

Founder Fundamentals

Seven Tips for Negotiating Your First Office Lease

By Michael J. Meehan

Whether it is expanding into a new market or moving out of the proverbial garage, startup companies often sign commercial lease agreements in their early stages. In negotiating the lease, the company's legal counsel will rely heavily on the owner to advise on the "business terms" of the lease. While we always recommend involving an attorney early in the negotiation process, in many cases the attorney is brought into the process after a letter of intent has been signed and the key business terms have been agreed upon. These business terms are important and can be difficult to re-trade once they have been established with the landlord. We offer the following seven tips for an owner negotiating the business terms of his or her first office lease:

- 1 Personal Guaranty.** The landlord may require a personal guaranty, particularly if the company has a limited operating history. This can be a difficult pill to swallow, particularly for a business owner who has taken the proper steps to incorporate and shield himself or herself from individual liability. In this scenario, not only is the tenant responsible for rent for the entire lease term, but the business owner is personally responsible for the same obligation. If a personal guaranty can't be avoided, try to limit the guaranty to a specified monetary amount (for example, the monthly rent multiplied by a certain number of months). You could also propose eliminating the guaranty as of a future, specified date (provided that the tenant does not default under the lease prior to that date).
- 2 Understand Your Additional Rent Obligations.** A tenant's "base rent" obligation is usually outlined clearly in the lease. However, in many commercial leases, the tenant will owe additional amounts in excess of the base rent. For example, taxes, insurance and/or maintenance expenses are passed through to the tenant as an additional rent obligation in many leases. While historical figures can provide a useful estimate of these expenses, they are not necessarily indicative of future charges. Pay careful attention to how large capital expenses or major renovations can be passed on to your company. Negotiating a cap on controllable operating expenses can be a useful way to limit the tenant's exposure in this area.
- 3 Assignment and Subletting.** When a business signs a lease, it agrees to be responsible for rent for the entire lease term. Accordingly, negotiating favorable parameters for assigning or subleasing the space can be extremely valuable if you ever need to downsize or exit. Pay particular attention to whether a merger, asset sale, or "change of control" triggers the assignment provision and requires the landlord's consent. You want to avoid a situation where you need your landlord's approval to consummate a merger or take on a new lead investor.
- 4 Permitted Use/Exclusive Use.** Contact the local municipality to make sure that your contemplated use of the leased premises is permitted by applicable laws and zoning ordinances. If you sign the lease and later learn that



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your desired use is not permitted, you may still be responsible for the entire lease obligation despite not being able to use the space for your business. Also, if you are renting in a building or complex, consider requesting an exclusive use provision that limits the landlord's ability to lease space to your competitors.

5 Improvements/Alterations. If you need to make alterations or improvements to the space for it to meet your company's needs, it can be helpful to negotiate and obtain approval for this work at the outset of the lease. Often, a landlord will perform these improvements or offer an allowance or free rent period to assist a tenant with the initial fit-out. It is typically better to negotiate these concessions upfront, rather than during the lease term.

6 Have a Plan for Reducing or Expanding Space. It can be difficult for an early-stage company to predict how much space it will need over a five-to-10-

year period. Sometimes a tenant can negotiate an early termination provision for all or a portion of the space. For example, the tenant signs a 10-year lease, but it has the right to terminate the lease after five years under certain, negotiated conditions. Conversely, if you feel the space may eventually be too small, consider seeking a right of first option/refusal to lease other space at your building or complex. This offers flexibility without requiring you to take on too much space before it is needed.

7 Surrender of Premises. In what condition are you required to deliver the premises at the end of the term? An obligation to return the premises in good or "broom-clean" conditions is fine. But some leases require the tenant to undertake repairs or return the premises in the same condition as when the tenant originally took possession. This can be costly, particularly for a tenant that makes substantial improvements to the premises during the term.

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