

Commercial Lease Checklist for Small Businesses Summary

This is a summary of the Commercial Lease Checklist for Small Businesses tool (“Summary”). This Summary briefly explains what a commercial lease is and explains how to use the Commercial Lease Checklist.

What is a Commercial Lease?

A commercial lease is a written agreement between the landlord and tenant (small business/renter). The word “tenant” refers to the small business/renter who is renting space for their place of business. The commercial lease lays out the responsibilities of the landlord and the tenant with respect to the commercial space.

The lease also describes what happens when the landlord or tenant does not meet their responsibilities stated in the lease agreement. When landlord or tenant does not meet their responsibilities, it is called a “default.” Sometimes being in “default” of the lease is referred to as a “breach” of the contract or lease. The lease agreement should clearly state when a party is in “default” and what happens when a party is in default of the lease. For example, the lease agreement will state when a tenant has to pay their rent and what happens when the tenant does not pay the rent by a certain date.

Having a written commercial lease is good because it clarifies what is expected from the landlord and the tenant. If there is a disagreement or claim that the landlord or tenant is not doing what they are supposed to, both parties can review the lease agreement and determine what they had agreed to.

There are many parts of the lease that are negotiated and agreed upon. Please see the attached Key Lease Terms, to see the common lease terms that are included in commercial leases and that are discussed in the full version of the Commercial Lease Checklist. It is important for the tenant (you) to understand every term (item) in the commercial lease agreement before you sign the lease. Please refer to the full version of the Commercial Lease Checklist tool for more details.

How to use the Commercial Lease Checklist Tool (“Checklist”)

In the Commercial Lease Checklist, you will find the following to help you understand each of the basic terms commonly found in commercial leases.

- Definition of key terms. To the extent legal terms are used, we have provided definitions of such terms.
- What to expect in a lease prepared by the landlord. Please be aware that any lease prepared by or provided by a landlord may "favor" the landlord and the landlord's rights and interests, and "dis-favor" the tenant and the tenant's rights and interests. While this is not always the case, it is important to review the lease in its entirety to make sure that it does not overly burden or disadvantage the tenant as compared to the landlord.
- What terms and conditions specified in the lease can the tenant (you) negotiate? You may ask the landlord to revise certain terms and conditions in the lease to reflect agreed-upon deal terms or issues that are of importance to you as the tenant.
- Things to consider and do. This is the checklist of things to consider and do in connection with your review and negotiation of the lease with the landlord.

IMPORTANT WARNING

This commercial leasing toolkit is intended to help small business owners better understand key terms in commercial leases and better protect their businesses. This commercial lease toolkit is for educational purposes and is not legal advice for your particular situation. Using the Commercial Lease toolkit is not legal advice and does not create an attorney-client relationship. It is also not a substitute for attorney review. Commercial leases are legally binding contracts and tenants should have an experienced real estate contract or general small business attorney review the lease on their behalf before signature.

Key Lease Terms

Key Lease Terms	Explanation
Tenant Formation	Even if the business is run by one or two individuals or spouses, they should form an entity that shields them from personal liability. For instance, a corporation or limited liability company should be formed, and that entity should sign the lease.
Lease Types	<p>A "Net Lease" is a lease in which the tenant is responsible for paying both a base rent and its share of building expenses (taxes, operating expenses and/or insurance).</p> <p>A "Gross Lease" is a lease in which the tenant pays one base rent amount and the landlord is responsible for paying all building related expenses. In a "modified" Gross Lease, a base year is referenced (usually the year in which the term commences, or the following year if the lease starts late in the year) and provides that after the first lease year under the lease, the tenant is responsible for its proportionate share of any increases over the expenses incurred by landlord during the base year.</p> <p>A "Percentage rent" lease is typically reserved for retail tenants and requires the tenant to pay the landlord, in addition to minimum rent, a percentage of its sales above a certain breakpoint.</p>
Relocation of Premises	Tenants, especially restaurants or retail tenants, should resist any right of the landlord to relocate the premises. The value of the business may depend on its location, the ability of customers to find it, its visibility, access, and proximity to other stores. If the landlord insists on the right, the tenant should get notice, premises of the same size and configuration, and completion of the tenant improvements by a given date, with the right to abate rent and new directory signage.
Landlord's Work; Delivery of the Premises	<p>The improvements to the premises the landlord constructs must be specified in detail. Terms such as "Grey Shell" or "White Shell" are not sufficient. If the landlord's work is not completed by a specified date, the tenant should be entitled to terminate the lease or a rent credit until the landlord's work is completed.</p> <p>What happens if an existing tenant fails to timely vacate the premises you intend to lease? Similarly, what happens if landlord fails to timely deliver possession of the premises with its construction substantially complete? Without the right protections, the answer is a tenant might find themselves waiting for a landlord to perform while the tenant loses sales and market position, and is forced to open on an undesired date that causes lackluster sales out of the gate. Tenants should also negotiate the right to terminate the lease if landlord's work is not substantially completed or possession is not delivered by a certain date following lease execution. Reimbursement of out-of-pocket costs (e.g., architect fees, permit costs) incurred in pursuing the business, and the return of security deposit and any prepaid rent should also be negotiated.</p>
Permitted Use	The permitted use should be defined as broadly as possible: "general office" or "general retail" uses are best. The landlord should represent that the permitted use is allowed by zoning, applicable laws and property restrictions.

