



Five Vital Clauses Fast-Growth Entrepreneurs MUST Have In Their Office Lease



Introduction

Many industries today are ripe for major disruption and more than ever, a company's growth plans and risk assessment must include the liability they take on when they commit to a workspace. They must strive to keep things flexible enough to roll with the punches.

Unlike traditional businesses of yesterday which had slow, predictable growth rates, today's entrepreneurs are faced with accelerating technological changes and changes to the marketplace. They need physical space and lease terms which are flexible, and which allow their companies to grow quickly, relocate, fail, adjust their business model, acquire another company or BE acquired. The horizon for predicting future events has become very short indeed!

While this modern phenomenon is becoming more obvious every day as yet another start-up throws another established and formerly-successful business model into disarray, the traditional commercial real estate business and finance model has **not kept up**.

Five Vital Clauses

Following are five Lease Terms which today's company founders can use to avoid being hamstrung by obsolete work-space lease terms:

1) **FLEXIBLE LENGTH** – Today's start-ups don't know how much space they are going to need in a year, never mind the typical three or five years most Landlords typically demand. Using shorter terms with several lease-renewal options, the tenant can better fit the growth needs of the company and move more frequently if need be. Sure, most Landlords are disappointed with shorter leases, and some circumstances make it difficult, but done right, it is still very do-able. Business owners need to value flexibility as a significant asset, and seek facilities they can use pretty much "as-is", so the Landlord doesn't have to invest a lot of money into interior improvements, and can therefore afford to do shorter leases.

The following sample of lease language is used for illustrative purposes only. Please have your attorney review and amend said language prior to using:

Tenant may renew this ___ year lease for ___ additional term(s) of ___ years, provided Tenant gives notice to Landlord of intention to renew no later than ninety days preceding expiration of the original term or any extension term. Rent for the renewal term shall be \$___ per month, for months ___ thru ___ during the first extension, and \$___ per month, for months ___ thru ___ during the second extension.

2) **LEASE TERMINATION CLAUSE** – Start-up entrepreneurs can also build in an option to walk away from the space and go elsewhere if the situation requires. Called a “kick-out” clause by industry insiders, this clause is usually tied to specific occurrences, time frames and penalties so it’s fair to both sides. Assuming a five-year lease, a typical example would be to allow the termination anytime after the 30th month for no reason or various reasons such as: if sales do not hit a certain target, or funding is not obtained, etc. Tenant should also give the landlord ____ month’s advance notice and reimburse the landlord for unamortized lease expenses including tenant-improvement dollars contributed by Landlord, leasing fees and legal fees.

The following sample of lease language is used for illustrative purposes only. Please have your attorney review and amend said language prior to using:

Provided Tenant is not in default of this Lease, Tenant shall have the option to terminate this Lease after the ____th month of the lease, under the following circumstances (pick the most appropriate reason):

- a) Tenant has not achieved ____ in average Gross Sales per month at this location, or
- b) Tenant has not achieved a long-term contract for business in excess of \$____ per month, or
- c) Tenant’s business experiences a decline in business of over ____% from the previous quarter’s sales, or
- d) Tenant merges with another company.

In order to exercise Tenant’s option to terminate, Tenant must give Landlord ____ months written notice, and in addition, pay Landlord a penalty equal to the remaining un-amortized leasing fees and tenant improvement contribution paid by Landlord at the inception of this Lease.

3) **EXPANSION CLAUSE** – Another way today’s entrepreneurs build flexibility into their lease is to obtain a right to increase the size of their space if requirements dictate. This is fairly palatable with many Landlords as getting a bigger tenant with an extended term is always a good thing, and is fairly practicable too when the overall facility is large enough to absorb this type of requirement. Typical expansion-clause terms provide that the length of the new lease gets extended beyond the term remaining in the original lease. In some cases, the expansion clause is written with specific (adjacent) space in mind, and a window of time in which the tenant can expand. The Landlord then agrees not to rent that space to another tenant for a period that goes beyond your right to expand into it.

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FIRST RIGHT OF REFUSAL FOR CONTIGUOUS SPACE

Subject to rights already in place with other tenants in the building, Tenant shall be granted a right of first refusal to lease throughout the Term, any space which becomes available for lease contiguous to the

Premises. If this option is exercised, the Rental Rate and term shall be coterminous with the existing lease and the tenant improvement allowance shall be proportionate to what Tenant was originally provided.

