

Commercial Leases

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Commercial leases can be very intimidating. They tend to be long, contain small print, and include terms which can be confusing. While there is no such thing as a standard commercial lease, there are provisions and concepts which are relatively common.

Unlike residential leases, prices for commercial property are not usually expressed as a monthly amount. Instead, costs are expressed as a dollar amount per square foot. In order to determine your monthly rent, you need to multiply the price per square foot times the total square footage and divide by twelve. For example, if your space will be 2500 square feet, and the price is \$13.50 per square foot, your monthly rent will be $\$13.50 \times 2500 = \$33,750 / 12 = \$2812.50$. Typically, the lease will list a price for the first year, usually called Base Rent. Rent will then escalate or increase in each additional year.

It would be nice to think that the calculations end here, but they usually don't. Many commercial leases contain clauses for CAM charges or Common Area Maintenance charges. These are particularly likely in leases for retail locations such as malls, but can also be found in office leases as well. The property agent (landlord's representative) should be able to tell you what the CAM charges have been for the past few years. These costs should be added to your monthly rent when considering your budget.

In addition, many leases contain what are sometimes called pass throughs. These are costs to the landlord that are passed on to you as the tenant such as: property taxes and utilities. Very often they are addressed in the lease as Additional Rent. Once again, the property agent should be able to tell you what these expenses have been in the past and they should also be considered as part of your budget.

Think you're through? Not quite yet. Many commercial leases also contain a clause for Percentage Rent. These provisions require that you provide the landlord with a copy of your sales figures every quarter or year. Additional rent is owed if your sales exceed a certain dollar amount. The rent is calculated as percentage, such as: 5% of all gross sales (excluding sales taxes) over \$250,000.00. So, if your gross sales, excluding sales taxes were \$350,000.00 for the year, you would owe an additional \$5000.00 for the year ($\$350,000 - \$250,000 = \$100,000 \times .05 = \$5,000$). Often you can negotiate these provisions out of a lease or set the minimum gross sales figure high enough that you are unlikely to owe additional percentage rent.

Now that you understand basic commercial rent structure, you need to understand the term or length of the lease. Most leases contain an Initial Term of a minimum of three (3) years and at least one Option for an additional three (3) year period. Some leases will contain more than one Option and prices will vary substantially. It is difficult to determine what Initial Term length is best for any business. However, for more established businesses, longer Initial Terms are usually better. For start-up businesses, shorter Initial Terms decrease risk, but tend to lead to greater expense for the Option periods. Be sure to consider your situation carefully to determine what is best for you.

Another distinctive feature in a commercial lease is how responsibilities are divided between the landlord and tenant. In residential leases, the tenant pays rent and if something goes wrong, he calls the landlord. In many commercial leases, the tenant is responsible for everything from the inside of the outside wall, in. Think of a store with brick walls. The landlord's responsibility ends at the brick. The roof and foundation are typically the landlord's responsibility, but electrical, plumbing, heating, air conditioning systems and anything else in the walls are the tenant's problem. Be sure to have a licensed plumber, electrician, or other systems specialist inspect the property before you lease the space. You can sometimes negotiate a clause which states that occupancy is contingent upon an inspector's report that the systems have a life expectancy at least as long as the initial term. If any problems do arise after occupancy begins, be sure to notify the landlord in writing. Mailing notices by certified mail, return receipt requested is always a good idea.

One of the most negotiable provisions in a commercial lease deals with credits to the tenant for initial construction, often called Build Outs. These provisions state that the landlord will pay or credit a certain dollar amount towards the initial construction. Don't expect the landlord to pay for everything, but usually a substantial dollar amount will be covered.

Finally, almost every landlord will require a personal guarantee. Sometimes, you can limit the guarantee for a period of time, such as the Initial Term or up to a certain dollar amount. Regardless, unlike a residential lease, your obligation for a commercial lease continues for the entire Initial Term even if you are evicted. The most important thing to remember is that once you sign a lease, you are obligated to its terms whether you have read them or not. If you are not familiar with commercial leases, you may want to consider being represented by a commercial real estate agent or attorney. And, it is always best to have any lease agreement reviewed by an attorney before you sign.

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