



Fast-Growth Entrepreneurs: Five Uncommon Clauses You Need In Your Office Lease

By Craig Melby, CCIM



Introduction

You're an entrepreneur so you see it every day and can feel it in your bones: Businesses today are being disrupted at a massive pace. Every day another unexpected technology OR development takes some business from boom to bust . . . or vice versa! Your financial future and responsibility to your investors require you to prepare as best you can, and keep your business obligations as small and flexible as possible – so you can roll with the punches.

Hi. I'm Craig Melby. Lease Negotiator. Site Selector. I've been helping companies select the best workspaces and negotiate the best leases for 35 years. (I know: that's before many of you were born and yes I feel like an old guy, but hey, think of all that experience I have to share!)

Unlike the traditional businesses I used to work with which had slow, predictable growth rates, my entrepreneur clients of today are faced with accelerating technological changes in their industries, and changes to the marketplace. While you may have started out in a virtual or co-working space or your friend's garage, at some point you'll grow to a point where you'll need physical workspace where the team can meet and brainstorm on a regular basis. When you do, you'll need lease terms that are flexible, so your company can grow quickly, pivot, relocate, fail, acquire another company or BE acquired. Your horizon for predicting future events is very short indeed!

Here's the problem you have, which we'll solve: While this modern speed-of-change phenomenon has become obvious to you and me, traditional office-space landlords and lenders have **not kept up. They don't get it.**

Five Vital Clauses

We don't want to see your business growth (and its contribution to the economy!) ham-strung by outdated and artificially placed barriers. Following, then, are five Lease Terms which we use to help protect today's company founders from being stymied by obsolete work-space lease terms:

1) **FLEXIBLE LENGTH** – Did you know most landlords want lease lengths of three to five years minimum?! I bet your start-up isn't sure how much space you're going to need in a year, never mind the typical long lease lengths most Landlords demand. By using shorter terms with several lease-renewal options, you can better fit the growth needs of your company into this

framework and move more frequently if need be. Sure, most Landlords are disappointed with shorter leases (and their brokers make much smaller commissions), and some circumstances make achieving that difficult, but done right, it is still very do-able. We urge you to value flexibility as a significant asset, and seek/select facilities you can use pretty much “as-is” when possible. This way, the Landlord doesn’t have to invest a lot of money into interior improvements, and can therefore afford to do shorter leases. (Remember, its all “money-in and money out” from the landlord’s perspective: “How much is my upfront cost of doing this deal, and how much rent will I receive back?”

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

Option To Renew: 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 (*or year, or per square foot*), for months ____ thru ____ during the first extension, and \$____ per month, for months ____ thru ____ during the second extension.

2) LEASE TERMINATION CLAUSE – OK. So maybe your circumstances don’t allow a short-term lease with multiple options. Maybe your space just requires too much investment by the Landlord: carpet, paint, walls added or removed, renovated amenities (hey, those nap rooms, casual kitchens and glass conference rooms cost real money!) Maybe the Landlord has other interested renters which look more attractive. Could be a lot of things. At least we gave it a shot. Still, start-up entrepreneurs like you need flexibility, so here is another way we solve that problem: 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. Here’s an example of what we’ve done in the past: Assuming the Landlord MUST have a five-year lease, we might negotiate a lease termination any time after the 30th month for: a) no reason, or b) various reasons such as: if sales do not hit a certain target, or funding is not obtained, or loss of a major client, etc. As part of this termination clause, tenant must also give the landlord ____ month’s advance notice, and might 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:

Lease Termination Provision 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 un-amortized tenant improvement contribution paid by Landlord at the inception of this Lease, or ____% of the remaining lease payments due, etc.

3) EXPANSION CLAUSES – In the lease termination provision we spoke of above, we were thinking mainly of circumstances when your business is not doing well and you need some relief. But what if things go better than expected? Another way to build flexibility into your work space lease is to obtain a right to increase the size of your space if needed – either thru a Right Of First Refusal, or a specific Option To Lease, or the Right To Relocate if the Landlord can't provide expansion space. If structured correctly this can be fairly palatable with many Landlords, since an expanding tenant with a longer term is always a good thing. This is fairly practicable too, when the overall facility is large enough to absorb this type of requirement, as in the case of a tall, multi-story building. To keep Landlords happy and help the numbers add up on their side of the ledger, typical "Option To Lease" terms provide that the length of the new/combined lease gets extended longer than the term remaining in the original, smaller lease. In some cases, the expansion clause is written with specific (usually adjacent) space in mind, and a window of time in which you can expand. The Landlord then agrees not to rent that space to anyone else for a time-period that infringes on your right to expand into it. If Landlord CANNOT provide the larger space you need, then, with proper notice and terms, Landlord shall allow the Tenant to terminate the lease and expand elsewhere.

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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.