TERMINATION PROVISION

Provided that Tenant is not currently in default of this Lease, Tenant may cancel this lease under the following circumstances:

a) LACK OF EXPANSION SPACE- Should Tenant out-grow the space and require more space to operate adequately, Landlord may either i) facilitate an expansion of Tenant's existing space, or ii) relocate Tenant into larger space on-site. In either case, the terms of the current lease (rental rate, lease expiration and renewal options shall transfer to the new lease) or, iii) if Landlord does not have adequate or acceptable space available, Landlord shall allow a termination of the lease;

b) DRAMATIC BUSINESS CONTRACTION – If Tenant's business decreases by more than ____% in any quarter, Landlord shall allow a termination of the lease;

Notices to Landlord: In either case A or B above, Tenant shall give Landlord ____ days advance notice in writing.

Termination Penalty: In either case above no penalty shall be due from Tenant if termination is effected after the ____ year of lease term. If termination is effected during the ____ year of lease term, Tenant shall pay Landlord a penalty equal to the remaining un-amortized portion of the leasing fees and any tenant improvement contribution paid by Landlord at the inception of this Lease.

4) **LIMITED PERSONAL GUARANTY** - Founders shouldn't be hamstrung by financial obligations that aren't absolutely necessary and which could complicate future choices and options. By choosing space where the Landlord doesn't have to invest a lot of funds making interior improvements to your unique specifications, company owners should not have to personally guaranty leases. Or if they DO personally guaranty a lease, the guaranty should expire at some point or have a limit to the financial exposure. We see leases where the personal guaranty - if needed – expires after the second year of a five-year lease, or the maximum dollar amount of guaranty is fixed at the amount of the landlord's cost of doing the deal (remodeling costs, legal and brokerage fees, etc.) Also common in the industry is an "evergreen lease guaranty", where the guarantor is always obligated for 12 months of term, which is way better than the full remaining term.

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Provided Tenant is not in default of the lease, this Guaranty shall expire after the ____ month of the lease term.

5) **LIBERAL ASSIGNMENT PROVISIONS** - Another issue to which fast-growing company owners need to pay attention is the lease assignment provision. Usually buried in the “boiler plate” of leases and often overlooked, it’s terms can become vital to fast growing companies that have fast growing evaluations. Thinking of selling your company? Most standard assignment clauses prevent an assignment of the lease without landlord’s approval and negotiation, so a company can’t sell to another entity and assign the lease to them without getting the landlord involved, who then may want to renegotiate everything to the Tenant’s detriment. You can’t cancel the lease and sell the company, but you can’t assign the lease and sell the company either! We have seen lease assignment fees as high as \$30,000, and perhaps even worse, another lease had language that gave the Landlord the option to terminate the lease if the Tenant even requested an assignment!

The following sample of lease language is used for illustrative purposes only. Please have your attorney review and amend said language prior to using:

Consent for Assignment and Subletting shall not be unreasonably withheld. Tenant shall have the right to assign or sublet all or any portion of the space to any person or entity which a) Has assets equal to or greater than Tenant, and b) Which use shall not violate any other Tenant’s exclusive use rights, zoning laws, or Landlord’s targeted Tenant mix. Landlord’s consent to same shall not be unreasonably withheld, conditioned or delayed. Tenant shall present all necessary documents to the Landlord for approval, at which time Landlord shall have fifteen (15) days to give consent, or an explanation as to why consent is withheld.

No consent will be required in the event the assignment or sublease is to a wholly owned subsidiary, or a newly acquired parent company, of tenant, nor shall it be considered an Assignment, and therefore not applicable to any recapture rights the Landlord may impose, or affect the rights to any concessions the Landlord has offered.

Do landlords like doing business in a new way? Of course not, but if given a choice between renting the space or leaving it vacant, they have to seriously consider it. Negotiation success also depends on the strength and prestige of the tenant, and the other terms of the lease. Just remember: With all the massive industry disruption going on, the modern world is not business as usual: If you need to pivot, or provide a new service and need to hire more people, your company’s growth should not be slowed because of the limited space you are in.

This article is adapted from the “Flexible Leasing” article by Craig Melby, originally published in Capital At Play magazine, April 2016.

Looking for a facility or have questions about YOUR lease? Feel free to contact us:

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