

Key considerations when negotiating commercial leases

BY IRYNA LOMAGA CAREY

If you are like most commercial tenants who think that rent is the only concern when leasing space, you're mistaken. A lease contains many different clauses, some of which can adversely impact your bottom line. Therefore, protect your business interests by closely reviewing four key non-economic considerations when negotiating a lease: exit strategies, expansion rights, alteration requirements and repair obligations. The health of your future cash flow may depend on it.



Set an exit strategy

Remember independent video rental stores? What happened when they lost their business first to Blockbuster and then to Netflix? When a business goes bust, the last thing it needs is to default on its lease obligations and be saddled with long-term lease debt. That's why it's

important to negotiate an exit strategy in your lease. Your landlord may resist, including such a provision, but addressing this early in the negotiation process may improve your negotiating position should your situation go south.

Exit strategies take several forms. For instance, a tenant can negotiate a termination right after a typical three- or five-year lease term. In return, the landlord is likely to ask the tenant that exercises its "termination right" to reimburse the landlord for its share of buildout costs, the unamortized cost of improvement allowances and brokerage commissions.

Also ask for the freedom to assign or sublease all or part of your space without landlord's consent. This way, if you downsize, you can generate cash from your extra space. Then, try to make the "use" provision as broad as possible. The use provision specifies how the leased space will be used. If the tenant's use is limited

to a coffee house, then the space could not be assigned or sublet to some other form of restaurant.

Plan for expansion

Growing companies, such as ones selling a new hot tech product, may someday outgrow their space. Plan ahead. Ask the landlord to add expansion rights to the lease. The two most common forms are (a) a right of first refusal and (b) a right of first offer if space becomes available in your building or complex. Although both of these options are similar, tenants are generally better off with a right of first offer.

A right of first offer requires a landlord to offer vacant space to the existing tenant before going to market, so the offer is often at the same rent the tenant pays for existing space.

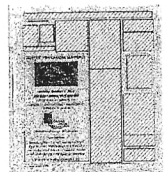
A right of first refusal gives a tenant only the option to match a current offer or proposal made for that space, which could be at a higher market rate.

Review alteration provisions

You can save both time and money by asking for permission to make interior, decorative, nonstructural alterations (which do not affect mechanical systems) without landlord's consent. Some landlords may require tenants to use a particular contractor, but this requirement should only apply if the proposed construction could impair the roof or building system warranty. You should retain the right to use your own contractors, subject to landlord's reasonable approval.

Tenants also should pay careful attention to how the construction provisions are drafted. You may find that the land-

lord requires you to post completion bonds, pay plan review fees, cover the cost of inspections, and reimburse the landlord for disabling the fire system so that you can connect to a building-wide system. You probably didn't budget for



these expenses.

Assign repair obligations

Landlords don't want to be stuck with a repair bill any more than you do. Relevant lease provisions are drafted narrowly to limit the scope of landlord's repair responsibilities so that the cost is shifted to tenants. Therefore, it is very important to review the operating expense provisions of a lease in conjunction with a landlord's repair obligations.

It is also recommended that tenants should conduct a thorough inspection of the premises, the HVAC and other systems, and utilities to determine if they may face unexpected repair or replacement costs. It is in your best interest that the lease specify that the premises are to be delivered to tenant "broom clean, free of tenants or other occupants, in compliance with law and with all mechanical systems in good working order." The phrase "in compliance with law" reduces the risk that you will be responsible for possible building code violations that are uncovered after you move in.

One last word of advice: Leases vary, as

do tenants. You may not be able to negotiate everything to your advantage. But a skilled and experienced legal adviser can help you determine what provisions will benefit you the most over the long term.

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