Option To Lease Landlord agrees to provide Tenant the option to expand the Premises by approximately _____ square feet ("Expansion Space") The Expansion Space shall be contiguous to the Premises, and shall be made available to Tenant on (date). This Expansion Space shall be on the same terms and conditions as this Lease, except that the Rent payable by Tenant shall be increased to reflect the additional space. The rental rate per square foot of the Expansion Space shall be at the same rate per square foot then in effect for the Premises. Landlord shall provide a tenant improvement allowance as follows: 1) if the space has been improved as office space for another tenant, \$_____ per rentable square foot or 2) \$_____ per rentable square foot if the space has not been improved for another tenant. This tenant improvement allowance shall be transferred to Tenant under the same terms and conditions as Exhibit _____, except that the Premises shall be accepted by Tenant in an as-is condition, subject to hidden defects and building code violations. Tenant must notify Landlord in writing of its intention to exercise this option, no less than 6 months prior to the date mentioned above. Within _____ days after notice, Tenant shall enter into an addendum to this Lease incorporating the Expansion Space into the Premises upon the terms set forth herein. If Tenant does not notify Landlord of its intention to exercise this option within the time frame set forth above, this option shall terminate and have no further force or effect. Tenant acknowledges that Landlord may lease this Premises to any other tenant so long as said lease is subordinate to this expansion option.

Termination Provision (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. Tenant shall give Landlord _____ days advance notice in writing. No termination penalty shall be due from Tenant if termination is effected after the _____ year of lease term. If termination is effected during the first _____ years 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 – As a modern entrepreneur, you've got enough weight on your shoulders without worrying about having your family's entire finances wiped out. You also shouldn't be hamstrung by contingent liabilities that aren't absolutely necessary and which can complicate future choices and options such as equipment financing, partnerships, additional facilities, etc. By choosing space where the Landlord doesn't have to invest a lot of money into making interior improvements to suit your unique specifications, you should not have to personally guaranty leases. Or if you DO have to 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.), or a set fee. 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.

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

Limited Lease Guaranty Provided Tenant is not in default of the lease, this Guaranty shall expire after the ____ month of the lease term. (or capped at \$_____ maximum personal guaranty obligation.)

PS – Here’s some good news on this: Check with your attorney about your state’s laws, but in some states it is the Landlord’s obligation to make their best attempts to re-rent the premises. And if they succeed, the Landlord must credit you with the amount they receive against the amount you owe. SO, if you vacate and still have 3 years of lease obligation and the landlord releases the space after six months, your obligation drops to the 6 months it was vacant. What is the likelihood of this? Well, if your space is prime and the rental rate you were paying is very fair or below market, it is VERY likely. So, the apparent risk drops quite a bit. (I have used this fact to negotiate Lease Termination Fees with Landlords, persuading them that by paying them a certain number of lease payments in one lump sum, if they rent out the space quickly, our payment is going to turn into a BONUS for them!)

Final note: When you are not on the lease personally, you have much more leverage to negotiate new lease terms if the future demands it. Unexpected things happen. Someday you may need to sit down with the landlord and say you need to work out something different. Either that, or you’ll have to fold the company. This is much easier to do if you haven’t put all your family’s personal assets on the line.

5) LIBERAL ASSIGNMENT PROVISIONS - Another issue you’ll want to consider carefully is the lease assignment provision. Usually buried in the “boiler plate” of leases and often overlooked because it reads so boring, it’s terms can become vitally important to fast growing companies that have fast growing evaluations and are considering liquidity events. Built a booming income machine and you’re now thinking of selling your company and retiring to the islands? Most standard assignment clauses prevent an assignment of the lease without landlord’s approval which then opens the door to renegotiation. You can’t sell the company to another entity and assign them the lease without getting the landlord involved, who may want more money or other negative terms. (higher rent = less profit = less company value . . . what kind of multiple are you using for company value?) And you obviously can’t just cancel the lease and sell the company either! But wait, there’s more! 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! This clause is not so boring any more is it?!

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

Lease Assignment Consent for Assignment and Subletting shall not be unreasonably withheld, conditioned or delayed. 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, or zoning laws, or Landlord's targeted Tenant mix. 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.

Do landlords like doing business in a new way? No. But if given a choice between renting the space or leaving it vacant, they have to seriously consider it. All of the terms mentioned here have been accomplished successfully during past negotiations we have performed. Negotiation success depends on the strength and prestige of the tenant, the other terms of the lease, and your negotiation skills. Remember: With all the massive industry disruption going on, the modern world is not business as usual: Don't put everything on the line when you don't have to. If you need to pivot, provide a new service or hire more people, your company's growth should not be slowed because of the limited space you are in, and terms which keep you in place.

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

Note: The lease terms are specific to rapidly growing companies. They are a small fraction of all the usual terms vital to all businesses. Owners will also want to make sure they address all the usual suspects like Lease Vs Rent Commencement, Full Service, Gross, Net, Common Area Maintenance, Repairs, As-Is, Holdover, SNDA, Tenant Improvements, ADA and Building Code Compliance and many others.