

Tips for successfully navigating a commercial lease

At some point in time a business owner will want to open an additional location, sell, and/or transfer his or her business. It

GUEST VIEW



Kathryn J. Scarmato

is important to recognize that no matter what stage you find yourself in, typically the biggest financial decision and obligation you will make is entering into a commercial lease or purchasing a building from which to operate.

Most businesses choose to rent instead of buying since it requires less capital. Before signing a commercial lease, renewing or extending a lease, it is important to understand the lease terms that define the rights and responsibilities of each party.

First and foremost, I highly recommend you use a qualified, business intermediary/broker, commercial real estate agent and/or, at the least, have a seasoned real estate attorney review the lease or any extensions or amendments before you sign on the dotted line. Secondly, when you do sign, work with your representatives to prevent you and any of your business associates from personally

guaranteeing the performance of the lease. You will thank me later.

Commercial lease agreements can be complicated as the terms are negotiable and vary greatly from lease to lease. Excessive lease payments can bleed the life from your business. An affordable lease should not exceed 6 to 8 percent of total sales. For example, if your business generates a \$1,000,000 in sales your lease should ideally be \$60,000 per year or \$5,000 per month. Additional lease expenses such as common area maintenance (CAM) utilities, property taxes, insurance should not exceed a combined maximum of 9 percent of sales.

Some of the key items you will want to look for and negotiate ahead of time are the following:

Lease Term: The shorter term, with the option to extend (pre-negotiated) is much more advantageous for the renter; it provides flexibility and additional options in the case of needing more / less space, relocating, assignment and/or closing.

Rent increases: Commercial lease agreements will usually provide for an annual percentage-based rent increase based upon the consumer price index (CPI). Have your reps negotiate on your behalf with the landlord for a cap on the

percent increase in order to avoid unmanageable rental costs down the road.

Security deposit: The lease should verify the amount of the security deposit, if it is to be held in an interest bearing account (recommended), who pays for the cost of the account as well as the terms regarding its return and any offsets, i.e. the premises must be in "swept clean" condition. When you transfer or assign the lease or when you sell the business, make sure your lease deposit is returned, the conditions are met and the assignee pays the security amount moving forward so you are not held responsible for any future liabilities.

Tenant Improvements: A lease should address what improvements or modifications can be made to the property, which party will pay for the improvements, and whether the tenant is responsible for returning the unit to its original condition at the end of the tenancy.

Use clause: Many lease agreements will incorporate a use clause to define the activity the tenant can engage in on the premises. These clauses are in place to protect the property from damage and limit the liability of the property owner. If possible, ask for a broad usage clause just in case the business expands into other

activities.

Assigning and subletting: Ask the landlord for the right to assign the lease or sublet the space to another tenant. This is an important term since the tenant is still responsible for paying the rent if the business fails or relocates, however, with an assignment or sublet clause in place, the business can find someone else to cover the rent.

Next month look for continued coverage of commercial real estate with regard to the advantages of a "Sale-and-Leaseback" consideration for those business owners who own their building and are seeking to free up cash.

Kathryn J. Scarmato is Managing Director of Ascend Capital Group a boutique M&A firm that specializes in the confidential sale and acquisition of companies and the related real estate as well as providing certified business valuations of companies with values up to \$40M. With over 425 successful transactions to date, Kathryn is a specialist with over 27 years of expertise. She has a BS from USC in Entrepreneurship & Venture Management, is a licensed CA real estate agent and a certified business mediator. You can reach Kathryn confidentially at (541) 633-6790 or email her at Kathryn@AscendCapitalGroup.com