10 QUESTIONS You Need to Ask About Your LEASE

By Thad Armstrong

In the world of commercial transactions, the lease agreement is the Rodney Dangerfield of contracts: it gets no respect.

A lease typically starts with a written term sheet or letter of intent in which the landlord and the tenant agree on the basic terms of the deal—the space, the rent, and the length of the term. These basic terms are then incorporated into the lease agreement, which is often quickly signed with little, if any, negotiation. This is a mistake. Lease agreements deserve more attention. Rarely will a company encounter another contract that will govern its legal rights and obligations for five, 10, or (with extensions) 15 to 20 years.

FIRST THINGS FIRST

The first key to protecting yourself in a lease is the agreement itself. Texas is a landlord-friendly state in the context of a commercial lease, offering very little protection to commercial tenants. You, as a tenant, must be able to rely on the strength of your lease agreement.

The following 10 questions will help you focus on some of the important issues in your lease agreement. This is not a complete list, but it will give you a good starting point from which to negotiate a more favorable agreement.

1. When Am I Required to Start Paying Rent?

Most leases require the tenant to start paying rent on a fixed date or upon the expiration of a period of time after the lease is signed. A tenant should avoid any circumstance that could result in the tenant being required to pay rent prior to the date on which the space is ready for the tenant's occupancy. A few factors could lead to such a circumstance. If, for instance, the landlord is responsible for preparing the space for the tenant's occupancy (e.g., a "turn-key" lease), the tenant should not be required to pay rent prior to the date that the landlord has completed the improvements to the space.

2. Other Than Rent, What Else Do I Have to Pay?

Most leases require the tenant to pay a proportionate share of the landlord's taxes, insurance, and costs to operate the property. The tenant's focus should be on the actual components of each category of expenses that the tenant will be required to pay. Certain components should be excluded. For example, the tenant should not pay for the landlord's income taxes (as opposed to property taxes), and the tenant should not pay for certain capital expenses incurred by the landlord. Dozens of costs are customarily excluded from leases.

3. What if the Landlord Doesn't Have My Space Ready When I Need It?

Tenants are rarely given the right to cancel a lease—no matter the reason. This stricture can be particularly punitive in the case of delayed possession. Most business owners lease new space because they have an immediate need for it. Rarely does a business have the luxury of indefinitely waiting on a new space. Delays in possession could result from several situations. A prior tenant could hold over beyond its expiration date. A landlord could cause unreasonable delays in making the new space ready for the tenant's occupancy. To protect itself under these scenarios, the tenant should negotiate the right to cancel the lease if the landlord is unable to deliver possession of the space by an outside date.

4. How Are My Tenant Improvements Built and Paid For?

Most leases contemplate the construction of improvements to make the space ready for the tenant's occupancy. The lease should clearly allocate responsibility for the initial improvements in two respects: (1) responsibility for the actual construction; and (2) responsibility for paying for it. If the landlord is responsible for the construction and is providing a monetary allowance (rather than completing the improvements on a "turn-key" basis), then the tenant must place tight controls on costs. In this scenario, the tenant should have the right to approve pricing before construction starts, as well as the right to approve subsequent change orders. Otherwise, the tenant could face liability for cost overruns that the tenant could not control.

5. What if My Roof Leaks? What if Building Services Go Out?

The lease should clearly allocate responsibility between the landlord and the tenant in two respects: (1) maintenance; and (2) building services (e.g., utilities, air conditioning, elevator service). With regard to maintenance,

in most multi-tenant properties the tenant should be responsible for non-structural interior items; structural items, building mechanical systems, and common areas should be allocated to the landlord's responsibility. With regard to building services, the lease should clearly describe the services to be provided to the tenant and at what cost. Tenants with good bargaining positions should also negotiate for special rights (e.g., an abatement of rent) during the interruption of essential services that result in the space being unusable for the tenant's business purposes.

6. What Happens if I Don't Pay My Rent?

Leases typically give the landlord the following remedies when a tenant defaults: the right to lock the doors; the right to permanently evict the tenant; the right to terminate the lease; and the right to sue the tenant for damages. These measures are harsh, and most leases allow the landlord to take them without first giving the tenant notice of the default and the opportunity to cure it. The tenant should therefore incorporate a notice-and-cure clause into the lease. The tenant should also pay careful attention to the amount it will owe the landlord after a default. The landlord should be allowed to recover lost rent, but many leases overreach and permit the landlord to sue the tenant for other damages that are out of the tenant's control.

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7. What Am I Liable for Under My Personal Guaranty?

The answer to this question is "probably everything." To soften the blow of personal liability, the guarantor should attempt to limit the guaranty in two respects: time and amount. With regard to time, the guarantor may be able to limit the guaranty so that it expires after a specific period of time. With regard to amount, the guarantor may be able to limit the guaranty to a specific amount of money. Many guarantees contain a hybrid of these two limitations that is commonly referred to as a "burn-off" clause. A burn-off clause in a guaranty reduces the guarantor's liability over time until it equals zero.

8. What if an Employee or Customer Slips and Falls in the Common Area?

The answer to this question goes straight to the indemnity clause. Indemnities unfortunately can be complicated and complex. One good solution for a tenant is to propose a fair, simple indemnity that allocates risk based on two factors: place and fault. In other words, the risk of injuries inside the premises is allocated to the tenant and the risk of injuries outside the premises is allocated to the landlord, unless the injury was the fault of either the landlord or the tenant, in which case the at-fault party would bear liability.

9. What if a Fire or Hurricane Damages the Property?

The lease should clearly describe the landlord's obligations and the tenant's rights following fire or hurricane damage. The landlord should, at a minimum, be obligated to restore the structure and shell of the building. But

the tenant should pay careful attention to which party is obligated to restore the tenant's improvements. If the landlord is not required to restore the tenant's improvements, the tenant must carry sufficient insurance to cover the restoration. The lease should also answer the question of whether the tenant is required to pay rent during restoration. The lease should allow the rent to be abated until the restoration is complete. The tenant should also focus on the issue of business interruption and ask itself the following question: How long can I afford to be without space? If restoring the damage will take or does take more time than the tenant can afford, the tenant may need the right to terminate the lease.

10. What if the Landlord's Bank Forecloses on the Property?

Under general Texas law, the lease might be wiped out following a foreclosure. A prudent tenant will require the landlord to provide an agreement, commonly referred to as an "SNDA," from the landlord's bank to prevent this from happening. An SNDA—which stands for Subordination, Non-Disturbance, and Attornment—is an agreement between the tenant and the landlord's bank that, in its most basic form, will cover three things: (1) the tenant's agreement to subordinate the lease to the bank's lien; (2) the bank's agreement not to disturb the tenant's possession of the space after a foreclosure; and (3) the tenant's agreement to recognize the bank as the tenant's landlord after a foreclosure. N

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