OFFICE *LEASING* ISSUES

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If your practice has outgrown its current space or you have decided that you want to relocate to another building for one reason or another, or you are opening an additional office location...for whatever reason you must lease space for your business. What do you do?

The first thing you should do is find a good commercial broker who works for tenants only and who has a concentration is medical office space. A good tenant broker will show you alternative spaces that are available, provide you with comparable rents for similar buildings and also explain to you, for example, what the impact on rent will be if the landlord pays for or contributes to the cost of your tenant improvements. The broker will work with the landlord's broker to prepare a letter of intent or term sheet outlining various business terms on which the final lease will be based. Then you will most likely be presented with the landlord's "standard form" lease. That does not mean, however, that you should blindly accept the landlord's "standard form" lease. There are many lease provisions that should be understood and considered by you prior to signing a lease for what will be at least a five year term, and perhaps even ten years. Your broker will review the lease and will or should recommend that you also have an attorney review it.

As mentioned above, the length of the initial term will be somewhat determined by how much the landlord is willing to give you for tenant improvements. The more the landlord pays, the longer the term the landlord will want. A shorter term, perhaps five years, with one or two renewal options is better for you since if there is an unforeseen default, you (and perhaps any guarantors of the lease) would not be liable to the landlord for as much in damages. On the other hand, unless the rental rate for the renewal term(s) is specified in the lease, a longer term with fixed rent increases ensures that you know what your rental cost will be over the years and you can plan accordingly.

Generally, in addition to paying base rent, you will be required to pay your proportionate share of real estate taxes and common area maintenance ("CAM") expenses. Sometimes the real estate taxes and CAM expenses will be included in the base rent for the first year of the lease term, in which case your share of CAM expenses and real estate taxes for subsequent years will be based on the increases in those amounts over the amount that was in effect during the first year of the lease. In other cases, real estate taxes and CAM expenses are not included in the first year's rent, and each year you will be assessed your proportionate share of those expenses. It is important that while you are getting information about base rent, you also ask for historical real estate and CAM expense information so you will have an idea of what your actual monthly cost will be. Also, it is important to have the definition of what constitutes CAM expenses reviewed and negotiated. For example, some landlords try to include capital costs as CAM expenses, and that should be negotiated away or at least modified. Also, if you are leasing a large space, you may be able to negotiate a cap on controllable CAM expenses, such as snow removal, cleaning service, management fees, accounting fees, etc. If a base year is used to calculate the real estate tax and CAM expense pass-through, it is also important that if the lease provides for renewal terms, the base year for taxes and CAM expenses for the first year of the renewal term be brought forward to the real estate taxes and CAM expenses for the first year of the renewal term, particularly if base rent is established as the then existing fair market rental value of the premises.

If the base rent for renewal periods is to be established using a calculation intended to determine the then fair market rental rates for similar premises, an attempt should be made to remove a provision that the base rent for the first year of a renewal term will not be lower than the rent payable during the last year of the initial term. The market rates may have declined significantly. This issue could be somewhat alleviated if, prior to formally exercising the renewal option, discussions are had with the landlord (and maybe your broker) about extending on terms that differ from what is written in the lease. If those discussions are successful, you would not be faced with either having to exercise an option that might not make economic sense or having to relocate your office when the then current lease term expires.

If the landlord will be contributing toward the cost of tenant improvements and assuming you will be in charge of having that work done, the lease must contain a reasonable method for disbursement of the tenant improvement monies. Some landlords will initially draft a lease such that the full amount of the tenant improvement allowance only gets paid after the work is complete. Obviously, if the tenant improvement work is costly, that could be a financial strain on your business. It is better to negotiate periodic disbursements as the work progresses.

For alterations, improvements, redecoration, etc. to the premises subsequent to the completion of the initial tenant improvements, two things should be considered. First, a request should be made for a provision enabling you to do this later work without requiring prior landlord approval provided it does not involve any structural work, require a building permit, or cost more than a stated amount. Second, leases prepared by landlords typically contain a provision allowing the landlord to require that all alterations, improvements, etc. be removed at the expiration of the term of the lease. This can be costly, and it is important to negotiate a provision at the inception of the lease that none of the initial tenant improvements must be removed and that if consent must be obtained for subsequent improvements, alterations, etc., the landlord must tell you at that time whether the improvements, alterations, etc. must be removed at the end of the lease term. Knowing that in advance, may impact upon your decision to do that work.

