

Commercial Leasing Tips and Traps

By Donna Toman Salvidio, Esq.

As a member of our Real Estate practice area, I routinely hear from clients asking me to draft or review leases for them. Whether it is a physician group looking to relocate their practice, a fitness facility planning an expansion of their existing space, a large distribution center considering a new transportation hub, a restaurant interested in leasing a second location or a small business interested in taking space in a shopping mall, each client has specific needs that the new space must fulfill.

Despite the common perception of many clients, leases are not “one size fits all.” Leases vary widely depending on whether the tenant is leasing an entire building, a portion of a building, an office suite or space in a mall. Leasing new space is an event that can have major implications for any business. If a company leases space that ultimately turns out to be unsuitable for its operations, or if the lease does not allow for expansion, the growth of the company can be hindered. If too much space is leased, the company will end up wasting its valuable cash resources.

Lease documents can be sophisticated and complicated contracts. More often than not, the language in today’s leases consists of dense and frequently poorly drafted “legalese.” It is important to understand a business’ present and anticipated future needs to tailor a lease suitable for the client. Many points beyond rent and square footage can directly and adversely affect a business tenant. For example, often vague and confusing clauses pertaining to operating costs and escalations, unless properly limited or capped, can result in unexpected liabilities. These unquantified amounts, when added to an otherwise reasonable base rent, can result in a total rent obligation that is well beyond the tenant’s ability to pay.

A lease review by an attorney who understands the ongoing economic implications of complicated lease language can be invaluable. A lease that provides a tenant with the right type of space and flexibility as the tenant’s needs change can become an asset and provide a competitive advantage.

To make the lease review process more efficient, I suggest that each client consider certain key points when they’re thinking about leasing space. I also suggest they put together a brief list identifying their particular business needs and wants for new space. This helps me to understand what is missing from the standard lease documents they are being asked to sign.

A prospective tenant might want to consider the following matters when entering into a lease:

The Premises. Do you know exactly what you are leasing? A precise plan ought to be attached to your lease. The square footage

of the usable premises also should be set forth. In the event future space needs are indefinite, an option to expand into or a right of first refusal on additional space should be considered, as well as an ability to downsize and give back space or reduce the lease term. If you are leasing a substantial portion of the building, an option or right of first refusal to purchase the building may be appropriate.

Identity of the Tenant. If you operate your business in a form other than a corporation or limited liability company (such as a partnership or a trust), nonrecourse language should be requested. All efforts should be made to avoid entering into the lease in the name of an individual. Similarly, personal guarantees should be resisted whenever possible.

Storage/Parking/Loading. Your lease should identify storage space (if any) and number of parking spaces, their location, their additional cost (if any) and whether parking spaces are assigned or used in common with other tenants. If loading areas are important to your business, your lease should identify the loading areas, any restrictions on their use and whether such areas are exclusive to your space or used in common with other tenants.

Permitted Uses. The permitted use clause, if any, ought to be broadly drafted so as to permit all contemplated uses of the premises and incidental uses. These uses should be checked against local zoning.

Initial Tenant Improvements. Unless the space is to be taken “as is,” perhaps the most significant item to be explored is the nature, timing and responsibility for the performance and cost of the improvements to be constructed. Your lease should also state whether all or a portion of such improvements can be removed at the end of the lease term, or whether they become the property of the landlord.

Operating Expenses. If you are going to share in the cost of operating expenses for the building, you should try to exclude capital items or limit your obligation to paying for such items as amortized over their useful life. You will generally benefit from operating expenses being determined in accordance with generally accepted accounting principles with carefully enumerated descriptions of included and excluded costs. If operating expenses are to be paid over a base, that base should, if possible, be the first full calendar year during which the lease is in effect, and the base should be “grossed up” to reflect full occupancy. Consideration should be given to negotiating a cap on increases in operating expenses and rent escalations during the lease term.

Maintenance and Building Services. Your lease ought to include detailed times and standards for building services and set forth the additional cost, if any, for off-hours or additional services, such as weekend or evening air conditioning or heating. You may wish to negotiate an abatement of the rent or lease termination right in the event an interruption of services continues for a specified time period.

Insurance. The lease should include a covenant by the landlord to insure the building for its full replacement cost and should include a waiver of claims by the landlord for any damage covered by insurance, as well as a commitment by the landlord to obtain a waiver of subrogation from its insurer.

Assignment and Subletting. The lease should allow the tenant to assign the lease to a related or affiliated entity without requiring the landlord's consent. The landlord should not be permitted to unreasonably withhold its consent to a requested assignment of the lease or to a tenant's request to sublet a portion of its space. Reasonable conditions to assignments and subletting ought to be spelled out in the lease.

Casualty or Taking of all or a Portion of the Premises. The tenant should negotiate an abatement of the rent or lease termination right in the event all or a portion of the premises is destroyed by casualty or otherwise unavailable to tenant due to a taking of the premises by eminent domain.

Tenant Default. You should receive written notice of any default including non-payment of rent or additional rent. The grace period after notice should be not less than five (5) days for monetary defaults and 30 days for nonmonetary defaults. The landlord should only be able to pursue remedies under the lease after notice and expiration of applicable grace periods.

Title Issues. A nondisturbance agreement should be requested from each present mortgagee, and the landlord ought to agree to obtain such an agreement from all future mortgagees if the lease is to be subordinate to such mortgages. Otherwise, if the landlord's lender were to foreclose on its mortgage you might find your lease terminated by that foreclosure.

In Massachusetts, if the term of the lease including all extension rights exceeds seven (7) years, a notice of lease must be recorded to assure protection of the tenant's leasehold interest from invalidation by mortgagees or purchasers who have no notice of the lease.

The experienced attorneys at Fletcher Tilton PC can assist you, whether you are leasing space for your business or own commercial space for lease. Let us help you navigate through the pitfalls of leasing and ensure that your lease is properly tailored to your business.

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www.fletchertilton.com



Donna Toman Salvidio

P: 508.459.8072

F: 508.459.8372

E: dsalvidio@fletchertilton.com

Fletcher Tilton ^{PC}
Attorneys at law

THE GUARANTY BUILDING

370 Main Street, 12th Floor
Worcester, MA 01608
TEL 508.459.8000 FAX 508.459.8300

THE MEADOWS

161 Worcester Road, Suite 501
Framingham, MA 01701
TEL 508.532.3500 FAX 508.532.3100

CAPE COD

1579 Falmouth Road, Suite 3
Centerville, MA 02632
TEL 508.815.2500 FAX 508.459.8300