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Option to Renew/Extend	<p>Many commercial leases contain either an option to renew or an option to extend the term of the lease. However, what many landlords and tenants do not know is that renewing a lease and extending a lease is not the same thing.</p> <p>A lease that is renewed comes to an end for an instant at the end of the original term, prior to the renewal term beginning. In other words, the renewal option creates a new lease. One consequence of this is that clauses that apply on the expiration of the term (such as, for example, removal of improvements or personal belongings) would become effective, although practically speaking the parties to the lease will typically not require compliance with these provisions. A second more important consequence of an option to renew is that any clauses in the lease that are personal to the tenant, such as rights of first refusal or guarantees (<i>i.e.</i>, clauses that are not an interest in land), do not flow through the renewal option. Landlords and tenants can, if they wish, mitigate this by explicitly setting out these clauses in the renewal option.</p> <p>A lease that is extended does not bring the original lease to an end: the lease is extended for the additional term without any interruption or modification.</p> <p>Issues to consider when renewing/extending: How many extension periods and the duration of each extension period. What will the rent be and how will rent be determined? Landlord's will use this mechanism to reset the lease rent to market rates. Common methods used by landlords and tenants to determine the rent during the extension term include (1) tying it to the consumer price index, (2) setting it by appraisal or arbitration, or (3) raising the last month's rent by a certain percentage increase agreed upon by the parties.</p>
Continuous Operation	<p>If the landlord requires continuous operation, there should be exceptions for employee training, renovation, restoration, repair, maintenance and holidays.</p>
Common Area Operating Expenses	<p>As a general matter, the tenant should pay a proportionate share of only maintenance and operating expenses of the common area and not any capital repairs or improvements. Tenants should try to minimize the pool of expenses to be allocated and passed through to it by: (a) excluding certain costs from the definition of common area costs or limiting the definition of common area costs; and/or (b) limiting landlord's ability to exclude certain portions of a shopping center. Another method is to request a cap. Typically, the cap prevents the tenant's share of common area expenses from increasing by more than a negotiated percentage over the tenant's share of such costs in the previous year. The cap amount is frequently a fixed percentage (e.g., 3 percent), but it can also be based on a variable number, such as a specific consumer price index.</p>
Audit	<p>The tenant should receive an annual statement of the operating expenses with a right to conduct an audit. If the tenant discovers errors, the landlord should reimburse the tenant, and if the errors are above a certain percentage, the tenant should also be reimbursed for the cost of the audit.</p>
Base Year	<p>If the increase in the operating costs is relative to a base year, the tenant should insure that the base year actually reflects the costs the landlord would incur in a typical year. For instance, the landlord may successfully challenge real property taxes and obtain a refund or receive payment on a guaranty, insurance or third-party claims during one or more years following the base year.</p>

