Commercial Leasing: 7 Pitfalls to Avoid

Law Department Management

Real Estate

When it comes to leasing office space, even the most seasoned in-house attorneys can overlook a number of potential issues. These pitfalls can exist not only in what the lease expressly covers, but also in what the lease does *not* expressly cover. Understanding the risks tied to both expressed and unexpressed considerations can go a long way to ensuring a fair deal for your organization. Below are seven pitfalls to avoid and some tips to help you navigate potential issues.

Pitfall #1: Not having a handle on your business objectives

While nobody can predict the future, understanding the short- and long-term objectives of your organization enables you to effectively tailor your lease agreement and negotiate lease terms with built-in flexibility to suit your company's current and future needs. Not thinking carefully about your short- and long-term needs at the very early stages of the lease negotiation process can cause your organization to become bound by a lease agreement that is not adaptable to your company's future needs. Thinking ahead strategically will prevent you from having to go back to the landlord after the lease has been signed to try and amend the lease when you have no leverage left to negotiate.

The more you understand your organization's short- and long-term business goals, the more likely the finalized lease agreement will be an effective and useful tool for your company and its business vision.

Pitfall #2: Not focusing on the term sheet

Term sheets are a critical first step to conceptualizing, drafting, and negotiating a lease. In an effort to speed up the leasing process, tenants often rush through the term sheet stage of the leasing transaction, thinking this will save them time. However, negotiating a term sheet is the best way for landlords and tenants to save time and money when entering into a lease transaction. Term sheets allow landlords and tenants to approach lease transactions in stages by initially outlining the vital business issues of concern to each party while preserving enough flexibility to address other issues in the context of the specific lease agreement. Be sure to address your organization's specific rights and protections during the term sheet negotiations, and then make sure these rights and protections are expressly provided for in the term sheet in as detailed a manner as possible. Negotiating these matters upfront during the term sheet stage will not only ensure that your potential landlord is willing and able to meet your company's specific needs, but will also save you a lot of time during the drafting and negotiating of the lease agreement itself.

Pitfall #3: Letting boilerplate trump your organization’s specific needs

It is not wise to assume your company's rights and protections will be addressed adequately by the lease agreement's "boilerplate," standard provisions. Protect your organization by insisting on specifically documenting in detailed and specific language in the lease agreement, the scope of the rights, and protective mechanisms important to your company's business.

Pitfall #4: Assuming you can use the premises for all of your business activities

Read your permitted uses clause carefully and make sure it is broad enough to align with your anticipated use of the premises for your business. Landlords may want to restrict the uses permitted in your space and these restrictions may be contrary to your expectations. The scope of needed uses can vary depending on your company's business. For example, your company may act as an incubator of much smaller businesses, and you may anticipate being able to share your office space with these smaller companies. However, your permitted uses clause may in fact not permit such office sharing. If your company needs this type of office sharing flexibility, your permitted use clause should specifically permit such shared work space arrangements so that you are not obliged to seek the landlord's consent when you are hosting other businesses in your space.

Pitfall #5: Failing to account for potential future growth

Term extension and space expansion options provide flexibility for a growing business. Make it a priority to identify any potential growth your company may have during the initial lease term. Even if that growth is just a projection and not necessarily guaranteed, building in lease term and space options during the lease negotiations will save your company a lot of time, money, and potential heartache down the road.

Pitfall #6: Failing to account for a potential downturn

Sometimes things don't turn out the way you wanted despite your best intentions. If your company is unable to continue its operations at that particular location or if the company doesn't have need for all of the space leased, then your ability to assign your lease or sublease all or some of your space can be used to reduce — or eliminate altogether — your on-going monthly lease obligations. This flexibility can be gained by negotiating tenant favorable language in the assignment and subletting clause of your lease.

Generally, a landlord will not want to allow the tenant to freely assign its lease or sublease all or part of its space without the landlord's prior written consent. However, there are ways to negotiate the clause to ensure that the landlord is required to adhere to reasonable standards when assessing whether or not to grant its consent to your assignment or subleasing request.

The assignment and subletting clause should be negotiated in conjunction with the permitted use clause to ensure that permitted uses for the premises are as broad as possible so that your space can be used by a broad array of viable candidate businesses. A more generic and broad use clause will allow you to more freely assign the lease or sublease the space without too many restrictive use limitations

These exit strategies can help your company efficiently eliminate costly rental payments for space that is no longer necessary for the business.

Pitfall #7: Glossing over proportionate share

Entering into a lease agreement is a monthly cost for your company. Beyond paying basic monthly rent, there are often additional costs incurred in connection with leased space, such as cleaning and maintenance costs, real estate taxes, and insurance premiums. Understanding how to negotiate the lease provisions covering operating costs and expenses can affect your monthly payments owed to the landlord, and can be very impactful and real on your company's bottom line. There are various negotiation tactics to make sure you are not being overcharged.

When there are many tenants occupying a building, it is common for the landlord to pass through to each of its tenants its proportionate share of certain costs as operating expenses. The proportionate share is usually equal to the percentage of the square footage of the leased premises the tenant occupies as compared to the total square footage of the entire building.

It is important to ensure that the landlord's determination of your company's proportionate share is accurate. Before signing the lease, you can have the space measured to feel comfortable with the landlord's determination of the proportionate share your organization will be responsible for paying while occupying the space. If the lease is signed before the space is improved and there is a significant build-out, try to negotiate for the right to have the premises re-measured by an architect after the build-out is complete. You can try to negotiate for the right to modify the tenant's proportionate share after the alterations are completed. This will ensure for a fair (post-lease signing) determination of the size of the space after all of the work has been completed. However, be aware that after the build-out, while your company's proportionate share may go down, it may also go up.

The continuing costs of an office lease can affect a company's bottom line. Using the above tips and carefully assessing risks, allocating costs, and keeping up-to-date on the latest legal and regulatory changes using resources that are updated regularly can help you avoid these pitfalls and achieve cost savings, provide for flexibility, and protect the tenant from unwarranted risks and intervening third party interests.

For more information on negotiating lease agreements, access the Practical Law Office Leasing Toolkit*.*

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Thomson Reuters Practical Law is an online provider of legal resources designed to help lawyers work more effectively. Previously she was associate general counsel at New York Life Insurance Company and assistant general counsel at Metropolitan Life Insurance Company.