



WHEN DETAILS MATTER: CAVEATS FOR COMMERCIAL TENANTS

October 2, 2015 | Alert

Like many of our successful clients, your business may be expanding locally, nationally or even internationally. To facilitate your expansion, you may choose leasing over purchasing your business premises. After you find the perfect location or ideal building for your business and have reached agreement on key financial terms of the deal, then the real work begins – negotiating a lease agreement with the property owner. Even a small space can come with big legal risks. Be prepared: the initial draft of the lease is typically drawn up by the landlord and will nearly always be biased in the landlord's favor. But as with any other important contract, details of commercial leases matter, and many provisions are negotiable. However, all too often, the following lease provisions are overlooked by commercial tenants.

Rent Commencement. Take a close look at the provisions regarding “commencement of rent.” Does the lease require you to pay rent starting on a fixed date whether or not the space is ready for occupancy? Commercial spaces often need to be customized for new tenants, and either you or the landlord will make the necessary changes or improvements. If the local municipality requires inspections and approvals before you are legally permitted to occupy the space, you will want to protect your business with a provision requiring completion of all renovations *and* municipal approvals *prior to commencement of rent*. If the landlord is performing the work, you should require the landlord to comply with all applicable laws and include meaningful remedies for its failure to do so.

Operating Expenses. Is the landlord permitted to charge you for operating expenses and taxes associated with the property? Be sure to negotiate exclusions for costs related to capital improvements such as the roof, building systems, structure, and parking lot. Consider adding caps on year-over-year increases for expenses that the landlord can control. Also, think about adding a provision that allows you to audit the books and records used to

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calculate the expenses you must pay. I recently reviewed a lease that allowed the landlord to charge the tenant for any expense, with no caps on year-over-year increases and the tenant had no right to audit. Do not give your landlord a blank check! If the landlord insists that you must pay for certain capital improvements, make sure those expenses will be amortized over their useful lives.

HVAC. Tenants are often responsible for maintenance and repair of the heating, ventilating and air-conditioning equipment (“HVAC”) serving the premises. However, leases may also include language requiring the tenant to replace the HVAC system when it fails – which can be very costly and unfair, especially if your lease term is short. The lease should require the landlord to be responsible for any major repair or replacement of the HVAC, while providing that the tenant only reimburse the landlord for the amortized cost of the repair or replacement on a monthly basis over the remaining lease term.

Assignment and Subletting. Make sure the lease requires the landlord to be “reasonable” in connection with any consents for assignment of the lease or subletting. If your company has many locations, you will want the flexibility to transfer your lease without the landlord’s consent when you restructure or sell your business. Leases often require the landlord’s consent for any kind of assignment or change in the control of the tenant’s business, even when it is only a stock sale. A Firm client recently purchased a company holding over 40 leases, most of which required the landlord’s consent to a sale transaction. Obtaining landlord consents can result in costly delays and place too much power in the hands of unreasonable landlords.

Environmental. If your business uses hazardous materials, make sure that your lease allows it, otherwise you might find yourself in default and subject to eviction. Most leases contain standard clauses prohibiting ALL hazardous materials on the premises. It is worth noting that common office supplies such as ink and toner for printers and copiers, cleaning products, insect repellent, paint and the like are considered hazardous materials.

Never agree to an environmental indemnity that could include environmental contamination that you did not cause. Many form leases contain such clauses. If the landlord insists on such an environmental indemnity, request a copy of a Phase I Site Assessment.

Indemnities. Imagine one of the landlord’s maintenance personnel negligently slams his truck into one of your employees while on the property you lease. When your employee rightfully sues the landlord for damages, watch out! Many form leases contain a clause requiring the tenant to broadly indemnify the landlord for “any personal injury occurring on the property.” Make sure your lease appropriately limits any indemnity so that the landlord and its employees’ and agents’ negligence, misconduct and breach of the lease are carved out from any indemnity given by you. In addition, the lease should require the landlord to indemnify you for its agents’ negligence, misconduct and breach of the lease.

Insurance/Waiver of Subrogation. Before executing any lease, provide your insurance risk manager with a copy to be sure that you can obtain the required coverage at a reasonable price. Next, make sure your lease contains a clause requiring each party’s property insurer to waive subrogation for fire or other insured casualty (even in the event of a party’s negligence). Think about it: as a tenant, your rent is paying the landlord’s insurance premium. However, if the landlord makes a claim under the policy, the insurer may file suit against you as tenant, to recoup its payout of the claim, if you or your employees are responsible. With a waiver of subrogation, the insurer agrees not to file suit against you in order to recover its losses.



Interruption of Utilities. There is not much the landlord can do about a neighborhood power outage. However, if the landlord's contractor negligently cuts the utility line to your premises, leaving you without power, you should not be required to pay rent when you cannot use your space for an extended period of time. This sounds crazy – until it happens. A clause providing for an abatement of rent if the utilities are not restored within a few days can incentivize the landlord to repair such problems quickly.

If this short list of legal issues has raised concerns for you, remember: if they were not adequately addressed in your existing lease, you can always attempt to address them upon renewal. Your lease should thoughtfully anticipate potential problems and equitably allocate risks, so that you can focus on conducting your business. Even if you have a great relationship with your landlord, your landlord may eventually sell the property. If that happens, your only protection may be that lease document.

For more information on commercial leases, please contact Brad Ader at 312/840-7137 or bader@burkelaw.com.