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Key Terms in Commercial Leases

DISCLAIMER: This outline is a general guide. Be sure to contact an attorney if you have questions or specific issues that need to be addressed.

Finding the right location can be essential for any brick-and-mortar business, but a bad commercial lease can end up being costly, frustrating, and can harm the future of the business. Also, commercial leases don't have a lot of the same protections as residential leases and so what's in your lease is often what goes. Understanding your lease, negotiating key terms, and spending the time thoroughly examining and discussing the aspects of your space can help avoid these pitfalls and give your business a place to grow. In this resource, we break down some of the basics of commercial leases.

- 1. Letter of Intent.** A letter of intent (LOI) is often the first step in the leasing process after you have found a space you likely want to rent. LOIs are usually not binding (meaning you aren't bound to pay or sign a lease yet), but that doesn't mean they are not important. LOIs usually establish the key terms of the lease and work to get the parties on the same page about major deal points before getting into the nitty gritty. Where folks can go wrong is thinking they can just sign the LOI with the terms the landlord gives them and negotiate them later. But that can backfire. The whole purpose of the LOI is to get on the same page on the major terms like length of lease, rent, security deposit, repair responsibility, other costs, etc. If you don't negotiate these during the LOI phase and try to negotiate them later, the landlord will often accuse you of acting in "bad faith," wasting their time, or refuse to negotiate those terms because you have "already agreed to them." Having a lawyer involved starting with the LOI process can be key so these terms can be negotiated up front before deciding if it is worth going into reviewing and signing a more detailed lease.
- 2. Rental Rate.** This is the monthly rate you will pay for rent. Super important! When looking at the rental rate, look at what the price per square foot is. If you have an agent or broker, ask them if that is comparable for your area and if not, try to negotiate. Your rent might also account for things like landlord work if the landlord is taking on any of the build out for you. If so, talk to

them about this. You also want to pay attention to the rental rate increases. You want to try to limit increases to no more than 2-3% per year if possible. If a landlord won't agree to set rental rate increases, try to negotiate a percentage cap should they choose to increase in the future.

- 3. Other Costs.** In addition to rent, commercial leases can often pass other costs onto the tenant. Unlike in residential leases, it is not uncommon to see tenants responsible for real estate taxes, common area maintenance, landlord insurance, and other costs. Read your lease carefully to determine which utility costs you are responsible for, if you have to pay real estate taxes, if you have to pay any common area expenses or maintenance costs (often referred to as "CAM" costs), how those CAM costs determined and what is included, and any other amounts you may owe. If you find that you are responsible for taxes or other shared costs, you may want to try to negotiate that you are only responsible for them over a "base year," meaning that you will only be liable for the difference between the current amount for these costs and any increases in these costs in the future rather than the whole cost. It is so crucial to read your lease carefully for these extra costs so you aren't blindsided with another bill on top of your base rent.
- 4. Code Compliance and Build Out Time.** Each type of business usually has set commercial building code requirements they have to meet (or be grandfathered in) in order to be open to the general public. Before signing a lease, it can be important to make sure the building can be used for your purposes, and if it can't in its current state, what needs to be done to make it compliant. You don't want to sign a lease and then find out you have to do \$100,000 in construction. Doing proper walk-throughs and inspections, bringing along a contractor or architect, and negotiating time to determine code needs in the LOI can all be great tools to account for this before binding yourself under a lease (because getting out of a lease can be very hard and costly). If significant improvements or changes are needed, this may be another negotiating point with the landlord, both in the sense of potentially sharing costs (especially if structural elements or basic utilities are not up to general code) and in negotiating a rent abatement for build out time. It can be tough being stuck paying rent while also spending thousands on construction (or while waiting for a food safety permit). If you need time for build out or inspection, you should try to negotiate 1-2 months of free or reduced rent to help ease the burden. If things are especially dicey you should also see if you can make the lease contingent (meaning you can terminate it without being in default) upon getting the proper permits.
- 5. Repairs and Maintenance.** This is a big one. What maintenance and other repair/replacement costs are you responsible for? Under commercial leases, landlords can put all repairs and replacement costs on the tenant or landlords do some repairs but still make the tenant pay for them. Obviously, this is not ideal for the tenant. So, it is important to read the lease carefully to determine what costs and work you are responsible for and try to negotiate protections.

Usually, it is best practice to at least try to get the landlord to be responsible for the structure, roof, flooring, HVAC, electrical, and utility repairs. Also, if the tenant is responsible for repair costs, it is good to try to limit it to repair, not replacement (for example you have to get a water heater repaired but not pay to replace it if it can't be fixed) or put a cap the amount of repair costs tenant could be liable for. Major repairs to a commercial building (especially older buildings) could break a business's budget, so this is definitely not a section to breeze over and is a commonly negotiated area.

Commercial leases can range from 5-50 pages, so it is important to know what you are getting into. While we're big fans of helping you DIY legal while you're getting started, this is one area where we really encourage folks to invest in an attorney. Lawyers know what to look for, commonly negotiated terms, and how to approach the lease process. Use this resource to help you understand the process and your lease, but hire a lawyer before signing ;).

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