning ordinances to determine what other limitations may apply to desired signage.
- 6) **Improvements:** The lease needs to specifically address what improvements or modifications your business can make to the property, which party will pay for the improvements, and whether the tenant is responsible for returning the unit to its original condition at the end of the tenancy.
- 7) **Landlord Casualty insurance:** Most landlords carry such insurance as a way to protect their investment – or because their mortgage lender requires it. But some landlords self-insure, which makes them more likely to sue a tenant for damages regardless of the cause, since they will want to avoid paying for repairs if at all possible. Plus, a self-insured landlord may have no money to rebuild, which could leave your business without a place to do business. In addition, the lease should also provide that if there is a major accident, the landlord will advise the tenant within a specified short time period, typically 30 days, whether they plan to rebuild and you should negotiate the right for your business to terminate the lease after any major accident. Also, ensure that the landlord's insurance policy includes a waiver of subrogation. Otherwise, your business is at risk of being sued by the landlord for any excess costs not covered by their insurance policy and the landlord's insurance company may sue the business for everything it paid the landlord. A waiver of subrogation guarantees that if the landlord's insurance company reimburses them for damage your business might have caused, the insurance company won't sue your business.
- 8) **Exclusivity clause:** This is an important clause for retail businesses. An exclusivity clause will prevent a landlord from renting space to a competitor in the same building or complex.
- 9) **Assigning and subletting:** It is important for your business to have the right to assign the lease or sublet the space to another tenant. Otherwise, the tenant is still responsible for paying the rent if the business fails or relocates. While landlord consent

is typically required for assignment and sublease, try to include a provision that such consent will not be unreasonably withheld.

- 10) **Compliance with the Americans with Disabilities Act:** Under the act, if a business is open to the public and has more than 15 employees, the premises must be accessible to people with disabilities. Making facilities ADA compliant is not an inexpensive proposition. The lease should specify that the property is compliant or, if not, state who is responsible for making and paying for any necessary modifications to the property. In most instances, the landlord should bear the burden of such modifications.
- 11) **Pass Throughs:** Most commercial leases are “net” leases that allow the landlord to recoup any operating costs related to the premises. A common trap for small business tenants is the annual increase in such operating costs or “pass throughs.” Originally designed to protect the landlord against increases in utilities, property taxes and operating expenses, landlords now see pass throughs as a way to increase their cash flow. Ask for documentation to substantiate any pass through allocation.
- 12) **Guarantees:** Many landlords now require a personal guarantee from the small business owner. This guarantee means that the person signing as guarantor is fully and completely liable for the whole of the lease obligation for the full term of the lease. You want to negotiate this provision so that if, for example, you sell the business or transfer the lease, the liability under the personal guarantee ceases at that point, rather than continuing on for the whole lease term.
- 13) **Early Termination:** Try to negotiate an early termination clause, which gives the tenant and the landlord the chance to end the lease early. For new businesses, this is a protective clause should the business not perform well and you need to close it down. Otherwise, there is a chance they may find themselves personally responsible for the lease when their business has failed.
- 14) **Subordination, Non-Disturbance and Attornment:** Since foreclosures have become a fact of life, your business’s landlord today may not be the landlord tomorrow. That’s why you need to pay special attention to typical boilerplate provisions regarding subordination, non-disturbance and attornment. When lenders take back a building, they can legally tear up leases and evict the tenants, which can cause a catastrophic disruption to a small business.

Leasing of commercial real estate often represents a small business’ largest single financial commitment, and its greatest annual expense other than payroll. It can have a major impact on the viability of the company. In today’s economy, a small business cannot afford to be caught unprepared, as the stakes are just too high. Avoiding just one pitfall can save your small business thousands of dollars each year.

It is my hope that this article will help clarify issues surrounding commercial leases. Let me know by commenting on HRGC’s FaceBook page (Hampton Roads General Counsel, PLLC), or by leaving a comment on the HRGC website (hrgclaw.com).