

Leasing: It's in the details

Why you should involve an attorney when leasing real estate

Costs and expenses associated with real estate leases often account for a significant portion of a business' overhead. Many business owners do not pay attention to the terms of a lease, other than the amount of rent and the length of the term, and may be surprised when required to pay unexpected expenses associated with the lease. Having an attorney experienced in leasing assist an owner from the outset will help avoid these surprises and other pitfalls. An experienced attorney will help level the playing field with a sophisticated landlord.

"It's best to engage an attorney from the very beginning of the leasing process," says Craig Chernoff, a member at Semanoff Ormsby Greenberg & Torchia, LLC. "Business owners typically do not deal with leases on a regular basis. Attorneys experienced with leasing do this work frequently, and are aware of the pitfalls."

Smart Business spoke with Chernoff about the importance of having an attorney assist in the leasing process.

Why have an attorney review your real estate lease?

Many business owners will sign a lease presented to them without having an attorney review it. Many do not even read the lease, thinking 'Oh, it is only \$5,000 per month, and it is just a form.' This is a serious mistake.

The proper way to view a lease is to approach it as an investment. For example, a \$5,000 per month lease for a term of 10 years is a \$600,000 investment. This is significant. Perhaps even more so than constructing a \$1 million building, which will have significant residual value. Also, the lease is not just a \$5,000 per month expense.

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There will likely be rent increases each year. The lease may also be a triple net lease, meaning a tenant will pay its share of operating expenses, taxes and insurance. These expenses will be significant, and there are many pitfalls.

What are some of the pitfalls associated with a triple net lease?

Hidden expenses are a major pitfall of a triple net lease. The most common are included as operating expenses. Leases may broadly define operating expenses, which may cause a tenant to incur significant, unexpected expenses. Having an attorney negotiate the lease could help limit these expenses.

At a minimum, the business owner will know what expenses may be imposed upon the business. For example, assume a tenant is responsible for 20 percent of operating expenses, and operating expenses include replacements. Now assume the roof is destroyed in the final year of the lease and the replacement cost is \$1 million. While tenant will only benefit from the new roof for a few months, tenant will be responsible to pay \$200,000 or 20 percent of a new 20-year roof. This is unreasonable, but it is what many form leases provide. An experienced attorney will recognize this issue and will limit these, and other, expenses.

Can the business owner be personally liable under the lease?

If the business is an entity, its owner is not personally liable if the entity is the tenant. However, many landlords will require the owner to sign a lease guarantee, whereby the owner guarantees all of the business' obligations under the lease. If the business defaults under the lease, the landlord may pursue the business and the owner individually.

While the provision of a guarantee is not uncommon, there are instances when providing a guarantee is not appropriate, such as when a business is financially strong, and there are instances when the owner's obligations under a guarantee may be limited. This should be negotiated at the letter of intent stage. An experienced attorney will suggest various methods to eliminate or limit a guarantee.

At what point in the leasing process should a business owner engage an attorney?

A business owner is best served by engaging an attorney prior to negotiating the term sheet. An experienced attorney will know what is common and what is not. The earlier an attorney is involved, the more level the playing field will be for the business and the business may save money and heartache in the future. ●