

Reading Between the Lines

The Many Issues in Negotiating Commercial Real Estate Leases

By JEFFREY FIALKY, Esq.

Commercial leases are not simply contracts; they are often roadmaps to both a landlord's and a tenant's future business plan for a particular premises.

Thus, both parties should exercise due diligence and take ample time to contemplate, discuss, and include within the lease all such matters that could arise during tenancy. If one distills the complexities of commercial real estate leasing to the most basic notion, the most important thing to remember is that nearly everything is negotiable for both sides.

Unlike residential real estate leases that are strictly governed by statutes and case law, the world of commercial real estate leasing is generally left to the landlord and tenant to decide. As a result, the commercial lease agreement is the bible when it comes to the landlord's and tenant's respective rights and responsibilities for the lease term.

How much of a 'template' lease is negotiable by each respective party? That often depends upon the leverage of the market and of the property being leased. For example, if the market has a significant amount of space for lease, the tenant will likely have more ability to dictate lease terms. Conversely, in a market where one particular piece of property is unique, or where the market has high occupancy rates and thus a smaller inventory of available space, a prospective tenant may find itself with less bargaining power.

Here are some considerations relative to issues that tend to emerge during lease negotiations.

Use of the Property

Regardless of market conditions, it is essential that the land-

lord and tenant contemplate each aspect of the tenant's business, what the tenant's needs will be during the lease term, and how the tenant's use will comply with the rights, requirements, and remedies of the landlord.

For instance, if the prospective tenant intends to operate a retail store or anticipates significant customer visits, the lease should contain a specific provision governing parking spaces reserved for the tenant's customers' use.

In addition, if a tenant is operating, for example, a coffeehouse and bookstore, then perhaps the landlord and tenant should re-

tion to pay rent to be delayed for a month or two, which may be referred to as the "rent-commencement date." The lease term may consist of an initial term with optional renewal terms of an equal or shorter duration than the initial term. To avoid any misunderstandings, is often helpful to set forth actual calendar dates, including day, month, and year.

Operating Expenses, Taxes, and Utilities

Each lease should specify the party responsible for the operating expenses, e.g. maintenance of

standing of which party is responsible, and at what cost, if any, to the tenant.

Very often, a tenant will pay a proportionate share of common operating costs in a building with multiple tenants. In this case, the lease should include the proportionate share as a numerical percentage (e.g. tenant's proportionate share shall be 43%) of the total leaseable space in the premises, to avoid ambiguity.

Building Systems

As an offshoot to operating expenses, the lease should also clarify the party responsible for providing and maintaining building systems. In New England, where both summer and winter represent extreme temperatures, a tenant should ensure that the HVAC system in the leased premises is sufficient to support its needs.

Also, if the tenant will have an ongoing obligation to maintain the system, he may consider having an inspection performed prior to the execution of the lease to evaluate efficacy.

Tenant Improvements

It is common for a tenant to perform some customization prior to opening the leased premises for business. This could be minor, like painting, or significant, such as installing a kitchen or other trade fixtures. The tenant should bear in mind that, during this period, he could conceivably be paying rent, even when the business is not open for business and there is no incoming revenue. With this in mind, the tenant should consider negotiating postponement of the rent commencement date during his renovation/improvement period.

While at the time the lease is negotiated, a tenant expects to occupy the leased premises for the full period of the lease, it is often the case that unforeseen events in the tenant's business modify reality. For instance, a tenant may merge with or sell its business to another party, or it may have a need for less space in year five than it had in year one.

evaluate leasing the adjoining space for use as a home theater/electronics demonstration business. Since the use of the leased premises is often restricted by the terms of the lease, the tenant should ensure that the intended use is specified and permitted.

Term

The term (length) of a commercial lease is determined by its starting date (commencement date) and its date of expiration. While a lease may have a specific commencement date, it is not uncommon for a tenant's obliga-

tion to pay rent to be delayed for a month or two, which may be referred to as the "rent-commencement date." The lease term may consist of an initial term with optional renewal terms of an equal or shorter duration than the initial term. To avoid any misunderstandings, is often helpful to set forth actual calendar dates, including day, month, and year.

Each lease should specify the party responsible for the operating expenses, e.g. maintenance of the leased premises, taxes (or tax escalator), and utilities. These costs, both individually and collectively, can be significant, and should be discussed by the landlord and tenant at the beginning of negotiations to ensure that all parties are in agreement from a budgetary standpoint.

Lease Rates

A major consideration for each party to be mindful of relative to rent is the consideration of the rent that will be paid over multiple "terms."

For instance, if a lease is five years in duration with rent fixed at \$1,000 per month, and the lease allows for two renewal periods of 10 years, the rent may be fixed for the entire 25-year period. Such a lease could ultimately end up being impractical to a landlord who may have the space leased for less than market rate. Accordingly, a lease should con-

template the potential need for a rent escalator after a certain period of time so that the landlord is assured that the rent obligations of the tenant remain consistent with the appreciating value of the leased premises.

Assignment/Subletting

While at the time the lease is negotiated, a tenant expects to occupy the leased premises for the full period of the lease, it is often the case that unforeseen events in the tenant's business modify reality. For instance, a tenant may merge with or sell its

business to another party, or it may have a need for less space in year five than it had in year one.

A tenant should realistically contemplate its business needs on a going-forward basis, and negotiate the lease terms accordingly. If there is a likelihood that the tenant's space needs may be less at some point, the ability of the tenant to sublease a portion of the leased premises to another subtenant is ideal. Also, if a tenant merges with or sells its assets to a third party, the tenant will want the ability to assign its rights in the lease to that third party.

Parting Thoughts

This summation is certainly not exhaustive, but it serves to illustrate that commercial leases are not merely contracts, but truly roadmaps, which must be read and understood so that both parties can get where they want to go, and without getting lost.❖

Jeffrey Fialky is an associate with the regional law firm Bacon & Wilson, P.C., who specializes in business, corporate, municipal, and real estate law; (413) 781-0560; jfialky@bacon-wilson.com