Key Lease Terms	Explanation
Exclusive Use	The tenant should obtain an exclusive right to conduct its business. An exclusive use clause is a covenant by landlord not to allow other occupants in the shopping center to operate a concept that would compete with the business of the tenant. The right should be as broad as necessary to insure that it does not lose necessary business to competitors. However, landlords want to protect their ability to bring in new tenants and does not want to overly restrict themselves.
Tenant Alterations	In no event should the tenant be under any obligation to alter the premises to conform to any change to law, rule, regulation or ordinance, unless specific to tenant's use or as a result of any modification to the premises by the tenant. The tenant should be entitled to make alterations as long as they are not to the structural elements, building systems or exceed a certain cumulative amount.
Tenant Maintenance	In no event should the tenant in a shared building be responsible for structural elements, public stairs, elevators or mechanical systems (including HVAC), plumbing, electricity, UPS, security and other similar installations. Please note that maintenance (but not replacement) for HVAC systems may change for single tenant buildings.
Landlord Obligations	The landlord should be obligated to operate, repair and maintain the building in a first-class manner and in conformance with all applicable laws, rules, regulations and ordinances. In all events, the landlord should not impair the visibility, access or use of premises.
SNDA	The tenant should require a Subordination, Non-Disturbance and Attornment Agreement (SNDA) from the existing lender as a condition of executing the lease. They should not agree to subordinate its interest to any future lender unless the lender agrees not to disturb the tenant's use of the premises and agrees to cure any continuing defaults by the previous owner.
Liquor License & Permit Contingencies	A tenant should always be concerned about their ability to obtain the necessary government permits, approvals, and licenses to build, alter, or otherwise operate their concept from the premises. This is especially true for restaurants planning to serve alcohol or those in need of a conditional use permit. For these reasons, tenants should negotiate a right to terminate their lease in the event these critical licenses/permits cannot be procured within a contingency period. Key items to negotiate in connection with this right to terminate is: (a) the length of the contingency period (e.g., usually tied to the amount of time it typically takes for such approval to be obtained from the particular governmental authority; (b) the identity of the permits/licenses at issue (e.g., health permits, conditional use permit, liquor license); (c) whether landlord will be granted additional time to seek the license/permit on your behalf; and (d) a termination fee (e.g., landlord's brokerage commission).
Gross Sales Termination Right	A gross sales termination right (frequently referred to as a "gross sales kick-out clause") grants a tenant the right to terminate the lease if their annual gross sales at the premises do not exceed a pre-negotiated dollar threshold by or during a particular time or times during the lease term. Contrary to what some might believe, a gross sales kick-out clause can be mutually beneficial. From a tenant's perspective, it offers an exit strategy because the failure to meet the dollar threshold suggests that the particular space is not as profitable as projected. Conversely, a landlord may be persuaded to accept this termination right because the failure to meet this threshold also suggests that landlord will not recoup the rent (by and

Key Lease Terms	Explanation
	through percentage rent) that they expected to receive when it underwrote the lease.
Lease Assignment/Sublease	A tenant's right to assign or sublease the premises is critical because it preserves one's exist strategy and facilitates corporate growth. To this end, for starters, tenants need to make sure landlord cannot unreasonably withhold or delay their consent to general assignments and subleases. Tenants will also want to make sure the assignment/sublease language does not include unreasonable conditions to transfer, such as a clause that triggers a substantial increase in rent in the event of a transfer. Tenants should also seek to negotiate permitted assignments/subleases (i.e., transfers that do not require landlord's prior written consent) clauses. Typical permitted transferees include affiliates/subsidiaries under common control as the original tenant, bona-fide franchisees, an entity that survives a consolidation, merger, or reorganization of the tenant or the tenant's parent, and an entity that acquires all or substantially all of the tenant's assets or stock or voting/membership interests.
Relocation	Tenants should strongly resist signing leases with a relocation clause because presumably the tenant chose to lease the space because of its location, and the economic terms of the lease were based on the metrics of that location. Furthermore, the relocation may disrupt the tenant's business, goodwill, and cause it to lose customers. The new location may also be less accessible and visible. In the event landlord will not agree to remove the relocation provision in its entirety, we suggest negotiating the following items. First , limit landlord's right to relocate your restaurant to a designated area, not more than once during the term, not during the first 12 months of the lease, and not during the months of November and December. Second , require landlord to provide 90 days' notice, at a minimum, of their decision to exercise of this right. Third , require landlord to pay for the cost of the relocation, including construction and incidental costs incurred by you as a result of the relocation. Fourth , require the new site to be comparable to the original space. It should not vary significant in size. If the space is smaller, rent should decrease. If the space is larger, rent should remain the same. Fifth , negotiate an unfettered right to terminate the lease in the event such relocation premises is unacceptable.
Security Deposit Burn-Offs	Landlords also frequently require large security deposits to protect themselves in the event of a default by tenant. In the event your landlord insists on a significant security deposit, consider negotiating a clause that requires landlord to refund a portion of your security deposit in the event you do not default (beyond applicable cure periods) within a certain period of time (e.g., three years following the lease commencement date).