Subleasing and assignment provisions are also subject to negotiation. Sometimes a landlord will want the ability to withhold consent to subleasing all or part of the space or assigning the lease in its sole and absolute discretion. If your circumstances change, for example, there is a decline in business that is expected to be long-term, you may not need the entirety of the space any longer and would like to sublease part of the premises. Or, you may have been forced into taking more space than needed because the landlord would have difficulty leasing a small amount of space to another tenant. Another scenario, particularly applicable to medical practices, is that doctors like to share space on certain days and/or for various hours of each day. If you know in advance that one of the latter two situations (or some other situation) may apply to you, the landlord's consent to certain specific subleasing situations should be negotiated at the inception of the lease. If you desire to sublease the entire space or to assign the lease, that generally means that you do not want to be in the space any longer. The landlord should still be reasonable, and a provision allowing the landlord to take back the space may be warranted. If none of the situations described above is applicable or desirable, the landlord should at least allow subleasing of the space or an assignment of the lease with consent, not to be unreasonably withheld. Another potential pitfall in the subleasing and assignment provision is that the language may say that the use of the premises may not change from the use specified in the lease for your business. For example, if you are a medical practice and your use provision specifies "for the practice of orthopaedics" and you want to sublease space or assign the lease to a gynecologist, the landlord may use that as a basis to deny your request.

Continued on page 15

Continued from page 14

In the event the premises or the building of which the premises are a part is damaged by fire or other casualty, many leases require the landlord to restore or rebuild the premises or the building, as applicable. However, there is generally no time period within which that repair or restoration must be completed. Landlords usually will accept additional language which allows you to terminate the lease if the landlord has commenced the repair or restoration but has not completed it within a specified time period (like, 180 days). That way you can begin to find substitute premises within which to conduct your business within a reasonable time period.

It almost goes without saying that grace and cure periods should be requested in the unlikely event of default. Notice is usually agreeable for non-monetary defaults, and sometimes notice can be negotiated for monetary defaults, although some landlords will only agree to give one or two notices of monetary defaults in any year.

If you are leasing a large amount of space within the building, a Subordination, Non-Disturbance and Attornment Agreement (SNDA) should be requested. The lease will contain a provision making the lease subordinate to any financing given to the landlord which is secured by the building in which the premises are located. Without an SNDA, if the landlord defaults on its mortgage and the landlord's lender forecloses, the landlord's lender could terminate your lease. An SNDA is an agreement between a tenant and a landlord's lender that allows you to retain possession of the premises provided you are not in default under the lease.

Most "standard" leases will contain a provision pursuant to which the rent doubles if the premises are not vacated at the end of the lease term. At the very least, a reduction to 150% should be negotiated; and, in addition, a provision should be added that the increase rent does not apply if at the end of the lease term, you and the landlord are negotiating in good faith for an extension.

If the space you are leasing is small in relation to other spaces in the building, the landlord may include in the "standard" lease a right to relocate you if a larger tenant on your floor or in the building needs more space, or if a new tenant wants to lease vacant space adjacent to yours, but that vacant space is not large enough. If the right to relocate cannot be deleted from the lease, at the very least, the landlord should agree to absorb all costs of moving you to comparable space in the building. This would include, for example, revising and reprinting all stationery products to change your suite number, relocating and moving all telephone and computer equipment, redecoration and/or renovation of the new space so that it is comparable to the existing space, and all moving expenses. Many landlords try to limit their costs to just moving expenses, but there are many other costs incurred with a relocation. Also, provisions should be added to ensure that even if the new space is a little larger than the existing space, the rent will remain the same, and that the physical relocation will take place on a weekend so your business is not unduly disrupted.

If you think your business may expand, you may want to consider requesting a first right of refusal to take more space either adjacent to your premises, on the same floor as your premises, or even elsewhere in the building.

A landlord may want the principals of your business to personally guarantee the lease, and, unless you have been in business for a long time and have a verifiable record of not having been in default in the past, eliminating a personal guaranty may be difficult. Sometimes, however, the duration of the guaranty can be limited (for example, assuming there has been no default, it is only effective for three to five years, depending on the length of the term of the lease, or perhaps, it can be limited to a specific dollar amount rather than, for example, all of the rent that would be due for the remaining term of the lease). Depending upon the relationship of the guarantor to the tenant, a guarantor may also want to request that he or she be given a longer time to cure a default than that given to the tenant in the lease.

The foregoing are only some of the areas that an attorney familiar with tenant leasing matters can attempt to negotiate. As you can see, if the attorney is successful, you will have a less onerous document governing your office leasing than might be the case without an attorney. The legal fees expended in such a review, including revisions to the proposed lease, will be money well spent. ■