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Lease Landmines Can Destroy Your Bottom Line

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Since most commercial real estate leases are initially presented to a potential tenant in a “boiler plate” format, it is critically important to review each and every clause to make sure that no detail goes unnoticed so as to avoid potential landmines that could financially devastate your bottom line.

Scrutinizing the fine print of a lease under the microscope is the only way to mitigate potential dilemmas. A prospective tenant must question every ambiguous clause and negotiate all unnecessary requirements in the contract to avoid financial nightmares that could haunt a company for the duration of its lease term. The most common landmines are:

- **Operating Expenses/Audit Rights.** Never agree to pay landlord operating expenses that have no exclusions and no cap on expenses. You must always have the ability to audit all expenses that the landlord expects to be reimbursed by you. Otherwise, you might end up paying for a country club membership or replacing an old roof when you have a short-term lease that expires soon. Instead, provide a long list of carve-outs— items that cannot be added to operating expenses— and thereby minimize the increase in expenses each year.



- **Staying Beyond the Lease Term.** This clause is usually expressed as “Holdover” in the contract and sounds innocuous, but the penalty is often Double Rent. A penalty is understandable because the landlord probably needs the space back for another tenant.

The space, however, could remain vacant after your departure. Meanwhile, you’re paying double rent for no reason. Amend the clause: No new tenant, no increase in rent.

- **Relocation.** Landlords frequently want the right to relocate your company to a different space. Landlords like this option so they can accommodate major tenants that need adjacent space or the balance of your office floor. That said, you can generally eliminate this clause if you ask or amend it to your satisfaction.
- **Building Damage.** The landlord usually demands unlimited time to rebuild the premises after fire or other damage, which can be a major disaster for a tenant. What happens if the building gets heavily damaged by fire, earthquake, or hurricane and is uninhabitable? As a tenant, you’d like to set up shop someplace else to avoid customer attrition. But if you relocate, you could be liable for rent and operating expenses on

the new space and your former space. You have two tools at your disposal to protect your interests here: Limiting the time the landlord has to rebuild, and negotiating cancellation of the lease in case of major damage.

- **Non-Disturbance Clause.** This item, which addresses what happens in the event the property goes into foreclosure, is only problematic if the landlord fails to place the clause in the lease. Without this stipulation, a financial lender and new owner of a property cancel your lease. Make sure a non-disturbance provision is included in the lease agreement.
- **Missed Commencement Date.** From time-to-time, a landlord does not have the space ready when promised, but you're ready to get set up, move equipment and furnishings into the space, and open for business. You've been hiring, training, and paying new employees and managers for months. We suggest inserting a missed commencement clause in the lease that requires the landlord to give the tenant free rent for every day of delay beyond a certain period. This requirement helps the tenant mitigate the extra expenses it incurs as a result of the delay.

- **Late-Payment Penalty.** Tardiness in payment is sometimes no fault of the tenant, especially with an unreliable postal system in your area. You should negotiate a late payment clause in the lease that allows late rent once a year without penalty.
- **Lease Indemnification.** Landlords try to indemnify themselves against any possible loss or damage, but sometimes they go too far. This is where the attorneys argue about "negligence" versus "gross negligence" and other subtleties, but basically you really want to be protected from the landlord's action or inaction and that of their employees. Make sure you're comfortable with the indemnification provision in the lease.
- **Renewal Option.** This is a problem if it's not in the lease. Renewal options are customarily only provided upon request, and you should demand at least one, preferably at a set rate rather than a "market rate." You should also ask for future refurbishment of the premises at this time.
- **Automatic Renewal.** On the other hand, automatic renewal that triggers if you fail to cancel is a landmine waiting to

explode, particularly if you have unfavorable lease-renewal terms or rates. If you agree to an automatic renewal, make sure the landlord gives you notice about the renewal with a requirement that you must respond in the affirmative or negative.

- **Sublease & Assignment Rights.** Landlords like to maintain control of their property, which is fair enough; however, they sometimes go too far and retain the right to reject arbitrarily a sublease or assignment. This can adversely impact a company's plans when it wants to sell or acquire a business and has new space needs. Therefore, take the proper precautions and make sure you can live with the conditions of this clause.

Conclusion

These problems and other hidden landmines in typical commercial office leases are best defused by a professional corporate real estate advisor. If you negotiate a lease without one, you risk a landmine exploding on your bottom line.

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